



Hazards of Depending on an Individual Trustee

As an advisor it's important to be aware of the hazards of depending on an individual trustee. This article is based on the experiences of our team members who have more than 125 years combined experience dealing with estates and trusts of all types and sizes. Over the years we've witnessed estate values diminish as a result of excess tax payments, legal fees, mismanagement, improper pre and post mortem planning and general mistrust, miscommunication and delay that often arises among individual trustees, estate executors and beneficiaries.

One of the most important decisions to make when establishing a trust is choosing a trustee that has the necessary skill, experience and impartiality to manage your client's trust as intended. Trustee choices generally fall into the following categories: Individuals, Corporate Trustee, or Team/Co-Trustees. This article covers the



pitfalls of choosing an individual trustee and how to avoid them.


Not adhering to the fiduciary duty

Trustees have a serious fiduciary duty to manage the trust and serve the best interests of all beneficiaries – whether they are income or remainder beneficiaries. Often these two types of beneficiaries have conflicting needs and desires. Trustees are also subject to regulations like the Uniform Prudent Investor Act which is designed to protect beneficiaries from inappropriate investment management. This means that the trustee, who is responsible for investing and managing trust assets, can be held liable for breaching certain ‘prudent’ investment rules and standards. The trustee must also be familiar with modern portfolio theory, managing the trust with a balanced, ‘total return’ approach in fulfillment of its investment discretion.

Investment management is the most litigated area of trust administration. Litigation can be long and difficult, leading to significant costs and delays in the ultimate distribution of assets. Individual trustees should either have the necessary tools and skills to understand and meet all fiduciary requirements, or know how to delegate the technical aspects of trust management to professionals. If they don’t it could lead to messy legal battles, potentially destroying family relationships.

Avoiding the compensation discussion

Unlike corporate trustees, that have published fee schedules, it is incumbent on the client / settlor of the trust to negotiate reasonable trustee fees with their selected individual trustee




during the planning and drafting stage of the trust. This can be an uncomfortable conversation between the settlor and trustee (often a family member, friend, or business associate).

The risk of not discussing fees up front (and how they will be charged and ultimately disclosed to beneficiaries) can result in confusion, misunderstandings and possible court action in the event of disputes between the trustee and beneficiaries. In some cases individual trustees serve for years without charging a fee. Then, when trust management and administration becomes too burdensome and time consuming, the trustee wants to be compensated. Where the fee and methods of charging the fee (to principal or income) have not been properly documented and approved from the start – conflicts can arise, potentially straining life long family relationships.

Nonexistent or Incomplete Reporting

Trustees are charged with the task of analyzing and reporting portfolio risk and return. They must also be capable of (or delegate) full trust accounting - maintaining a separation between principal and income on a current and timely basis. Annual trust tax reporting, including the filing of special fiduciary tax returns is also a trustee obligation. There has recently been an increase in the number of lawsuits involving incomplete (and downright fraudulent) trust reporting, statements, tax reporting and administration. This is largely due to individual trustees' inability to fulfill these daunting and complicated tasks. Trustees are also required to document all of their decisions, including why they decide to deny or approve distributions from the trust.



Failure to adhere to these responsibilities can result in the beneficiaries challenging the investments and/or distributions from the trust in court.


A common example of an often overlooked trustee responsibility involves irrevocable life insurance trusts (ILITs) where proper recordkeeping also means sending out 'Crummey' notices each year. These required communiques notify heirs that a gift (equal to the annual premium payment) from the settlor was made to the trust and that they have the right to withdraw this monetary gift. Failure to issue these notices have gift tax consequences, so it's important for a trustee to maintain proof that the notices were sent.

Being Switzerland

All trustees (whether individual or corporate) must be able to look past their own interests while adhering to the dictates of the trust document that governs all aspects of trust management – investment, administration and reporting. This can be difficult if the trustee is related to a beneficiary or has emotional ties to the family. For example, it may be hard to remain neutral in a situation where the trustee must decide if the trust should fund a family business (the settlor's business) in which some of the beneficiaries are non-working. Naming a corporate co-trustee can help to minimize the effect of emotions that all too often complicate otherwise straightforward decision-making.

Why Use a Corporate Trustee?

A corporate trustee employs professional trust administrators who



can be counted on to fulfill the obligations required of a fiduciary. This means a professional trustee can offer greater consistency and continuity of service than an individual trustee is capable of providing. A corporate trustee is also subject to many levels of oversight from internal auditors, outside auditors, and government regulators—all for the protection of the trust beneficiaries.

Selecting the proper trustee is crucial. You want someone who will provide careful management of your trust assets, exercise the appropriate level of diligence when executing your wishes, and demonstrate the ability to put the interests of your beneficiaries first.

It makes sense for settlors to initially select a corporate trustee or co-trustee to serve with an individual (and we always suggest that the individual be given the right to change the corporate trustee in event of untoward mergers, acquisitions, management changes, etc.). Alternatively, in the trust document, the settlor can require an individual trustee to delegate key trust management duties to a professional.