The Navigator

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Trustees have a fiduciary duty to your trust, and they are responsible for finding high quality tax, investment, accounting, and legal expertise. To make a wise selection of trustee, it is critical to understand trustee responsibilities, important characteristics for potential trustee candidates, and key trust considerations. Since trustees control the trust, this decision is crucial.

The Critical Task of Selecting a Trustee

by Joshua D. Strauss, CFA

A trust is a fiduciary relationship in which one party (the grantor) gives another party (the trustee) the obligation to hold title to property or assets for the benefit of a third party (the beneficiary). Trusts are set up to provide legal protection for assets, establish rules for the distribution of those assets, and, in certain cases, reduce inheritance or estate taxes.[1]

Selecting the right trustee is crucial because the trustee essentially controls everything about the trust. You should always retain the option to change trustees, should the trustee deviate from the explicit rules set out in the trust, but a thoughtful first choice of a trustee can save significant time and effort.

1 A primer on the basics of estate planning is helpful background reading. Prior to doing significant estate planning, cobbling together a roadmap for heirs can also be quite useful.

Responsibilities of a Trustee

In choosing a trustee, it is important to consider the role's duties and responsibilities, which fall into three major categories: record keeping, trust administration, and investment management.

Record Keeping

The trustee holds responsibility for maintaining the books and records of the trust throughout the trust's lifetime, which could span multiple generations. With the coordination and assistance of both the custodian and the investment manager, the trustee must make sure that payments made from the trust are properly carried out and recorded. The trustee is also responsible for ensuring that the trust's tax returns are prepared and filed on time. The trustee does not necessarily need to know relevant Federal and state tax codes, but they do need to hire a tax accountant who has these skills.

Trust Administration

The trustee must balance the needs of all beneficiaries, both current and future. Requests for cash distributions must be reviewed carefully by the trustee, and approval of such distributions can only be made in accordance with the specific terms of the trust. Provisions regarding the timing and amount of distributions must be carefully evaluated.

Investment Management

The trustee must ensure that the trust assets are managed in a way that is appropriate for the beneficiaries' long-term needs. Preservation of capital and growth of trust assets are essential considerations for the trustee. The trustee is not required to directly manage the assets (which can be interpreted as a potential conflict of interest). Regardless, the trustee is responsible for hiring an appropriate investment manager to assist with this responsibility. In addition, ongoing monitoring of investment management is a required aspect of this role.

Considerations for Choosing a Trustee

Trustees should have certain common characteristics. Given the all-important fiduciary duty, hiring a trustee with impeccable ethics is a requirement. You do not need to hire someone who has deep expertise in accounting, taxes, investment management, and estate law. While these skills are undoubtedly helpful, hiring a trustee who knows his/her own personal and professional limitations is critical. A suitable trustee needs to know when to reach out to experts with such specific knowledge. The trustee must also understand that their role is spelled out in the trust document and must acknowledge that following the instructions in the trust is of paramount importance. Understand that there is no perfect trustee for all beneficiaries, so you should not feel guilty if some of the beneficiaries view your choice of trustee unfavorably.

Several key points should be considered when evaluating a trustee:

Serving as your own trustee is often prudent.

Certainly, no decision-maker understands what you want to do with your assets better than you. That is why most revocable trusts are structured with the grantor serving as trustee. An individual acting as the trustee of his/her own trust can make whatever decisions necessary regarding distributions and investments. However, as a trustee, you will need to have contingency plans in place for the future as you age. Your trust is likely to outlive you, so you will need a successor trustee to serve after your passing or if you become mentally incapacitated.

Using a third-party trustee has its merits.

Many people use a trusted friend or family member as a trustee. These people typically understand your needs well due to your close relationship with them. Nevertheless, they do not necessarily understand the detailed complications associated with trust accounting, record keeping, and investment management. It is also possible that using a close friend or family member may exacerbate family tensions and resentments amongst beneficiaries. Due to lack of specific expertise or experience, these close friends or family members, in their role as trustees, may offer inappropriate investment counsel or ignore important trust rules, thus leading to far more significant problems down the road. On the positive side, these sorts of trusted people, more times than not, do not charge a fee for their services.

Should you select a friend or family member as your trustee, there are a couple of important characteristics that this trustee must have: impartiality, understanding of trust rules, the ability and willingness to follow professional advice, and youth (they should at least be younger than you for trust continuity purposes).

It is common for people to consider hiring their accountant, lawyer, financial advisor, or other personal advisors as a third-party trustee. The thought process behind that potential choice is that these people provide a vital consultative role in your legal and financial affairs. This responsibility adds to or complements the work they already perform for you. While there is some validity to that perspective, appointing a lawyer, accountant, or investment advisor may lead to an unintended conflict of interest, depending on their role in your life.

Hiring a corporate trustee is an expensive, risk-averse choice.

One of the most positive attributes of corporate trustees is that they are intensely focused on the legal and tax rules associated with their responsibility as trustees. A corporate trustee brings experience, objectivity, and deep professional resources to ensure that the trust rules are enforced. Legally, they cannot side with one beneficiary vs. another; the corporate trustee, therefore, helps with family unity by taking sole responsibility for distributions to beneficiaries. A corporate trustee weighs distribution requests impartially, without consideration for any family politics or emotional situations. They follow specific policies and procedures to ensure unbiased professional services. Often, they provide detailed monthly account statements and written explanations for trust decisions.

With their deep staffs, extensive institutional knowledge, established sets of checks and balances, and understanding of legal liability associated with their role, corporate trustees charge a hefty fee for their services. Most corporate trustees operate under a standardized fee schedule that outlines the services performed and the fees for such services. Also, corporate trustees typically are stricter with regards to distribution rules than individual trustees.

There are two primary types of corporate trustees. A bank trust company provides trust accounting, trust administration, executor services, and investment management. On the other hand, an advisor-friendly trustee provides trust accounting and administration but delegates the beneficiary or grantor to choose the investment advisor. Corporate trustees should exhibit the following characteristics: the ability to balance both objective and subjective goals, low trust officer turnover, the ability to put themselves in the client's shoes, and a reasonable fee structure.[2]

Continuity and protection matters.

The average lifespan of a trust is approximately 40 years. Therefore, not only should you choose a trustee to perform these critical duties, but you should also have detailed contingency plans in place. Successor trustees should be named in your trust, and specific rules should be laid out to choose new trustees if necessary. Trustees should have the capacity and necessary plans in place to serve you and your beneficiaries for many years. Working with a corporate trustee can ensure that appropriate decisions are made well after you pass away.

Multiple trustees balance out responsibilities.

The best answer may well be to hire multiple trustees, which can help to defray any potential favoritism, spread the work, and keep all the trustees in check with one another. Furthermore, you can choose both an individual trustee and a corporate trustee as co-trustees to balance trust accounting, administration, and investment management amongst the trustees.

Fees for third-party trustees can be considerable.

The responsibilities and liabilities borne by trustees are not inconsiderable, which is why corporate trustee fees seem high on the surface. Many individual trustees will accept their roles without remuneration, but few unrelated third-parties would play the trustee's role without fees being paid. Fees can be split up between investment management and other responsibilities. There are plenty of third-party trustee options out there, and fees are often negotiable.

In the final analysis, even the most well-constructed trusts can run into difficulty because the proper time and care were not invested in selecting a trustee. Most people expend quite a bit of energy and thought in growing and protecting their financial legacies, but the choice of trustee sometimes gets short shrift in this process. In protecting your legacy, you should weigh the trustee decision very carefully. Should you wish to discuss this issue further, please reach out to your portfolio manager. We would be more than happy to help you make an informed decision for you and your family.

2 It should be noted that both of our primary custodians, Charles Schwab and Pershing LLC, provide corporate trust services to their clients.