

# INVESTMENTS & WEALTH MONITOR

*A reprinted article from September/October 2023*

## Comparison of a Family Trustee and an Advisor-Focused Trust Company: Pros and Cons

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# Comparison of a Family Trustee and an Advisor-Focused Trust Company

## PROS AND CONS

By Christopher Holtby, CIMA®, CPWA®

John was puzzled. During the past three weeks, two clients and one prospect had asked for solutions for wildly different but eerily similar situations: An older client needed help choosing an estate executor; a middle-aged business owner client asked how to pick a primary successor trustee for her updated estate plans; and a prospect, a beneficiary of an irrevocable trust, was unsatisfied using an existing trust company to manage trust assets.

How should John balance his advice on the executor and trustee problems for his two clients and one prospect?

### BACKGROUND: TRUSTS AND ESTATE PLANNING

Trusts are an essential tool in estate planning and can play a critical role in helping to preserve a client's legacy for future generations.<sup>1</sup> In most situations, a trust is a legal entity with a tax identification number holding assets. A trustee manages those assets, of any sort, for beneficiaries based on the rules of a trust document. Trusts offer several advantages in estate planning, including privacy and asset protection benefits.

They also offer legacy and generational planning benefits beyond minimizing estate and probate taxes. One key benefit of using trusts in estate planning is their ability to delicately balance the philosophical needs of a family while preserving wealth for future generations. These benefits can help prevent family disputes and ensure that legacy plans

and assets are used in a way that aligns with the values and goals of the grantor(s), i.e., wealth creator(s).

Critical philosophical issues need to be included in the trust document. Lawyers draft and execute trust documents. A financial advisor can help raise issues and questions around the philosophy of family and wealth, which lawyers incorporate into a trust document for family harmony.

### DEFINITIONS

John's process for finding solutions to the three trust questions started with defining the available trustee choices.

**Individual trustee.** A personal trustee is the grantor's family member or friend, chosen to manage and administer the trust assets. Family trustees can offer several advantages over trust companies, including their familiarity with family dynamics, potential cost savings, and greater control and flexibility. The most qualified family trustees embrace impartiality, humility, and a willingness to seek help on legal, tax, and investment issues.

#### Advisor-focused corporate trustee.

Clients also can select an "advisor-focused corporate trustee," i.e., a trust company that does not compete against financial advisors in one of the top seven trust law states.<sup>2</sup> Because advisor-focused trust companies specialize in working with financial advisors, they often can offer customized solutions to meet clients' unique needs.

John knew that a traditional trust company competing against him was no longer the solution. Ultimately, choosing between a family trustee and an advisor-focused trust company would depend on various factors and decisions (see figure 1).

### FAMILY TRUSTEE VS. ADVISOR-FOCUSED TRUST COMPANY

John examined the advantages and disadvantages of a family trustee versus an advisor-focused trust company to make informed decisions about how he would advise the two clients and the prospect.

#### FAMILY TRUSTEE (PROS)

##### Familiarity with family dynamics.

Family trustees typically are family members or close friends who intimately understand the family's values, goals, and dynamics.

**Potential cost savings.** Family trustees typically do not charge fees, which can help reduce the overall cost of managing a trust. When they charge fees, they generally equal that of a traditional trust company.

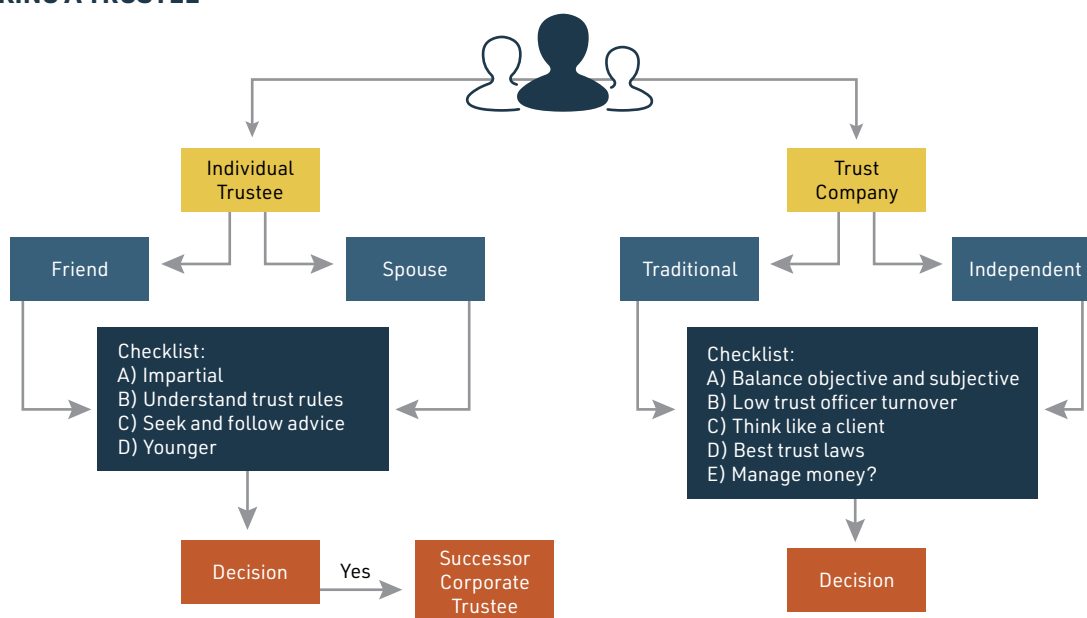
#### ADVISOR-FOCUSED TRUST COMPANY (PROS)

##### Professional expertise and resources.

Advisor-focused trust companies have teams of professionals that specialize in managing trusts and have access to resources and expertise in areas such as tax, legal, trust administration, trust law, and accounting.

Figure  
1

## PICKING A TRUSTEE



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**Objectivity and impartiality.** Advisor-focused trust companies are independent third parties that can make decisions based solely on the interests of the trust beneficiaries from the grantor's intent outlined in the trust document, working collaboratively with the financial advisor.

**Continuity and longevity.** Advisor-focused trust companies have a dedicated team of professionals that can ensure the continuity and longevity of trust management.

**Regulatory oversight.** Trust companies must comply with state and federal banking regulations and submit to bi-annual government audits and external financial audits.

### FAMILY TRUSTEE (CONS)

**Potential for conflicts of interest.** Family trustees may face conflicts of interest when making decisions that benefit the family versus their interests. Choosing a family trustee who is humble and impartial can negate this potential disadvantage.

**Limited expertise.** Family trustees may lack the expertise to manage complex trust arrangements, especially in the areas of trust and tax law.

**Lack of continuity.** Because most trusts are designed to last for decades, a family trustee may not be able to provide the same longevity and continuity as a corporate trustee; the family trustee may pass away, become incapacitated, or otherwise be unable to fulfill the role over time.

**Lack of regulatory oversight.** Unlike a corporate trustee, a family trustee operates without regulatory oversight, opening the possibility of malfeasance.

### ADVISOR-FOCUSED TRUST COMPANY (CONS)

**Potentially higher costs.** Both advisor-focused trust companies and some family trustees charge fees, making the comparison more nuanced.

**Less familiarity with family dynamics.** Advisor-focused trust companies may not have the same understanding of the

family's values, goals, and dynamics as a family trustee. A video or letter about the grantor's intent of trust and trust distributions can mitigate this disadvantage.

### Limited flexibility and control.

Advisor-focused trust companies may lack flexibility and alignment with family values. However, these drawbacks are mitigated when combined with an independent financial advisor for holistic financial planning and investment management.

The choice between a family trustee and an advisor-focused trust company also depends on other factors, such as the complexity of the trust arrangement, the resources and expertise required, the cost, and the trust law location.

### TRUST LAW LOCATION

Trust location is vital because trust law falls under state law, not federal law, a result of the nation's founders granting the original 13 states the power to control property taxes, i.e., this means that the real estate owned in trusts also would fall under state law.

The trustee and the trust’s governing law, which affects the interpretation of trust administration under the trust document, do not have to exist in the same state where the beneficiaries and/or the financial advisor live. However, potential tax complications can ensue when a family trustee lives or moves to a high-income tax state<sup>3</sup> if the trust document governing law requires the trustee to live in a low- or zero-income tax state.<sup>4</sup>

With an advisor-focused trust company, the trust would fall under one of the top trust law states where all trust administration would be done. Adding flexible future trust law locations can be done simply for new trusts.<sup>5</sup> For existing trusts, changing the trust law location typically does not pose a problem for advisor-focused trust companies.

TRUSTEE SELECTION PROCESS

Actuaries assign percentage weights to factors that contribute to an answer or solution. To help formulate answers for his two clients and one prospect, John outlined the five factors affecting the outcome with their consequences (see table 1). Advisors can use this factoring concept to determine the better choice.

This factor table allows John to create an objective and subjective solution for

his three situations: (1) an executor looking to settle an estate, (2) a primary successor trustee, and (3) a prospect unhappy with an existing bank trustee.

THE SOLUTIONS  
THE TRUST AND ESTATE  
SETTLEMENT SOLUTION

For the older client who needed help choosing an executor to settle his estate, John explained that a family trustee, often a family member or close friend, can offer a personal touch. This person would be intimately familiar with an individual’s circumstances and wishes and the family’s unique dynamics. A family trustee can operate flexibly and may provide services at no cost. However, executors require technical knowledge, administrative skills, and a substantial time commitment. The person must navigate complex tax laws, manage assets, and handle potential disputes among beneficiaries. The role’s fiduciary responsibilities expose this executor to personal liability as a fiduciary if mistakes are made, or duties are performed inadequately.

On the other hand, a corporate trustee, such as a bank or trust company, brings professional expertise and objectivity. Corporate trustees are well-versed in trust administration, tax laws, and

investment management, providing dependable execution of an estate plan. Their processes are transparent, regulated, and impartial, which minimizes the risk of family disputes. However, their services are more costly and may lack the personal touch that a family member or friend could provide.

John’s client held an estate worth \$6 million comprising a \$1-million house and \$5 million in marketable securities inside a taxable account with no individual retirement accounts. Because the client’s heirs were to serve as their own trustees for the trusts funded from the estate, John recommended using a family friend to serve as the executor. To ensure that the family friend has access to the trust estate attorney (if any probate issues arise) and the CPA (for filing the estate tax return), John suggested that the three of them (the attorney, the CPA, and himself) meet with the chosen trustee to review expectations and responsibilities.

THE SUCCESSOR  
TRUSTEE SOLUTION

John’s middle-aged client with a blended family has more than \$23.5 million in financial assets and needed help to choose a primary successor trustee. The client had children from two

Table  
1

FIVE-FACTOR TRUSTEE CHOICE MODEL

Factors	Weighting	Family Trustee	Advisor-Focused Trust Company
1. Family Dynamics	15%	<ul style="list-style-type: none"><li>Family harmony</li></ul>	<ul style="list-style-type: none"><li>Blended family</li><li>Family harmony and disharmony</li></ul>
2. Trust Law Location	15%	<ul style="list-style-type: none"><li>Who has investment fiduciary risk?</li><li>State income tax?</li><li>State estate tax?</li></ul>	<ul style="list-style-type: none"><li>Directed or delegated</li><li>Asset protection</li><li>Dynastic</li><li>Silent trusts</li><li>No state income tax</li><li>Privacy law</li></ul>
3. Trust Complexity	25%	<ul style="list-style-type: none"><li>Net income-only distributions</li><li>Unitrust (percentage) distributions</li><li>Trust size less than \$2 million total</li></ul>	<ul style="list-style-type: none"><li>Discretionary distributions</li><li>Generation-skipping trusts exempt and non-exempt</li><li>Trust size greater than \$2 million per beneficiary</li></ul>
4. Resources and Expertise Required	35%	<ul style="list-style-type: none"><li>Owns marketable securities only</li><li>No regulatory oversight on decisions and/or activities</li><li>Team player</li></ul>	<ul style="list-style-type: none"><li>Directed or delegated trust allowing for a blend of marketable securities and/or entities, real estate, businesses, and alternative assets</li><li>Regulatory oversight</li><li>Deep experience on trust tax and legal issues</li><li>Collaborative</li></ul>
5. Cost	10%	<ul style="list-style-type: none"><li>Price versus result</li><li>Free or charging</li></ul>	<ul style="list-style-type: none"><li>Price versus result</li></ul>

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marriages and wanted a solution where the money, or the inheritance left to her heirs, would not tear the family apart.

John organized a collaborative meeting among the client, her trust estate attorney, and himself. In this meeting, they mapped out the overall estate plan and tax issues and estimated how much could be owned within her estate at different times. John also questioned the philosophy of his client's family and wealth. The team discussed these issues at length. Some of the more difficult parts for John's client were who gets what, when, where, and how. Or, how should the client's heirs inherit the money, and how should that money get distributed to them? The discussions around trust distributions were challenging but fruitful. John raised another series of questions about how distributions should be defined with enough latitude for trustee interpretation.

Ultimately, the team decided on a co-trustee solution: a family trustee paired with a corporate trustee who didn't manage investments. For the latter to work on the investment duties, they decided to use a directed trust concept for managing the trust assets, i.e., the corporate trustee would have no authority or oversight on the trust's investments. John would have the sole investment fiduciary responsibility. The beneficiaries would have the power to remove and appoint the primary successor corporate trustee with another corporate trustee.

The client also provided a brief handwritten letter explaining her intent around the trust distributions to offer insight into her thinking for her blended family and future generations.

### THE IRREVOCABLE TRUST AND UNHAPPY BENEFICIARY SOLUTION

John's prospect was a beneficiary stuck using an existing traditional trust company that managed trust assets

of \$6.8 million held in marketable securities. The beneficiary had heard from his attorney that John might have a possible solution for an alternative corporate trustee solution. John had been telling his centers of influence that he could invest trust assets when a bank trustee, i.e., corporate trustee or trust company, for an irrevocable trust was necessary. Why? Because John had access to an advisor-focused trust company that was custodian-neutral.

The beneficiary was frustrated at the constant back and forth with the trust company for more information and documentation to approve distributions. The trust company generally approved the distribution request, but the disjointed process seemed unreasonably cumbersome. The beneficiary also had another \$2.2 million in outside investments managed by another department within the bank, i.e., the non-trust side. Still, there did not seem to be coordination between the trust and non-trust assets for the overall financial plan.

John decided to meet with the prospect and the advisor-focused trust company to sketch out the process of who would do what. John explained how his comprehensive financial planning process would include trust and non-trust assets. He also suggested a new CPA that would coordinate the trust tax return and the beneficiary's tax return. This provided a clear benefit because the traditional trust company did the trust tax return but no tax planning, i.e., coordinating gain/loss recognition with the beneficiary's tax bill.

After the initial meeting, the beneficiary was undecided, but John expects he will earn a new client.

### CONCLUSION

There is no one-size-fits-all answer when deciding between a family trustee and an advisor-focused trust company. Both options have advantages and

disadvantages. The decision ultimately depends on various factors, including the unique needs of the trust and the preferences of the grantor and beneficiaries.

To decide, start the conversation with the estate or trust. If the estate is worth more than \$2 million, use the five-factor weighting matrix to select the issues affecting the answer. If the estate is worth less than \$2 million, choose a family trustee because trust companies cannot adequately serve smaller account sizes based on the economics.

Picking a trustee should rest on the philosophy of doing no harm over the short, medium, and long term. Depending on the circumstances, the best answer may be having the best of both worlds—a situation where a family member or friend acts as a co-trustee with an advisor-focused trust company. 🟡

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### ENDNOTES

1. See Getty Oil Co. Shareholders Litigation, 1985 Del. Ch. LEXIS 227 (Del. Ch. Nov. 19, 1985).
2. The top seven trust law states include Alaska, Delaware, New Hampshire, Nevada, South Dakota, Tennessee, and Wyoming.
3. High-income tax states can include California, Illinois, Iowa, Massachusetts, New Jersey, New York, and Pennsylvania.
4. Texas, Florida, or South Dakota are examples of states with no state income tax. Tax rates change. Consult your tax advisor for the current tax rate in any state.
5. The trustee can update the governing law of the trust location with simple language inserted into the trust. For example, "The Trustee has the authority to change the governing law for situs and trust administration purposes."

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