A Closer Look

Choosing a Trustee to Preserve and Transfer Your Family Wealth

BESSEMER TRUST

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In Brief

- **Trusts are a time-tested way to transfer wealth and achieve other financial goals for your family.**
- **Serving as a trustee can be an honor, but it certainly is a responsibility involving a serious commitment of time and care.**
- **Trustees are responsible for managing the trust faithfully, distributing and investing trust assets, careful recordkeeping, and compliance with state and federal tax laws and other regulations.**
- **Choosing a trustee who is prepared to take on these responsibilities — whether an individual, corporate trustee, or a combination — is one of the most important decisions the trust originator (the grantor) must make.**

For many individuals and families, trusts are an essential way to provide for loved ones, fulfill charitable goals, and protect and preserve both wealth and family values for generations to come. Thanks to their flexibility, trusts can be used to achieve a wide range of specific goals, such as encouraging positive behavior and development for younger family members, minimizing taxes, or providing protection from creditors. Yet no matter how expertly designed, trusts can't be fully effective without the hands-on attention of a dedicated trustee.

Although it may be considered an honor to have been selected as a trustee, the role brings a host of responsibilities and complex decision-making. Tasks range from understanding and administering the trust according to the specific terms established by the trust's grantor to investing and distributing assets, to overseeing accounting and tax compliance, among others. And unlike the executor of an estate, whose work usually ends once the estate is settled, a trustee generally signs on for the life of the trust — which could mean a decade or two of service, or potentially much longer, depending on the terms of the trust.

For these reasons, choosing the appropriate trustee — whether a family member or trusted friend, a corporate trustee, a lawyer or accountant, or some combination of the above — is one of the most important decisions you can make in order to ensure that your wishes are carried out. In the following pages, we'll examine some of the specific duties trustees must be prepared to undertake, as well as some considerations when deciding whom you should ask to take on that role.

A Bond of Trust

As the name implies, the obligations of an appointed trustee begin and end with "trust." At a basic level, the trustee must be faithful to the grantor's wishes. Doing so involves a responsibility to use the language of the trust as a guide when making decisions and to administer the trust according to those terms. And that, in turn, requires not just a general familiarity with the trust but a deep understanding of its specifics.

As fiduciaries, trustees are also charged with being loyal to the beneficiaries, meaning they must act solely in the beneficiaries' best interests. They are also bound to avoid conflicts of interest and to remain impartial when making decisions. This can create emotionally difficult situations.

Say, for example, a beneficiary in his 20s requests a distribution of 60% of the assets of the trust for an extravagant purchase or a highly risky business venture. But the terms of the trust stipulate that the trust is supposed to help support that person throughout his life. If the trustee is the beneficiary's aunt, making the difficult but necessary choice to deny the request could damage a lifelong relationship. The situation may become even more complex with multiple beneficiaries, when choices may involve balancing the needs and desires of siblings, or even the current generation and generations to come. In such cases, having a disinterested party serving as trustee or co-trustee may help make such decisions easier.

Another key requirement is that trustees perform their duties with skill and care — whether or not they have prior experience. Based on the terms of the trust and on state law, trustees are in most cases required to keep beneficiaries fully informed about trust activities.* At the same time, trustees must maintain strict confidentiality with respect to outsiders. And while the obligation to administer the trust according to its terms requires adhering to specific language, serving as trustee involves much more than just following instructions. Being faithful to the terms often involves many subjective decisions as issues arise, whether related to investment, distributing the assets to beneficiaries, or limiting access to beneficiaries if the situation calls for it.

Investing the Assets

Assets not being distributed must be invested based on specific criteria, such as the trust's duration and its underlying mission. Therefore, overseeing the investment strategy requires more than a deep knowledge of financial markets and asset classes; it must also take into account what the trust is set up to accomplish. For example, if the trust is intended to provide current support to a specific individual, the investment strategy may be conservative, emphasizing liquidity to meet the beneficiary's needs, and minimizing risk. By contrast, a trust with a duration of multiple generations, that is not expected to make distributions until many years have passed, might require an investment strategy aimed at long-term growth, with somewhat higher risk in the short-term. In any case, the trustee must be able to articulate the reasons and aims behind a specific strategy.

Depending on the situation and the nature of the trust, a trustee may also need knowledge of specialized assets, such as commercial real estate; an interest in a business; or tangible personal property, such as expensive artwork. In cases where the trustee is an individual who does not have expertise, the task is often to hire an independent investment manager who has both a special experience in trusts and the willingness to craft an investment portfolio specifically around the distribution schedules for the beneficiaries. Even when those tasks are delegated, the trustee generally must maintain oversight on the direction of the process.

Distributing the Assets

One of the most important and potentially challenging aspects of serving as a trustee involves how and when to distribute assets to beneficiaries. Discretionary distributions often involve difficult, delicate choices. Such distributions must take into account the trust's

* Some states allow for "quiet trusts" (also known as "silent trusts"), in which the trust provisions are not shared with beneficiaries. Yet in most cases, trustees are responsible for regular and thorough communication.

Investing in the Interests of All Beneficiaries

Complex or even competing needs of trust beneficiaries may require specialized investment strategies in order for the trustee to serve the best interests of all. Consider a grantor who establishes a trust to support his spouse from a second marriage during her lifetime, with the remainder going to his children from his first marriage, after her death.

To provide the income she needs, the spouse favors a conservative portfolio consisting mainly of bonds. By contrast, the children favor a more aggressive stock-based strategy giving the assets an opportunity to grow before the children receive their distributions later on. A corporate trustee, with extensive experience with investing assets and serving as a trustee, in this case might use an approach known as exercising the "power to adjust."

Available in most states, the power to adjust enables the trustee to recharacterize the trust's investment returns as income regardless of their source. Rather than relying just on bond income, the spouse in this case receives, say, 3% of the fair market value of the trust assets each year. Not only does this assure the annual income she needs; it also means her interests and the children's are now aligned, since all beneficiaries can benefit from continued growth of the trust principal.

mission, its terms, its assets and income, a history of the account value, the beneficiary's prior requests, and the impact the distribution will have on the trust's overall value, asset allocation, and taxes, among other issues.

The personal side of making distributions may be even more complex, especially for trustees who are related to the beneficiaries. In some cases, distributing money to a beneficiary could actually put that person at risk. For example, he or she may have a substance abuse or gambling problem, or a record of spending recklessly and running up debt. If the grantor established the trust with the intention of protecting the financial future of that beneficiary, making distributions that are likely to be lost could impair that individual's future. Depending on the flexibility allowed for in the trust, the trustee might decide to make certain payments directly to creditors, for example related to a mortgage and taxes. With payments made directly from the trust, the money doesn't pass through the hands of the beneficiary, where it might have been spent on other things.

For a trustee who is a relative or close friend of the family, deciding to withhold the money could put a valued personal relationship at risk. For guidance and support, the trustee might turn to an attorney or accountant with experience in handling trust distributions. Or, if the trust is administered by a corporate trustee with deep experience, such decisions could be made according to well-established practices.

Records, Accounting, and Compliance

Careful records are at the heart of effective trust management. They are essential to distributing assets, establishing an appropriate investment strategy, and demonstrating that the trustee is managing the trust according to the terms established by the grantor, and in the best interests of the beneficiaries. This includes records of all actions taken by the trustee; clear, accurate, and comprehensive accounting; and compliance with state and federal tax laws and other regulations.

Since individual state laws govern many aspects of trust administration, a deep knowledge of state law is essential. As with investing the assets, a trustee who may not have experience with these rules, or with accounting, will likely have to hire and oversee outside experts to help. Administration requires careful accounting and adhering closely to state and federal tax laws.

Choosing a Trustee

Because of these and other complexities, a trust, no matter how carefully structured, may be only as effective as those entrusted to manage it. In that sense, the selection of a trustee is as important as the trust itself.

Individual trustee. For many grantors, it may feel natural to look first to someone with close ties, by blood or friendship. This choice has undeniable appeal. Who would you trust more to faithfully carry out your wishes when you're no longer here? A grown child or other relation, moreover, is likely to understand your wishes and motivations at the deepest level, and to have your best interests, and those of your beneficiaries, at heart when making decisions.

At the same time, it's important to consider the level of responsibility involved, and whether the individual you have in mind has the experience, expertise, time, and temperament to handle the duties over the life of the trust. Another key consideration is whether that person is prepared to handle any sensitive issues or disagreements involving beneficiaries. As an alternative to a friend or family member, a grantor may ask a trusted attorney or accountant to serve as an individual trustee. This person may be better able to remain impartial in making decisions, will offer the advantage of expertise in his or her given field, and can hire outside help for other areas, such as investing.

A corporate trustee. Another option to consider is appointing a corporate trustee with special experience in managing and administering trusts. A corporate trustee will typically have the expertise to handle legal issues, taxes, and investing, as well as complex accounting, recordkeeping, and communications. Having this experience in-house means that various specialists work as a team and are able to anticipate and address needs before they arise. They can also work at a peer-to-peer level with your personal attorney and accountant to ensure that your wishes are met. Corporate trustees also have an unlimited lifespan, which can be a stabilizing presence and reduce the worry about succession planning for the role.

Because they are not family members, corporate trustees have a built-in buffer from the emotional stresses that may affect individual trustees. They can be compassionate and empathetic, while at the same time delivering objective solutions. And, whereas an individual trustee may be encountering challenging situations for the first time, corporate trustees will likely be able to rely on best practices developed over many years to help guide difficult decisions.

Meeting Current Needs While Preserving the Future

A trust beneficiary has found her dream home — large enough for her growing family and close to excellent schools. She needs a sizeable amount of cash to cover the down payment until she can sell her current home, and turns to the trust for help. Because the need is within the purposes of the trust, and the beneficiary has clearly demonstrated that she's responsible with money, it might seem natural for a trustee to authorize an outright distribution.

Yet the experienced trustee administering this trust conducts a careful evaluation revealing that a distribution of that size right now might affect the trust's ability to support future generations of beneficiaries. As an alternative, the trustee suggests making a short-term loan to the beneficiary — similar to a bridge loan — to cover the down payment and other costs. When her current home sells, the beneficiary repays the loan. She takes ownership of her dream home, and the trust principal remains intact to fulfill its long-term goals.

Taxing Issues for Trustees

State laws vary widely when it comes to whether and to what extent they tax trust income. Such taxes may have a significant impact on the trust's assets — and in ways that may come as a surprise. Say, for example, a trust is established and a trustee named in a state that does not tax trust income. If the trustee subsequently moves to a state that does tax such income, the trust could now be liable for income tax on the basis of where the trustee lives and the trust is administered — even if the grantor and the beneficiaries have no connection to that state.

In that case, the trustee may face a difficult choice of resigning the position or exposing the trust to taxes. A corporate trustee serving as co-trustee could assess the impact taxes might have, and help that individual reach an appropriate decision. A corporate trustee acting as sole trustee and in the right jurisdiction would work to avoid that scenario entirely.

Co-trustees. If you want the immediacy of a family member or close friend, and also find the experience of a corporate trustee appealing, you might choose to have the individual and corporate trustee work together. With this arrangement, the corporate trustee may provide the expertise, efficiency, and best practices for managing the trust, while the individual trustee provides oversight as well insights into the dynamics of the family.

Ultimately, the decision may rest on a number of factors, from your family situation to the complexity of the trust and your overall financial goals. When the decision is made with the same level of care that went into creating the trust itself, the trustee or trustees you select are likely to understand both the honor and responsibility of serving, and devote themselves fully to carrying out your wishes.

About Bessemer Trust

Privately owned and independent, Bessemer Trust is a multifamily office that has served individuals and families of substantial wealth for more than 110 years. Through comprehensive investment management, wealth planning, and family office services, we help clients achieve peace of mind for generations.

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