New Investment Thinking for Trustees?

ATTORNEYS

Jonathan Kinney

Jennifer Schiffer

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Jennifer Schiffer and Jonathan Kinney
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Traditionally, trustees invest the assets within a trust to ensure the assets are preserved for when they are distributed to the beneficiaries, often when the beneficiaries reach a certain age. However, this "cautious" investing by trustees, while in line with modern day portfolio theory and existing law, may not be the most advantageous for the beneficiaries.

Current Practices

General wisdom for trustees investing trust funds with set distribution dates suggests the trust invest in "safe" options similar to a set date retirement fund, like the 2050 XYZ Mutual Fund (funds which historically reduce their exposure to equities and increase their exposure to bonds over time). While these types of funds may be less likely to have downturns than regular equities, they also appear to have a smaller upside. "… [A] portfolio that starts at 30% equities and finishes at 70% equities has a higher (91.5%) probability of success, not to mention a lower average equity exposure through retirement (an average of only 50% in equities instead of 60%)," said Michael Kitces and Wade Pfau, financial planners. In theory, the same results should hold true when investing for a set time frame.

Does the General Wisdom Make Sense?

Generally, a trustee has a responsibility to take affirmative actions to protect the trust. For example, in *Fontenot v. Chopin,* the trustee was removed for various reasons, including failure to invest life insurance proceeds. Rather than investing the proceeds, the trustee simply placed the funds in an interest-bearing checking account. The Court held this was not sufficient to fulfill the fiduciary duties of the trustee, and thus removed her. The court said that "a violation by a Trustee of a duty she owes to a beneficiary, as Trustee, is a breach of trust. A Trustee shall administer the Trust solely in the interest of the beneficiary. A Trustee in administering a Trust shall exercise such skill and care as a person of ordinary prudence would exercise in dealing with her own property. A Trustee is under a duty to a beneficiary to take reasonable steps to take, keep control of, and preserve the Trust property."

This raises the question of whether a trustee who simply invests trust funds in a set year stock/bond fund, for example, could also be breaching his fiduciary duties knowing that a different investment strategy likely would result in higher returns.

The Rising Glide Equity Path

"Recent research shows that despite the contrary nature of the strategy—allowing equity exposure to increase during retirement when conventional wisdom suggests it should decline as a retiree ages—it turns out that a "rising equity glide path" (where

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the path of equity exposure 'glides' higher year after year) actually does improve retirement outcomes," said Kitces and Pfau.

Based on this recent research, a trustee should consider using a "rising equity glide path" to produce the best result for the trust's beneficiaries. Trustees are aware from *Fontenot* that simply investing in the safest option (e.g. interest bearing checking account) can be a breach of fiduciary duties. Therefore, they should consider whether with the new research on the rising equity path they are opening themselves to removal if they just invest the assets in a "safe" investment such as a pre-set standard of equities and bonds with equities decreasing over time instead of investing using a rising equity path.

Just how successful the equity glide path truly is depends on many factors in the marketplace. Because it challenges conventional wisdom, it is something trustees should consider when determining how best to invest the assets under their control. Trust grantors should consider giving explicit investment guidance to trustees by indicating if the trust should be managed to "produce" the best returns for beneficiaries or to preserve existing capital. Existing portfolio guidance seems to favor preservation over return. While such a standard may meet most trust grantor's objectives, it should not be an automatic default particularly where the trust grantor wants the trust managed for return over preservation.

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