Practical Guidelines For Selecting An Individual Trustee

No one should choose a trustee lightly, and a named trustee should never lightly agree to serve. This article examines the issues that should be considered in advance, before the trustee is named or agrees to serve.

by KIMBROUGH STREET, Attorney

Three years ago, I was asked by several firm clients to serve as trustee of several noncharitable trusts. I accepted readily. I had a mental image of myself as trustee: a parent figure, wisely counseling receptive and attentive beneficiaries, and responding at convenient times to reasonable requests for appropriate distributions.

I've been lucky. While my mental image was naive, I have been spared for the most part the possible fate that can befall an individual trustee: to become a hapless umpire for disputes among disgruntled and unreasonable parties - a thankless job compensated primarily by sleepless nights and heartburn.

I have, however, become firmly convinced that no one should choose a trustee lightly and that a named trustee should never agree lightly to serve. The trustee - beneficiary relationship is often a long-term and personal relationship, always dynamic rather than static, and possibly very time-intensive. From the trustee's point of view, entering into a trust relationship has some disturbing parallels to acquiring a puppy: initial enthusiasm, followed first by acute awareness that the owner's life is going to be disrupted not only for two weeks of housebreaking but for the foreseeable future, and then by the recognition that the puppy soon will have large teeth and a voracious appetite for everything.

Discussions with colleagues suggest that most individual trusteeships are reasonably successful. The likelihood of a successful trust relationship can be maximized by careful advance consideration of the daily realities of what the particular trust relationship will entail. This advance consideration should include the following:

1. Diligent review of the trust instrument against the legal landscape of the trustee's duties and the applicable law.

2. Recognition of the critical importance of subjective aspects of the relationship.

3. Exploration of investment considerations.

4. Realistic assessment and allocation of the administrative burdens.

Thoughtful consideration of these issues will deter a settlor from choosing a trustee for the wrong reasons, such as: "He's the oldest"; or "I don't want to hurt his feelings!" In turn, realistic assessment by the proposed trustee will help prevent acceptance for the wrong reasons: "I'll have power and prestige as trustee"; "I'm flattered"; or " I'll feel guilty if I don't do it."

If the trust is currently being established, or if a trustee is being replaced, the realities of the trust relationship will warrant immediate consideration by everyone who is beneficially interested in (or has an influence on) the trust, including the settlor, the proposed trustee, any cotrustee, and the beneficiary (assuming the beneficiary is competent and old enough to have opinions).

On the other hand, if a testamentary trust is involved, it is uncertain when and if the trust will be established. Nonetheless, the testator must consider the choice of trustee carefully. Moreover, to guard against a vacancy, the document should

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name several back-up trustees and contain a mechanism for filling a vacancy. When the testator dies and the trust is to be established, the named trustee must not automatically agree to serve; he or she must fully assess the situation at that point in time and may decline to serve.

The following discussion examines many of the practical, common sense issues to consider before a trustee relationship is established. It does not address substantive issues that may arise during the trust's administration or tax reasons to avoid naming a particular trustee. The comments focus on the choice of an individual trustee even though a corporate trustee might be preferable in a given situation. Any practitioner who is considering serving as trustee must review such additional issues as whether registration as an investment advisor is required, what ethical concerns are involved, and whether the attorney's malpractice insurance coverage encompasses acts as a trustee and is adequate.

Initial Homework

Both the person naming the trustee and the proposed trustee must understand the traditional duties of a trustee: to distribute property to the beneficiary in accord with the instrument; to conserve trust assets and generally invest them to be productive; and to perform required record-keeping, tax, and accounting functions.

Familiarity with the legal landscape. The proposed trustee should be particularly alert to any uncertainties as to what law will govern the trust's interpretation or administration. For example, if the trust was created by an Oregon domiciliary and is now being administered in Washington, to what extent will the trust be governed by Washington law and to what extent by Oregon law?

The proposed trustee should also be made familiar with the applicable statutory climate for trust investments. Some states are revising their trust statutes to reflect modern investment theory. Even in these states, however, there is little case law interpreting the new statutes. Similarly, the effects of the *Restatement (Third) of Trusts*, which adopts a "prudent investor" rule, have not yet been fully felt. The trustee should know that case law across the country historically has often taken a restrictive view of permissible trust investments, condemning some common types of investments made by individuals as *per se* imprudent for trusts. Thus, although modern statutes are evolving, there is still a climate of some uncertainty for the trustee who wants to find case law to support a nontraditional investment decision.

Review of the trust instrument. The proposed trustee must review the trust instrument - not a perfunctory look, but a thoughtful examination of the entire document, particularly all provisions relating to distributions and investments by the trustee. Specific provisions in the trust instrument often override the governing law.

The trustee's distribution duties may be either simplified or complicated by the trust instrument. For example, a trustee who is to distribute all income but make no principal distributions will not be deluged with distribution requests from "hungry" beneficiaries. In contrast, a trustee who has discretion to make distributions for the beneficiary's "support, health, and education" will be called upon to exercise judgment and make hard decisions. If the trust benefits multiple beneficiaries, is there any direction in the instrument regarding who should be preferred as between successive or concurrent beneficiaries? To what extent is the trustee, in making distribution decisions, to consider other resources available to the beneficiary and, if so, what kind of other resources?

The trustee should assess candidly whether he or she will be comfortable carrying out the distribution directions in the trust. For example, grandparents may have provided that no trust distributions are to be made to their grandson if he is cohabiting but unmarried. The trustee might not be comfortable with the provision, but the trustee needs to know whether he or she could be liable for making distributions to the grandson without exercising "reasonable care" to ascertain the grandson's living situation.

The proposed trustee should be particularly attentive to any investment provisions. Does the trust instrument contain provisions regarding

retention of, nondiversification of, or investment in, real estate or stock in a closely held business? If so, the proposed trustee is cautioned not to assume what these provisions mean; he or she may want to insist on securing legal counsel as to the probable legal effect of the language used. For example, even if the instrument authorizes the trustee to retain closely held stock, the trustee who simply "puts the stock on a shelf" and ignores it may risk liability.

If an inter vivos trust is to be established, frank discussion in the drafting stage between the settlor and the proposed trustee can often ensure that satisfactory language is included in the instrument. If the trust's language cannot be varied, the proposed trustee may want to secure the agreement of the prime players concerning certain issues *before* agreeing to serve. (Such an agreement, of course, poses its own questions regarding full disclosure and adequacy of consent.)

Subjective Considerations

The importance of subjective considerations cannot be overemphasized in predicting the probable success of a trust relationship. First, the real "players" in the trust relationship must be identified; some players are obvious while others are less so. Next, it is very helpful to assess "personality fit" and explore the expectations of the various players.

The proposed trustee. What is the reputation and current situation of the proposed trustee? Is the person honest and reliable? Is the proposed trustee (or a close member of the trustee's family) experiencing any major personal problems, such as problems of substance abuse, a divorce, change or loss of job, or illness? Any of these circumstances could significantly shift the trustee's time or attention away from the trust administration. Perhaps worse, they could increase the possibility that the trustee would divert trust funds to personal use or to the use of a family member.

Does the trustee have any conflict of interest that would cloud administration of the trust? For example, if a testator names his son from his first marriage as trustee of a trust for his second wife, the second wife may end up at odds with the son. The wife may request distributions for travel, and the son - trustee may resist because he secretly hopes to preserve the trust assets until the wife's death, when they will be distributable to him. Conflicts of interest can also arise if the trustee has an interest in any asset in held in the trust.

During the meetings, each player can assess whether the other prime players are reasonable people with integrity and realistic expectations or whether any is litigious and distrustful. Each player can note the relationships and comfort levels among the prime players. In a trust with multiple beneficiaries, the beneficiaries should be alert to whether the proposed trustee is closer or partial to one beneficiary; the trustee will note whether a beneficiary has that perception, even if it is unfounded.

A successful trust relationship is based on a sound and appropriate level of respect. Will the proposed trustee *listen* to the beneficiaries' requests (even if not all requests will be granted!) and explain the trustee's decisions? The relationship may sour if the trustee will be either condescending or dictatorial.

In turn, the trustee will want to consider an important intangible: whether the key players will respect the trustee. Obviously, the trustee should not be venerated; the beneficiary and other interested parties must feel free to ask questions of the trustee and enforce their rights. On the other hand, the other key players should not expect to interfere with the trustee's job or to direct the trustee in the exercise of his or her discretion.

The trustee should be particularly attuned to any hidden reason why respect might be lacking. An older beneficiary might find it difficult to respect a young trustee. A sibling for whom a trust has been created may not be comfortable if another sibling is crowned trustee. Is there any reason a male trustee would not command sufficient respect because the beneficiary wants to work with a woman, or that a female trustee would not command sufficient respect? If the proposed trustee is from a cultural background different from the family's, insurmountable problems in communication and respect may result.

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All players should be alert to any historical facts that serve as "storm warnings" of potential difficulties. Sometimes the reason the trust is being established may forewarn the trustee of potential problems. If a prior trustee is resigning, why?

Expectations. Last, but by no means least, the individual players in the trust should be encouraged to voice their expectations about the trust relationship. The proposed trustee can try to get a sense both of the beneficiary's current lifestyle and of his or her expectations about a desired lifestyle. What are the beneficiaries' real expectations as to yield (both income and growth) and distributions from the trust? Clearly, one beneficiary's expectation of high income may have a direct impact on another beneficiary's expectation of high growth investments. If any beneficiary's expectations are simply out of line or unrealistic, that is a red flag to an incoming trustee.

Tactful inquiry will reveal whether the settlor expects to have continuing input regarding the trust's administration. The trustee may be willing to serve only if it is understood in advance that the trustee will consider, but not be bound by, the settlor's ongoing advice. Does the beneficiary expect to be involved in decisions relating to the trust? For example, if a spouse - beneficiary expects to be consulted about investment decisions, is the trustee willing to do so as a courtesy, as long as it is understood that the trustee must make the final decisions and be free to act quickly in emergencies?

Frank discussion of fees and expenses in advance can also smoke out unrealistic expectations and potential problems. Acting as trustee entails considerable responsibility, inconvenience, and potential risk. Although it is often anticipated that an individual trustee will not charge a fee, the trustee should certainly understand what is involved before agreeing to serve without a fee. If it is anticipated that the individual trustee *will* take a fee, it may avoid misunderstanding if the instrument specifies (or there is agreement) that a fee will be taken, and if possible, how it will be calculated.

Investment Considerations

Investments can seriously complicate or compromise the trust relationship. Consequently, the trustee must assess realistically whether, in light of the governing instrument and the applicable law, the trustee is comfortable with the current assets and, often more important, with any investment expectations of the players. Someone - for example, the co-trustee, the beneficiary, or the settlor - may expect the trustee to invest in a type of assets with which the trustee is unfamiliar or uncomfortable, such as out-of-state assets, residential or commercial real estate, a business enterprise, foreign securities, or gold. The current or expected investments may not be adequately diversified in the view of the proposed trustee. Discomfort and outright disputes can sometimes be avoided by advance discussion of investment expectations.

As to particular investments, the trustee should be aware that certain real estate investments may be dangerous to the trustee's personal financial health because under current law a trustee can be held *personally liable* for cleanup of a hazardous waste site owned by the trust, even if the trustee was not involved in the contamination. The trustee needs to be aware that even relatively benign looking sites may harbor potential hazardous waste, such as pesticides. Before accepting a trust that owns *any kind* of real estate, the trustee should inquire as to whether such concerns have been put to rest by legislative or regulatory enactment or clarification. In addition, *before accepting the trust*, the trustee may need to view the site personally with an expert advisor and, in order to minimize or avoid later liability, to document investigation and inquiry into previous ownership and uses of the property.

If life insurance may be a trust asset, the trustee should be aware that prudent management may require not only timely premium payments but also periodic verification of the insurance company's financial health and periodic confirmation that the policy continues to be the best product available for the trust's situation.

The prime players should discuss frankly the trust's involvement with any closely held business interest in the trust. What will be the anticipated degree of the trustee's involvement in the day-to-day operations of the business? Is the trustee expected

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to - or should he or she - sit on the board of directors? Are there expectations about how the trustee will vote his or her interest?

Once the likely investments are identified, it is worth discussing in advance how investment functions will be carried out. If it is expected that the trustee will manage all investments personally, does the trustee have the requisite skill? If not, does the trustee have the wisdom to recognize when expert advice is necessary and the sophistication to avoid "get rich" schemes and to evaluate potential advisors? The applicable law may permit a trustee to employ investment advisors, and the new *Restatement (Third) of Trusts* looks favorably on the use of investment advisors. Nevertheless, the trustee needs to know whether he or she can be liable for delegated investments.

Last, the cost of retaining advisors must be evaluated. Is the advisor to be paid in addition to the trustee? Would a different trustee have the requisite expertise, so that no advisor would be needed? Would simpler investments, not requiring costly advice, actually result in equal or better net return to the trust, possibly at less risk?

Practical Concerns

Even if the trust document is well drafted, the governing law clear, and the trust's directions to the trustee unambiguous, and even if the personality fit of the prime players is excellent, day-to-day operational concerns can cause the trust relationship to founder.

In most ongoing trust relationships, availability will be key. Is there a time when communication can routinely occur between the beneficiary and the trustee and between co-trustees. Can the beneficiary and trustee be disturbed during working hours, or are the parties willing to conduct time-consuming trust business at night or on weekends? If the players are located in different parts of the U.S. or the world, communication difficulties can be greatly exacerbated by different time zones. Realistically, how much time will the trustee need to spend during working hours supervising particular assets (such as income-producing real estate) or hiring, supervising, and consulting with advisors to the trust (e.g., property managers, investment advisors, accountants, and tax counsel)?

Broad, frequent, up-to-date communication with beneficiaries is the best way to prevent problems from developing in the trust relationship. Is the trustee committed to ongoing communication about trust developments and the beneficiary's changing situation? Who is going to cover for the individual trustee, assuming there is no co-trustee? What will happen if the trustee is unavailable due to vacations, illness, or family emergency, at a time when the beneficiary has an emergency need? How often does the trustee contemplate being away from "trust headquarters" for more than two to three days?

In addition to the concerns regarding day-to-day communication, does the trustee have a realistic appreciation of the scope of the record-keeping, accounting, and tax planning and return preparation requirements? Is the trustee willing to perform those duties on an ongoing basis or to see that they are performed adequately? The keeping of trust records may be even more important now, under the developing prudent investor approach of the *Third Restatement*, than it has been in the past.

A look ahead: suppose the trustee relationship is not successful? The trustee who is contemplating entering into a trust relationship needs to know that once he or she starts to serve, it may not be easy to resign. In some states, the resignation process may be time-consuming and cumbersome. What is worse, it may be hard to find a replacement trustee. Moreover, in identifying a possible replacement, the resigning trustee should guard against "turning a wolf loose with the chickens."

The beneficiaries and settlor may want to satisfy themselves that there are adequate trustee removal powers in the trust. Should there be an incompetency committee to trigger an orderly succession in the named trustees?

The potential for the trustee's personal liability for a breach of trust should be understood. If the trustee does breach the trust, his or her own assets are "on the line" to make the trust whole. That possibility can give an individual trustee pause,

particularly because of the environmental concerns discussed above if any real estate may be involved. In addition, the settlor or testator may want the trustee to have sufficient assets to "make good" any loss to the trust.

Conclusion

My personal experience in the last several years, while limited, suggests careful consideration both in the naming of a trustee and in the decision by a proposed trustee as to whether to serve. Due diligence by a named trustee *before agreeing to serve* is preferable to the trustee's "jumping in," only to discover quicksand.

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