Excerpts from IICLE (Illinois Institute for Continuing Legal Education) Seminar:

Trust Administration:
Essential Duties for Trustees and Their Advisors

Choice of Trustees … Including Successor Trustees

January, 2009: Springfield, Illinois

January, 2009: Chicago, Illinois

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I. INTRODUCTION

Perhaps no more than a generation ago, it was a simple matter to determine who would act as trustee under most type of testamentary and *inter vivos* trusts: for tax and other reasons, corporate fiduciaries were almost always chosen. And while trust beneficiaries might be given limited removal or appointment powers, the category of eligible successor trustees was usually also limited to the corporate entity.

Over the last twenty-five years there has been a sea change in the factors which are involved in the trustee selection process. Changed client attitudes, available out-sourcing of investment assistance, favorable tax decisions and IRS rulings, and advances in computer hardware and software technologies, have been so expansive that today the trustee selection process is both simultaneously broader in its possibilities, and more complex.

As the selection process has become subject to more permutations, more numerous have become the different types of trusts which can be the subject of the process. Estate planners have added a significant number of new trust instruments to the acronym stable that houses planning tools where a trustee is a required party - GRATs, GRUTS, QPRTs, IDGTs, CLATs and CLUTs (their near relatives, CRATs and CRUTs), ILITs, QTIPs, SCINs, QDOTs, APTs, QSSTs, CEBTs, and on and on.

The focus of this chapter, however, is on that traditional type of testamentary or *inter vivos* trust which forms the core of a typical client's estate plan - a trust which become fully irrevocable only at the death of the trust's grantor (or the survivor of both grantors, in the case of a joint-grantor trust), and which is intended:

(i) to deal with the bulk of a client's assets, and

(ii) to benefit the immediate family members of the grantor (spouse, children, grandchildren) over what may be an extended period of time.

In most cases the grantor will act as her own trustee (or the trustee's duties will be suspended until the death of the client, in the case of a testamentary trust). For the sake of convenience, the term "initial trustee" in this chapter refers to the trustee named to act after the death of the grantor or grantors (and does not refer to any intermediate trustee who might act while a client is disabled and no longer able to act as trustee during her life). "Successor trustee" will refer to any one or more persons or entities named to act after the initial trustee.

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Equally important with the selection of initial and successor trustees is the responsibility of identifying trust situations which will require the involvement of non-trust persons or entities, either for reasons of unique or unusual assets which the grantor has directed the trust to continue to hold, or because of issues related to particular beneficiaries. Such non-trustee persons are referred to generally herein as "trust advisors".

The author of this section is not making recommendations regarding the selection of initial or successor trustees, or trust advisors. The purpose of this section is rather to set out some (certainly not all) of the factors which should be considered in the selection process, a process that is more art than science. Consideration must be given to the fact that in many cases estate planning clients will be looking for advice and guidance from the attorneys who draft the pertinent planning documents, from banking and brokerage contacts, and from others, including family and friends.

Few clients will come to the initial estate planning conference with both a well-grounded understanding of the mosaic of tasks involved in trusteeship AND a list of nominees ready to be given to the drafting attorney. Somewhat like certain recreational activities that appear simple to grasp in concept and execution (sky diving would be a good example), no one <u>really</u> understands what serving as a trustee truly involves .... until they have done it. It has been remarked that being named a trustee is, for the person who is not a trustee by profession, an honor for about 10 seconds. After that it is a lot of other things, most of which were not contemplated by the client who made the designation, or the person who accepted the office.

II. THE INITIAL TRUSTEE; THE SUCCESSOR TRUSTEE: COMMON ISSUES FAVORING THE INSTITUTIONAL TRUSTEE

Whether a trustee is an institutional entity, or an individual not a professional trustee, the duties and responsibilities of any trustee (initial or successor) are fairly straight-forward:

- Maintain custody or control of trust property, while conserving it and making it productive;

- Distribute trust income and principal for the benefit of identified beneficiaries, in accordance with the terms and provisions of the trust; and

- Perform all required accounting and record-keeping functions, including tax planning, tax reporting, and tax payment functions.

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In expanded form, these duties and responsibilities include the following:

A. Duty Of Care:

The trustee must perform with the care, skill, prudence and diligence that a person familiar with the job of serving as trustee would use during the administration of the trust in order to carry out the intentions of the trust's grantor. This standard extends to even a "first time trustee", who will be held to the same high standard of performance.

B. Duty To Make Trust Assets Productive:

The trustee has the duty to invest trust assets appropriately. If the terms of the trust do not provide otherwise, the trustee will be obligated to adopt a program of diversification (including appropriate allocation of assets by class). In general, the trustee must keep in mind the intentions of the grantor, the needs of the beneficiaries, and the ability of the beneficiaries to tolerate risk.

C. Duty To Follow The Trust's Terms:

The trustee must administer the trust strictly by the trust's terms. The trustee is bound solely by the terms of the trust instrument, and is restricted by the grantor's intention as gleaned only by the provisions of the trust instrument itself. Obviously, then, a trustee must be able to read and comprehend the trust document. If the trustee needs assistance in understanding the terms of the trust, the trustee must seek help from an attorney qualified to give such advice. In the case of ambiguity or trust provisions which are in conflict or otherwise clearly inapplicable to the current administration of the trust, the trustee will need to seek guidance from the courts.

D. Duty To Communicate and Account:

The trustee must communicate with and furnish information to trust beneficiaries, trust advisors, co-trustees and perhaps even designated successor trustees as required by the trust instrument. Instances of such information would include:

- a notice of delegation to another trustee,
- notice of resignation, or designation of a successor trustee,
- notices regarding rights of withdrawal or rights to remove or appoint trustees, or rights regarding the appointment of trust advisors,
- notices with required tax information which the beneficiaries will require,

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- periodic accountings to the beneficiaries, which would include any acts of the trustee which are reasonably related to the interest of a beneficiary in the trust's administration.

E. Duty Not To Delegate:

General fiduciary principles prohibit a trustee from delegating to others the performance of any trustee duties which one would expect the trustee to perform personally, and in particular any trust-related actions which involve the exercise by a trustee of discretion. Written records should be kept of any significant decisions made by the trustee, and the reasons for them. While a trustee may employ agents, attorneys, accountants and investment advisors, to assist the trustee in carrying out the trustee's duties, the trustee may not accept without question recommendations made by these advisors. Depending on the terms of the trust instrument, a trustee may be able to delegate powers to a co-trustee. While a trust instrument may contain exoneration provisions for any trustee making a permitted delegation to another trustee, it is likely that the delegating trustee would not be relieved from liability if actual notice was had of any breach of trust by the other trustee.

F. Duty To Defend The Trust; Duty To Prosecute Claims:

The trustee must reasonably defend the trust (it's terms, validity, etc.) and the trust's property against claims, as well as prosecute claims in favor of the trust. In this context "reasonable" means considering the economic consequences of defending, prosecuting, or attempting to settle a claim. A successor trustee must examine the accounting tendered by the prior trustee, and independently determine the possible existence of claims which the trust may have.

G. Duty Of Confidentiality:

The trustee must maintain confidentiality with respect to all aspects of the trust, except as required by law. This extends to beneficiary identification, their interests, and all other terms of the trust; it obviously also extends to personal information about any beneficiary. If the trustee believes disclosure of any information to third parties is required for the trustee effectively to carry out the terms of the trust, then the third parties to whom disclosure is made must agree to appropriate confidentiality. An example would be disclosure of a beneficiary's medical condition(s) to a health care provider being asked to make a current determination of a beneficiary's needs or condition.

H. Duty To Avoid Conflicts:

The trustee must act solely in the interests of the trust beneficiaries, and may not do anything which would put the personal interests of the trustee in conflict the interests of any of the trust beneficiaries. This duty of loyalty can be particularly troublesome where a beneficiary has been named as a trustee of a trust which benefits other persons in addition to the trustee. Again, however,

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the trust instrument may anticipate and allow a trustee to engage in activities which normally would constitute a breach of the conflict of interest requirements.

I. Duty To Act Impartially:

The trustee must treat beneficiaries impartially. This requirement extends to beneficiaries who share a common class, as well as to the balancing of trust investments so that the interests of current and remainder beneficiaries are treated fairly.

The institutional trustee has a clear advantage over an individual "non-professional" trustee with respect to the areas listed above. An individual who is not an estate planning attorney (for purposes of reading and interpreting the trust instrument), who is not a professional investment advisor (for purposes of carrying out the trustee's investment obligations), and who is not an accountant or tax attorney (for purposes of planning tax elections and filing the trust's tax returns) will have to out-source many of the duties which can be handled in house (probably in a more co-ordinated and efficient fashion), by the institutional trustee. The costs involved in paying multiple non-trustee advisors must be compared to the single fee of an institutional trustee. Further, the institutional trustee will not have to deal with the type of potential conflicts of interest (no matter how well drafted for) inherent in the situation where an individual acting as trustee is also a beneficiary.

These factors do not absolutely tip the scales in favor of the institutional trustee, but they must be explained to the client in order for the client to make an informed decision regarding designation of trustees.

III. THE INDIVIDUAL INITIAL OR SUCCESSOR TRUSTEE: ISSUES RELATED TO THE PROPOSED INDIVIDUAL

A client may correctly perceive that an appropriately selected individual named as trustee (or co-trustee) will be better able to handle the ongoing "give and take" involved in dealing with the client's beneficiaries. It is an understandable assumption that an individual with a long involvement with the client and the client's family (beneficiaries) will likely know the client's intentions and the personalities of the players better than institutional trust personnel only recently introduced to the beneficiaries.

The possible adverse income, gift or estate tax consequences to the individual trust beneficiary who might be named as trustee are beyond the scope of this discussion, but obviously also must be addressed.

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In addition to tax issues involved in a "beneficiary trusteed trust", attention must also be given to the changing landscape in the creditor protection arena. While properly drafted ascertainable standards of distribution may protect the trustee / beneficiary from adverse tax consequences, the very nature of an ascertainable standard may weaken the trust's protections for the trustee / beneficiary from a creditor protection aspect. The newly revised *Uniform Trust Code,* which as of this date has been adopted by some 13 states (not including Illinois), weakens even more any such creditor protection features where a beneficiary is acting as trustee. The loss of such protections will be of concern to most clients, and need to be addressed. [1]

Apart from tax issues, a client considering naming an individual as trustee should, in addition to examining the individual's ability to deal with the common issues set about above, and depending on whether the individual is a beneficiary, a friend, or a professional advisor, address the following issues as well:

A. Does the individual being considered understand his limitations in the areas of investments, trust construction, and trust (and tax) accounting and reporting, and will she select appropriate advisors and monitor their performance? In addition to reporting to state and federal tax authorities, trust beneficiaries (and their tax advisors) often need assistance in dealing with the information given them (Sch. K-1 and the like) which needs to be interpreted so that they can prepare their personal returns. Will the individual be able to respond? Will an accountant (or attorney) retained by the trust have the time, or be willing, to deal with such beneficiary inquiries which are often posed just before return filing due dates? If so, at what cost?

B. What is the understanding of the individual being considered, and of the client, regarding the costs of out sourcing the investment, legal, and accounting functions?

C. Does the individual being considered appreciate the potential liability she is being exposed to for acting as trustee? Does the individual understand that the trustee's personal assets are at risk? That there are extraordinary risks involved if the trust owns or has owned environmentally contaminated real estate?

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[1] For a detailed review of trustee / beneficiary issues, see the materials presented by Steven J. Oshins in his outline *The Beneficiary Controlled Dynasty Trust: The Centerpiece of the Advanced Estate Plan*, included in IICLE's "15th Annual Estate Planning With The Masters" [Fall, 2005].

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D. Is there a different individual available who would have the required investment, accounting, or legal expertise so that no outside advisor would be needed, thus reducing the trust's expenses?

E. Has the client considered a trust with simpler investment goals, which would not require the costs of outside advisors, and might actually result in better returns to the trust, with a lower risk exposure?

F. Does the individual being considered have a realistic idea of what the record-keeping and accounting requirements involve? Does the individual understand the serious consequences involved in not adhering to required distribution and reporting duties? Will the trustee have to pay someone to tend to the administrative "paperwork" details of the trust?

G. What are the expectations of the individual regarding trustee compensation, in the light of anticipated outsourcing of normal trustee functions? What are the client's expectations? How will the trust instrument be drafted to reflect these understandings?

H. Does the individual have any history of personal problems (including domestic, employment, medical, financial, tax or substance abuse)?

I. Does the individual have personal knowledge of and care for the beneficiaries? Does she understand the client's intentions regarding the beneficiaries? Will she give beneficiaries adequate and fair hearings on concerns, requests, or complaints they may have?

J. Is the individual capable of impartiality and fairness among all beneficiaries?

K. Is the individual capable of "mentoring" (whether or not specifically requested by the grantor)?

L. Is the individual capable of saying "no" when required? Capable of saying "no" in a diplomatic manner which will not unduly frustrate or alienate a beneficiary?

M. Does the individual have any conflict of interest (real, perceived, or even imagined)? Even if no conflict exists, will the individual be ill at ease because of any property interests the individual has?

N. Is the individual a future beneficiary under the trust?

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O. Is there anything in the history of the individual or the beneficiaries that will make the trustee unduly subject to pressure or influence by a beneficiary?

P. Is the individual capable of dealing with unfair criticisms and complaints?

Q. Is the individual capable of generating, and maintaining, appropriate respect from the beneficiaries?

R. Are there any age, cultural, gender, employment, educational, business, family or other issues which might cause the trustee - beneficiary relationship to be less than respectful?

S. Does the individual have any kind of track history in carrying out duties which require the kind of ongoing personal relationship required of a trustee?

T. If no successor to the individual is named and that function is left in the hands of the individual being considered, how is that decision likely to be made?

U. Is the individual being considered sometimes "out of contact" for long periods of time (business travel, vacations, etc.)?

V. Is the individual being considered willing to establish a schedule for and take time to regularly communicate with the beneficiaries? Can the individual regularly be reached during working hours?

W. Are there other trusts already established for beneficiaries, with other trustees already acting, making it more efficient and economical to consolidate trust operations with another trustee?

IV. ISSUES RELATING TO BENEFICIARIES

Wholly apart from basic common issues, and particular concerns or questions related to a particular proposed trustee, a client and the client's advisors need to consider whether there are particular beneficiary issues that will make it more or less likely that a proposed trustee can successfully serve. Included among these are:

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A. Is a second spouse named as beneficiary?

B. Is it possible that a trust created for a child may not terminate at given point during the child's adulthood, so that a future class of beneficiaries must be considered?

C. Is the beneficiary suffering from any particular type of physical, mental, or developmental disability? Is there any reason to anticipate that any beneficiary may be so affected in the future?

D. Is the beneficiary receiving disability - related benefits of any kind? Is there any reason to anticipate that a beneficiary may (apart from the affect the trust may have) be eligible for such benefits in the future?

E. If both parents are deceased or unavailable, will a minor (or young adult) beneficiary need the "normal" level of mentoring in handling financial affairs, or is the need for such mentoring or assistance likely to be severe and ongoing?

F. Does any beneficiary have any history of personal problems (including domestic, employment, medical, financial, tax or substance abuse)? Is there a spouse or dependent of any beneficiary with any of such problems?

G. Does any beneficiary (or the spouse or any dependent of such beneficiary) lead a "live on the edge of the envelope" fast lane life?

H. Are there any other "unseen players" who are likely to influence the life of a beneficiary, and affect demands made on the trustee for how the duties of the trustee should be carried out? Business partners? Creditors? Friends? In-laws?

I. Does the proposed trustee have any knowledge of a poor relationship between the grantor and any beneficiary?

J. Are any of the beneficiaries hostile to each other?

K. Does the proposed trustee have personal knowledge of the character of the beneficiaries? If not, have meetings been scheduled to give the proposed trustee and the beneficiaries an opportunity to size each other up? Based on whatever knowledge the proposed trustee has,

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does any beneficiary appear to have unrealistic expectations, to be confrontational or litigious, lacking in trust or unable or unwilling to engage in communications?

L. What are the beneficiary's educational attainments? How are they likely to change as time passes?

M. What are the beneficiary's demonstrated accomplishments in becoming a productive self-sufficient person apart from any assistance given (or expected to be given) by the trust's grantor?

N. Does a beneficiary expect that the beneficiary's future lifestyle will differ considerably from the current lifestyle?

O. To what degree does the beneficiary expect to be consulted with respect to the various types of decisions the trustee will have to make?

P. Does the beneficiary resent even the idea of being a beneficiary, instead of having sole unsupervised control?

Q. Does any beneficiary have particular expectations regarding the retention of existing trust assets, such as closely held business assets or real estate? Regarding the acquisition of different assets?

R. Do the beneficiaries understand the compensation arrangements under which the proposed individual trustee will operate?

No hard and fast rules can generally be stated about when it is or is not appropriate to use an individual as a sole trustee or co-trustee, except perhaps the following:

1. It is probably appropriate to name an adult, competent, mature individual as sole trustee of a trust of which that individual is the sole beneficiary if:

   - appropriate limitations are included to avoid tax problems,

   - the beneficiary has either a broad special power of appointment or a general power of appointment, such that there is no other class of beneficiaries who have any rights under the trust, and

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- appropriate special drafting is included in creditor protection features are important.

2. It may be appropriate to name a surviving spouse as sole trustee of a Family Trust (credit shelter or bypass trust) or a Marital Trust if:

   - the spouse is not a second spouse and there are no children not mutual children,

   - appropriate limitations are included to avoid tax problems,

   - the grantor has confidence in the spouse's ability to recognize when assistance (investment, accounting, legal, or otherwise) is needed; and

   - the grantor wants the spouse to have sole and complete control over income and principal distributions with no other possible beneficiary being in a position to criticize the actions of the spouse, and to that end the surviving spouse is granted a board power of appointment which effectively gives the spouse the ability to disinherit all other family members.

Except possibly for these two narrow examples, there are no "hard rules" for the selection of trustees. A developing hybrid is the appointment of an institutional trustee as co-trustee with an individual (who may or may not be a beneficiary). With careful drafting and an eye to allocation of certain responsibilities (for example, custody of assets), this approach brings all the strengths of the institutional trustee to the table, along the individual's strengths in understanding and dealing with beneficiaries, based on the individual's unique knowledge and understanding of the grantor's intentions, and of the beneficiaries involved.

In those instances where a single trustee is named, consideration should be given to routinely including a power for the acting trustee to name a co-trustee, subject to such conditions, restrictions and limitations as may be expressed in the instrument of appointment. Such an "escape hatch" provision can provide the means for a trustee to deal with a particular problem (whether asset or beneficiary oriented), without having to take the extreme step of resigning.

V. ACTEC CLIENT GUIDE: WHAT IT MEANS TO BE A TRUSTEE

[available separately]

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APPENDIX D – ABOUT "ACTEC"

The American College of Trust and Estate Counsel (ACTEC), headquartered in Los Angeles, California, is a professional association comprising approximately 2,700 lawyers from throughout the United States. Fellows of the College are nominated by other Fellows in their geographic area and are elected by the membership at large. A lawyer cannot apply for membership in the College. Fellows are selected on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to these fields through lecturing, writing and teaching.

Among the purposes of ACTEC are improving and reforming trust laws, maintaining an association of lawyers skilled and experienced in the preparation of wills and trusts, and bringing together qualified lawyers whose character and ability will contribute to these purposes.

Within ACTEC there are various working committees of Fellows, among which is the Practice Committee. The members of the ACTEC Practice Committee concentrate on subjects relating to the practice of ACTEC members. Members of that Committee serving during 2002 and recent prior years have prepared this ***Guide*** for clients of ACTEC Fellows, especially those who are considering accepting a trusteeship or creating a trust and naming a trustee. The goal is not to encourage or discourage accepting a trusteeship, but rather to insure that any such decision is made with sufficient information to understand the ramifications.

Considerable information about ACTEC may be found at **www.actec.org**.

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