WHO DO YOU TRUST?

Understanding Your Choices When Selecting a Trustee

"How do I choose the right trustee?" This is a question we frequently hear from families engaging in estate planning. Establishing a trust affords families greater control over how and when their money is passed to beneficiaries, such as children, grandchildren or other loved ones, rather than leaving it to them outright. In setting up a trust, one of the most critical decisions the trust creator (also known as the "grantor") makes is who to name as trustee. The trustee is the legal fiduciary with responsibility for managing and administering the trust assets for the beneficiaries in accordance with the trust's terms. As a fiduciary, they are obligated to act in the best interest of all beneficiaries because they have the duties of care, loyalty and good faith.

As an investment advisor with no affiliation to a trust company or other interested party, we often help clients weigh the tradeoffs associated with various trustee options. As the name implies, a trustee should be someone who you trust, but there is a continuum of choices with different attributes.

SPECTRUM OF TRUSTEE POSSIBILITIES

INDIVIDUAL — PRIVATE FIDUCIARY — INDEPENDENT TRUST COMPANY — CORPORATE TRUSTEE

WHAT IS THE ROLE OF A TRUSTEE?

A trustee has responsibility for implementing the intentions expressed in the trust document and administering the trust. They serve as a fiduciary who is required to make decisions in the beneficiaries' best interests.

Key responsibilities include:

* Safeguarding, investing and monitoring the trust assets, either alone or with an investment manager
* Making distributions while balancing the needs of all beneficiaries
* Maintaining records of trust activities and reporting to beneficiaries
* Filing the trust tax return and any other required filings

There is certainly no one-size-fits-all answer to the trustee selection question and the best solution for one family, trust or situation may not be the right fit for another. Each family has different interpersonal dynamics, financial circumstances and emotional sensitivities. In certain situations, a family may have such specific needs as to warrant establishing or using their own private trust company. However, for the purposes of this paper, we will focus on the most common trustee options and delve into key considerations as you explore the right solution for you and your family. It is worth noting that it is possible to combine some of the options by appointing co-trustees.

It is also important to note that the location of the trustee can have a significant impact. Certain states have more or less favorable income tax implications depending on where the trustee is located. While we will not delve into state-by-state specifics in this paper, grantors should be aware of how the jurisdiction of the trustee might affect their taxes.[1]

[1] This can apply to the location of individual trustees and the location of the trust company selected.

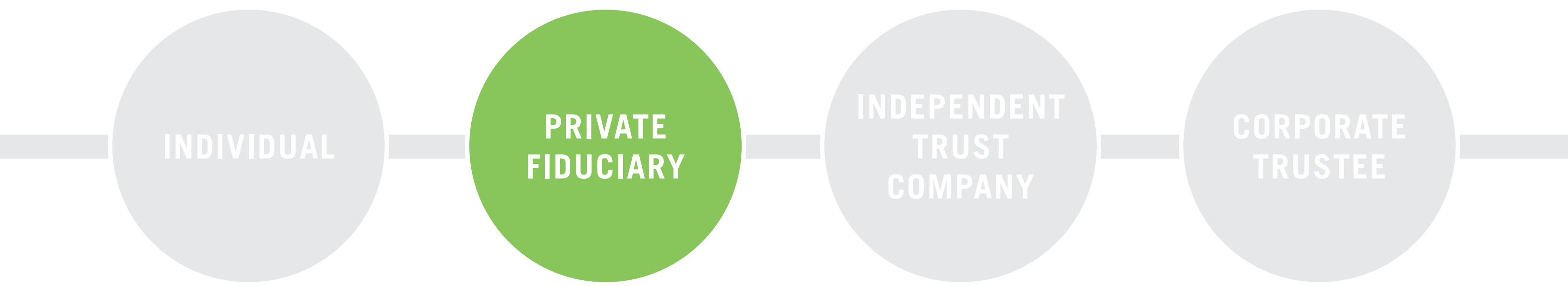
INDIVIDUAL — PRIVATE FIDUCIARY — INDEPENDENT TRUST COMPANY — CORPORATE TRUSTEE

CHOOSING AN INDIVIDUAL

Frequently when selecting a trustee, a grantor will consider a family member or close family friend as the "go-to" trustee choice. In fact, many people initially think that they must select an individual even though that is not necessarily the case. Typically, the grantor will select someone who knows the family well and is implicitly trusted to keep the family's personal and financial information private. Other qualifications include the individual's perceived financial acumen or, at the very least, their sound judgment. There can be a benefit to having a trustee who understands the family dynamics and is already familiar with the beneficiaries. A family member or friend may not charge a fee—or may charge a fee at less than the going rate—making them typically the lowest-cost option on the spectrum. It is helpful and necessary for the individual trustee to work with and frequently communicate with the family's other advisors such as their CPA, attorney, life insurance professional and investment advisors.

While selecting a family member or friend is commonly assumed to be the most trustworthy option, there can be drawbacks. The trustee may be influenced by their personal relationships which could cause them to make decisions that are ultimately not in the best interest of the trust parties. For instance, to avoid being viewed as the "bad uncle," a trustee may disperse assets to a 21-year-old nephew who is not yet mature enough to properly manage them. The lack, or reduced amount, of compensation can also pose problems if the role becomes time-consuming, leading to trustee responsibilities being on the "back burner" or creating resentment on the part of the trustee.

Any individual acting alone introduces an element of "human risk," meaning that the unexpected can happen. A trustee relationship can be impacted by a debilitating health issue, a personal distraction or potentially even an abuse of power. Anticipating that an individual trustee could become unable to serve or pass away, it's important to identify successor trustees or appoint co-trustees. Having co-trustees, or even a trustee committee, can simplify succession issues but may introduce other dynamics depending on the personal relationships between trustees. Additionally, having more than one trustee may add a layer of fees and complexity. It could also make decision-making more time-consuming, as multiple trustees would have to coordinate and agree on decisions.



SELECTING A PRIVATE FIDUCIARY

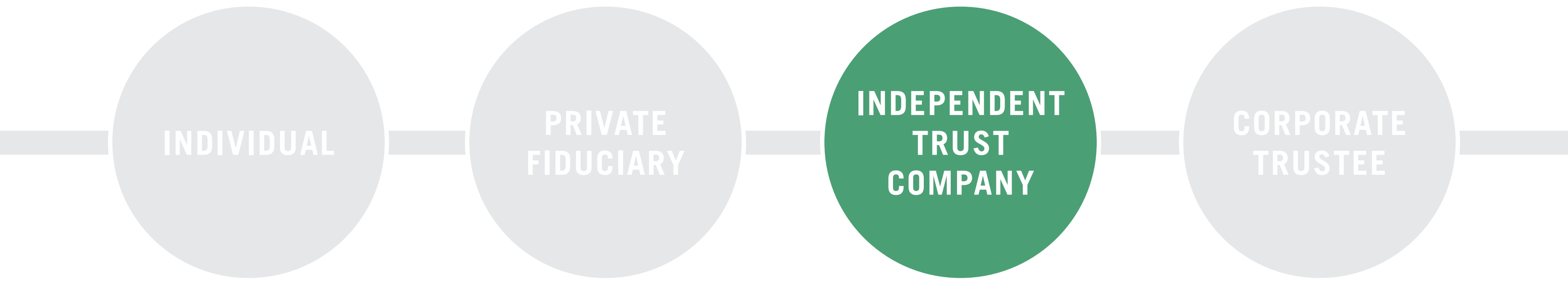
A private fiduciary is a third-party professional who brings specific knowledge to the role of trustee, generally in-depth legal, tax and/or financial expertise. Grantors may choose to use a private fiduciary rather than a family or friend to ensure that their trusts are managed and administered professionally, especially if they do not have anyone in their lives with the desired expertise or prefer to select an unrelated individual to serve. Although not all states require fiduciaries to be licensed, private fiduciaries may choose to get certified by the National Association of Certified Financial Fiduciaries (NACFF) to ensure they are properly credentialed. A grantor may select a private fiduciary to handle the trust's affairs because they believe they will be more impartial if they are not intimately involved in the family's interpersonal dynamics. They may already be working with the family in some capacity, for instance as a lawyer or accountant.

Just as with any trustee, their mandate is to follow the stipulations of the trust document and apply unbiased judgment that is ethically and financially sound. Because of the professional expertise they bring to the table, they understand how to handle the sometimes-burdensome administrative duties and legal/regulatory compliance. A private fiduciary will expect to be compensated for their services but may charge less than a corporate trust company.

Compared to corporate trustee options, a private fiduciary typically has fewer clients and may provide more personalized service. Unlike a personal friend or relative serving gratis who might have a different full-time job, for a paid private fiduciary, serving as a trustee is their job. They understand the responsibility to perform their trustee duties timely and diligently. The most successful fiduciaries will take time to get to know a family's specific circumstances and sensitivities, which can be helpful if they need to help maintain harmony among beneficiaries. If several siblings squabble over their trust distributions, it may be valuable to have the involvement of a trusted third party.

The greatest drawback of using a private fiduciary is related to human risk. As is the case with a family member or friend, an individual trustee's performance can be diminished by any number of personal issues, or the person can pass away. If the arrangement does not work out, it may be easier to replace a third-party professional than to move on from a family or friend where the relationship could be strained.

As with any professional you hire, it is critical to invest time and energy into finding a private fiduciary with the right personality and skillset. Depending on what you prioritize in a trustee relationship, your "job description" may change. In instances where the grantor would like to appoint a family member or friend who does not have enough trust-specific knowledge or time, it may make sense to appoint a private fiduciary as co-trustee.



USING AN INDEPENDENT TRUST COMPANY

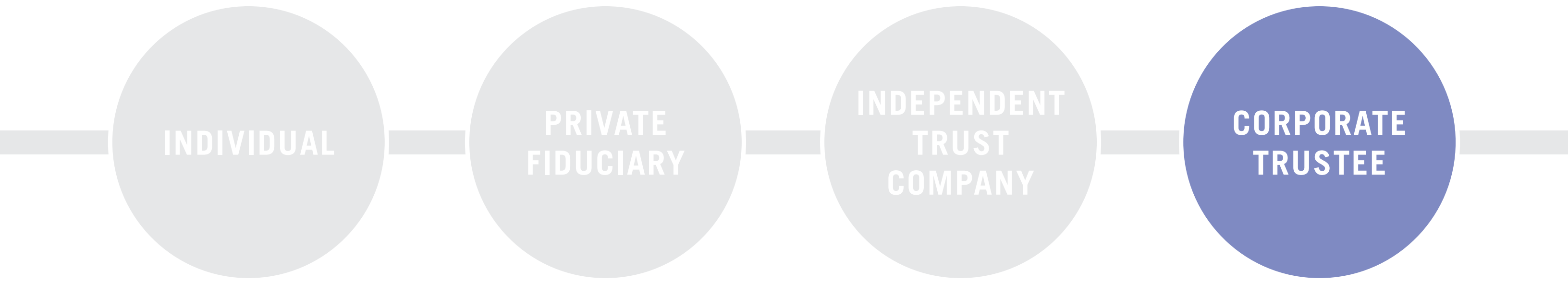
An independent trust company is a trust company that is not associated with a large bank and does not have a requirement that it directly hold the trust's investment assets at the firm. It performs the same function as a private fiduciary, but unlike naming an individual who may need to be replaced or succeeded, another employee of the trust company can assist or take over. Often within a trust company, beneficiaries will be assigned to work with a specific trust officer. However, if the assigned trust officer has a personal issue, or is simply on vacation, there is a built-in system to ensure reliability of service because of the trust company's more robust infrastructure. As part of the diligence process, it is important to understand the depth of the trust company to ensure there are ample resources. Of course, even people within a team can change, so there is no guarantee that the trust officer will stay in the same role for your family.

Like a private fiduciary, trust officers and other employees at an independent firm have specific expertise in their field including financial, legal and accounting insight. Unlike individual trustees, independent trust companies are regulated and must be granted the power to operate as a trust company under the state law in which they operate.

Using an independent trust company can help ensure that the trust officer provides unbiased and impartial advice because they must follow the firm's policies and procedures. In fact, most trust companies will have conflict-of-interest rules in place to prevent the appearance of any impropriety. Some families prefer to engage a third party that is structured to be free from personal bias so they are neutral in case of any disputes, and are not reliant on one person like an individual or private fiduciary.

As mentioned above, many independent trust companies do not require that the trust assets be managed within their company, which many grantors like because they may already have an investment manager with expertise in managing the trust assets.

With greater resources and more employees, an independent trust company will likely charge more for their services than a private fiduciary. In addition, having more people involved in the relationship naturally adds a layer of complexity. Trust companies will often follow stricter policies and procedures than an individual acting alone. If the entire team is involved in decision-making (e.g., if the trustee is deciding whether a discretionary distribution should be made), the process may be slower. Additionally, in complex or ambiguous situations involving language in the trust, an independent trust company may be more likely than an individual trustee to involve outside legal counsel and/or the courts in interpreting the trust documents rather than relying on their personal judgments. If legal action is taken, it is important to note that legal expenses are generally paid by the trust instead of being paid personally by the trustees or the trust beneficiaries, reducing the corpus of the trust.



ENGAGING A CORPORATE TRUSTEE

A corporate trust company, frequently a bank, brings the greatest expanse of resources to the trustee role. Often, the grantor will select a large corporate trust company based on the notion that bigger is better. Large trust companies may offer a range of services related to safeguarding and investing trusts, such as providing tax, financial and estate planning advice. In that sense, they can be perceived as a one-stop shop. However, many large corporate trustee firms require that the grantor use one of their other services, such as custody or brokerage, in addition to providing a corporate trust officer.

As is the case with smaller, independent trust companies, a grantor can expect to find well-qualified trust officers at a large corporate trust company. A family will generally be supported by a team of professionals, rather than one individual.

It's possible that a large corporate trust company may offer less personalized service than an individual or a smaller independent trust company might provide. Typically, each trust officer will have a larger number of clients and trusts to administer which may make it more difficult to get to know family members and beneficiaries well. As with any large firm, there may be higher turnover and your originally assigned trust officer may not be part of the relationship over time. Decisions are also more likely to be made by committee following stricter policies and procedures than in smaller organizations. Similar to an independent trust company, in the event of a question about language in a trust document, a corporate trustee is most likely to involve outside legal counsel or petition the courts to interpret the trust documents (using the trust resources to bear the legal costs).

If the trust company has multiple business lines, this can create misaligned incentives for trust officers. For example, there could be incentives for the trust officer to use internal products of the trust company such as investments, loans, etc. Not all trust companies are structured in the same way so it is important to understand the incentive construct. Even if incentives are aligned, a corporate trust company will likely charge more than the other possible trustee options because of the number of employees at the firm, the overhead and the additional lines of business. It is possible to draft a trust so that the trust assets are managed by an advisor who is not affiliated with the corporate trustee (known as a "directed trust").

COMBINING TRUSTEE OPTIONS

As demonstrated above, each trustee option has pros and cons. To combine the benefits of—or mitigate the less positive aspects—of a certain type of trustee, a grantor may elect to appoint co-trustees to act together. For example, a family member or friend with less time and expertise may benefit from the support of a corporate trustee, whether it is at an independent firm or a large trust company. The individual has the advantage of knowing the family well and understanding any sensitivities, while the firm will bring administrative support and trust knowledge. If an issue arises, such as a dispute, a trained professional may prove to be especially valuable in helping mediate the situation.

The downside of having multiple trustees is that it will likely lengthen any decision-making process, add a layer of fees and perhaps increase complication if there is a disagreement between co-trustees. However, for some grantors, the pros of combining different backgrounds and skill sets outweigh the possible downsides.

REMOVING AND REPLACING A TRUSTEE

Sometimes despite best efforts, a trustee may need to be replaced, either because they turn out to not be the right fit or, in the case where the trustee is an individual, personal reasons cause them to not be able to carry out their required responsibilities. As mentioned earlier, a host of issues can derail a relationship, such as a trustee not performing their duties diligently, not looking out for the beneficiaries' best interests or, in the worst case, engaging in malfeasance. In some cases, it is simply a matter of clashing personalities. With an independent trust company or corporate trustee, a grantor may find themselves "stuck" if their preferred trust officer leaves and is replaced with someone who does not get along well with them or the beneficiaries.

In cases where the trust document does not specify who can remove trustees, the process for trustee removal may not be simple. It may include requesting that the trustee resign (which many corporate trustees are not typically apt to do without going through a long process, if at all) or having to petition the court to request that the trustee be removed and replaced.

The best way to avoid this situation and provide flexibility in the future is to include provisions in the original trust document that outline the process for trustee removal. This may include giving the grantor, if possible, and beneficiaries the power to remove and replace trustees. While this does not prevent difficult conversations, it does make the process more clear if a change becomes necessary.

For this reason, we strongly recommend that grantors think through trust removal when they establish the trust. Adding clear language specifying who can remove and replace trustees can avoid problems, regardless of whether you select an individual, a private fiduciary, an independent trust company or a corporate trustee.

CONCLUSION

The selection of trustee(s) is an extremely personal decision. It is critical to find people who are trustworthy, financially astute and capable of making difficult decisions if necessary. Beyond that, each grantor should be prepared to prioritize what matters most to them and their family when they set up a trust. As we have discussed, considerations include the expertise of family members and close friends, the age and maturity of beneficiaries, intra-personal dynamics and sensitivity to fees among other things. We strongly encourage family discussion of long-term goals as they relate to its trusts and the beneficiaries.

	INDIVIDUAL	PRIVATE FIDUCIARY	INDEPENDENT TRUST COMPANY	CORPORATE TRUSTEE
PROS	• Family knowledge • Privacy • Personal relationships • Generally lower cost	• Independent/unbiased • Trust expertise • Personal service • Responsive • Can be lower cost	• Smaller structure • Independent/unbiased • Trust expertise • Collaborative • Continuity of service	• Robust infrastructure • Objective • Trust expertise • In-house resources • Continuity of service
CONS	• May lack expertise • Personal biases • Time consuming • Lifetime only • Personal liability • Human risk	• May not know family • Human risk • Lifetime only	• Smaller entity • May not know family • Decision by committee • Higher cost • Employee turnover • Less flexibility • Legal costs (if lawyers are involved)	• Higher cost • May not know family • May have corporate investment requirements • Employee turnover • Less flexibility • Longer decision process/ greater bureaucracy • Legal costs (if court is involved)

As you are selecting a trustee, below are a few questions you might consider:

1. Do I have a family member or close friend with the expertise necessary to serve as a trustee (e.g., investment and financial/accounting acumen) as well as the time to serve? What other professional support is in place to assist this person?
2. How do I gauge the complexity of the intra-personal dynamics as it relates to the beneficiaries and other involved parties, such as siblings or second marriages?
3. How much do I value the personal bond between trustees and beneficiaries vs. using an independent trustee?
4. Am I looking to consolidate my trust relationships and use other services that a trust company might offer?
5. How sensitive am I to paying fees to trustees?

As an investment office serving multi-generational families, all with different circumstances, we are happy to help you think through priorities as you explore your trustee options.

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Denise is a Director with over 25 years of legal and financial experience working with multi-generational client families on all aspects of their financial lives. Denise draws on her past experiences to help clients develop and implement their wealth transfer plans and makes recommendations about wealth transfer and income tax saving strategies. Denise joined Hirtle Callaghan from Wells Fargo's Abbot Downing division where she was a director who specialized in working with complex families. Denise obtained a juris doctorate degree from the Arizona State University College of Law and graduated magna cum laude with a bachelor's degree in accountancy from Arizona State University. She also obtained her Certified Public Accountant (CPA) designation (not currently practicing) and is a member of the Arizona Society of Certified Public Accountants. Denise is based in Hirtle Callaghan's Scottsdale, AZ office.

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