Can an investment be biased?

Luther Carter's revocable living trust served as his main estate planning document as well. At his death, the living trust divided into a Marital Trust, a Generation-skipping Separate Trust and a Family Trust. The Marital Trust was of the QTIP (Qualified Terminable Interest Property) variety. That means that Luther's widow, Audrey, must be paid all of the income from the trust so long as she lives, while his daughter from an earlier marriage, Tiffany, will receive the trust assets when Audrey dies. No part of the Marital Trust principal may be distributed to Audrey. The Marital Trust was funded with $2 million. The GST and Family Trusts for Tiffany and her descendants each received $1 million.

Audrey was named the trustee of the Marital Trust in 2003, and in that capacity she invested solely in tax-free municipal bonds. That investment approach can be a good one for generating income, but it does nothing to grow the value of the trust. Also, limiting the investments to bonds is not very well diversified.

Tiffany brought a lawsuit alleging that Audrey breached her fiduciary duties with this investment plan. A trustee has a duty impartially to balance the interests of all the beneficiaries, and that balance extends to investment choices. For example, an investment plan that takes excess risks with the trust principal in an attempt to increase current income could run afoul of the rule. On the flip side, a plan to invest only in growth stocks that pay no dividends, in order to maximize the remainder interest at the expense of the income beneficiary, could similarly be unacceptable.

Tiffany claimed that as a result of Audrey's self-interested investment decisions, the trust was, in inflation-adjusted terms, already worth $300,000 less than when it was funded. What's more, she argued that investing in a single type of asset violated the "prudent investor" rule that applies to trust investing. She asked that Audrey be removed as trustee.

Boilerplate

To resolve this question, the Court needed to determine Luther's intention for creating the Marital Trust, determined in the context of the entire estate plan. A look at the fine print of the trust document was helpful. The trust authorized bond investments, as well as others, "regardless of diversification." That clause lessened the concern over investing in just one asset class. The primary purpose of the Marital Trust was to create a secure income stream for Audrey, while the other trusts provided for Tiffany.

Audrey testified that she believed the municipal bond investments were a conservative approach to delivering consistent income during a period of significant volatility in the financial markets. She said that she monitored the investment choices and discussed them with her broker, her sons and her friends. Someday she might shift some trust investments to stocks, if there are adverse changes to the bond market.

The Court concluded that even if inflation takes a toll on the real value of the marital trust assets, that is consistent with Luther's intent of providing financial security for Audrey for her lifetime.

Professional trusteeship

Luther's trust did well by not limiting the trustee's choices for investment management. However, naming a family member as trustee is an invitation to argument. Worse, it can lead to litigation within the family, as it did here. That means one party will win; the other will lose; lawyers will be paid; and family harmony goes out the window.

The better course, we would suggest, is to name a professional trustee, such as us. Providing fiduciary services to affluent families is our business, our only business. We are impartial and, as important, we are *perceived* as impartial by trust beneficiaries. Call on us to learn more.