Appreciating Corporate Trustees

I always used to argue against the institutional trustee. Now I think it can be a good idea. Here's why

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I have not always been an advocate of corporate trustees. Quite the contrary I used to give a standard speech when my clients were wondering whom to name as a trustee. "You could appoint a corporate trustee," I'd tell them. "But keep in mind that corporate trustees charge a lot; they have frequent staff turnover; and they invest conservatively in their own pooled funds with very low returns. On the other hand, they are permanent and cautious. So if you want a corporate trustee, be sure to add an individual co-trustee who will have the right to remove the corporate trustee at any time, for any reason."

That's what I used to say But during the last 10 years, I've changed my mind about the value of corporate trustees. The marketplace has changed. Some of my previous assumptions about cost and investment performance were disproved. I've also come to realize that there's one significant advantage to corporate trustees I hadn't previously taken into account: their ability to deal with generational conflicts.

Selecting the right trustees is of course an individual process. I'm certainly not endorsing the blanket selection of corporate trustees. Unfortunately, they still suffer from staff turnover <exacerbated by mergers), and some complacent institutions still insist on traditional internal investments. But I do think we should all take afresh look at three particular areas in which corporate trustees can excel: cost, competency and conflict among the generations.

one of them was aware of the extent of their duties. In fact, it would probably be unrealistic to expect these family members to know and understand the law that applies to trustees. Yet knowing and understanding was their legal obligation.

Another risk of having a family member or friend serve as trustee comes up when the settlor is still alive. I've seen many situations in which the individual was more of an alter ego of the settlor, and would do whatever the settlor wanted. This is not just a breach of fiduciary responsibility. It's also a serious risk from a tax perspective: The Internal Revenue Service could claim that the settlor retained control over the trust property, which could lead to the inclusion of the trust property in the settlor's taxable estate.

In fact, many estate-planning attorneys say that the primary area of trustee negligence is the failure to understand and comply with the complex tax rules that apply to trusts. Kathleen Ford Bay, a partner in the Austin, Texas, law firm of Blazier, Christensen, Bigelow & Virr, PC, has seen a number of tax omissions and incorrect filings by individuals serving as trustees. Beneficiaries brought claims for her to handle that she said could have been prevented by a more skilled trustee.

GOING. PBIVATE

Increasingly, families are creating their own private trust companies and having those companies act as trustee for the family trusts. This arrangement at its best provides professional, ongoing administration-with a personal touch. But the private trust company only works if it can retain skilled stafr.

A number of family office executives report that their families formed private trust companies in response to what they perceived as their relatively poor treatment at the hands of institutional trustees and the corporate trustees' unresponsiveness to their families' interests. Such unhappiness is not unusual. I still remember a beneficiary years ago who asked if she had any right to better service from her institutional trustee. I was unable to find any law firm in that city that would even consider filing a request with the court to have that trustee resign. This is why I still recommend that clients who have corporate trustees always have an individual who can remove the corporate trustee.

Some clients seem to think that they can more easily control a private trust company than an institutional trustee and that they will save fees as well.

According to John P.c. Duncan of Chicago's Duncan Associates, a lawyer who has set up a significant number of private trust companies, a private trust company is often in fact a "directed" trustee and in many ways is subject to the control exercised by the family owners of the trust company If the private trust company hires qualified staff to provide all the trust services, there may not be any cost savings.

If a private trust company elects not to pay for its own skilled staff, but hires an institutional trustee to proVide those services, there's an assumption that this will limit the liability (and thereby lower the cost) of the outside institutional trustee, because the outside trust company is proViding fiduciary services as an agent and not as a fiduciary This is an example of the splitting of traditional trustee roles. At the end of the day. the beneficiaries are still entitled to enforce their rights against the trustee, who bears the ultimate legal responsibility

CONFLICTS

When family and beneficiary conflicts do arise, as seems inevitable, the corporate trustee is an independent party thaI can act as a buffer. The institut ional trustee also is at those critical times a positive influence because it is the the long-term trustee's duty to watch out for the interests of all generations.

In families of substantial wealth, natural tensions between Siblings and between generations are orten made worse by the role an individual trustee has had in the family In my experience, when a family member or friend is the sole trustee, that trustee tends to have a close relationship with the senior generation. This causes the younger generation to rebel against the trustee, almost as a matter of human nature. Then, at the moment when stability is most needed in the family-when the senior generation passes away-the relationship with the family trustee becomes most precarious. The younger generation wants its representative and tries to replace the senior, experienced trustee. Such instability too often causes irreparable damage to family relations and accumulated fortunes. The new trustee may lack the skills and experience, and may restructure the portfoliO with short-term objectives.

The solution is not to name a corporate co-trustee to begin serving after the client dies. Too often, clients name individuals to act as trustees during their lives and provide that, upon their death, an institutional co-trustee will be added. But the period immediately following a client's death is exactly the wrong time to introduce an unknown trustee; it only increases instability. Beneficiaries often will have had little experience with the institution-which is not good during the time of their greatest anxiety.

There are additional reasons to avoid the last-minute add-on. The institution may have changed since lhe time it was named; the client may not have kept in touch enough to know it well. Also, as noted by Gail ColH'n, general trust counsel at Fiduciary Trust Company International in New York, one of the benefits of using a corporate trustee is continuity, as corporations do not die and their trust administration continues uninterrupted; but naming the institution to serve only after the client's death disrupts this continuity because the institution cannot act until it then qualifies as trusteC'.

TIMING

It's far better to add a corporate co-trustee during the client's lifetime. This allows everyone time to become familiar with each other and get used to working together. It also gives time to change the corporate trustee, if the experience proves unsatisfactory I still think, though, that the individual co-trustee should be given the power to remove and replace the corporate co-trustee if, after the settlor dies, that institutional fiduciary becomes unsatisfactory.

Finally. because substantial family trusts are like small, family-owned businesses, the wisdom of including outside directors on a family business's board of directors, applies to trusts as well. John Ward, a leading family business consultant and professor at the Kellogg School of Management at Northwestern University in Chicago, teaches that haVing outside directors is one of the most important factors for the successful continuation of a family business from generation to generation. I believe the same holds true for family trusts. The addition of a corporate co-trustel' can be a positive factor in the successful continuation of the family fortunl'. This is because, as with outside board members, a more objective professional with outside experience of other families is at the table.

A corporate trustee can be proactive in helping the wealth, with some of the issues that most trouhle them-such how to educate the next generation. John Holt, a lawyer in Denver who spent a number of years as a trust officer, created a number of innovative tools toward this end. He organized sessions to teach the younger generation how to understand the trust accounting statements. For a complex family, he created a family advisory committee to work closely with the trustee. Each branch of the family elected representatives, who were able to communicate concerns (such as about distributions) to the trustee and to communicate trustee concerns (such as about diversification) back to the family. This communication has meant that a smooth generational transition is more likely to occur.

In other words, a good corporate trustee can be the bridge to the family's future.

So these days, when clients are wondering whom to appoint as trustee, I tell them: "You may want to name an individual-but you also should consider some advantages that a corporate trustee can add." ■

COST

The first objection I used to raise is that corporate trustees simply cost too much.

But I was making that argument before institutions started unbundling servICes and negotiating their fees. Although this flexibility supposedly began more than 10 years ago. it used to be more of a marketing statement than an actual practice. Now, though, I do find corporate trustees are more responsive to concerns about their fees.

Institutions are getting used to offering a menu of optional services, each for a separate fee. The trustee fee depends on those services selected: custody, portfolio management, monitoring outside managers, serving as sole trustee or co-trustee, preparing tax returns, etc. Most firms also are willing to depart from their fee schedules. Recently, for example, I asked a number of leading institutions what their fees would be to serve as the corporate co-trustee for a family trust of $300 million. Responses varied from a set fee schedule to one that would charge one-half of the standard set amount, based on which services the family selected and how complex their anticipated needs would be.

Recently in Tokyo meeting with representatives from the Association of Trust Banks, I spent a lot of time explaining why there is no easy answer to their question, 'How much do trust banks in the United States charge for being a trustee?' I gave them a brochure from the Carlsbad National Bank in New Mexico, the town in which [grew up and the bank on whose board my father was a member for many years. That brochure has an extensive list of different services for different types of trusts and corresponding charges. I told the Tokyo bank representatives that this a *fa carte* menu had become typical, even in small towns.

In fael, for the past year, I've been advising a private wealth group of a large institution, Harris Private Bank (HPB>, about educating the next generation, family governance and broad aspects of succession. HPB's trust department typically provides its private wealth group with a detailed list of fees that corresponds to the service's HPB provicJes. Despite this comprehensive list, I've seen the HPB trust department regularly depart from. the fee schedule, and take into account the' nature of the particular services that it will supply, including the extent of other family relationships with the bank. With large trusts. it's fair to expect institutions to negotiate for fees. Families understand this, and are beginning to ask advisors to shop around.

But it's also important to weigh the cost of a corporate trustee against the lower cost of an individual trustee. Although many individual trustees agree to serve for a nominal charge, they usually lack requisite skills, and need to hire others to carry out their trustee functions. This means that although the actual trustee fee is a bargain, the total cost may not be. For example, Alan Yanowitz, an estate-planning lawyer in Rochester, Minn., notes: "Whenever a family member has been named as trustee, I have frequently suggested that the trust hire an investment manager. The cost of the investment manager, plus additional costs of accountants and lawyers, frequently neutralizes the cost savings."

In other words, it may be better to focus on the services that will be needed and then consider who's best equipped to provide those services. Treating cost as a primary concern leads clients to what they chose as a low cost alternative-a family member or friend, who may not have any of the competencies required to administer a trust properly

COMPETENCY

We should encourage clients, when selecting trustees, to consider how complicated the task really is. Many families assume that anyone can serve as a trustee, without appreciating the fiduciary's serious and extensive legal responsibilities. Relatives and friends end up agreeing to be a trustee as a favor. Trustees are exposed to claims from beneficiaries, and individual trustees are not likely to have any fiduciary malpractice insurance coverage. The fact that they are paid very little does not free them from such claims. Even if the trust agreement contains indemnity provisions, a court may not uphold those provisions.

When I think of the many family members I've seen named as trustees, I wonder if any

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