The Value of Independent Corporate Trustee Services

STERLING | TRUSTEES

THE POWER OF INDEPENDENT THINKING℠

INDEPENDENCE. THE WORD CAN MEAN DIFFERENT THINGS TO DIFFERENT PEOPLE.

But when it comes to trust services, the definition becomes even more unclear…and with higher stakes. Most people who look for someone to manage a trust depend upon their centers of influence – estate planners, attorneys and accountants – to help identify the right company for them. Since those professionals usually don't have sufficient expertise with the management of trusts, they frequently recommend a name-brand trust company or the trust department of a well-known bank to take on the work.

An unfortunate reality, though, is that many trust companies oversee both the administration of a trust and the investment advisory role for that trust. Too often, these companies expect or actively encourage clients to use their in-house or affiliated investment advisory services and financial products – and some even insist that they use them as a condition of administering the trust.

This relationship represents a clear potential conflict of interest – one that is unknowingly accepted by clients who either don't understand the distinction between providing investment advisory services and trust services, aren't aware that the option to choose an independent corporate trustee exists or aren't familiar with the small number of trust companies that are truly independent.

THE FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC) OUTLINES ONE OF THE PRIMARY CONCERNS OF CONFLICTS.

Conflicts of interest arise when a fiduciary's duty of loyalty to another opposes with other interests of that fiduciary. Conflicts involving the use of proprietary investment products are frequently tied to the generation of additional fee income. When a bank, as fiduciary, invests fiduciary assets in proprietary products, a key consideration is whether the bank is acting in the best interest of the beneficiary or in its own interest.

A common example is the continued use of a poor-performing proprietary investment product in order to maintain a critical mass of assets under management. In doing so, the fiduciary benefits from economies of scale and earns additional fee income at the

expense of the beneficiary, who sacrifices the potentially higher return that could be obtained from investing in better performing mutual funds. This is a particularly sensitive situation for trust accounts where the entire asset allocation consists of proprietary mutual funds.

THE OPTIMUM MODEL FOR INDEPENDENCE

When financial advisors who don't administer trusts partner with independent corporate trustees that don't manage money, everyone benefits. Additionally, an independent custodian provides a totally segregated solution – ensuring that situations like the Madoff case will never occur with your clients' trust assets.

Yet surprisingly, only a handful of firms across the country appear to be committed to doing business this way. And identifying which companies are genuinely independent can be a challenge.

"Corporate ownership can be really complicated because trust companies often have different holding companies, and majority/minority ownership is not easily defined," notes Cerulli Associates senior analyst Robert Testa, who provides quantitative analysis for The Cerulli Report series. "Since statistics are reported on individual entities, and companies can be federally chartered or state chartered, it can be quite difficult to determine the regulatory structure and figure out whether a company is managing trust assets or just has assets in custody – especially if they don't take deposits."

Many trust companies that manage assets internally try to streamline operations and serve as a holistic, "one-stop shop" provider of integrated services – often a market-savvy approach in many industries. But when it comes to trust services, that approach yields an inevitable conflict of interest that can be dicey to avoid.

"A lot of these companies are trying to overcome the perception of trust services as a stodgy shop on the second floor of a local bank making too-conservative investments, and I don't think there is anything inherently wrong with that," says Testa. "But if the trust company is using all in-house products, alarm bells should go off. It can affect their independence and may mean less rigorous due diligence

when deciding how to integrate those products into the portfolio and when they should remove them. If the investments they're making are not performing as well, are not diversified enough or don't meet the standards that other funds do, it can be hard to defend."

Will the trustees make the decision to move those assets into better-performing funds to protect the beneficiaries' interests or does the bank's bottom line rule the day?

Using an independent trustee allows the client great flexibility in choosing a directed or delegated trust. With the directed trust, the trustee is mainly responsible for administrative functions, like making distributions and preparing tax returns. In this case, the client determines who the trustee is and understands that the trustee does not oversee the investment advisor or money manager's performance.

While historically many investment advisors are wary to recommend outside trust companies because they worry they will lose the right to manage those assets, using directed trusts can address that concern, says Scott Martin, senior editor of The Trust Advisor.

"The client assigns the right to manage the assets to an advisor – usually the one he or she is already working with," writes Martin in a recent article. "The trust company does what it does best: run the trust. The client is happy to have an advisor looking out for his or her ultimate best interests. The advisor-friendly trust company gets new trust accounts to run. And the advisor doesn't lose."

On the other hand, if the client wants the trustee to have full discretion and to provide independent third-party oversight of the investment advisor, using a delegated trust offers your client the best protection. Although for the investment advisor introducing an independent corporate trustee with full discretion opens the advisor up to the possibility of losing those assets if their service and performance is sub-par, introducing an independent corporate trustee makes the advisor look good his clients. It proves that the advisor puts his client's best interest first. When advisors are unwilling to bring in a third-party trust company, clients should question their ability to manage money and their insecurity over losing business. Since trustees handling delegated trusts are held to a higher standard with fiduciary responsibility, technology is critical to real-time monitoring of assets – so it's important to find an independent corporate trustee with the infrastructure to track complex and ever-changing portfolio performance.

ABOUT THE AUTHOR



Antony Joffe is the Chairman of Sterling Trustees LLC and oversees Sterling's vision and mission. He has over 20 years of trust industry operating experience and has led the growth of Sterling to over $13 billion of assets under administration. He earned his MBA in finance from Temple University and his bachelor's degree in accounting from Emory University.

ajoffe@sterlingtrustees.com / 610-234-0626

This white paper is provided for educational purposes and does not constitute legal, tax, or investment advice. Trust siting decisions depend on the residency of the grantor and beneficiaries, the location and character of trust assets, and the specific terms of the trust instrument, among other factors. Readers should consult with qualified legal and tax advisors regarding situs selection and trust structure decisions specific to their circumstances.

One in a series of white papers authored by the independent trust administration firm of Sterling Trustees.

STERLING | TRUSTEES

THE POWER OF INDEPENDENT THINKING℠

sterlingtrustees.com

© 2012 Sterling Trustees LLC