Choosing a Trustee, Who Can You Trust?

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Choosing a trustee is one of the most important and, often times, the most difficult decision for clients when creating a trust. The success of the trust depends in part on the trustee's capability to carry out the terms of the trust.

The trustee is a person or financial institution named in the trust agreement to carry out the objectives and terms of the trust as set forth by the settlor (the creator of the trust agreement).

The role of the trustee involves three basic functions: day-to-day administration; investment management; and distribution. The day-to-day administration function of the trustee involves beneficiary communication regarding the trust, trust accounting and reporting and tax compliance. The investment management function requires the trustee to manage the investments of the trust, typically in a manner consistent with the requirements of state law, which in Ohio are generally set forth in the Ohio Uniform Prudent Investor Act. The distribution function requires the trustee to make decisions regarding distributions to beneficiaries where the trust does not require distributions to be made on a mandatory basis. This function may be the most sensitive function entrusted to the trustee. The choice of trustee should be made in light of these basic functions.

The trustee may be an individual, such as a family member, friend, or advisor, or a corporate trustee, such as a bank or trust company. Many settlors are inclined to choose an individual trustee, such as a family member or friend because of such individual's personal knowledge of the family and trust beneficiaries. However, most individuals do not personally possess the ability to competently perform all of the functions of a trustee. In those instances, the settlor must rely on the individual trustee to hire qualified professionals to assist the trustee in the performance of its functions, for example, investment management, accounting and tax compliance.

Settlors commonly believe that an individual trustee will be a less expensive than a professional trustee. This is not necessarily the case. Individual trustees are entitled to trustee's fees and the trust will incur expense if the individual trustee hires qualified professionals to assist the trustee with respect to his or her duties.

In deciding whether to appoint an individual as trustee, the settlor must not only consider the individual's ability to perform the basic trustee functions and ability to hire qualified professionals when needed, but also the potential liability and burden for the individual who has been asked to serve as trustee, as well as the possibility of complicating relationships between the trustee and beneficiary.

An alternative to having a friend or family member serve as trustee is to appoint a professional trustee, such as a bank or a trust company. Corporate trust departments typically offer the advantage of experience and expertise in each of the core functions of a trustee, including investment management, accounting, tax compliance, and the ability to work with beneficiaries. Many settlors may consider it an advantage to have a disinterested third party as the trustee to make what may be difficult distribution decisions.

In circumstances where the settlor wants the personal knowledge of a family member or friend and the professional experience and expertise of a bank or trust company, appointing the individual and bank or trust company as co-trustees is an option. Under this structure the individual trustee and the corporate trustee work together, each bringing their own knowledge and expertise to the table.

There are many other considerations that could be important in the selection of a trustee. For example, the tax characteristics of the trust in question may dictate that an "independent trustee" be involved in order to avoid adverse tax consequences.

A trust that will hold unique assets, such as a closely held business, may require a trustee with special expertise or experience.

Many trusts are designed to last for an extended period of time, so provisions must be made for successors, particularly if individuals are involved. Long-lasting trusts may require the need for a corporate trustee at some point if the settlor is uncomfortable with unknown individuals serving as trustee in the future.

The foregoing is just a brief introduction to some of the considerations that impact the choice of a trustee. If you have any questions about choosing a trustee or would like to review or update your trust with respect to the trustee provisions, please do not hesitate to contact your Vorys attorney.