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Fiduciary Best Practices for an Individual Trustee
––Reducing Liability and Improving Client Relationships—

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Agreeing to act as trustee is a major responsibility. Attorneys, accountants, and other trusted advisors, are being asked with increasing frequency to serve as trustees for their clients' trusts. Changes in technology, trust laws and client preferences are driving this trend. It is easier than ever before to access information, many states have enacted favorable trust laws, and people are becoming more comfortable appointing individuals as trustees.

Individual trustees – whether professionals or family members – need tools and techniques to fulfill their fiduciary duties and may not be familiar with the investment responsibilities that they now hold. While individual trustees lack the staff of a corporate trust department, these individuals have similar responsibilities and will be held personally liable if they are found to have breached their fiduciary duty. Whether advising a client who is named as trustee or serving as the trustee yourself, the following "best practices" will mitigate the risk of breaching your fiduciary duties as they relate to the investment of trust assets.

The Uniform Prudent Investor Act

The Uniform Prudent Investor Act (UPIA), enacted in 1994, has been adopted – with minor modifications - by most states. The act requires trustees to follow the Modern Portfolio Theory (MPT) of investing. The MPT theory assists in creating a framework for a diversified investment strategy that includes different asset class combinations and identifies the optimal risk/return solution for each of these combinations. Prior to the enactment of the UPIA, trustees were subject to the "Prudent Man Rule" which limited the investment choices of a trustee to only safe or conservative investments and did not allow trustees to delegate investment decisions.

The chart below provides an introduction to the major provisions of the UPIA. As of this writing, most states have adopted the UPIA with only minor modifications; however, the requirements of state law in the state in which the trust is located should always be consulted.

Section Name	Provisions and Comments
Prudent Investor Rule	The trustee owes a duty to all beneficiaries – current and future - to act prudently. The trustee may reasonably rely on provisions of a trust that expand, restrict, eliminate, or otherwise alter the prudent investor rule.
Standard of Care; Portfolio Strategy; Risk and Return Objectives	The trustee must consider various circumstances in investing and managing trusts. Decisions should be evaluated in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust.
Diversification	The trustee must diversify the investments of the trust unless they reasonably determine that the purpose of the trust is better served by not diversifying. Comment: Where the trust document directs the trust to hold a non-diversified asset (e.g. single stock or family business), the trustee would be wise to obtain consent from the beneficiaries as decisions are made.
Duties at Inception of Trusteeship	A new trustee must review trust holdings and bring the trust portfolio into compliance with this act as well as the purposes, terms, distribution requirements, and other circumstances of the trust. Comment: retaining assets in the trust may be appropriate and should be documented accordingly.
Loyalty	The trustee must act solely in the interests of the beneficiaries as opposed to the interests of himself or other 3rd parties.
Impartiality	The trustee must take into account the different interests of the trust beneficiaries. Comment: this includes both current and future beneficiaries.
Investment Costs	The trustee has a duty to incur costs that are appropriate and reasonable in relation to the assets and purpose of the trust.
Reviewing Compliance	Compliance with UPIA is based upon facts and circumstances at time of decision. Comment: the test of prudence is based on facts and circumstances and not on hindsight; trustee is not a guarantor of investment performance.
Delegation of Investment and Management Functions	Delegation of investment and management functions is authorized. Comment: This delegation was not permitted under prior law.

Gather Information

Thorough documentation is an important part of being an effective trustee and of mitigating the risk of being sued for breach of fiduciary duty. A trustee should gather all relevant documents including the trust document, income, gift and/or estate tax returns, custodial statements, current investment management agreements, etc. “Know the Client” standards imposed on trustees include knowing the beneficiaries and awareness of the trust provisions. For beneficiaries, the trustee should generally be aware of the ages, time horizons, financial situations (including earned income, outside assets and potential inheritances and resources), level of financial sophistication, maturity, etc. With regard to the trust document, the trustee should know the settlor’s intent, time horizon and ages of the various beneficiaries of the trust (including future beneficiaries), and distribution of income and principal requirements of the trust.

Establish Roles and Responsibilities

The individual trustee should define, document, and acknowledge the roles and responsibilities for all parties involved in administering the trust. This should include custodians, investment professionals, trust administrators, tax preparers, valuation consultants, attorneys, and other professionals. When new relationships are introduced, a due diligence process should be followed and documented. For example, when delegating investment decisions to an investment advisor, the individual trustee should understand the standard of care that the advisor must follow. The trustee must know the difference between a broker who need only follow a “suitability” standard for investments and a Registered Investment Advisor who is required to follow a Fiduciary Standard. The roles and responsibilities of all professionals advising the trustee should be outlined in writing.

Establish a Plan: The Investment Policy Statement

A written Investment Policy Statement (IPS) is an essential document to help mitigate the risk that a trustee will be challenged for breaching his or her fiduciary duties with regard to investment decisions. The parameters of an investment plan that should be described in an IPS include the time horizon, risk level, targeted return, appropriate asset classes, and any implementation requirements. A balance must be struck between the needs of the current and remainder beneficiaries. These inputs are used to create a diversified investment portfolio based upon the MPT, discussed above. Merely holding a number of different securities is not enough for a portfolio to be considered “diversified.” There must be a plan and that plan must be documented. The most appropriate portfolio solution for a given trust situation should be the guide for developing an IPS and implementing the investment plan that the trustee will follow. The typical IPS covers basic information about the beneficiaries, the main components of the investment strategy, and implementation and monitoring requirements. An even better IPS would also include elements of the trust's provisions as they relate to investment considerations.

Implement the Plan

The trustee - or the delegated investment advisor - should choose investment vehicles that are appropriate for the portfolio size, the needs of the trust beneficiaries and the purpose of the trust. Due diligence should be performed and documented as part of the selection process for both investment strategies and custodians. Strategies could include both passive and actively managed vehicles. For actively managed accounts, track records, manager style and longevity, firm size, and history are among the important factors to consider. For custodians, breadth of investment offerings, costs, conflicts, and service capabilities will be important factors.

Monitor the Plan

Investment returns, as well as the IPS, should be monitored and, where appropriate, updated on an on-going basis. Periodic reports should be prepared to compare trust investment performance versus benchmarks and IPS objectives. Evaluations should be made of investment managers and any other decision makers to ensure that they are meeting the objectives as laid out in the IPS. Fees for investment advice, including commissions and hidden fees should be transparent and understood and documented, by the trustee.

Manage Expectations

In addition to documentation and following the requirements of the UPIA and state law, a trustee would be wise to cultivate good relationships with the beneficiaries. Managing client relationships as a trustee is best accomplished through both formal communications and making an effort to understand the family dynamics that play a significant role in many trusts. As a formal matter, it is a sound practice to send all beneficiaries a trust summary letter detailing each beneficiary's rights and how the trust will be administered. It is also prudent to send each beneficiary a copy of the IPS, as well as annual update to summarize trust activity during the course of the year. "Knowing the Client" is often a key variable in managing a trust—especially where discretionary distributions are involved.

Conclusion

Becoming a trustee gives rise to fiduciary responsibilities regarding the investment of trust assets. Individuals who serve as trustee do not have the processes and procedures in place that a corporate trustee would have, and without such processes and procedures, could be subject to the risk of a lawsuit by one or more beneficiaries of the trust. Since an individual trustee is personally liable for breach of fiduciary duty, fulfilling these responsibilities in an organized and disciplined manner will help insure a satisfactory experience for both trustees and beneficiaries. Whether advising a client who is named as trustee or serving as the trustee yourself, the above "best practices" will mitigate the risk of breaching your fiduciary duty as it relates to the investment of trust assets.

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