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How To Be An Effective Trustee

There's an adage that the two best days in a boat owner's life are the day they buy their boat and the day they sell it. A similar notion applies to being a trustee – it's an honor to be named and then a huge relief when it's over. That's because being a trustee is difficult. It requires knowledge about a wide range of topics, including:

- Trustee fiduciary duties, such as loyalty, impartiality, prudence (often referred to as the duty of care), protection of trust property and enforcement of claims, and the duty to inform and account to beneficiaries, among others. Violation of these duties exposes the trustee to liability.
- Understanding the terms of the trust, including the specifics of the distribution terms and their legal meaning.
- Investments, plus the ability to hire and oversee suitable investment managers.
- Administrative matters such as record keeping and principal and income accounting.
- Estate planning, trusts, and the basics of the estate, gift, and GST taxes.
- Income taxation, including how trusts are taxed both at the federal and state levels.

In addition, the trustee must be adept at productively communicating and working with the beneficiaries on their financial wellness and distribution needs (an area that can be fraught with conflict).

It's a daunting list. I've encountered lawyers, accountants, and financial advisors who assumed they were well prepared to serve as trustees given what they do for a living, but only realized the true extent of the undertaking after being a trustee.

Trustee Best Practices

Being a trustee is difficult, but adopting the below four best practices employed by professional trustees will go a long way to ensure that you'll effectively execute your duties and mitigate your liability.

1. Assemble a team

No one person can be adept at all required to be an effective trustee. Our firm is a trust company, yet we still seek outside help and advice on all sorts of matters. If your day job isn't being a trustee, it's essential to assemble a team of primary advisors. Of course, as the trustee, the buck stops with you, so an excellent way to think about it is that the trustee will be the CEO of the trust, and the advisors are the trustee's direct reports providing expertise and advice.

Who should be on your team?

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- An attorney with trust expertise. Usually, this is an estate planning attorney. Sometimes, however, advice of a trust and estates litigator is needed.
- A tax accountant knowledgeable about the taxation of trusts.
- Unless the trustee has investment expertise, an investment advisor should be part of the team. The investment advisor will help set the investment strategy, select investments, and provide performance reporting. A word of caution – check to see the standard of care under which the investment advisor operates. A “registered investment advisor” and advisors at banks and trust companies are fiduciaries and must act in their clients’ best interests, which is also the standard for trustees. In contrast, advisors at a broker-dealer merely must recommend investments that are suitable (but may not be in their clients’ best interests). This gap between a broker’s standard of care and the trustee’s fiduciary duties can expose the trustee to liability.

A good practice is for the trustee to have regular meetings with the team of advisors, both as a team and individually. As such, the trustee shouldn’t be shy in picking up the phone and getting advice. At our firm, we constantly remind ourselves, “you don’t know what you don’t know,” so it’s best to err on the side of getting a specialist’s advice. The division of duties should be clear; each team member should clearly understand their responsibilities.

2. Understand the key trust terms

Knowing what the trust document says and what the key terms mean are fundamental duties of trustees. (Can you imagine a beneficiary suing a trustee and their defense being “I didn’t understand what the trust document said.”)

Upon becoming a trustee, a best practice is to read the entire trust document and go through the document with an attorney and have them explain the key terms. Some of these key terms may involve (a) the distribution standards, (b) special provisions relating to investing, particularly direction to sell or not to sell certain assets, (c) provisions that the trustee should act upon, like the power to appoint a successor, and (d) knowing whether the beneficiary’s age will trigger distributions or any other actions.

3. Work productively with beneficiaries

Dealing with beneficiaries is often the most challenging aspect of being a trustee. Differences of opinion over distribution amounts, investment strategy, or other matters relating to the management of the trust can lead to disagreement.

To mitigate potential issues with beneficiaries and facilitate a productive relationship, trustees should be mindful of the following:

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- **Communication and Transparency.** Most issues with beneficiaries can be avoided by frequent and transparent communication. Having regular meetings (2-4 meetings per year), providing account statements, investment reporting, annual accountings, and periodic phone calls are all best practices.
- **Beneficiary Education.** Education about the trust at the beginning of a trustee-beneficiary relationship is an excellent way to manage expectations. The trustee and members of the advisor team should educate the beneficiary about the grantor's intent regarding important aspects of the trust as well as the primary trust terms, especially the distribution standards.
- **Distribution Clarity.** The trustee should understand the beneficiary's financial situation and distribution needs. A good way to do this is to assist the beneficiary in creating a budget and determining what regular distributions are appropriate given the amount of trust assets and the distribution terms. Discussing cash flow and upcoming potential special distribution needs at regular meetings will avoid surprises. At our firm, we find it is usually best to provide a regular monthly distribution and then special distributions as appropriate.
- **Provide Required Information.** A primary trustee duty is to keep beneficiaries reasonably informed about the trust, including what the assets are, fees and expenses paid (including trustee compensation), and the amount of distributions. To limit their liability, the trustee must provide such information to beneficiaries. Most states have a statute detailing the information a trustee should provide to beneficiaries.

4. Documentation is Crucial

A familiar saying is that the three most important rules of real estate are “location, location, location.” Similarly, the three most important rules of trusteeship are “documentation, documentation, documentation.” Although trustees cannot guarantee perfect results, they must act with care, skill, and impartiality. Trustees need to have rational reasons for their decisions, and documentation of them is critical because it substantiates the trustee's careful, rational, skillful, and impartial decision-making. Without it, decisions that seemed perfectly reasonable at the time of action may have lacked judgment in retrospect. A trustee will rarely regret documenting a decision or communication but may regret a lack of documentation.

Examples of decisions that should be thoroughly documented include: (a) distribution decisions; (b) decisions that set investment policy; (c) initiation or termination of investments and the hiring and firing of investment managers/funds; (d) principal and income allocations; (e) verbal communications with beneficiaries; and (f) decisions to hire experts or agents (investment managers, lawyers, accountants). At our firm, we constantly ask ourselves what we would wish we would have documented if a beneficiary sued us in ten years.

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