Historic article – illustration only

The prudent trustee - steadying the investment ship in a financial storm

Credit crunch, financial crisis, turmoil in the world stock markets, banks and investment houses going bust, alleged fraud in the fund industry, recession....there is no doubting that we are in the middle of a storm and that as trustees we have to remain calm and focused and ensure that investment strategies and actions remain on course. ***John Smith, Head of Wealth Structuring at XYZ Institution,*** *discusses the steadying hand of the prudent trustee.*

In times of recession and turmoil marketing teams talk of opportunities, speculative investors gamble on volatile stock markets, investment mangers fret over red screens and falling indices and trustees.....well, trustees pull on the cloak of prudence, settle down behind their ledgers, and do what they always do best - be safe, boring, but inherently trustworthy and reliable.

Yet there is an immense challenge to acting as a prudent trustee when everything around you is falling apart. It can take great strength and resolve in the face of beneficiaries and Settlors who are panicking, angry, worried and who may, quite blatantly, disagree with what their trustee is doing and suggesting. Hanging over all this, of course, is the ugly threat of litigation should it all go wrong.

Believing in the basics

Worried? There is no need to be because as professional trustees we are fully aware of our duties and responsibilities and all that is needed is to continue to steer the steady course. It is not a question of panic and survival and clinging to life rafts, it is a time for double-checking that every action is correct, that second opinions and expert advice are sought as and when necessary and that individual trust strategies are reviewed and reassessed. In short - it is a time to stay focused, calm and to act with prudence.

The Prudent Man Rule

It is worth considering what the word 'prudent' may mean when applied to a trustee. One often-quoted definition, which also fits the current climate, is *'The Prudent Man Rule'* which is based on common law stemming from a decision of the Massachusetts Court in 1830.

The Rule directs trustees - "to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested".

There is also a more potent phrase applied to the responsibility of a trustee towards the trust assets and which comes from Guernsey Trust Law. It is written in old Guernsey French and is short and simple - *'A bon pere'* - which in broad terms means that the trustee should look after the trust assets 'as would a good father'.

Trust reviews

Given the case for prudence, what should the prudent trustee be focusing on in volatile and turbulent times? The first action must be to remain pro-active. For example, now is the time to carry out the next trust review, not on the next review date that may be six months away. A good trust review form will cover all the key areas - liquidity needs (including the management of liquid cash and income requirements); investment parameters; investment performance; investment sectors (including diversity and balance); and, finally, analysis of reports from any advisors to whom trustee powers have been delegated.

Monitoring delegated powers

The latter is a key area because a number of trustee responsibilities will, quite properly, have been delegated to professional advisors. Meeting with them and having a thorough, hard review and open conversation about the investment portfolio is crucial. There are probably four key elements to focus and act upon -

- The trustee should review and agree an investment profile with set objectives, which meet the needs of the Settlor or beneficiaries and which have a time horizon and acknowledged and accepted risk tolerance expectations
- The trustee must understand and have total confidence in the ability of the investment manager to deliver on the chosen profile. This is best achieved through a well articulated and transparent investment process together with continual ongoing communication
- The trustee needs to constantly monitor and openly review and question the investment performance to understand what is driving the returns and, if appropriate, where and why the investment strategy is failing
- In the current volatile climate the profile and strategy should be revisited every three months, even if only to agree that nothing should be changed.

Throughout this process it is also important to ensure that everything is well documented and all actions properly minuted.

Communication with the Settlor and beneficiaries

An extremely important area that can be overlooked amidst the focus on investments, is communicating with the Settlor and the beneficiaries. They will have expectations and concerns that need to be dealt with in a professional manner. They will be looking for reassurance and for confidence in their trustee and this is where effective communication skills are extremely important. The words will, of course, have to be supported by action or, if it is appropriate, no action.

A number of Settlors and beneficiaries will be immediately active themselves and in contact, wanting to know what is happening, what are the trustees views on the world stock market, what should be bought and sold, how are you, their trustee, going to limit losses, how long is this all going to last, what are you intending to do and why aren't you doing x, y and z?

This is where corporate trustees need to have in place a clear course of action. This will range from who will speak to the Settlors and beneficiaries, through to the message that will be given. They will want to understand why their trustee is taking - or not taking - a particular course of action and their trustee needs to be fully briefed with the answers.

Remember - the future starts now

Despite being surrounded by negativity, a trustee must remain positive and also focus on the future. Should reinvestment start now, perhaps in tranches, to avoid piling everything into a still falling market, but ensuring that bargains are found? It is worth remembering that when the equity market crashed in 1987 it recovered to end the year higher than it started. A trustee will be just as readily criticised for 'missing the boat' as for 'sinking the boat'. That is the unenviable position of the modern trustee!

Summary

Throughout stormy periods such as these, the fundamental role of the trustee does not really change. Their duties and responsibilities to the Settlor and the beneficiaries remain exactly the same as does their duty to preserve the Trust assets. If anything changes, it will be the need to focus on the investment of trust assets in even greater detail and constantly review, monitor, question and communicate.

END