

CHOOSING A TRUSTEE

*Making the Right Choices for Your Family***The Wealth Strategies Group**

at Atlantic Trust integrates estate, financial and investment planning through sophisticated assessment of goals with the objective of multigenerational capital preservation, family business continuity and strategic philanthropic objectives.

Trusts are extremely flexible tools that can serve a variety of estate- and tax-planning goals. But how well they succeed depends largely on the trustee responsible for carrying out your intentions.

Whether you select an individual or an organization, your choice of a trustee is one of the most important decisions you make when you create a trust. Key factors to consider include the purpose and complexity of the trust, how long you want it to last, and the powers you plan to give to the trustee. The best time to address these issues is when your advisors are drafting the trust.

What It Means to Be a Trustee

When you put property in a trust, which can be created during life or through your estate plan, title passes to the trustee, who holds it for the beneficiaries—the individuals or charities that will receive the assets. Legally, the trustee is a fiduciary, which means the trustee has a duty to avoid conflicts of interest and always put the beneficiaries' welfare first.

Trustees can play a variety of roles. Their three main responsibilities are:

- Investing and monitoring the assets—either themselves, or by hiring investment managers
- Balancing the needs of income and remainder beneficiaries in making distributions of income or principal, and keeping careful records of these payouts
- Filing the trust tax return and any other required government or regulatory filings.

ATLANTIC TRUST

PRIVATE WEALTH MANAGEMENT

Depending on the purpose of the trust and who the beneficiaries are, trustees may serve a variety of related functions. Some clients rely on them to help educate younger generations about financial matters. With trusts set up for minors, the trustee may step into the shoes of a parent who dies prematurely and become the child's financial guardian.

Trustees must be impartial to both current beneficiaries, who are entitled to assets immediately, and future (remainder) beneficiaries, who will not receive distributions until some event occurs—such as when they reach a certain age or the current beneficiary dies.

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The Purpose of the Trust

Since the purpose of the trust will at least partially define the trustee's role, it is one of the first factors to consider in choosing a fiduciary. Trusts can be used to provide asset management, save taxes, protect assets from creditors, provide for children who are minors, or prevent funds from being eroded by spendthrift family members. It is important to think about who the beneficiaries will be, and how you would like the trustee to interact with them.

Certain kinds of trusts may call for trustees with particular qualities. For example, with a marital trust, designed to minimize estate taxes in a couple's estate, it is crucial to feel that your trustee can relate well to your spouse. If you are establishing a special needs trust to maximize outside resources while providing supplemental benefits to a disabled individual, you may want trustees with particular understanding of disabilities as well as the complicated legal requirements of special needs trusts. When looking for a trustee for your revocable or "living" trust, a key consideration is the fact that this trustee will be in charge of your finances if you become mentally incapacitated.

CHECKS AND BALANCES

One of the challenges when creating a long-term trust is to find a framework that will achieve your goals many years in the future.

To do that, a growing number of clients and their advisors are using a technique in domestic trusts that until recently was more familiar in the context of foreign ones. In addition to naming a trustee, they are also designating a trust protector (sometimes called a "special trustee" or "trust advisor") who can make certain key decisions or adapt various trust terms as circumstances change.

To serve this role, most clients choose friends, personal advisors who know the family, close business associates, or family members who are not beneficiaries. The trust can authorize the protector to:

1. Add or delete beneficiaries within a family
2. Remove and replace trustees
3. Accelerate payments of principal
4. Direct investment decisions
5. Amend the trust to accomplish new tax strategies made possible by changes in the law
6. Change the situs or location of the trust to a state that offers better creditor protection, or that permits dynasty trusts, which can last for many generations

Split a single "pot" trust into multiple ones, so that each beneficiary has his or her own trust. ■

Broad or Narrow Powers?

The precise boundaries of a trustee's powers, which can be narrow or very broad, depend on how the trust is drafted. With narrow powers to make distributions, the trustee can only pay out income and principal for very specific reasons. Examples include: "health, education or support," "college education," or "medical emergencies." Narrow powers are commonly used in situations in which the creator of the trust wishes to control and tightly define the use of trust property, particularly if the trust is intended to last for multiple generations, benefiting descendants that the grantor will never know.

Broad powers to make distributions—with or without a specific standard—are more subjective and call for the trustee to exercise independent judgment. Such powers may be stated as "maintaining reasonable comfort" or preserving a beneficiary's "accustomed manner of living." These powers tend to be most prevalent in trusts for the benefit of a surviving spouse or the children of the grantor, where the grantor is comfortable that the broad permissible guidelines will not be abused.

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The more authority a trustee has, the greater the likelihood that the trust can adapt to changing circumstances. Some trusts give trustees or trust protectors (see "Checks and Balances") the power to amend documents, change investments, or even move the trust to another jurisdiction when it will achieve a strategic advantage such as tax saving or better creditor protection.

Whatever power you want trustees to exercise, it is important to define them in the trust. Advisors at Atlantic Trust can work with the attorney who is drafting your estate planning documents to be sure they express your intentions.

What Are the Options?

The ideal fiduciary is objective, a careful record-keeper, and experienced with trust administration. "If trustees are not experts in wealth management, tax and accounting themselves, they can and should retain professionals in each of these fields to guide them," says Linda S. Beerman, chief fiduciary and risk officer. Since being a trustee can be a time-consuming job, you will want a fiduciary who can give your trust as much attention as it requires, over a prolonged period, if necessary. In choosing a trustee, you have the following options:

Family and friends. Even assuming they have the necessary background, training and objectivity, these individuals, who often serve as trustees without compensation or for a minimal charge, may not have time to handle the complex demands of trust administration. Another consideration is the potential legal liability. A fiduciary can be found liable for negligence as well as intentional misdeeds. If they mishandle trust investments or distributions, they could be the target of a lawsuit by disgruntled beneficiaries. They may not have the financial resources and insurance protection to cover their errors.

Professional advisors. Lawyers, accountants and other advisors sometimes offer fiduciary services. A key question is whether they are equipped and have the time to field the day-to-day questions that can come up in trust administration. Although you may be pleased with their other services, when acting as fiduciary they may not have the resources or the knowledge base of a large organization, says Judith A. Saxe, managing director.

Corporate fiduciaries. “An institution with substantial fiduciary experience offers stability and permanence that individual trustees cannot match,” says Saxe. “And that can be especially helpful for multigenerational planning.” Even if one of the professionals responsible for your trust leaves the organization, other fiduciaries can provide continuity and constant vigilance in managing the matter.

With corporate trustees, you also have the benefit of expertise in a variety of disciplines. They can help implement investment and tax strategies to help maximize the trust assets. Their in-house specialists can handle the complex accounting and tax-reporting requirements involved in trust administration. As independent and impartial decision makers, they are able to minimize or resolve conflicts among beneficiaries while carrying out your intentions. Internal audit procedures ensure that they act responsibly.

A common criticism of corporate trustees is that they can be rigid, bureaucratic, and slow in making decisions when beneficiaries request special distributions of principal. “But not all corporate fiduciaries operate this way,” Saxe says. In fact, Atlantic Trust’s distribution committee meets weekly, and more often when there are emergencies. “We try to be flexible and creative in our approach to meeting beneficiary requests within the parameters of what the trust document allows,” Saxe says.

Pairing Individual and Corporate Trustees

Some of our clients appoint co-trustees: an individual who knows the family well and can help make decisions about distributions, as well as a corporate fiduciary with extensive experience in trust administration. “This might be appropriate when parental-like authority is necessary to protect the interests of children or grandchildren,” Saxe says. In that case, you might want to limit the individual’s role to making the kind of decisions that would normally fall to a parent if that individual were living, such as deciding how much money to distribute to the beneficiaries. As co-trustee, the corporate fiduciary could have sole responsibility for asset management and legal compliance.

In recent years it has become increasingly popular to appoint beneficiaries as co-trustees for their own trusts, which are primarily overseen by a corporate fiduciary. This approach fosters an involvement with wealth that beneficiaries might not feel when all the control rests with a trustee. Some clients use this structure as a tool for educating the next generation about money.

“There is one potential pitfall, however,” notes Beerman. “Giving beneficiaries of the trust authority over discretionary distributions could have adverse consequences, such as causing the property to be included in their estates, or exposing it to their creditors.” Therefore, it is much more common to see family co-trustees participate in decisions that do not involve distributions to themselves.

Especially when individual trustees are involved, it is crucial that your document include a succession plan, so there is a mechanism for choosing subsequent trustees if the initial ones become unwilling or unable to serve. Some clients allow individual trustees to choose their successors. Others simply provide that as their tenure ends—for whatever reason—their power will shift to a successor, perhaps corporate, fiduciary.

“Many modern trusts cover the subject in greater depth, particularly if the arrangement will continue for many generations,” says Beerman. Not only do they include guidelines for choosing successor trustees as circumstances may require it,

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CASE STUDY

MAINTAINING FIDUCIARY STANDARDS

One family patriarch named his adult granddaughter, along with Atlantic Trust, as co-trustee of a trust that would benefit her uncle (the patriarch's son). The trust would pay net income to the uncle for as long as he was alive. After that, the entire principal would go to the granddaughter.

Unfortunately, the patriarch overlooked the fact that uncle and niece did not get along—so much so that her interest as a beneficiary colored her judgment as a co-trustee. When making investment decisions, she consistently favored equities that might appreciate long term, but which generated very little income for her uncle.

As co-trustee, Atlantic Trust served as a counterpoint to the family dynamics. Our experienced fiduciary officers reminded the niece that as a trustee she had an obligation to avoid conflicts of interest. Ultimately they persuaded her to more equitably allocate the trust assets. Unlike a co-trustee who is also a beneficiary, a corporate fiduciary “must be objective,” says Jonathan Kadish, managing director. “As a corporate fiduciary, we can remove personal feelings from the decision-making process and be impartial and objective.”

MAKING DISCRETIONARY DISTRIBUTIONS

When exercising their discretion to distribute trust principal, fiduciaries at Atlantic Trust sometimes engage in “a delicate balancing act that individual trustees might not fully grasp,” says Kadish. The first question is whether the terms of the trust would allow such a distribution. Next, trustees consider the size of the trust, the beneficiary's lifestyle, spending pattern, and the frequency and magnitude of prior requests for distributions of principal. Unless a unique situation arises, we try not to distribute more than 5% of the trust assets annually, especially if the trust document suggests that the creator of the trust wanted to preserve trust assets for the long term.

“Sometimes, as co-trustee with a family member, ‘we act as the bad guy,’ declining a request for distributions when a family member cannot or will not take a hard line,” Beerman. The circumstances involving such refusals of principal invasion may involve bad habits—such as gambling, alcohol abuse or drug addiction—or simply extravagant spending habits that the grantor wished to protect against.

Still, our seasoned trust officers are committed to meeting beneficiaries' needs within the parameters of what the trust allows, rather than following rigid guidelines. “Members of our distribution committee are not statues. They also are parents and children and husbands and wives themselves,” says Beerman. In addition to their professionalism and awareness of fiduciary standards, “they bring a real life experience to the table,” she says. One example of Atlantic Trust's flexible approach involved a beneficiary who bid on a valuable painting at auction even though she did not have the funds to pay for it. “Members of the Atlantic Trust distribution committee met the same day and decided to authorize the distribution,” Kadish says. In this case, the painting was comparable to others the beneficiary and her husband had collected together while he was alive. She had never relied on trust funds to make similar purchases before, and the purchase price represented just a fraction of the trust's total assets. ■

but they also delegate responsibility for removing and replacing existing trustees. These provisions may apply to both individual and corporate trustees.

“It is increasingly common to see income beneficiaries granted the power to remove and replace trustees,” says Beerman. For example in a marital trust, which initially benefits the surviving spouse, that individual—assume it is the wife—might have the power to remove a corporate trustee unilaterally if she is not satisfied with their services. If the children are beneficiaries after she dies, the trust might give them the power by majority vote to remove and replace a trustee. In longer-term trusts, the document could designate one individual (sometimes called a trust protector, special trustee or trust advisor), a group of people (such as a committee of family members—even beneficiaries), or a business (such as a bank or law firm) to appoint the successor.

“If you plan to include powers to remove and replace trustees, the trust document should clearly define the circumstances under which removal may occur and the type of successor trustee you prefer,” Beerman says. Many long-term trusts that start out with individual trustees ultimately are with corporate fiduciaries because they can be more enduring. Over time, corporate trustees may be better suited “to deal with events and people that you can not anticipate when establishing the trust,” she adds.

Choosing a trustee requires some planning, and thinking through contingencies that may not be pleasant. However, with a little forethought, you can create a structure to implement your wishes for many years to come. ■

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