WHY NAMING THE RIGHT SUCCESSOR TRUSTEE IS OF UTMOST IMPORTANCE

Southern Arizona Estate Planning Council
October 21, 2020

Kristin Yokomoto, Esq.
ky@albrechtbarney.com
949.263.1040, Ext. 114

TOPICS

* IMPORTANCE OF THE SUCCESSOR TRUSTEE ROLE
* WHO TO SELECT
  * (1) Individual beneficiary
  * (2) Individual family member or friend
  * (3) Individual attorney, CPA, other professional
  * (4) Private fiduciary
  * (5) Corporate trustee
* ADVISING THE TRUSTEE
* TRUST PROTECTORS
* DIRECTED TRUSTS

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IMPORTANCE OF THE SUCCESSOR TRUSTEE ROLE

Significance of Selecting a Trustee

* One of the most significant estate planning decisions that your clients will make is selecting a successor Trustee.

* Ron Aucutt, ACTEC:

  "Identifying the trust creator's primary purpose for establishing the trust is the first step in selecting the initial trustee or trustees and designing the trustee succession and control arrangements"

Identifying the Trust's Primary Purpose

What is the Trust's Primary Purpose?

* Preserving a family culture or business
* Protecting a beneficiary against himself or herself
* Maintaining a balance between interests of present and future beneficiaries
* Providing children with access to income and principal
* Providing children with asset and divorce protection

Trustee is a Fiduciary

- A Trustee is a Fiduciary
- The Trustee exercises discretionary power over the significant practical interests of the beneficiary
- A Trustee owes the beneficiary a Duty of Loyalty
  - The Trustee may not put his personal interests in conflict with another beneficiary
- A Trustee also owes the beneficiary a Duty of Care – care, skill, prudence, and diligence

Additional Duties of Trustee

* Duty to administer trust by its terms
* Duty to act impartially
* Duty to avoid conflicts of interest
* Duty not to delegate – trustee may employ agents such as attorneys and accountants to assist; but may not blindly follow their advice
* Duty to diversify
* Duty to make property productive and invest under the Prudent Investor Rules
* Duty to enforce and defend claims

WHO TO SELECT?

Poll #1

1. Who are your clients naming to act as successor trustee?

* Select as many as you want:
  * (1) individual – beneficiary
  * (2) individual - family member or friend
  * (3) individual attorney, CPA, other professional
  * (4) private fiduciaries
  * (5) corporate trustees

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Considerations

* Family dynamics – age, relationships, disinherited heirs
* Family conflicts or potentially difficult family situation
* Economic disparity among beneficiaries
* Beneficiaries – special needs, spenders, addicts, divorce
* Distributions – outright, intervals, subtrusts
* Trusts for surviving spouses in blended family situation
* Number and complexity of trusts – living trust, bypass trust, marital trust, residence trust, life insurance trust, gifting trust, education trust
* Types of assets – business, commercial property, unique
* Size of estate – federal Estate Tax Return
* Co-trustees

INDIVIDUAL BENEFICIARY

* Benefits of naming a child – can be efficient, especially if child is familiar with the family assets.
* Challenges – child's age, experience, place of residence, demanding job, relationship with siblings, the time required to administer the trust, and unique trust assets.
* Will the child be able to separate personal feelings and exercise good judgment?
  * Frequent reminders that child is acting as a fiduciary with duties to siblings.
* Ability to analyze investments
* Family members may be more likely to understand the beneficiaries' needs

Individual Beneficiary (continued)

* Family may not take a compensation, depends.
* A sibling as trustee can exacerbate tensions and resentments among the beneficiaries (blended marriages).
* Without experience, may abuse the trust through ignorance.

* Potential concerns:
  * Your client names a child because she is the oldest.
  * Your client names a child because he would be hurt if not named.
* Equally concerning:
  * The individual accepts to serve out of obligation, power, or fees.

Example – Individual Beneficiary

* Daughter – she is an investment advisor
* Familiar with out trusts, very familiar with assets and various trusts of deceased parent's – survivor, family, ILIT, and grandchildren's trust
* Obtaining assets and values went very smoothly
* Signed agreements happened quickly.
* Only question was how to make continuing distribute the grandchildren's trust money over the years if some didn't go to college

INDIVIDUAL FAMILY MEMBER OR FRIEND

* Family members may be more likely to understand the beneficiaries' needs
* Family may not take a compensation
* A sibling as trustee can exacerbate tensions and resentments among the beneficiaries (blended marriages)
* Without experience, may abuse the trust through ignorance

Example – Family Member

* Niece
* Patient and nice
* Difficult properties to sell because land is still owned by third party builder
* Buyer must buy the house from trustee, and the land from third party, plus the properties need significant renovations.
* Lots of travel from Northern California.
* She is taking a moderate compensation (less than the California statutory probate fees).

INDIVIDUAL ATTORNEY, CPA, OTHER PROFSSIONAL

* Lawyer - ethical considerations
* CPA- can a tax adviser understand the dynamics of your family
* Experience as a trustee?
* Will professional malpractice cover trustee acts?
* Professional advisers may charge a higher or lower fee than corporate trustee

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Example - CPA

* Years of experience with deceased grantor’s businesses
* Partnerships owning real property
* Active partnerships which needed to be managed
* Very technical administration
* Beneficiaries have attorneys
* Specific distributions to third wife and children from three marriages
* Represent this CPA as trustee of other trusts

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PROFESSIONAL FIDUCIARY

* Individual licensed by the state law to serve in a fiduciary capacity
* Certain education or experience requirements and exam
* Criminal background and credit check
* Participate in continuing education
* Annual reports to the state
* Regulated by the state agencies

Professional Fiduciary Pros

* May have significant experience in managing financial assets.
* May have access to resources to help oversee important financial and care matters like managing the client's estate by
* appropriately investing the assets, keeping bills and taxes paid.
* May be able to assist a client's physicians and care providers with medical decisions, assuring proper medical care is in place.
* May help with determining appropriate housing.
* Growing area for clients with dementia or Alzheimer's.

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Professional Fiduciary Cons

* Most likely will need to hire a slew of professionals to assist with all the aspects of administration.
* The fees can certainly add up and may cost just as much as, or even more than, an institution's fees.
* Could be risky to depend upon one person.

Example – Professional Fiduciary

* Before he died, dad was losing capacity
* Step-daughter brought him in to change his trust
* Couldn't remember his first wife's name so told him to come back another day
* Died
* Rumors that step-daughter had married him to obtain property rights – never found marriage certificate – threatened to challenge trust terms
* Home had many drug users living there, not clean
* Eviction and then trespass – DOJ case
* Specific distribution beneficiaries moving shelter to shelter
* Almost done but can't find one specific so remainder waiting

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CORPORATE TRUSTEE

* May be appointed as personal representative, guardian or conservator of an estate, or trustee.
* A corporate fiduciary will administer your client's estate or trust with a high standard of care.
* Typically, a bank that offers trust administration services or an independent trust company can serve in this role.
* May not be appointed guardian or conservator of the person or a ward or conservatee.

Corporate Trustee - Pros

* Expert Management
* Corporate fiduciaries are highly trained at what they do.
* Multiple staff members with many years of experience.
* Easy access to portfolio managers will help ensure they prudently invest the trust funds - leading to expert management and investment services.
* Neutrality
* Won't have the emotional stress and strain that a family member or friend could be subject to when serving.
* A corporate fiduciary won't be biased by a beneficiary's past choices or present lifestyle.
* Licensed, bonded, insured and subject to strict state and federal regulation.

Corporate Trustee - Cons

- Sometimes lack of flexibility – could lead to unhappy beneficiaries who will be forced to go to court to resolve disputes between them and the institution.

- Expensive

- Corporate fiduciaries use committees to make many of their decisions, which can lead to slow responses to a beneficiary's questions or concerns.

- Corporate fiduciaries are corporations made up of multiple departments and offices located in different buildings and, perhaps, various cities. Cutting through the red tape to find someone who can help in a pinch can be daunting.

Example – Corporate Trustee

* Second death and blended family
* Beneficiaries of Survivor's Trust different than Family Trust
* Survivor's Trust – beneficiary own trustee and outright
* Family Trust - Iowa corporate trustee because Iowa farm – trust required that $5k be distributed each month, at some point the investment account would be depleted and would be forced to sell the farm
* Family Trust – intervals – must sell farm
* Beneficiary visited farm – will keep it in the family with divided interests
* Iowa family values
* Trustee was very flexible
* Corporate trustee also trustee for Grandma's trust

Advising the Trustee

Trustee Compensation

* Compensation is governed by the laws of the state in which the trust is administered and by the trust provisions.
* Alternatively, a fee schedule may be described in the trust.
* Some of the criteria –
  * Degree of risk and responsibility assumed by the trustee
  * Time required of the trustee.
  * Value of the trust estate and its income.

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Trustee Protection and Risks

* A trustee can become personally liable for breach of duty when the breach results in a loss to the trust.
* Trustee is not a guarantor of the principal and income and usually will not be liable for losses that occur despite faithful performance of her duties.
* Trust commonly provide for exemption or exoneration from liability.
* Trustee may be liable for actions of agent, unless specific authority in trust for trustee to delegate.
* State law governs the statute of limitations on an Accounting.
* Resignation and removal.

Poll #2

Have your clients needed to petition the court for approval to name a successor trustee because the only named trustee was a corporate trustee who declined?

* (1) yes
* (2) no

Vacancy

* If named successor Trustee and alternates cannot act, the first review the trust provisions for direction on how to fill a vacancy.
* If trust is silent, you can petition the Court.
* Or, in California, the beneficiaries can appoint a corporate trustee.
* It may be challenging to find a corporate trustee if the distributions are outright or consists mainly of real property.
* Ways to avoid delay:
  * Name multiple alternate successor Trustees
  * Name a Trust Protector who can appoint a successor Trustee

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Consistency

* It is best that your clients select the same fiduciary to act as the:
  * (1) successor trustee during incapacity and at death (trust)
  * (2) power of attorney agent during incapacity (POA)
  * (3) executor at death (Will)
  * Note - agent for health care decisions – generally family; often professionals and corporate trustees will not accept to act.

TRUST PROTECTORS

Poll #3

How often are your clients naming trust protectors?

* (1) never
* (2) 25%
* (3) 50%
* (4) always

Trust Protectors

* A practical solution to many trust problems
* A Trust Protector can provide a low-cost means for adapting a trust to changes in circumstances
* Definition of a Trust Protector
* Fiduciary vs. non-fiduciary

Powers of Trust Protectors

* Discretionary distributions of trust income and principal
* Correction of mistakes
* Replacement/ removal of trustees
* Changes in law or beneficiary circumstances
* Resolution of disputes

DIRECTED TRUSTS

Directed Trusts

* What is a "Directed Trust?"
* The powerful (and practical) benefit of a Directed Trust
  * Creates a structure where families can participate in the management of family wealth
  * There are several states that have favorable laws for Directed Trusts
  * A Directed Trust makes it much easier to deal with a family-owned business or a heavy concentration of assets

Poll #4

* Do you prepare directed trusts where the administration is handled in a directed trust stand and the investments are handled by the family's investment manager or an investment and distribution committee?
* (1) yes
* (2) no
* (3) no but interested in doing so

Directed Trusts (continued)

* Directed Trusts facilitate the avoidance of state taxation that is often linked to the location of the trustees.
* California taxes nongrantor trust on the basis of the number of trustees located in California

Directed Trusts (continued)

* A Directed Trust bifurcates the responsibility of advisors from the rest of the trustee obligations
* Directed Trusts have committees that carry out obligations that normally apply to trustees
  * Distribution Committees
  * Investment Committees
  * Probably should not be located in California

Directed Trusts (continued)

* Case law indicates that even though the trust agreement seeks to absolve trustees from liability, the courts have not been sympathetic to the trustees who oversee concentrated ownership positions
* Liability of persons who act as "Advisors" in a Directed Trust structure are generally considered less than the liability of individual trustees.
* Some states allow an advisor to be excused from liability

Directed Trusts (continued)

* Directed Trusts lend themselves to the concept of family participation at the trustee level. This avoids the problem where family members are infantilized when relegated to only being a beneficiary.

Migration of Existing Trusts

* Governing Law Issues
  * Some trust agreements provide that the governing law cannot be changed at all
  * In drafting trust agreements, specify that the trustee can change governing law
* Which state?
* Plan ahead for decanting to Directed Trust state

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Example – Directed Trust

* Second death
* Six trusts
* Close relationship with investment advisor while living
* Investment advisor able to continue to act
* Life insurance policy and retirement plans
* Charitable beneficiaries
* Daughter’s inheritance is protected and managed
* Administrative trustee takes direction by written instruction

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Takeaways

* Emphasize to your client the importance of the fiduciaries
* Review your clients' fiduciaries for consistency and alternates.
* Discuss importance of trust protector provisions to make changes (other than changes to beneficial interests).
* Encourage clients to communicate with named fiduciaries before death – assets and family values.
* Consider directed trusts to keep investment advisor as manager of investments.

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