WealthManagement.com


kentoh/iStock/Thinkstock

WEALTH PLANNING > ESTATE PLANNING

Unbundled Trust Management

Ten competitive advantages.

Charlie Douglas | Aug 22, 2017

For many years, estate-planning attorneys have routinely recommended that clients consider naming a traditional bank trust department as a successor trustee or successor executor in their estate plan. Perhaps a client's younger children may need a bank trustee until they reach a certain age of maturity, or maybe a bank is named as the final back-up fiduciary, after other trusted family members have been earlier named? Whatever the case may be for naming a corporate trustee, this institutional and routine recommendation is starting to wane.

Traditional bank trust departments often boast that they're well suited and uniquely positioned to administer the many facets of a trust in view of the legal, fiduciary accounting and investment management needed during administration. The proffered value proposition is that "bundled" trust services are a one-stop shop that can effectively and efficiently handle most all fiduciary and investment management aspects of a trust. But traditional bank trust departments are losing traction today. The model for bundled wealth management isn't better—in many cases it's more conflicted.

Unbundled Bank Trustee Fees

Unexpectedly, the U.S. Supreme Court significantly contributed to the awareness and to the growing conversation surrounding "unbundled" trust management.

It used to be that a bank's trustee fees were simply deducted as a cost of administration for trust accounting purposes. These fees included both fiduciary services and investment management services. Fiduciary services are those activities more closely aligned with administering the trust or with a trustee making a trust distribution to a beneficiary. Investment management services primarily are those activities surrounding investment advisory/asset management.

As client's trusts paid the bank's all-encompassing trustee fee, this expenditure was commonly deducted on the trust's fiduciary tax return. But neither the client nor the trust officer knew how much of the fee was actually apportioned between fiduciary management or investment management.

That all changed with the Supreme Court's ruling in *Knight vs. Commissioner*,[1] and the Internal Revenue Service regulations published thereafter. Essentially, the court ruled that "bundled trustee fees" needed to be unbundled to determine their deductibility. More specifically, a trust's investment advisory fee, like an individual's investment advisory fee, would only be deductible as a miscellaneous itemized deduction to the extent it exceeded 2 percent of adjusted gross income.

Lopsided Revenue

In a post-*Knight* world, both clients and their advisors have gained valuable insight and appreciation as to what they were paying for regarding fiduciary fees versus what they were paying in investment advisory fees. This new insight underscored the industry notion that bank trust departments, in general, make a lot more money from their investment advisory fees than they do from their fiduciary fees. This salient fact has attracted the attention of bank regulators. The Office of the Comptroller of the Currency (OCC) is responsible for the oversight and supervision of our national banking system. Notably, the OCC oversees national bank trust departments, and as far back as 2000, they publicly opined that declining interest margins and the desire for a stable and diversified revenue stream caused banks to look for ways to increase the level and source of noninterest income. The OCC observed, with some consternation, that asset management products and services were a growing and significant contributor to total revenue and the overall profitability of many national banks.

Conflicts of Interest

In the OCC's Comptrollers Handbook (2000) on Conflict of Interest, the OCC publicly pointed out a few of its' concerns: "A bank that provides asset management services for clients may be required to manage a variety of actual or potential conflicts of interest." "Conflicts of interest are not limited to instances in which the bank is acting as a fiduciary. In fact, as the trust business increasingly becomes an asset management business, the opportunities for a bank to find itself in a conflict of interest increase. When a national bank provides these services, the best interests of the client and the bank are not always the same."

In keeping with the OCC's "conflicts of interest" observations, if a bank trust department essentially derives the bulk of its revenue from asset management, then how "impartial" might that bank be when it comes to honoring, for example, its fiduciary duty to make discretionary distributions for trust beneficiaries or to incur trust expenditures? Because the bank is increasingly incentivized to retain, rather than to disburse trust assets, the bank has an inherent conflict of interest.

10 Competitive Advantages

Unbundled trust management separates the fiduciary function from the asset management business, in which each is independent of one another. While lacking in scale and perhaps the suite of services offered (that is, the ability to effectively administer complex trust assets like oil and gas) by the traditional bank trust model, this innovative model can, nevertheless, offer the following competitive advantages:

1. **Minimized conflicts of interest**—While no model is free from conflicts of interest, the separation of fiduciary oversight from asset management prevents asset management from swaying fiduciary objectivity.

2. **Maximized utilization of resources**—Since resources are no longer shared under one institutional house, each independent business can focus and dedicate 100 percent of its resources toward doing what they do best.

3. **Greater professional interdependence**—The late author of 7 Habits of Highly Effective People, Stephen Covey, opined, "Dependent people need others to get what they want. Independent people can get what they want through their own effort. Interdependent people combine their own efforts with the efforts of others to achieve their greatest success." Importantly, Covey adds, "interdependence is a choice only independent people can make."[2] By extension, only independent trust management professionals can freely choose to work toward the synergy of interdependence.

4. **Positive collaborative conflict**—The road to a better client experience is often paved with conflicting ideas as to how best to advise and serve the client. Differences of opinion and brainstorming sessions, where independent professionals are free to disagree, especially in the presence of a client, can often yield positive results. Be that as it may, it's rare that institutional professionals (that is, investment advisors and trust officers), who are often on fixed internal teams, reporting to the same boss, and with aligned revenue goals for their region, feel the freedom to candidly engage in positive collaborative conflict.

5. **Relief from the cross-sale crunch**—National banks have a bevy of business lines, each one with their own sales and revenue goals as reported quarterly to Wall Street. In some cases, clients end up being continually cross-sold products and services they have little want or need for.

6. **Best of breed partners**—With the open architecture of unbundled trust management, a best-in-breed team of independent practitioners can be assembled to serve the client. Teams aren't limited to the talent under the same institutional roof.

7. **Feeds the need in younger generations**—Choice and impact are important for many today, but these characteristics are particularly "must haves" for younger generations. Younger generations do not trust stodgy traditional institutions. Instead, they yearn for the freedom to choose their team's players, robo or otherwise, and are less inclined to be saddled with an old-style bank's trust department.

8. **Competitive costs and fees**—As consumers, we've become accustomed to the value proposition that bundling services (cable, internet and phone) should result in substantial savings. Yet, the aggregate costs of a separate fiduciary and an independent asset manager are, in many cases, very competitive with a bank's published fee schedule.

9. **Freedom from proprietary products**— Proprietary asset management products are a growing contributor to asset management revenue at many national banks. While some proprietary asset management products sold by banks are best-in-class, most aren't.

10. **Exploits favorable trust jurisdictions**—Because of their expansive footprint, national bank trust companies aren't able to exploit advantageous state trust law that may provide such favorable benefits relating to: asset protection, no state income tax, a longer rule against perpetuities, non-judicial modification, decanting, virtual representation and directed trusts. While some national trust companies may also have a separate and independent trust company in a favorable trust jurisdiction such as Delaware, they still lack the breadth and nimbleness of being able to do sitused trust business in the multitude other favorable trust jurisdictions like Nevada, South Dakota and Tennessee.

Change May be Afoot

Traditional trust institutions have merit and are still the leader in the clubhouse, at least for now. But the conventional bank model of bundled fiduciary and asset management services has a hard time stacking up against the many benefits of unbundled trust management.

Endnotes

1. Knight vs. Commissioner, 552 U.S. 181 (2008).

2. *See* S.R. Covey, *The 7 habits of highly effective people: Restoring the character ethic*, (2004 Rev. ed.).

Source URL: http://www.wealthmanagement.com/estate-planning/unbundled-trust-management