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Professional vs. Amateur: Selecting the Right Trustee for You

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Few people really understand what trustees do, so it's very hard to know how to select the right one for when planning your estate. This article describes both the duties of a trustee and the comparative strengths and weaknesses of individual and institutional trustees. Hopefully, considering these factors will help you take the first step in selecting an appropriate trustee: deciding between an individual and an institutional trustee.

What Does a Trustee Do?

A trustee is responsible for administering a trust. A trust is legal entity designed to own assets and hold them for eventual distribution to one or more beneficiaries. The trust is governed by a written document that basically tells the trustee what to do with the assets held in the trust. In other words, a trust agreement is really just a set of instructions you write out telling the trustee what you want the trustee to do with the money and other assets you put in the trust. For example, you might create a trust in your will for the benefit of minor children so that their inheritance is held for them until they are old enough to manage the money on their own. In the trust you might tell the trustee to use the money for a child's educational expenses, to pay for the child's healthcare and to make sure the child has money for things like clothes, food and housing. The trust might go on to say that at age 30 the trust ends, and the trustee is to turn any money remaining in the trust over to the child. A well written trust would say a lot more than that, but most people focus on the trust's dispositive provisions, i.e. the "who gets what and when" provisions.

During the term of the trust, the trustee has several jobs:

1. Oversee the investment of the trust's assets and make sure they are not lost to poor investment decisions.
2. Decide when and how to make money available to the beneficiary.
3. Maintain detailed records of the trust's investments and spending so the trustee can account for the trust's financial activity.
4. Keep the beneficiary informed about the trust's assets, how they are invested and how they are being spent.

Each of these tasks requires skill and good judgment. Selecting the best trustee means asking yourself how well you think a prospective trustee will perform these tasks. So it's important to know a little bit about each of these basic duties.

What Kind of Investment Decisions Does a Trustee Make?

When handling trust investments, the trustee's primary duty is to maintain the value of the trust's assets. This is very different from trying to grow the trust's assets. Most of us want our investments to grow, and we make decisions based on what we think will provide the best return on our investment. A trustee is supposed to look at investing very differently. The trustee's primary job is to keep from losing what the trustee is given, not growing it into an even more valuable portfolio. The trustee also wants to receive a good return on investments, but that is a secondary concern. Not losing the money is the trustee's primary concern, and often that means the trustee sacrifices a little investment growth in favor of a safer, less risky investment plan.

Consequently, trustees usually invest conservatively. Rather than going for investment home runs, trustees are looking to hit singles that keep the trust's assets from becoming less valuable over time due to inflation.

Trustees should develop an investment plan for the trust and make sure the trust's assets are invested according to that plan. From time to time the trustee must adjust its investment plan based on changing market conditions and the needs of beneficiaries. For example, if the stock market declines because of a major economic downturn, the trustee might alter the trust's investment plan to anticipate poor returns in the stock market for the next several years.

Trustees also have to make sure the trust's investments are set up to help the beneficiary when money is needed. For example, if a beneficiary is getting ready to go to college, the trustee should not have all the trust's money tied up in long-term certificates of deposit or annuities that have penalties for early withdrawal. Instead, the trustee should have enough cash and other liquid investments on hand to write tuition checks when they are needed.

Finally, the trustee must monitor the trust's investments and make changes based on market conditions. Trustees may not simply diversify, duck and cover. They must rebalance the trust's investments to reflect gains and losses. Usually, this involves making sure the trust's investments are set up to follow the trustee's investment plan, but sometimes it means making large scale changes to the trust's entire investment plan.

So Who Invests Better, a Bank Trust Department or an Individual?

No investor can guarantee investment success. Generally speaking, however, institutional trustees like bank trust departments are very disciplined investors who follow an investment strategy that's tried and true. An individual trustee may or may not be as knowledgeable as a bank's investment experts.

If institutional trustees have a weakness when it comes to investments, it usually comes from a lack of attention to the trust's portfolio because the trustee has too many accounts to handle. Sometimes an institutional trustee may be too tied to its investment plan and fail to react quickly to changing circumstances. For example, the trust company's investment plan may require it to invest in funds owned by the trustee's parent company rather than better performing funds maintained by a competitor bank or investment company.

By comparison an individual usually lacks the investment experience and expertise of an institutional trustee, but <u>may</u> be more attentive and quicker to react if circumstances change. They also may have fewer restrictions and limitations on investments and so can be more flexible when setting up an investment plan. That said, individual trustees usually don't watch the investment markets daily or monitor the latest opinions on market conditions like the investment experts working in banks and so usually there are fewer safeguards in place to make sure the trustee is following the trust's investments carefully.

So the question of who is better really depends on how skilled and diligent the individual is. Generally speaking, an institutional trustee will outperform an individual unless the individual is a serious and skilled investor (or is willing to hire one to help the individual trustee).

Who Makes Better Decisions About Distributions to the Beneficiary?

Here individuals often score better than their institutional counterparts. Often they had a close relationship with the person who created the trust and know how that person would react to a given set of circumstances. In contrast, institutional trustees tend to make decisions about distributions in a methodical, somewhat bureaucratic, manner that seems a lot like applying for a car loan. They have little insight into the opinions and preferences of the person who created the trust. As a result, institutional trustees can be criticized for being miserly and unwilling to make distributions that are not required by the trust agreement.

If you want the trustee to say no to requests for distributions more often than it says yes, an institutional trustee may be the better choice. If you want the trustee to be more flexible and empathetic, then an individual trustee is probably the better choice.

Who Keeps Better Records?

Here it's hard to beat an institutional trustee. Banks and investment companies are very good at keeping records. They understand how to prepare accountings and are used to sending out statements regularly. Individuals, however, are usually pretty poor record keepers. Even when they keep the necessary records, they often struggle to organize those records so it's easy for them to retrieve information when needed and put accountings together for beneficiaries.

Who's Better at Communicating with the Beneficiary?

It's hard to pick a clear favorite when it comes to communication. Most institutional trustees will contact the beneficiary at least annually, but few spend a lot of time talking with beneficiaries, learning about their needs and goals and keeping the beneficiaries informed. They will issue regular statements about the trust's investments and for some, that's really all the beneficiary wants to know about anyway.

By comparison, individual trustees often know the beneficiary quite well and see the beneficiary often. They may not be quite as good about sending out investment reports, but they tend to reach out to the beneficiary more often. However, there are many individuals serving as trustees who communicate very poorly. It all depends on how open the individual is and how committed he or she is to keeping the lines of communication open.

Who Charges More?

Anyone serving as a trustee can charge a fee. Institutional trustees have published fee schedules, while individuals tend to make decisions about compensation as they go along. There is no question that being a trustee is hard work and trustees deserve to be paid. All trustees must charge a fee that is reasonable under the circumstances. What makes a fee reasonable depends on the level of the trustee's expertise, the quality of the trustee's work, the benefits obtained for the trust by the trustee, the time needed to do its job and amount paid to other trustees for doing comparable work.

Some individuals will serve without compensation, but you should not expect that. If the individual is a professional like a lawyer or accountant, he or she will probably want to charge a fee similar to what he or she makes as a lawyer or accountant. That could be much more or much less than what an institutional trustee would charge. Institutional trustees will always charge a fee. After all, that's why they are in business. Usually, an institutional trustee's fee is based on the size of the trust's portfolio, so the trustee has an incentive to grow, or at least not deplete the trust so that its fee grows or at least does not decline.

So What's the Bottom Line?

A skilled, thoughtful and honest individual serving as a trustee is hard to beat. However, such a person is very hard to find. Few of us have the investment expertise and organizational skills to do a really good job as a trustee. So the next best thing to a really skilled individual is either an institutional trustee or an individual who recognizes his or her shortcomings and gets third parties to help overcome them. Often people make the decision about who to select as a trustee based on what they think the trustee will charge. However, if you think an individual will charge less, don't forget to consider the fees of the lawyers, investment advisors and accountants the individual will employ. Added up, those advisory fees may equal or exceed what an institutional trustee (who keeps lawyers, accountants and investment professionals on staff) will charge.

If you pick an individual, make sure the person you select understands the job you are asking them to perform. Have them read this article and find out if they are willing to learn those things they don't know about being a good trustee.

Also consider how long the trustee will serve. Sometimes trusts can go on for decades. In that case an institutional trustee will likely provide greater continuity than an individual who may resign due to age or health problems. Consider also that the institution you select today may not exist in the future. Bank mergers can turn small trust companies into multinational institutions over night. Moreover, the trust officer who inspires your confidence now may not work in the trust department tomorrow.

Finally, if your beneficiary is getting government benefits like SSI or Medicaid, strongly consider an institutional trustee. They have the longevity and technical skill to run a special needs trust that almost all individuals lack. Keeping up with changing rules for government benefits is a full-time job and very few individuals can do it properly.

Most importantly, realize that deciding between an individual and an institution as your trustee is only the first step in picking a trustee. You will also need to consider very carefully what your trust says, paying particular attention to changing trustees, if it turns out that the trustee you pick does not perform as well as you expected.

William R. Blumer, Esq. is an attorney at the law firm of Leisawitz Heller. He concentrates his practice in the areas of elder law, estate planning and administration, fiduciary litigation and business representation. Presently, he serves on the advisory board for the Berks County Office of Aging. Mr. Blumer received his J.D. from Dickinson Law School and holds a M.L. in taxation from the Villanova University School of Law.