



STRATEGIC
FINANCIAL GROUP
PRIVATE TRUST SERVICES

**MANAGING
INVESTMENTS FOR
TRUST ACCOUNTS**

**TRUST CONNECTION
CLIENT INSIGHTS**

A Monthly Report on
Trust News and Information



Managing Investments for Trust Accounts

Managing investments for trust accounts is not a simple task. Investing trust assets requires the trustee or directed fiduciary advisor to consider and balance several factors in order to carry out the trust's purpose in the best interests of its beneficiaries. Additionally, there are several accepted principles that affect how the assets are to be managed in the absence of specific guidance contained within trust documents.

It is critical the trustee or directed fiduciary understand the various factors and how they interrelate. These guiding principles are fairly broad and do not provide clear, absolute rules to guide fiduciaries shouldering the investment management responsibility.

Successful trust investment management requires a careful and objective consideration of several factors, and there are times where these factors may conflict with one another. Careful planning and expertise are necessary to strike the appropriate balance that preserves the trust assets for the family while also providing a meaningful value to beneficiaries receiving current distributions.

Uniform Prudent Investor Act

The Uniform Prudent Investor Act (UPIA) is a statute that sets out guidelines for trustees to follow when investing trust assets. It is an update to the previous prudent man standards intended to reflect the changes that have occurred in investment practice since the late 1960s.

This legal guideline requires a fiduciary to act in the best interest of the trust's beneficiaries and outlines standards for legally controlling investment portfolios. Specifically, the UPIA reflects a modern portfolio theory (MPT) and total return approach to the exercise of fiduciary investment discretion.

By taking the total portfolio approach and eliminating category restrictions on different types of investments, the UPIA fosters a greater degree of diversification in investment portfolios. It also makes it possible for trustees to include investments such as derivatives, commodities, and futures. While these investments individually have relatively higher degrees of risk, they could theoretically reduce overall portfolio risk and boost returns when considered in a total portfolio context.

Trustees and directed fiduciary investment advisors should consider the following:

- Diversification is explicitly required as a duty for prudent fiduciary investing. Avoid high concentrations of a single security.





- A trust account's entire investment portfolio is considered when determining the prudence of an individual investment. Under the UPIA standard, a fiduciary would not be held liable for individual investment losses so long as the investment was consistent with the overall portfolio objectives.
- No category or type of investment is deemed inherently imprudent. Instead, suitability to the portfolio's needs is considered. As a result, investment lien loans, investments in limited partnerships, derivatives, futures, and similar investment vehicles are now possible. However, speculation and outright risk-taking is not sanctioned by the rule and remains subject to possible liability.
- Maintain sufficient liquidity (including bonds and FDIC-insured deposits) to fund cash flow needs and avoid being forced to sell at an inopportune time.
- Regularly monitor investments for fundamental changes in the nature or risks of the holdings.
- A fiduciary is permitted to delegate investment management and other functions to third parties.



Understand the Trust's Purpose

A trustee and any directed fiduciary have the duty to know for whom they are investing and the overall purpose of having funds available for one or more beneficiaries. It is quite common to find that the trust document does not provide specificity regarding what constitutes sound investment management. Trust documents can contain investment restrictions such as ethical, environmental, social, or other factors. For example, the trust may be prohibited from making investments in any company or its affiliates in the manufacturing or distribution of cigarettes.

Here are some of the considerations when understanding the trust's purpose and, subsequently, how to understand investment objectives:

- What is the purpose of the trust?
- Who are the beneficiaries and what are their ages?
- Is one individual or generation to be favored?
- Does one or more beneficiary's interest have priority over another?
- What is the projected term (lifespan) of the trust?
- Are there specific needs and over what time horizon?
- What is the amount of anticipated distributions to beneficiaries?



The fiduciary investment manager is required to consider the provision of regular income, the needs of the trust's beneficiaries, and the preservation of the trust's savings. The UPIA primary guiding principles are diversification, minimization of fees, and the balancing of income production and capital appreciation.

While one can't predict the outcome of every investment decision, a trustee must apply the prudent investor rule when making investment decisions based on the information available at the time. Whether the outcome is good or bad is not a factor if the trustee followed the principles of the prudent investor rule.

Trustees and directed fiduciary advisors are expected to analyze and make sound decisions that are compatible with the trust's distribution requirements, the level of risk tolerance, and other factors pertaining to the trusts they manage. The nature and level of the investment risk should be compatible with the purpose of the trust and its beneficiaries.

Best Practice

The asset allocation set by the fiduciary investment manager is the most important investment decision. The asset allocation should consider all the factors mentioned above and provide for an expected return that meets the trust's purpose and requirements for distributions. As the risk tolerance of the trust's beneficiaries changes, the asset allocation should reflect their evolving circumstances.

Using an Investment Policy Statement (IPS) that frames the purpose of the trust, the current family dynamics and circumstances, anticipated economic outlook and expected market returns, and future beneficiary needs within the guidelines of the trust document is important. The IPS should consider appropriate asset allocation for the trust and the beneficiaries. It should set targets for asset classes and determine reporting for co-trustees, the beneficiaries, and other interested parties. Lastly, the IPS should reflect the investment manager's position and plan regarding the following:

- Diversification
- Conflicts of interest (e.g. use of proprietary funds)
- Portfolio rebalancing
- Investment restrictions (i.e. ethical, environmental, social)
- Other significant assets held by the beneficiaries or their families
- Tax minimization strategy





Understanding the purpose of a trust and then managing the trust's investments rests on the shoulders of the trustee or directed fiduciary investment advisor. With that in mind, it's extremely important to make sound, prudent investment decisions that are aligned with both principal and income beneficiaries. Families are entrusting others to find that appropriate balance between preservation of capital and distribution of assets to care for their beneficiaries for many years.

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Colleen Henes, CFP®, JD

Financial Advisor - Advanced Planning

Belin Robertson

Head of Wealth Management, West Coast

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For information and assistance contact us at:

StrategIQ® Financial Group, LLC

773-917-6500

info@sfgweb.com | www.sfgweb.com

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