Ascent
PRIVATE CAPITAL MANAGEMENT

Seven Keys To A Better Beneficiary-Trustee Relationship

Helping Beneficiaries Understand Trusts and Trustees

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When Sir Galahad went off to fight in the Crusades, leaving his wife and children behind, the knight entrusted the Bishop of La Maine to protect all his worldly possessions and asked the bishop to care for his family until his return. Should word of his demise come to his family, Sir Galahad instructed the bishop to continue protecting his property for the benefit of his family and heirs. By asking the bishop to serve in this trusted role, Sir Galahad was establishing a "trust." Sir Galahad was the trust creator, his wife and children were the beneficiaries and the bishop was the trustee.

Alas, Sir Galahad was not successful in his campaign, and the Bishop of La Maine received news of Sir Galahad's demise. We imagine the insightful bishop then inquired, "How do I carry out Sir Galahad's wishes while maintaining a positive relationship with his wife and children so that they consider the trust a blessing rather than a burden?"

While this story is a mere fabrication, the bishop's question is an important one for us to consider today. Indeed, in a presentation to the Denver Estate Planning Council in January, 2013, respected family wealth consultant and author James E. Hughes, Jr., noted that 80 percent of the trust beneficiaries he has polled over the years consider their trusts to be a burden!

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The following are some of the reasons beneficiaries may consider their trusts and the resulting relationships with their trustees to be a burden.

Perceived roadblocks: Beneficiaries who view the trustee as an obstacle between them and "their" money are often frustrated, while beneficiaries who view the trustee as a partner to facilitate the trust creator's wishes are more often happy with the trust arrangement. Trust assets are (or were) those of the trust creator and were given to the trustee for a reason. Not knowing the purpose of the trust and not understanding the fiduciary duties imposed upon the trustee to carry out that purpose are the most common reasons why some beneficiaries see trustee decisions as unreasonable or arbitrary.

All too often, the focus at the creation of a trust is family wealth preservation, when the true focus should be family relationship preservation.

Complexity: Trusts and the laws that govern them are complex. Simply put, a trust is a contract between the trust creator and the trustee. The trust agreement contains the terms of the contract. Because most trusts plan for a multitude of issues and scenarios that may occur over several generations, they tend to be painfully long and boring to read. However, each provision is there for a good reason, and trustees are usually excited at the opportunity to have a conversation with the trust beneficiaries about them.

Family dynamics: Trusts are created by families for families, most often by parents for children and grandchildren. Add "family" to any business/contract/trust arrangement and the complexities increase greatly because of the lifetime of experiences and emotions that come into play. For beneficiaries whose trust creators are still alive, engaging in some type of family dynamics consulting may help create a safe environment for learning about the purposes of the trust. Family wealth mission, vision and values statements can help beneficiaries and trustees greatly. When trust creators are unavailable, understanding that a trustee is driven to discern a trust creator's intent can really help those beneficiaries who may be struggling with the loss of a family member, especially where communication may not have been the greatest. Without anything else, the trustee is required to follow the language of the trust agreement as interpreted by a state's laws. But just because the typical trust agreement is about as impersonal and tax motivated as any agreement out there, it doesn't mean that feelings of love, care and concern weren't the primary motivating factors for the trust's creation.

It's a gift: Some of the beneficiaries who seem unhappiest with the trust structure have a sense of entitlement to the assets. It's understandable that an entitlement mindset would give rise to a lack of appreciation for the concerns that created the conditions around a transfer in trust. If so, any trust provisions may feel burdensome. On the other hand, some of the happiest beneficiaries understand that the trust was created to enhance their lives. They also understand that gifts with strings are usually better than no gifts at all. Having an attitude of gratitude, coupled with an understanding of purpose invariably fosters a more workable and harmonious relationship between the beneficiaries and the trustee.

Lack of information: While most beneficiaries have a deep appreciation for the trust from which they benefit, they often think to themselves, "I would be much more grateful if the assets had just been given to me outright." In part, this internal conflict stems from a lack of information. If trust documents are not expressed clearly, many beneficiaries are left to ask, "What was the reason for not just giving me the assets directly? What are the right things to do with the money? Why does my family seem to resent that I spend money the way I want rather than how they think I should?"

These questions are rarely answered sufficiently to help the beneficiary understand the trust creator's purposes, hopes, intent, visions and dreams for the trust assets and how they were intended to impact the beneficiary's life. All too often, the focus at the creation of a trust is family wealth preservation, when the true focus should be family relationship preservation. The question that should be asked, and to which consideration should be given at the time of trust creation is, “Will this trust serve to enhance the lives of its beneficiaries in the manner the trust creator envisions?”

A trust creator can increase the likelihood that the trust will enhance the lives of the beneficiaries by sharing with them, through language in the trust document or in a related set of documents, his or her intentions, thoughts, concerns, goals and expectations. What is the money for and what isn’t it for? The more the trustee and beneficiaries understand the reasons and rationale behind the placement of assets into a trust and the particular terms included regarding their care and disposition, the greater the likelihood that the trustee/beneficiary relationship will be considered a blessing instead of a burden.

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SEVEN KEYS TO A BETTER BENEFICIARY-TRUSTEE RELATIONSHIP:

The most productive and satisfying relationships between beneficiaries and trustees may be those in which the beneficiaries are willing to learn and understand how the trust is required to function and where the trustee is willing to teach and mentor the beneficiaries. When this relationship works, a trust may no longer feel like a burden.

Beneficiaries should be willing to:

1. Understand the terms of the trust.
2. Understand that the trustee is a fiduciary.
3. Understand that trusts may have multiple beneficiaries.
4. Understand basic trust accounting and taxation.
5. Understand trust investments.
6. Know how to read a trust accounting statement.
7. Know how to most effectively request a trust distribution.

1. UNDERSTAND THE TERMS OF THE TRUST

Trustees are often dismayed to find that many of the trust beneficiaries they work with have never read the trust agreement to which they are a beneficiary. If they have read it, they admit that they really don’t understand it. That’s not surprising, as most trust documents are filled with technical legal terms and boilerplate language meant to cover any and all possible outcomes and circumstances and must be in compliance with state and federal trust and tax law. Often, trust documents contain language that takes an experienced tax lawyer or CPA to understand. But, with the considerate assistance of the trustee, beneficiaries can gain a solid understanding of their trust terms.

An understanding of the trust terms and guidelines allows a beneficiary to consider in advance whether a distribution request would be reasonable or not.

When reading a trust agreement, a beneficiary should start by focusing on the players: current beneficiary(s), remainder beneficiary(s), trustee(s), grantor or trust creator (sometimes called the settlor or trustor) and, if included, trust investment advisory committee member(s) and/or trust protector(s). Next, they should focus on the provisions around distributions of trust income and principal, along with any guiding language regarding those distributions. Finally, they should look at the termination provisions and eventual distributions to the remainder beneficiaries. When does the trust terminate, or is it perpetual? What happens at the death of the current beneficiary (or the primary beneficiary if there is more than one current beneficiary)?

Gaining a firm grasp on the primary dispositive terms of a trust is essential for a beneficiary to have intelligent, meaningful conversations about trust distributions with the trustee. An understanding of the trust terms and guidelines allows a beneficiary to consider in advance whether a distribution request would be reasonable or not. An unreasonable request would be one that the terms of the trust clearly prevent the trustee from granting. A beneficiary with an understanding of the trust terms can bring a request to the trustee with an explanation of how he or she feels the request is reasonable and meets the specific language and intent of the trust.

2. UNDERSTAND THAT THE TRUSTEE IS A FIDUCIARY

When beneficiaries understand the role and fiduciary obligations of a trustee, they are much less likely to perceive the trustee as a roadblock. A person designated as a fiduciary is a person in whom another person has placed a great deal of trust and confidence to manage and protect property or money for the benefit of the beneficiaries.

A trustee must always act in accordance with a fiduciary standard of care, which is the highest standard of care. The duty of care requires a trustee to administer a trust in good faith, exercising powers in the same manner as a prudent person would with “reasonable care, skill and caution.” This requires trustees to consider multiple factors when exercising the powers granted to them. A trustee has a duty of impartiality and must not favor the interests of one beneficiary over those of another. A trustee has a duty to be loyal to the trust creator’s wishes as expressed in the trust agreement and to do what the trust creator would do in the same circumstances. This is why it is so helpful when the trust creator places guiding language in either the trust instrument or other documents. A fiduciary must avoid self-dealing or conflicts of interests in which the potential benefit to the trustee is in conflict with what is best for the beneficiary.

When beneficiaries appreciate that the decisions and actions of trustees are based on these fiduciary duties and obligations, there is a greater likelihood that there will be a meeting of the minds rather than misunderstanding and frustration.

3. UNDERSTAND THAT TRUSTS MAY HAVE MULTIPLE BENEFICIARIES

Whether there is one current beneficiary or multiple current beneficiaries, and regardless of how many remainder beneficiaries there are, a beneficiary must remember that he or she may be only one of the people the trust creator intended to benefit. Unless directed otherwise by the trust agreement, the trustee will attempt to be equitable to all beneficiaries. If current beneficiaries are mindful that they are sharing the trust resources and that the trustee is attempting to consider the interests of all beneficiaries and not breach the duty to be impartial, beneficiaries may gain insight as to why the trustee has made particular decisions. Also, current beneficiaries need to realize that any requests for distribution of assets from the trust will have an impact on the other beneficiaries and that those beneficiaries may not appreciate or understand this. Being sensitive to this may prevent difficulties from arising between beneficiaries.

When there are multiple beneficiaries of a trust, each beneficiary will have competing and sometimes conflicting interests. For example, when income beneficiaries are different from remainder beneficiaries, they may have different preferences about how the trust assets should be invested. Income beneficiaries may request that the trustee place a large amount of fixed-income assets in the trust to produce as much income as possible, while the remainder beneficiaries may request that there be a large investment in growth assets, with little emphasis on dividends or income-producing investments. Both of these are self-interested requests that fail to consider the impact on the other beneficiaries. Thus, absent an agreement among the beneficiaries, trustees historically have balanced assets in trusts of this type between income-producing investments and growth assets to avoid violating their duty of impartiality.

4. UNDERSTAND BASIC TRUST ACCOUNTING AND TAXATION

Unfortunately, the laws that govern trust accounting and taxation are complicated. But understanding some basic terminology and key issues may help prevent confusion. More importantly, when a beneficiary doesn’t feel comfortable asking questions, the conversations between trustees and beneficiaries can become unproductive.

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Because so many of the decisions trustees make have to do with balancing the competing interests of current income beneficiaries and remainder beneficiaries, it is helpful for a beneficiary to understand what is considered principal in a trust and what is considered income. Principal refers to what the trust owns (its assets). Income refers to certain types of money made from those assets, such as interest, dividends, rents and royalties. An area that causes some confusion is when an asset in the trust is sold for a gain. Does that income get distributed to the income beneficiary, or is it added to principal that will stay in the trust for the remainder beneficiary? The answer, according to the Uniform Principal and Income Act, is that it is added to principal even though the trust has to pay income tax on the capital gain.

Periodic meetings with the trustee and other advisors when trust accounting statements are presented are great opportunities to build relationships and alleviate any frustrations that come from misunderstanding.

It is also helpful to understand how expenses are allocated in a trust. Unless the trust expressly states otherwise, the burden of trust fees and expenses is typically shared equally by principal and income. This means distributable income will be reduced by one half of the total trust fees. Understanding these types of trust accounting and tax issues can help avoid confusion and facilitate better communication between the trustee and beneficiaries.

5. UNDERSTAND TRUST INVESTMENTS

A trustee who manages and invests trust assets must do so under the prudent investor rule. In acting as a prudent investor, a trustee will make decisions by considering the purposes, terms, distribution requirements and other circumstances of the trust. While there is a presumption that prudent investors diversify investments, diversification is a common source of trustee/beneficiary conflict. Many beneficiaries are emotionally attached to a particular stock that has "always treated them well" and the one that granddad said, "We should never sell." As a result, the bulk of the trust's assets may be tied up in one or two stocks that the family has held onto for years. In many cases, a corporate trustee will have internal policies in place that do not allow such high concentrations of stock, even seemingly "safe" stocks. When beneficiaries understand that asset concentrations are inherently risky over time and that asset allocation may actually enhance portfolio returns over time, it may help them feel better about the diversification decisions trustees have to make.

6. KNOW HOW TO READ A TRUST ACCOUNTING STATEMENT

Trust accounting statements are typically prepared at least annually. Often, statements of investment performance can be made available more frequently, such as quarterly. The statements will have an account balance, a balance sheet of the assets held, gain/loss information and often information about how the account has performed in relation to some benchmark (e.g., the S&P). The statements will also contain information about distributions that have been made and expenditures for the care and maintenance of certain trust assets. It is helpful for the beneficiary to sit down with the trustee to go over each aspect of the accounting statements so they know what everything means. It is also important to ask questions whenever something is not clear. Periodic meetings with the trustee and other advisors when trust accounting statements are presented are great opportunities to build relationships and alleviate any frustrations that come from misunderstanding. Also, beneficiaries should communicate with the trustee about what is most important to them and let the trustee know what information they would like to have readily available and/or what they find most useful. Most trustees enjoy these conversations and the opportunity to prepare meaningful materials.

7. KNOW HOW TO MOST EFFECTIVELY REQUEST A TRUST DISTRIBUTION

Beneficiaries who have taken the time to get to know the trustee and understand the various issues the trustee must consider may have a much more positive experience. Few people like to be told “no,” so getting to “yes” easily (if possible) is key. The most important aspect when making a distribution request is to understand whether the request is permitted under the trust document. The beneficiary should also understand whether the request is within the spirit and intent of the trust. When a beneficiary approaches a trustee with these two things in mind, the conversation is usually much easier. Inherent in these two areas is helping the trustee feel like he or she is doing the right thing. Therefore, providing reassurances on how funds will be used and helping the trustee understand that the requested funds are to be used for purposes the trust creator would have authorized can go a long way toward building a healthy trustee/beneficiary relationship.

Consider also that requests do not always need to be for outright funds. Most trusts permit the trustee to lend money to a beneficiary. This may be advantageous to a beneficiary who seeks funds for a business venture or when other monies may become available from other sources in the future. Loans can be structured with security interests in assets, so if a business fails, the trust can provide a return of assets ahead of other creditors, thus reducing the risk and/or the magnitude of loss. Such a structure may help the trustee make the decision to fund current opportunities because of the remainder beneficiary’s interests.

Beneficiaries can benefit from tapping into the knowledge and experience of the trustee and understanding that the trustee is ultimately working on their behalf. We recommend trustees and beneficiaries take the time to get to know each other and to learn from each other. Those who have an appreciation for the fiduciary mindset are more likely to have a positive experience with their trustee.

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