A Primer for the Non-Professional Trustee

Executive Summary

- Many people are asked to serve as a trustee by a friend, relative or business acquaintance.
- A trust is a financial relationship where a grantor allows a trustee to hold title to property or assets. Trusts can be classified as public or private, and as revocable or irrevocable.
- Trusts involve complex legal issues with substantial risks and uncertainties for a trustee.
- A trustee acts as a quasi-CEO for a trust by handling all of the investments and business decisions.
- Most often there is little or no compensation, yet there can be considerable financial risk unless the trustee fully understands the relevant issues.
- The key concept governing the conduct of private trustees is the Fiduciary Duty, which states that trustees must exercise good faith and act solely in the interests of the beneficiaries, not for themselves.
- Risks include objections by beneficiaries, involvement by the judicial oversight system, financial elder abuse, and being sued for negligence, willful misconduct, or a breach of the Fiduciary Duty.
- Fortunately for trustees, trusts can allow day-to-day investment decisions to be delegated to professionals for management.

Introduction

Many people are asked to serve as a trustee by a friend, relative or business acquaintance based on the strong faith they have in his or her reliability, honesty and character. Such a request is flattering and people usually accept, but it's not a decision that should be made lightly. It's important to understand the responsibilities they will face as a trustee and then decide if they are willing and capable of handling the job.

A strong argument can be made that the friend, relative, or business acquaintance is best served by choosing a professional trustee with appropriate training, licenses and insurance. Non-professional trustees generally chosen on the basis of personal relationships typically lack the knowledge and experience of professional trustees.

A non-professional trustee should, at a minimum, consult with an attorney or another professional familiar with trust law before accepting the position. Trusts involve complex legal issues with substantial risks and uncertainties for a trustee. Most often there is little or no compensation, yet there can be considerable financial risk unless the trustee fully understands the relevant issues. What seems at first an honor may over time become a serious burden involving long-term personal risks and obligations.

Covering the Basics

There are three main roles that function around a trust:

- The person establishing a trust is known as the "*Settlor,*" "*Grantor,*" or "*Trustor.*"
- The *Trustee*, also known as a *fiduciary*, acts as a quasi-CEO by handling all the investments and business decisions of the trust.
- The benefits accrued in the trust are transferred to *beneficiaries*.

Non-professional trustees are most often recruited for private trusts, which can also be called grantor trusts or testamentary trusts. These are trusts that are established and funded voluntarily by private persons to benefit themselves (the grantor is also the beneficiary), their family, their friends or other specific causes. Less common are public trusts, which are usually associated with charities and pension plans. There are also "special purpose" trusts for education, charitable remainders, Medicaid, generation-skipping transfers, special needs and many others.

Two common classifications for trusts are revocable and irrevocable. A revocable trust can be amended, modified, or terminated at any time by the Settlor. A revocable inter vivos trust, or revocable living trust, is a revocable trust established to provide that the assets in the trust are for the lifetime benefit of the Settlor. If not revoked, it may outlive the donor and become irrevocable. An irrevocable trust can only be modified or terminated with the express permission of the beneficiaries.

The single most important role of a trustee is representing the trust and officially acting in its name. Trustees act most properly and safely when expressly named "as trustee." With that designation, trustees may enter contracts, be listed as owning bank accounts or other assets of the trust and may conduct all business for the trust.

This means that trustee Jonathan D. Doe signs only "John Doe as Trustee of the Jonathan D. Doe Family Trust" in any transaction for the trust. A title or bank account name of a trust will typically read "X as Trustee of the Y Trust." If a trust is amended, the official trustee designation must also change. After an amendment, John Doe now signs only "John Doe as Trustee of the Jonathan D. Doe Family Trust as Amended and Restated." Failure to follow these signing protocols could cause the trustee to be held personally obligated for debts intended to be obligations of the trust.

To this point, a trustee absolutely needs sound legal advice because all too often amateur trustees will talk with a non-lawyer and feel they have fulfilled their duty when in actuality the trustee has a significantly higher degree of performance to meet their fiduciary obligation.

The Fiduciary Duty

The Fiduciary Duty is the key concept governing the conduct of private trustees. It exists "when one reposes faith, confidence and trust in another's judgment and advice." The Uniform Prudent Investor Act (UPIA) is a trust investment law that outlines the standard of prudence as applied to any investment. The central principle of the fiduciary's duty as detailed in the UPIA is to act for the benefit of the other party regarding matters within the scope of the relationship.

A trustee must carry out the terms of the trust as directed by the Settlor, unless a judge declares the terms invalid. The tendency today is to give the trustee broad power of sales for both real and personal estate. In some cases, even where such power is not expressly given, it will be implied from the nature of the duties that the trust calls upon the trustee to perform.

The UPIA explicitly requires diversification in order to be a prudent investor. This means that a disproportionate part of a trust fund or trust assets should not be invested in any single kind of stock or bond, or other single assets. Other investment issues, such as how to react to fluctuating market conditions, are handled in a more case-by-case basis. There is, however, a duty to dispose of improper investments within a reasonable time, and a trustee may be held responsible for any loss by failing to identify improper investments.

The office of trustee can never be used for personal advantage or gain except for reasonable compensation for the trustee's work. The fiduciary duty state that trustees must exercise good faith and act solely in the interests of the beneficiaries. They must dispense with all self-interest, particularly if it becomes adverse to the rights of the beneficiaries. A trustee must fully disclose to all beneficiaries all facts surrounding any self-interested transaction and obtain fully informed consent.

The general principle governing the conduct of fiduciaries dealing with trust property, funds or assets is they are never allowed to derive any personal gain or advantage from the use or sale of trust property. Fiduciaries must account for and remit all profits arising from such improper use, if profits are made by misconduct.

However, trustees are allowed to receive modest and reasonable fees for their work. The purpose for the fee should be payment for work efforts such as being on call or overseeing the management of the trust or trusts. Many non-professional trustees work for free and are not paid at all if the trust assets are relatively small.

To summarize, a trustee owes trust beneficiaries the duty of good faith and loyalty, a duty not to engage in self-dealing conduct, a duty to fully disclose possible conflicts of interest and a duty to always segregate trust property from the trustee's personal property.

In addition to care and protection of trust assets, a trustee is, unless excused, also under a separate duty to keep and render "accounts." Accounts for trusts are records of all assets, liabilities and expenditures. When called upon for an accounting, the trustee has the burden of proving that he properly disposed of all assets or funds received in trust. In some cases, this accounting can be held in the court system.

A formal accounting is a judicial proceeding in which the court adjudicates the amount of funds that ought to be in the possession of the trust and makes a determination of any amounts for which the trustees are liable to the trust or beneficiaries. Because the burden of proof in judicial accounts is on the trustee to account for all money or property held in trust, it is also the duty of the trustee to maintain clear and complete records. Destruction of trust records constitutes a violation of the fiduciary duty and trustee ignorance of that fact is not a valid excuse.

In addition to accounts, trustees of irrevocable, or non-revocable trusts, must file annual state and federal tax returns for the trust. This can be burdensome for a nonprofessional trustee. Trust documents should at a minimum authorize the trustee to hire and pay necessary accountants. In many cases, trustees who do not realize they are obligated to file tax returns for the trust are held personally liable for penalties and interest.

5 Risk Mitigation

There are many risks a trustee faces during the administration of trust business. These risks include objections by beneficiaries, involvement by the judicial oversight system, financial elder abuse, and being sued for negligence, willful misconduct, or a breach of the Fiduciary Duty.

To assess the risks one might face, a prospective nonprofessional trustee should ask the donor or his attorney a few polite but tough questions in a businesslike and formal manner. This way, the trustee can determine what kind of trust it is, what the trust’s purpose is, and how and when the trust is funded now as well as in the future. It is also important to determine if there are other trustees and how trustees are selected. Which state the trust is held in is an often overlooked consideration, as different states have different laws regarding trusts.

For most states, a trust is not a separate entity and acts solely through its trustees, except for the purpose of suing or being sued. This means that the trust itself is not legally distinguished from the trustee acting for it. To this extent, the trustee does not act as an agent or employee of the trust; a trustee is instead the embodiment or legal personification of the trust when dealing with trust property and in making contracts that affect trust property. If a trust sues a third party or a current or former trustee, the amount recovered belongs to the trust, not its beneficiaries. When the existence of a trust is in doubt or disputed, the person asserting the existence of the trust must prove that one exists. Like corporations, trusts have beneficiaries who may seek legal remedy if they feel aggrieved.

Trustees in many contexts face personal liability for violations of the various duties they owe to beneficiaries and also can be liable for trust liabilities to other persons. Liabilities can include unpaid taxes, losses from improper investments, or misallocated funds. With no exceptions, the law states that the responsibility of the trustee is to work for the best interest of the beneficiaries, avoid conflicts of interest, and seek advice from professionals if and when a conflict might need to be fully vetted.

In some cases, a trust document may include provisions to protect a trustee from personal liability. However, such protective or "exculpatory" clauses do not provide complete blanket protection. They are valid and enforceable only if placed in the trust instrument without any overreaching or abuse by the trustee of any fiduciary duty or confidential relationship with the Settlor. They are not enforceable in cases of trustee violations of duty committed in bad faith or with reckless indifference to the interest of the beneficiary.

In order to avoid fines or incarceration a responsible fiduciary should:

1. Use competent legal advice and accounting
2. Follow the UPIA guidelines
3. Check with an insurance company to see about coverage using a rider under an umbrella policy for:
    a. Insurance on fiduciary responsibilities
    b. Insurance on caregivers for elders

Fortunately for trustees, trusts can allow day-to-day investment decisions to be delegated to professionals for management. In such cases, trustees may employ investment advisors and pay them reasonable compensation out of the trustee's fee or, if permitted by the trust, out of trust assets. The non-professional trustee should ask the investment advisor to produce a letter defining if the advisor is following a sales suitability standard or the fiduciary management standard.

The difference between the two standards is stark and important to know if a trustee is to be prudent. An advisor who recommends investments from which they receive commissions is likely following the "Suitability Standard," as it is in their best interests to sell products from which they can profit. A Registered Investment Advisor (RIA), on the other hand, must operate under the "Fiduciary Standard." This standard is similar to the Fiduciary Duty in many ways, including requiring the advisor to put the client's best interests first. An advisor following the "Fiduciary Standard" will offer best advice based on the specific needs of the client while avoiding conflicts of interest.

Conclusion

The points discussed in this paper illustrate how the intersection of friendship, affection, money and loyalty in a trust can be dangerous for any trustee. If a person deems it entirely safe to accept the role of an amateur private trustee, he or she should think again.

Before doing anything, he or she should read the trust instrument fully. Dense legal wording typically merits the guidance of an independent professional, preferably an estate planning attorney. The documents should be checked for key information. How is the trustee selected and how can he resign or be removed? What are the trustee's duties and what are the terms for the ending of the trust? Is the trustee protected from liabilities for negligence or good faith errors? What, if anything, is said about compensation to trustees?

If a prospective trustee can't find the answers to these questions or they still have any doubts about their qualifications to serve as trustee and to accept the risks it entails, he or she should regretfully decline.

References

"Prudent Practices for Investment Stewards" handbook, written by Fiduciary360

Uniform Prudent Investor Act:
http://www.uniformlaws.org/shared/docs/prudent%20investor/upia_final_94.pdf

FDIC Trust Examination Manual:
https://www.fdic.gov/regulations/examinations/trustmanual/index.html

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