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INDIVIDUAL TRUSTEES DON'T KNOW WHAT THEY ARE DOING

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Individual Trustees don't know what they are doing. Right now, about \$4.5 trillion is currently held in trust which is overseen by Corporate Trustees¹. Meanwhile, about 95% of the Trustees named in our Wills, Revocable Trusts, Gifting Trusts, and other estate planning documents name an individual as Trustee rather than chartered corporations or banks. **95%!** Around \$46.7 trillion exists in non-retirement accounts most likely using an individual trustee (excludes life insurance death benefits, commercial and residential real estate, and private company values).² Individual Trustees who don't have a clue what they are doing – we have to start paying attention. What if 95% of Americans smoked, or didn't wear a seatbelt, or never washed their hands? These would all result in negative and dangerous outcomes, yet we are content to allow 95% of all Trusts to be administered by individuals who lack the experience, resources, and time to do the job right? It is time to change that.

The Individual Trustee can come in many forms. Maybe it's an aunt or a brother who is "really smart," a trusted lifelong best friend, or even a hired professional like an attorney, CPA, or financial advisor who supposedly "knows what they are doing." The dangerous reality is that, when it comes to Trust administration and the duties of a Trustee, a very small fraction of these individuals actually knows what they are doing.

So, if naming an Individual Trustee is such a bad idea, why do 95% of our clients do so? There is a multitude of reasons that our clients point to as a basis to name an Individual Trustee. Many want to retain control, want a Trustee with a personal connection to the beneficiaries, or are simply reluctant to pay the fees for a Corporate Trustee. While all of those reasons may sound compelling, the overwhelming reason that our clients are naming Individual Trustees is that we are telling them to. Our clients look to their attorneys, CPAs, financial advisors, and others for advice on important decisions, like the naming of a Trustee, and when these trusted advisors tell them to name an Individual Trustee, they are not getting good advice.

¹ Federal Deposit Insurance Corporate. December 31, 2022. www.fdic.gov. Accessed September 4, 2024.

² Federal Reserve Bank of St. Louis (<https://fred.stlouisfed.org/series/BOGZ1LM193064005Q>) and SIFMA (<https://www.sifma.org/resources/research/us-fixed-income-securities-statistics/>). Accessed September 4, 2024.



BEING A TRUSTEE IS HARD: DUTIES OF A TRUSTEE

The selection of a Trustee is such an important decision when planning an estate because being a Trustee is difficult and risky! The moment that an individual accepts their role as a Trustee, they are inundated with a laundry list of complex tasks, jobs, duties, and standards, that the Trustee must meet under threat of legal liability.

The Trust Instrument itself imposes a lot of substantive duties and responsibilities upon the Trustee. These often include prudently investing assets, considering and granting distribution requests, keeping records and accounting, filing tax returns, and anything else the grantor may require. Maintaining all these duties and responsibilities requires significant time, expertise, and resources; things that most Individual Trustees severely lack.

While the Trust Instrument governs much of what is required of a Trustee, what makes being a Trustee most difficult is the additional legal duties and standards imposed by the common law, which are often NOT laid out in the Trust instrument. Among these includes, but are not limited to:

- Duty of good faith, fair dealing, loyalty, and fidelity over the trust's affairs and its principal;
- Duty to make the assets of the trust productive while at the same time preserving the assets;
- Duty to fully disclose all material facts known to the Trustee that might affect the beneficiaries' rights;
- Duty to account to the beneficiaries for all trust transactions;
- Duty to properly manage, supervise, and safeguard trust funds;
- Duty to refrain from self-dealing with trust assets;
- Duty to refrain from lending trust funds to itself or one of its affiliates, employers, directors, officers, employees, or business associates; and
- Duty to invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust

That's a lot of duties! Each of these legal duties imposes its own, often unclear, standard and a breach of any of these duties opens the Trustee up to personal liability from the beneficiaries and will cost the Trustee, beneficiaries, and the Trust itself significant expenses to pay for costly litigation, even if you win the case.

A mistake made by a Trustee, whether intentional or not, that causes the Trusts assets to be damaged is actionable. Even suspicion of a mistake can lead to costly legal fees. For example, a beneficiary that suspects a Trustee has engaged in malfeasance can demand a full accounting to be presented to the beneficiaries by the Trustee. The Trustee must either endure the costly and time-consuming process of preparing a full accounting or endure the costly and time-consuming process of fighting off the demand in court. Trustees are held to a high legal standard, which places them in unique situations of serious legal liability, and unfortunately for our clients,



Trustees are often allowed to use Trust assets to defend themselves in a breach of fiduciary duty lawsuit, and Trustees get sued a lot.

The Trustee of a Trust is also legally a fiduciary and is held to a general fiduciary standard, similar to that of an attorney, investment manager, or broker. Fiduciary duties are stringent standards to meet, which is why they are typically reserved for licensed professionals, not a random family member who claims to “know what they are doing.”

WHAT IS SO BAD ABOUT AN INDIVIDUAL TRUSTEE?

The Individual Trustee can come in many different shapes and sizes. Among those often selected are family members, friends, and hired professionals. All of these come with their own unique characteristics that should discourage their selection as Trustees. All Individual Trustees, regardless of their form, share significant disadvantages including time, experience, and resources.

Proper administration of a Trust can be extremely time-consuming, and an Individual Trustee has not the time, nor the desire to make the time to do the job right. Generally, an Individual Trustee is not going to quit their day job to become a full-time Trustee. Their administration of the Trust is going to be a part-time job that gets put on the back burner behind their “more important” personal obligations. Selecting a Trustee, that you know from the start does not have enough time to properly administer the Trust, is akin to shooting yourself in the foot ten seconds before running a marathon.

Trustees are essentially required to do the job of an attorney, accountant, investment advisor, and financial planner, all at the same time. While some Individual Trustees may have experience in some of these areas, most do not have experience in every necessary skill required of a Trustee. This leaves the Individual Trustee with two basic options: hire additional professionals to fill the gaps in their knowledge and experience (and pay them with Trust assets), or simply attempt to do the job without the knowledge and experience needed (and likely fail).

The Family Member Trustee: RECIPE FOR FAMILY DISASTER.

Grantors often like to choose close family members, such as a spouse, sibling, aunt or uncle, or even a child. These options appear appealing because a family member knows the grantor well. The family member Trustee is supposedly familiar with the wishes and desires of the grantor, the needs and lifestyles of the beneficiaries, as well as the nature of the assets to be held in Trust. While this may sound like a good thing, familiarity often leads to conflict and bias. When significant assets are at stake, important decisions need to be made without the influence of pressure or bias. The close relationships that seemingly make selecting a Family Member Trustee seem like a good idea, in reality, are disadvantages to the administration of the Trust.

Naming a Family Member Trustee can lead to family issues and division. One of the most difficult things that a Trustee must do is decide if and when to make distributions to and for the beneficiaries. This can lead to tension and resentment among beneficiaries when their distribution requests are denied while others are granted. Having that resentment and anger directed at a member of the family, only amplifies the division and issues that result, putting the



Family Member Trustee in a very difficult situation. For example, a mother who must make distribution decisions between two of her children, or a sister who must make distribution decisions for a brother, is a recipe for a family disaster that will reach far beyond the extent of the Trust administration.

Family Member Trustees are also more susceptible to pressure or influence. The fiduciary standards and duties imposed upon a Trustee demand that the Trustee make distribution requests without consideration for the pressure of family dynamics and influence of family members. Naming a Family Member Trustee, makes objective decision-making nearly impossible. This is doubly dangerous, as improper administration of the Trust based on family pressure or the influence can be grounds for a costly and contentious lawsuit, and nothing brings a family closer together than an inter-family legal battle!

Many grantors who seek to avoid a family fiasco often name a close friend to serve as Trustee. This option certainly eliminates a lot of the risks involved with family dynamics, but presents the same risks regarding lack of experience, time, and resources. A close friend is likely to require outside assistance from professionals to administer the Trust, which costs money. A close friend may also be more reluctant to serve for free, further driving up the cost imposed on the Trust.

Hired Professionals: Not All They Are Cracked Up to Be, but Double the Price.

A common alternative to a family member or trusted friend is to hire a professional, such as an attorney, accountant, financial planner, or broker, to serve as Trustee. While a hired professional may offer at least a semblance of expertise or experience in one area, they won't be an expert in all of the required areas and require significant tradeoffs in cost and time.

Hiring a professional is expensive. Significant Trust assets will have to be spent to pay the hourly rate of an attorney or accountant. And that's only the fee that will be paid for their services. Much like a family member or a friend, a hired professional will have to hire other professionals to fill in the gaps in their experience. For example, an attorney will be able to perform any legal services that the Trust requires, however, the attorney will have to hire an accountant, financial planner, and investment advisor to handle non-legal aspects of the Trust administration. In the end, the grantor may think that they are hiring a single professional, but in reality, they are hiring a network of expensive professionals that they will never meet, all of which are charging unpredictable hourly rates to the Trust's assets.

Similarly, to the family member Trustee, the administration of a Trust is not going to be a professional's top priority. By nature, hired professionals are just that, a professional with a separate and busy career that will take precedence over the duties of Trust administration. Proper Trust management requires significant time and effort, and most hired professional simply do not have the extra time to properly manage a Trust. Our clients should be naming a Trustee that they can be assured will dedicate enough time and resources to ensure that their goals are properly met.

An Attorney Trustee, specifically, can present unique issues involving conflicts of interest. For instance, if the Trust's grantor is a client of the attorney (which is common) the attorney now has



separate, and often conflicting, fiduciary duties to the grantor as his or her attorney, and the beneficiaries as their Trustee. Any conflict between the beneficiaries and the grantor presents a clear conflict of interest for the attorney. Similarly, a beneficiary who becomes upset with the administration of the trust may want to sue the Trustee, who is the attorney for the family. Conflicts of interest can cause serious issues for Trust management which requires significant discretion to be exercised by the Trustee.

PROS OF A CORPORATE TRUSTEE

If Individual Trustees are so bad, then who should we be telling our clients to name instead? If our clients want their Trustee to possess all of the necessary expertise, time, resources, and safeguards, to properly administer their Trust (which they should!) we should be telling our clients to name Corporate Trustees. The Corporate Trustee offers a dedicated and professional administration of the Trust, through Trust departments packed full of experts in every required aspect of Trust management, extensive resources and support staff with specialized training, and a much higher level of regulation and accountability.

A Trust departments primary and only purpose is to manage Trusts. Trust Administration is the top priority and will not be placed on the back burner behind other career obligations.

A Trust department employ's a multitude of Trust administration experts including attorneys, accountants, investment professionals, and more. Trust departments often employ accountants, attorneys, and financial advisors, along with other experts to ensure that the department all the expertise needed to properly manage the Trust. Because of this, a Corporate Trustee will not have to go out and hire additional professionals to engage in any expertise gap-filling. Naming a Corporate Trustee means naming an entire department of Trust management experts who actually know what they are doing. Corporate Trustees also possess a vast array of resources and support staff dedicated to Trust management. Top-of-the-line technology like computerized accounting systems, investment software, and proper record-keeping are vital to a proper administration of a Trust and are not generally possessed by an Individual Trustee.

Along with vast resources that can be used to manage the Trust, Corporate Trustees also possess deeper pockets to handle disputes. Lawsuits directed at Trustees are becoming increasingly common with modern Trusts, and when Individual Trustees do not have deep pockets, they are unable to efficiently settle disputes without draining their own, and the Trusts, assets. A Corporate Trustee on the other hand has deep enough pockets to settle lawsuits and disputes before they drag on into lengthy and costly legal battles. Along with the ability to settle disputes, Corporate Trustees are heavily insured, meaning any loss attributable to mismanagement can be fully recovered. An Individual Trustee who causes the Trust major losses, can be sued all day long, but if they aren't insured or don't have deep pockets, those losses may never be recovered.

Corporate Trustees are professionals and therefore are held to a higher standard of accountability in comparison to an Individual Trustee. Corporate Trustees are also highly regulated by state banking laws and examiners as well as both internal and external auditors. This level of regulation and accountability ensures that the utmost care and precaution are taken with respect to the Trusts administration. Individual Trustees on the other hand are subject to far less



accountability and regulation which leaves the Trust far less protected against Trustee mistakes and malfeasance.

Lastly, an often-overlooked advantage of the Corporate Trustee, is that they cannot get sick or die. All Individual Trustees will eventually die, but a Corporate Trustee can last forever as long as the financial institution remains in operation.

FALSE RESISTANCE TO NAMING A CORPORATE TRUSTEE

If the Corporate Trustee is so great, then why aren't our clients selecting a corporate Trustee every time? There are two main reasons that clients will point to why they might not want to name a Corporate Trustee:

- (1) Lack of personal connection between the Trustee and the grantor or beneficiaries
- (2) (the big one) A reluctance to pay for a Corporate Trustee

Lack of Personal Connection

Many clients are attracted to the idea of a well-known Individual Trustee due to the personal connection that individual may have with them or the beneficiaries. The client wants to ensure that their goals and wishes are properly carried out, and an individual with close personal knowledge of the grantor and their family is "the best person to do that." For all of the reasons explained above, an Individual Trustee is likely not "the best person to do that." Regardless of how well the individual may be familiar with the grantor's assets or goals, or the needs of the beneficiaries, an Individual Trustee who lacks the required experience, time, and resources is not going to be able to carry out the grantor's wishes. Additionally, this personal connection may be more of a disadvantage than an advantage. Administration of a Trust requires significant discretion and decision-making. A Trustee that is too familiar with the grantor or beneficiaries will have a much more difficult time making unbiased decisions that are best for the Trust.

A Corporate Trustee, on the other hand, is far less likely to be influenced or pressured into making decisions that are not in the best interests of the Trust. Additionally, a Corporate Trustee is required to perform detailed due diligence to understand the goals, objectives, and wishes of the grantor, as well as understand the needs of the beneficiaries in-order-to properly manage the Trust. The idea that a Corporate Trustee would just take over the Trust and do whatever they want with it simply because they are not a lifelong friend of the grantor is unfounded.

Reluctance to Pay Fees

The primary reason that most clients do not want to name a Corporate Trustee is a reluctance to pay the fees associated with a Corporate Trustee. In comparison to the cost that an Individual Trustee will incur in hiring other professionals, coupled with the benefits that come with the Corporate Trustee's fee, the difference is nominal.

At the end of the day, a Trust that names an Individual Trustee is going to end up paying about the same amount, if not more, in fees over time. While the specific fees given to the Trustee upfront might be initially lower, when the costs to hire additional professionals to aid the Trustee



in administration, the potential costs of litigation and any other costs an Individual Trustee may incur, the cost difference will end up being nominal.

While the costs may come out to about the same, the quality of Trust administration will not. The benefits that come with the Corporate Trustee far outweigh any increased fee associated with a Corporate Trustee. If a grantor is going to have to end up paying a similar amount in the end, why not pay for a high-quality professional Trustee? When it comes to a Corporate Trustee, you get what you are paying for, and it's worth the price.

CONCLUSION

As we approach what will be the largest transfer of generational wealth in the history of the US, it is more vital than ever that grantors are being given sound advice on the selection of a Trustee. While every Trust is different, the risks and disadvantages of the Individual Trustee compared to the professional and accountable advantages of a Corporate Trustee, are undeniable, and a 95% rate of Individual Trustee selection cannot continue. Next time you, or a client, is deciding who to name as Trustee, always remember: Individual Trustees don't know what they are doing.

For more information - <https://sharpelaw.com/> (Dallas, Texas)