COLONY
TRUST COMPANY

CHOOSING A TRUSTEE

Trusts may be the most flexible and strongest component of someone's estate plan. People establish trusts for a variety of reasons, including tax reduction, asset protection from creditors and divorcing spouses, preservation of assets for children and grandchildren and preventing funds from being eroded by spendthrift family members. Trusts are also utilized to plan healthcare decisions in advance, avoid probate, care for a disabled family member and donate to favored charities. They are also used to promote and maintain greater financial privacy following a decedent's death. As a result, the success of any estate plan may depend in large part on the trustee selected to properly carry out your wishes.

The Role of a Trustee

A trustee's role and its duties are often unclear to many who are considering forming a trust. Additionally, family and friends who are named as individual trustees may not fully appreciate the extent of their fiduciary responsibilities. A typical trust arrangement, which can be created during one's life or through a will, involves a trustee taking title to property to conserve and grow it for beneficiaries (heirs who will ultimately own or enjoy the assets). Legally, this creates a fiduciary relationship. The trustee has a duty to act in the best interests of the beneficiaries and to avoid conflicts of interest when administering the trust.

Given a trustee's duties, this fiduciary relationship can also generate potential fiduciary liability. When individual trustees are named, it is imperative to communicate the potential liability risks they assume as part of accepting their responsibilities of service as a trustee. As the legal owner of the trust assets, the trustee manages the investments and administration of the trust assets on behalf of the beneficiaries. Trustees with full investment powers have a fiduciary duty to invest the trust assets prudently. In addition to investment duties, trustees also have the following administrative responsibilities:

- Safekeeping of trust assets as custodian
- Evaluating and implementing distributions of income and principal in favor of trust beneficiaries consistent with the terms of the trust
- Detailed record keeping
- Comprehensive reporting and data aggregation
- Calculation of trust gains, losses, income and deductions
- Tax preparation
- Systematic and regular account reviews
- Meetings with beneficiaries
- Mentoring trust beneficiaries; promoting stewardship

If family trustees are involved, sometimes decisions may lead to strained relationships within the family and even lawsuits. For this reason, many families choose unrelated and independent trustees

(individual or corporate) versus family members to promote and maintain family harmony. Nevertheless, it is important that anyone serving as trustee consider an acceptable amount of fiduciary liability insurance coverage to protect themselves from potential legal costs and litigation.

Choosing a Trustee

Choosing a trustee and successor trustees may be among the most important decisions people make when they create a trust. Who they select depends on a variety of factors, including the purpose and complexity of the trust, how long it's designed to last and the trustee powers. Nearly three-quarters of households with more than a million dollars in investable assets have trusts.

Individual or Institution?

For many people, the threshold question is whether to appoint an institutional or individual trustee. Institutional services are available through banks, trust companies and some law firms. Colony Trust Company is a private institutional trustee exclusive to the clients of Colony Family Offices and other families who are looking for a large bank trust department alternative. Individual trustees can be family members or people who are unrelated to the grantor — business associates, close friends or professional advisors such as lawyers and accountants are popular choices. The best trustees have fiduciary experience, investment knowledge and the diplomatic skills to negotiate complex family dynamics. Above all, they should have practical judgment and time to give the trust as much attention as it requires.

Corporate trustees are required to keep up with changes in the law that can affect the investment return or tax efficiency of the trust. They should also understand the complexities and potential pitfalls of certain types of trusts. A prime example involves life insurance trusts, wherein the trustee needs to monitor the performance of the policy held by the trust and follow various formalities to preserve tax benefits. Corporate fiduciaries also provide continuity through multiple generations and serve as an institutional memory, which is especially helpful in long-term trusts. When choosing a corporate trustee, the grantor will want to inquire about the company's length of experience in the field, trust assets under management and number of accounts. Since a corporate trustee is assuming fiduciary liability, they will maintain fiduciary liability coverage. Fees can range widely and will depend on the services trustees perform. If they are managing an investment portfolio, their charges will be higher than if they are simply making distribution decisions.

Some people find the most flexible arrangement is to appoint co-trustees — an individual who knows the family well and a corporate fiduciary with extensive experience in trust administration. Naming family members as co-trustees can help educate younger generations about financial matters and make them feel more connected with their wealth. Another common form of ownership separates investment management from the administrative tasks associated with managing the operations of the trust for the beneficiaries.

Directed Trusts

A "directed trust" contemplates the appointment of an investment advisor that may or may not be different from the actual administrative trustee. Under these arrangements, the administrative trustee performs the administrative services listed above. These tasks are distinct and separate from investment management.

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If an institutional trustee is being evaluated, the flexibility of an institutional trustee's policies and procedures to promote enhanced family engagement should be something the family considers. For example, some corporate trustees may allow for the creation of special "sub-committees" for unique situations or assets to promote more dialogue and education among the family. Larger bank trust departments may be less willing to create customized policies and advisory councils for select families. If the trustee arrangement is not a pure "directed trust" arrangement that clearly unbundles and identifies each fiduciary's respective responsibilities in writing in the trust instrument, a corporate trustee with full powers will ultimately retain responsibility for all "non-delegable duties." However, the implementation of family advisory councils may remain a method employed by smaller, more nimble, institutional trust companies to promote enhanced family engagement even where the corporate trustee retains ultimate responsibility for certain decisions.

Consider the Trust's Purpose

To some extent, the specific choice of trustees will depend on the type of trust. A revocable or living trust is a popular tool for protecting privacy, avoiding probate and handling the finances of a person who becomes mentally incapacitated. In this arrangement, the person who creates the trust (known as the settlor) is the primary beneficiary and may also serve as a trustee indefinitely.

However, the trust must designate an alternate trustee to take over when the settlor becomes unable or unwilling to serve in this role. This person or institution may be the current settlor's co-trustee. Since revocable trusts can be changed or even revoked if the settlor is alive and competent, they don't achieve any estate tax savings — the trust property is still considered part of the person's taxable estate. Therefore, the settlor can have broad powers as trustee, including the power to distribute assets, without defeating any tax-saving goals.

That is not the case with an irrevocable trust — one that the settlor cannot change or revoke. When properly drafted, an irrevocable trust will shelter assets from estate taxes when the settlor dies. In long-term trusts, it is also possible to avoid estate tax on the trust assets and protect them from the claims of creditors for multiple generations. To achieve these benefits, however, the beneficiaries cannot have the unfettered power to withdraw trust income or principal. They can still serve as trustees, but care should be taken such that distributions would be subject to certain ascertainable standards.

Empowering Trustees

When choosing the best trustee for the job, it is important to keep in mind the powers the grantor wants the fiduciary to exercise. Most trusts require payouts according to an "ascertainable standard," meaning that the trustee will be limited by more narrow guidelines (for example, "health, education, maintenance and support"). Still, there is a growing trend to draft trusts — particularly long-term trusts that must remain flexible for multiple generations — to give independent trustees sole and absolute discretion over payouts for any reason they deem proper. In both cases, the trustee should evaluate the beneficiary's needs and interpret the settlor's intent as expressed in the trust document. But with "fully discretionary" trusts, the trustee will exercise much more independent judgment. It is recommended that the settlor consider documenting a letter of desires to provide additional direction on the framework and parameters that the trustee should consider with regards to trust distributions.

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Set the Stage for Future Trustees

The trust should also name successor trustees or create a mechanism for choosing them. If the trust document does not name an alternate and the initial trustee becomes unable or unwilling to serve, a court may decide for the family, and there's no guarantee the decision will reflect the desires of the family. Most people would rather have a committee of family members, or an independent party known as a trust protector, name a successor trustee. Some families prefer giving beneficiaries older than a certain age — such as 30, 35 or 40 — the power to choose successor trustees for their own trusts, sometimes with the consent of another family member or trusted advisor.

Finally, make sure the people the trust designates are able and willing to serve. As obvious as it sounds, omitting this step may lead to confusion and complication after the fact. As discussed above, selecting the right trustee will go a long way toward ensuring peace of mind as families plan their estate.

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