

Some Thoughts Concerning Trustee Selection

by Langdon T. Owen, Jr.

The selection of an appropriate trustee is of concern for anyone establishing a trust. A good trustee will provide real tangible benefits, and a bad trustee will provide nothing but nightmares. This article contains thoughts on the subject of trustee selection that counsel drafting trust instruments may find useful in dealing with clients.

GENERAL SELECTION CRITERIA

Any trustee of any trust should have certain fundamental characteristics. Does a trustee need to be a saint? No, but it would be a step in the right direction. Standards of trustee integrity and skill are quite a good deal higher than for the general business world with which most people are familiar.

Honor

The trustee should be absolutely honest. If there is any doubt on this matter, the inquiry should end – this is not the person who should be a trustee. In this context, honesty includes not just a lack of lying, stealing, and cheating, but goes further to include the ability to honorably meet the trustee's major duties to the trust: to be loyal and operate the trust for the benefit of the beneficiaries, to avoid any self-dealing or conflicts of interest, to accurately and unflinchingly account for the trust's and the trustee's performance, and to keep the beneficiaries informed of their rights relating to the trust. A trustee must have the unhesitating ability to withstand pressures, sometimes from surprising sources, including spouses or other family members, to compromise where appropriate and stand firm where appropriate on the numerous little things which alone or in the aggregate can destroy the trust of the beneficiaries, as well as on the fewer, bigger things which would be or could be abusive of the trustee's position. Everything a trustee does must be able to not only withstand, but to shine in, the light of day.

Financial Ability

The trustee should have money and property skills. This does not mean the trustee must have the investment expertise of a professional – the trustee can always hire a professional advisor. The key characteristic is the ability to understand financial matters and to make prudent financial and investment choices. The trustee must be proactive and cannot be neglectful; must be

prudent and not easily swayed by sales pitches; must be practical and able to fit general financial concepts to the particular needs of the trust. The trustee will need to make investments over the life of the trust and will need to plan ahead to maintain some liquidity to meet the goals of the trust. The trustee will need to be able to foresee many of the needs of the beneficiaries and plan to meet those needs. The trustee will need to know what he or she doesn't know and seek cost-effective and sound advice. The trustee cannot blindly rely on advice, however, but must use the trustee's own sound judgment as to what makes sense for the trust.

People Skills

The trustee will need to be able to effectively deal with the beneficiaries, and with others, too. The trustee should have a good understanding of the family dynamics. This understanding may be obtained by talking with the family members and others. The need for such understanding in no way disqualifies a nonfamily member from being a trustee if he or she is willing to look into the relevant matters. However, the trustee should not be so personally involved in any controversial family matters that he or she has some axe to grind or is perceived as being biased for or against some family members. The trustee must not only be honorable, but he or she must be able to consistently command the respect of the beneficiaries for having such honor. Even a misperception by a beneficiary can create wasteful conflict.

The trustee needs to be able to listen well to the beneficiaries and have some empathy for their positions, yet have the backbone to say "no" clearly and emphatically in appropriate circumstances. A trustee may, by reason of his or her position, have great power and influence in the family, yet must be humble enough to realize that he or she cannot possibly have all the answers and that he

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or she will need a good deal of input from others in order to make sound decisions – and that even then can be mistaken. A trustee will need to have the strength of character to be able to patiently persevere through many a thankless task, even at times of personal pain; the trustee's people skills are not just external, but must be internal, too.

Longevity

Some trusts can last years, even whole lifetimes. It is of benefit to the trust and its beneficiaries to have continuous and consistent management. Thus, the health, age, and mobility of the trustee are factors to be considered. In the best situation, the trustee will be in top form and will perform throughout the term of the trust without any need for a replacement; but to get the benefit of mature judgment and experience, it may well be necessary to come to a balance on the expected length of service of a trustee. The trustee should keep records and otherwise act to make any future transition a smooth one.

Follow Trust Instrument and Law

The trustee must follow the trust instrument and comply with applicable law. Thus, the trustee must have the ability to understand legal concepts and apply them to the particular circumstances

of the trust and its beneficiaries. The trustee should be able to recognize the need for legal and accounting help and be willing to seek out and follow appropriate advice.

Disability Trust Concerns

All the foregoing general matters relating to trustee selection apply even more emphatically to trusts for beneficiaries suffering from a disability. Disability trusts are more likely to run a whole lifetime than other sorts of trusts, and consistent treatment of the beneficiary over the long term will often be of greater importance to a disabled beneficiary than to fully-abled beneficiaries.

The main beneficiary, to an extent depending on the depth of the disability suffered, may well not be able to fully understand the functioning of the trust or to personally oversee and provide constructive criticism or input as to the performance of the trust and its trustee. The beneficiary is much more likely to be strongly, or even wholly, dependent on the proper functioning of the trust and the good faith and good judgment of the trustee for rather basic day-to-day needs or comforts. A failure of a disability trust to function properly can be very immediately and personally painful to a disabled beneficiary. Careful, consistent, and conservative trust management will be a primary concern for a trust for a

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disabled person and risks which might be quite reasonable for other sorts of trusts may well be inappropriate for disability trusts.

Beneficiaries with the greatest needs can at times be, or at least seem, the most demanding, sometimes unreasonably so. The same can be true of those who provide care for and who love the disabled beneficiary – they may push the trustee well beyond the usual extent. This sort of push comes from the right emotional place but may not be balanced by a longer or broader view. The trustee's job is just harder when disabled persons are beneficiaries. Thus, unfortunately, it is also often harder to recruit the sort of trustees these beneficiaries so greatly need.

Furthermore, the nonsupport, special needs trusts used for disabled persons who are on government assistance, often tend to be of modest size. This can make it difficult to adequately compensate the trustee, again adversely affecting recruitment. Some people will have a tendency to see adequate compensation for a trustee as exploiting the disabled person because these people will not have a clear understanding of the trustee's efforts or responsibilities.

Most, perhaps the vast majority, of initial family trustees for disabled persons act as such from a personal emotional commit-

ment to the disabled person and are willing to take on this tough job even without adequate, or sometimes without any, compensation. Such persons can prove to be exemplary trustees. However, as the initial trustees die, become disabled themselves, move away, or otherwise become unavailable to serve, it can be very hard to replace them. The precedent of low or no compensation for the initial trustee may then become a barbed wire fence of unrealistic expectations which can keep others off the job.

PROFESSIONAL TRUSTEES

Let's compare some of the more important factors concerning the use of individuals as trustees or professional trust companies as trustees. Let's remember the key characteristics a trustee should possess.

Honor

With individuals, honor is a personal attribute developed over a lifetime; where it exists it is often deep, strong, and inviolable. On the other hand, persons who appear honorable sometimes violate their honor when under financial or psychological pressure.

For a trust company, honor is an institutional mandate with

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institutional constraints and protections. Trust companies have recruitment programs designed to attract good people and human resource programs designed to train and develop the sense of honor, service, and professionalism in these people and to weed out those who do not make the grade. Also, trust companies are regularly audited by various state and federal regulators. The regulatory process tends to prevent abuses.

If, however, an error or individual dishonesty occurs, the trust company can generally respond in damages, usually directly but sometimes through bond or insurance proceeds. Regulations require trust companies to maintain certain proportions of net capital which can fund such recoveries. Individual trustees may also be bonded against the worst sort of dishonest acts; but most trusts are drafted to require no such bond because it is an expense with little benefit. The sorts of dishonorable acts found among individual trustees tend to arise more from conflicts of interest and such than from outright theft. Thus recovery (if any) against a fiduciary bond is not always a clear-cut thing. The ability of an individual to respond in damages will vary with the financial situation of the individual and will probably change, for better or worse, over time.

Financial Ability

Trust companies are usually pretty good money managers. The best individual money managers can out-perform the trust companies from time to time, but such individuals are seldom available to serve as trustees. Also, high returns are almost always related to high risk, and the sorts of investments some individuals make for themselves will not be appropriate to make for a trust and its beneficiaries in many circumstances.

If an individual trustee has sufficient intelligence, prudence, willingness to work, and foresight to seek good advice, he or she can do just fine with the financial aspects of most less complicated trusts. On the other hand, some trust assets or some trust requirements can be quite complicated. If professional assistance is going to be a constant need, a trust company may be able to fill this need more cost effectively.

The recruitment, training, and retention policies, committee oversight, and management policies of a trust company along with the regulatory controls to which trust companies are subject, tend to assure that trust companies act prudently and do not make bad mistakes. If a trust company were to go badly wrong through imprudence, however, it will have the resources to make good the loss.

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Individuals can and do make bad investment and financial decisions, and when these bad decisions are made in a trust context, they can be devastating where the trustee does not have the financial capacity to respond fully in damages for the harm done.

People Skills

Individuals known to and trusted by the beneficiaries may be able to best meet the trust's need for good people skills, at least as long as such individuals are available. On the other hand, these individuals are not always willing or able to take on the full burden of trusteeship or may not have all the other attributes necessary in a trustee to the full extent desirable. In such cases, these individuals may make good co-trustees with a trust company or with another individual.

Trust companies recruit and manage their trust officers to develop people skills and to assure the proper use of those skills. Seldom do trust companies keep trust officers who are unable to develop a good working relationship with beneficiaries; trust companies are selling a service and they use their management abilities to see that the services are provided at an acceptable level. However, the very checks and balances that assure integrity and financial responsibility can sometimes interfere with the personal touch

as trust officers need to consult superiors or trust committees on significant issues. Also, trust companies, like other financial service businesses, have relatively high levels of employee turnover. Some beneficiaries complain that almost as soon as they have developed a relationship with a really good trust officer, that trust officer is promoted inside the company or leaves the company to work elsewhere. Nevertheless, trust companies almost never have the truly abysmal and adversarial relationship with beneficiaries which some individual trustees manage to develop and which cost the beneficiaries greatly in litigation expense and heartache.

Longevity

People die, become disabled, and retire; trust companies don't. Some trust companies have been around for over a century. Despite employee turnover, for long-term stability, trust companies will almost always have a significant edge over individual trustees. If a trust officer is promoted, he or she can still be consulted; if he or she quits, the trust company will have good records and will have trust committee members who will recall the major matters involved with the account, and there will be very little transitional disruption.

Follow Trust Instrument and Law

Well-advised individual trustees can follow the directives of the trust instrument and comply with the law, particularly when they seek the advice of counsel as needed. These matters may, however, go beyond the abilities of typical individual trustees when they raise especially complex and continuing issues.

Trust companies generally have a good deal of experience in following trust instruments and in legal compliance. They have built administrative systems over the years to help them do so. They may occasionally seek court guidance on legal points where an individual trustee might choose not to spend resources to seek such guidance, but generally trust companies don't go overboard on this and where guidance is sought, do obtain for the beneficiaries the court's determination which can be relied on by all interested persons.

Some individual trustees will occasionally take unrealistic or ill-advised or simply higher tax risks; trust companies almost never do so because they are unwilling to put beneficiaries at risk for a loss on the issue or for the cost to defend a challenge, or because they are in the game for the long term and are unwilling to weaken their reputations for probity.

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Conclusion as to Professional Trustees

Individual trustees are capable of meeting and exceeding every expectation for a top-notch trustee. Individual trustees are also capable of the most incredible greed and stupidity which might be found in a bottom-of-the-barrel trustee. The top is very high, and the bottom is very low, but most individuals are somewhere in between and have no track record as a serving trustee by which to judge them. The grantor of the trust must judge based on knowledge of the individual formed under circumstances usually quite different from those which will face the individual as a trustee. If an individual trustee does damage, it may prove difficult to obtain an adequate response in damages unless the individual is wealthy.

Trust companies generally perform their services consistently and sufficiently well. They are managed and regulated so as not to fall below a certain standard; this is profitable for them, while truly top-end service generally is not, absent a premium price. (Promises of premium service for a premium price, however, should be viewed with healthy skepticism in the retail trust business.) Trust companies do not always reach the highest peaks of performance or service, but they also seldom fall below an acceptable standard and almost never reach the lowest depths

of dereliction or abuse. They have track records by which they can be judged. When they cause damage, they are generally adequately financially responsible to make good the loss.

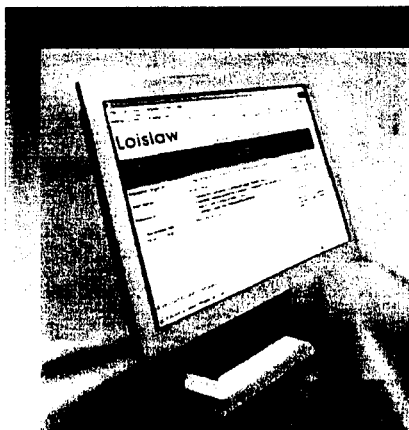
CO-TRUSTEES

For some trusts, co-trustees can provide an effective balance of skills and at the same time create some checks and balances which will prevent problems. However, there are negatives as well as positives to consider.

Avoid Unworkable Relationships

People who do not get along well with each other in particular or with others in general should not serve as co-trustees. There will be pressures and disagreements if the trustees take their job at all seriously. Yet the trustees must be able to disagree without being disagreeable, and must be able to use diversity of viewpoint as a constructive management tool.

Obtaining diverse points of view can be a good thing, but gridlock can destroy the benefits intended to be provided by the trust. Thus, if it is clear that the persons have such diametrically opposed views of the goals and methods of trust management, or of the benefits to be provided or not provided by the trust,



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that common ground is unlikely to be achieved, these persons should not be co-trustees.

For any checks and balances system to work, the trustees must be equals in fact as well as theory. Thus, if one has a relatively strong tendency to defer to the other, they probably should not serve together as co-trustees. On the other hand, appropriate deference in certain areas born of honest respect may be a good thing where the respect is the result of independent judgment, and where the respect does not imply any blanket willingness to avoid the exercise of independent judgment or to avoid even appropriate disagreements.

Enhance Teamwork

Co-trustees should have sufficient mutual trust that they can effectively act as a team to accomplish the goals of the trust. No co-trustee should have reason to feel the other co-trustees either are shirking or are unilaterally usurping control.

Cross-checking and watching out for each other to prevent inadvertent errors are very good for improving and maintaining quality trust management. On the other hand, if a trustee feels he or she must constantly watch out for the incompetencies of another in order to prevent all co-trustees from being sued, there is serious trouble brewing.

A division of primary responsibility may obtain for the trust the benefits of appropriate specialization. However, each trustee must remain aware of what all other trustees are doing and be willing to help out in other than his or her primary area as needed and be willing to put a stop to inappropriate actions in other than his or her primary area. The law requires this level of co-responsibility as a general rule of fiduciary conduct, with personal liability as the sanction for failure to meet the co-responsibility.

Succession and Transition

Anytime co-trustees will serve together, the plan should include provisions dealing with succession and transition. If one co-trustee dies or resigns, is another co-trustee to be appointed to serve, or will the remaining co-trustees or co-trustee serve without an additional co-trustee? If a new co-trustee will be appointed, who will it be? Can the new co-trustee be integrated well into the co-trustee team?

RESTRUCTURING TRUSTEES

One ultimate check and balance tool which can be included in trust instruments is the power of removal or replacement or other restructuring of trustees. These powers provide strong medicine to those who hold them. A grantor whose main concern is having a trustee willing and able to put a stop to certain sorts of things may not want to give strong restructuring powers to the very persons (for example, extravagant beneficiaries) who may need to be stopped. In such cases, the grantor may be well satisfied with the power of a court to remove a trustee for cause.

General Successorship Provisions

Trusts generally contain provisions for the replacement of a trustee who dies, becomes incapacitated, or resigns. Successor trustees can be named in the order they are to serve, a third person could be given the power to appoint a successor, or the successor could, as a fallback, be named by a court on request of any interested party.

Special Provisions for Co-Trustees

Also, it may be appropriate in some cases where a co-trustee is lost to let the serving trustee or co-trustees decide whether a replacement co-trustee should serve or not. This ability of the serving trustees to choose can even be generalized so that they may at any time, not just on the loss of a co-trustee, add a new co-trustee to the roster (perhaps up to a maximum number) if they believe it would be helpful to do so.

Further, serving co-trustees could be given power to remove and replace a serving co-trustee by, for example, a two-thirds

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majority. The removal power could be useful to smoothly eliminate a problem co-trustee, but it could also be used to just as smoothly eliminate a voice of caution and good counsel.

Beneficiary Powers of Removal

Similarly, the beneficiaries could be given the power to remove and replace a co-trustee (or even a sole trustee), for example, by action of a majority or super majority in number of the then current income beneficiaries.

Combined Action for Removal

Another alternative could be for removal on the combined action of, say, two-thirds of the trustees, and of a majority of the beneficiaries. The benefit of the combined action is to take into account the interests of those who may be entitled to the remainder interest. (Remainder beneficiaries generally will be contingent and unknown until trust termination.) Action by the income beneficiaries alone may tend to bias the trust toward the income beneficiaries and against the remainder beneficiaries. This is fine where the trust is intended to be so biased (as will often be the case with disability trusts), but it is not so fine where the trust is intended to provide the remainder beneficiaries something substantial. The vote of the trustees could help provide

some voice for the unascertained remainder beneficiaries in the latter situation. Useful variations of the combined action approach could be to have a trust protector (an independent person, not a trustee, but with certain supervisory authority) act with the beneficiaries (especially where there is only one trustee) or to have one of two co-trustees act with the beneficiaries.

Limit Power to Particular Circumstances

It may sometimes be useful to limit powers to replace a trustee to certain specified circumstances less than legal cause. However, this inevitably invites disputes over whether the circumstances exist and may thus tend in some degree to prevent an easy transition. Still, by specifying circumstances, the scope of any such dispute may be narrowed and a full showing of legal cause for removal may be avoided. A trustee may steadfastly fight a removal for cause because the allegations leading to such a removal can be harmful to the trustee's reputation and the trustee may want some type of court finding of exoneration. A less harsh form of removal on specified circumstances may make it easier to get a trustee to leave without a major battle. The description of such circumstances would need to be carefully tailored to advance the most important of the particular goals and desires of the grantor of the trust.

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Trust Protector

It is not too unusual in trusts, particularly those for a disabled beneficiary, to have a trust protector named to review accountings and with power alone or with the guardian of the disabled person to replace the trustee. Since the trust protector will be independent and will be neither a trustee nor a beneficiary, he or she can bring some objective perspective to what may otherwise be an even more difficult situation.

NUMBER OF TRUSTEES

The number of trustees serving can make a real difference in the management of the trust, and there are some important factors to consider.

Sole

A family member acting as sole trustee can act quite expeditiously, and this can be good. However, if the beneficiaries are unable (or unwilling) to watch out for their own interests, there will be a lack of institutional checks and balances to prevent potential abuses or good faith mistakes. Trust companies have internal checks and balances to prevent problems, but a trust company may tend to pay more attention to quality service if it knows it could be replaced in at least some circumstances without a showing of cause. Thus, even where a trust company is serving (with its internal checks and balances), some sort of trustee removal and replacement mechanism may be appropriate. The law allows for trustee removal for cause, and the grantor may want to consider if this is sufficient protection. The cost of a single trustee may be less than where multiple trustees are serving.

Two

Where two co-trustees serve, one can act as a check and balance on the other but there is also the potential for devastating deadlock. A deadlock breaking device may be appropriate. For example, a temporary third trustee to decide the single issue may be appointed by provisions of the trust instrument. However, in long-term trusts, such as disability trusts, the long-term availability of such a named deadlock breaker may be a problem. One or more persons could be named in order to act as a secondary deadlock breaker; this could be of help, but eventually it is possible that none of the named persons will be available. If the co-trustees cannot agree on the issue at hand, it is not too likely they will be able to agree on a mutually-acceptable, deadlock-breaking trustee. The alternative is to seek court guidance on the disputed issue or a court ordered removal of one of the co-trustees (depending on the nature of the problem). Two trustees serving may be less expensive than three but is likely to be more expensive than one.

Three or More

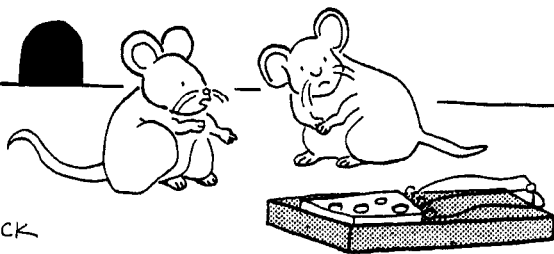
With three co-trustees, there is a built-in deadlock-breaking mechanism if, as will generally be the rule in Utah, two of the three can decide an issue. However, three trustees tend to cost more, and action by them tends to be more cumbersome. Third parties may want all three (or more) trustees to sign everything, even if this is not mandated by the trust instrument or by the law. Nevertheless, some administrative features can be provided in the trust to reduce inconvenience. For example, one trustee could sign checks less than a set dollar amount, while two would be required for greater amounts. It almost never makes sense to have more than three persons serving as co-trustees, due to the cost and inconvenience involved. If an even number were to serve, some deadlock-breaking mechanism will be useful. A removal and replacement mechanism can be useful with three or more trustees, but with more trustees who are less likely to deadlock or who can outvote a problem trustee, the need for such deadlock-breaking or trustee-removal mechanisms may not be as intense as where there are fewer trustees.

CONCLUSION

The single most important decision a grantor makes about a trust to be established may well be the choice of the trustee or trustees to serve. There are a number of factors to consider in making such an important decision. No family situation is the same as any other so there can be no single answer right for every family. The grantor's counsel should discuss with the grantor the major factors, outlined above, that may be relevant in that family's circumstances.

Jest is for all

by Arnie Glick



"If you ask me, someone should bring a products liability case against the manufacturer of that cheese dispenser!"