Choosing a Successor Trustee

One of the principal advantages of revocable living trusts is that they can be drafted to last many years following the death of the trust maker. This allows the trust maker to delay or stagger distributions of cash or other assets to young adults who have not yet demonstrated financial maturity, and allows for significant asset protection features discussed in previous As We Age columns. But for a trust to survive the trust maker, the trust maker must name a successor trustee, someone who will manage the trust when the trust maker is incapacitated or has died.

Most often, a couple will name the surviving spouse to fulfill the role of successor trustee. The surviving spouse is empowered to seek as much professional assistance as needed to manage the trust. The bigger question is, who should be named to manage the trust upon the incapacity or death of the surviving spouse?

There are three options in selecting a successor trustee: (i) family members, relatives or friends; (ii) professional advisors, or (iii) corporate trustees. This column discusses some of the pros and cons of each approach.

First, you can name an adult child, a relative of the family or a close friend. The advantages to this approach are that the successor trustee likely has an in-depth knowledge of the family, and the family dynamics. This means that the successor trustee likely has a clear understanding of family investments and business interests. Additionally, the successor trustee probably knows the beneficiaries well, and knows their strengths and weaknesses which can factor into when and how assets are distributed. And lastly, putting the responsibility in the hands of a competent family member, relative or friend could save a significant amount in management fees and keep family business in the family.

Potential drawbacks of naming a family member, relative or friend is their inexperience in administering a trust. Thus, mismanagement of trust assets, even embezzlement, is more likely to occur. In the event of mismanagement, the successor trustee is unlikely to have deep pockets, whereas a trust company or professional advisor would likely be insured to cover a breach of their fiduciary obligations. It could also be that a family member, relative or friend is too empathetic to the beneficiaries, and gets emotionally involved in decisions that should have some degree of rational detachment. Finally, the successor trustee may favor one beneficiary over another based on their close relationship to the beneficiaries over the years.

Professional advisors serving as successor trustees often include attorneys and certified public accountants. Depending on the trust maker's pre-existing relationship with the professional advisor, the advisor may have a good understanding of the family dynamics, as well as the family's investment and business interests. There is also a higher degree of confidence that a trained professional will not mismanage trust assets. However, just because an attorney or CPA is competent at their chosen specialties, that is no guarantee that they understand or have experience in trust administration. Professional advisors, however, are subject to strict ethical standards and are likely to have a network of professionals they can turn to if they need assistance.

A professional advisor, however, may not devote adequate time to trust administration if their principal business keeps them busy. Further, although they may have some form of liability insurance, the coverage available may be just a small fraction of the damage done to mismanaged trust assets. Professional advisors can also end up in conflicts of interest through no fault of their own, that would require bringing in other professionals to resolve various issues. Finally, professional advisors charge fees and remove control of family matters from the family. Sometimes this is exactly what is needed; other times it is entirely unnecessary.
Corporate trustees include bank trust departments and stand-alone trust companies. The benefits include professional and experienced trust administration; deep pockets if they fall short of their fiduciary obligations, and an objective, detached approach to dealing with beneficiaries. Further, corporate trustees are regulated by state and federal laws and have published fee schedules. In certain circumstances, a corporate trustee is the only good choice, for instance where a family is dysfunctional or a particular beneficiary is expected to create problems.

The disadvantage of corporate trustees is that they may be too dispassionate and have no understanding of the family dynamics. Additionally, corporate trustees are very conservative financially, and may be too conservative in their interpretation of trust documents. And, as with professional advisors, corporate trustees expect compensation. Lastly, with the consolidation in the banking industry, you may start out with a great relationship with your local bank, but just a year later end up with a trustee based in Albuquerque, New Mexico simply because the local bank got bought by a big nationwide bank. Trust companies are less likely to be purchased, but it does happen.

It is important that if you go with a corporate trustee or professional advisor that the beneficiaries, or a trust protector or advisor, have the ability to fire the trustee and move the trust to another institution if the relationship sours.

Choosing a successor trustee is one of the most important decisions you will face in setting up a revocable living trust. There are pros and cons to each approach that should be discussed at length with your estate planning attorney.