Considerations for Choosing a Trustee

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Selecting suitable trustees and the appropriate mechanism for naming successor trustees over time is a crucial decision for your clients who are creating trusts. Ultimately, trusts designed to span multiple decades—or even forever—can only be as successful as the trustees.

Most importantly, trustees bear a fiduciary responsibility to ethically act in the best interests of the trust beneficiaries. Fiduciary responsibilities include, among others, to:

- Administer and invest the trust property according to the trust document;
- Act impartially when dealing with trust property and payments to beneficiaries;
- Exercise discretionary powers over distribution of income and principal;
- Maintain clear and accurate financial records and report that information periodically to the beneficiaries, as well as filing income tax returns;
- Follow up on any legal claims and defend the trust;
- And distribute the principal of the trust to the appropriate persons upon termination of the trust.

We hope this column helps you with the important client decision whether to designate individuals, corporations, or a combination of both as trustee.

Designating Family Trustees

A family member or a close family friend is one of the first people considered for a trustee role. If the trust is structured primarily to transfer assets such as real estate and family businesses to children or grandchildren, then your clients appointing a relative or close family friend as trustee would seem a sound choice.

When considering a family member, discuss these considerations with clients:

Make sure you and the grantor understand exactly what the trust document's purpose and specific provisions are prior to naming the trustee. Also, it is imperative that the grantor notify the individual trustees that they are being considered and get their permission to be appointed.

Ensure the prospective trustee understands your clients' family history. Gauge whether the trustee may objectively and responsibly carry out the duties independently. Are there any family disputes or problems that could hinder the impartiality of the chosen trustee?

Be mindful that the trustee will have to treat all of the clients' beneficiaries impartially, which is the reason designating professional trustees or naming co-trustees may be sensible options for families with complicated or strained relationships. Does the trustee have the personal characteristics to make difficult decisions, if needed, without upsetting the family?

Does the trustee have the skills and expertise required to fulfill your clients' obligations? Be sure to select prudent and accessible trustees who can carry out the provisions of the trust and manage investment, tax, accounting, legal, and interpersonal issues. Choose impartial trustees who are flexible and sensitive to the family's aspirations and changing needs of trusts.

Carefully review trust candidate qualifications and look at their backgrounds to see if they have ever been sued in a trust or investment-related lawsuit. Whomever assumes the trusteeship must also have a solid track record of either managing investments or selecting an investment adviser who is also a fiduciary and monitoring that adviser's performance.

Most fundamentally, your clients' trustee needs to manage the trust assets in a way that is appropriate for the long-term needs of the beneficiaries, many of whom may be young children. Simultaneously, the trustee has to recognize the needs of the current income beneficiary. Generally, these two needs are in conflict. The trustee has a duty to make the trust's assets productive, as assets need to produce earnings, appreciate, or benefit the trust's current and future beneficiaries in some other way.

Can the family trustee keep beneficiaries reasonably informed about the trust and administration? The trustee's duty may mean balancing the requirement to know against rights of privacy, such as in the case of delicate health care decisions. In addition, the terms of some trusts and state laws mandate that the trustee provide some level of accounting to some or all the beneficiaries. Generally, the trustee must notify the beneficiaries of a trust when certain important events occur, such as a revocable trust becoming irrevocable, a change of trustee, or a change of trustee fees. Failure to follow through on these duties can result in serious ramifications.

Continuity for the term of the trust is important. Is the trustee available and does he or she have a backup in case of incapacity or death?

Will the family member expect to be paid, and does the trustee expect that a family member should be paid for their services? This is an important and often time-consuming role that may merit some level of compensation from the trust.

Is the trustee's residence an issue that might cause undue taxation of the trust? For example, if a trustee is a resident of California, the trust will have to pay California income tax. Are there other legal issues that need to be considered based on the trustee's residence state?

Professional and Corporate Trustee Benefits

A professional or corporate trustee may be preferable for larger, more intricate trusts, or if a family member does not have the expertise or countenance to be the sole trustee. Your clients may nominate a professional trustee, like a trust company, bank, or other neutral professional to serve as trustee. A professional trustee is expected to bring experience, objectivity, and extensive resources to help ensure that the trust is administered according to the trust's terms. Further, a professional trustee can assist in maintaining family harmony by taking sole responsibility for all distributions.

Corporate trustees also assume fiduciary responsibility and maintain fiduciary errors and omissions insurance coverage, because they are generally examined by internal and external auditors. Be aware of how long your clients expect the trust to last. Trusts that benefit more than a few generations may be better suited for the continued stewardship of a professional trustee. Be cognizant that one person alone is unlikely to have the longevity to manage the specific lifetime needs of beneficiaries over multiple generations.

Professional trustees may be more nonjudgmental than family members and do not hold the emotional ties that can become problems when family members manage a trust. However, be aware that if this person is not acting for a corporation, you have the same longevity issues with any other person.

Shared Trustee Responsibility

Some families decide to appoint co-trustees, ordinarily a family member and a professional or corporate trustee, who share responsibilities and serve as a check and balance to each other. Be certain to include a mechanism to mediate or arbitrate disputes to deal with conflicts that may arise among family members or even co-trustees.

Note that professional or corporate trustees may not be as familiar with your client or your client's family when it comes to knowing whether the beneficiary has a history of gambling or reckless behavior, for example. Beneficiary requests may have to go through a committee with a large institution before being approved. In addition, there may be gaps in continuity between trustees and beneficiaries, because there is an increased possibility of oversights and mistakes due to misinformation whenever an institution has been acquired, merged, or reorganized.

Your clients should factor in how much a professional and family trustee would cost. Professional or corporate trustees typically get paid a percentage of assets managed, which may make them cost-prohibitive for trusts of less than $500,000. Even though personal trustees may be entitled to compensation for their services, many family members waive the right to payment. Overall, what is reasonable payment depends on the work involved, the amount of funds in the trust, other expenses paid out by the trust, the professional experience of the trustee, and the total expenses for administration of the trust.

Trustee Succession and Location

Regardless of whom your clients decide to appoint as trustee, you should incorporate language in the trust that enables the client or their heirs to change trustees, if needed. Some trust creators even designate "trust protectors," who generally have power to fire and hire trustees. Encourage your clients to communicate their decision-making process to those involved.

Discuss the optimal location for the trust administration with your clients and their qualified estate planning lawyers. The institutional co-trustee is often based in another state, so the clients can take advantage of favorable tax and trust laws. Some attorneys will suggest Delaware, South Dakota, Nevada, and Alaska as locations for trust jurisdiction. Identify a trustee who meets your client's unique trust administration needs in that state. For instance, you should ascertain that the trustee understands how special needs trusts are administered for beneficiaries who need to remain eligible for federal and state government benefit programs while receiving trust distributions.

Discuss choosing appropriate trustees with your clients; this important decision has a meaningful impact on clients' future generations. ■

The authors thank Jorge Padilla, CFP®, for his assistance with this column.