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Choosing a Trustee

One of the most important decisions in your estate plan is choosing a trustee. Held to a very high standard of care, your trustee is expected to understand the trust's terms and the laws of fiduciary duty, and pay more attention to a trust's investments and management than he or she would her own personal assets. In this episode of Choate's Family Office Podcast Series, Choate's Wealth Management Group co-chair Kristin Abati is joined by partner Renat Lumpau to discuss the structure of a trust, the different types of trustees that exist, and how to effectively choose your own trustee.

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Welcome to the Choate Family Office Podcast Series. On this show we explore important topics related to wealth management, investing, and managing risk across generations.

KA: Hello everyone. Thanks for joining us. My name is Kristin Abati, I'm a partner in Choate's Wealth Management Group and I'm also co-chair of the group. I'm here today with Renat Lumpau. Renat is also a partner in Choate's Wealth Management Group and we're going to be talking today about trustees. What exactly a trustee does and how you might choose your own trustee. Renat how about if you start by telling us first what is a trust?

RL: Thanks Kristin, that's a great question. A trust is a structure in which a person called the donor puts aside money or other property from someone else called the beneficiary. The trust property is held by the trustee. Importantly, this creates a fiduciary relationship, meaning that a trustee has many important duties and responsibilities. We'll talk about some of them later on. The donor gets to write the rules of the trust in the trust instrument and as a result, the donor has a lot of control of the operation of the trust. In fact, the grantor's intent in creating the trust is extremely important and will always be respected. But generally speaking, after the donor signs the trust and transfers the property to the trust, the donor has no further rights to those assets in they are entirely in control of the trustee.

KA: That's right and we should clarify that we're talking in this conversation about irrevocable trusts by which we mean trusts that are intentionally irrevocable at the outset for tax planning purposes. For example, to use a client's gift tax exemption and also trusts

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that are irrevocable because the donor has passed away. Once a trust becomes irrevocable, the trustee is in control. This makes the choice of trustee very important.

RL: That's exactly right. Now let's talk about who we might name as your trustee. A trustee can be a person or an institution, like a bank or trust company. There are pros and cons to choosing different types of trustees and we'll get to that in a moment. Mechanically, the initial trustee is chosen by the donor and named directly in the trust instrument. In addition to naming an initial trustee, it's important to think about a succession plan for trustees. This is important because if the initial trustee is an individual, at some point he or she will retire or pass away. Also, for both individual and corporate trustees, the grantor may want to change trustees in the future. Likewise, after the grantor's death, the beneficiaries may want the flexibility to name a different trustee. For all these reasons, it's a good idea for the donor to spell out in the trust instrument how trustees can be appointed or replaced. For example, the donor can keep the power to hire and fire trustees and at some point, the beneficiaries can also be given this power. As a technical note, these powers are subject to certain tax rules about choosing an independent replacement trustee. This is one of the exceptions to the general rule we mentioned earlier that the donor cannot control the trust after it's been funded.

KA: Great point and that's really a significant point that even though the choice of trustee is extremely important, it doesn't have to be permanent. Depending on how you draft your trust, the family can keep the power to fire the trustee and choose someone else. So let's talk now about the job itself. Renat, what does a trustee do exactly?

RL: Great question. Being a trustee carries significant responsibility and also legal liability and in fact, there is a whole body of law governing a trustee's duties. Before we turn to the specific trustee's tasks, let me mention a couple of important big-picture principles. First and foremost a trustee is a fiduciary as I mentioned earlier. This means that the trustee is held to a very high standard of care and is expected to pay more attention to a trust's investment and management than if that trustee were dealing with his or her own personal assets.

KA: That's right and let me just mention one specific example. An individual is free to invest her own assets in any way she chooses. To take an extreme case but not a crazy case, meaning this actually happens. I could decide to invest everything I have in one specific asset, one single company stock or Bitcoin (heaven forbid). But if I did that as an individual, just fine, I'm entitled to lose all my money. But if I were acting as a trustee, and investing those assets for someone else, investing the trust assets in that way, that would be an entirely inappropriate decision by me and would open me up to legal liability as a trustee. And this is because a trustee invests money for the benefit of others as we've said and that means that as a trustee, they have a duty to invest prudently.

RL: That's right. In addition to this general rule, all trustees have several specific fiduciary duties which are created by the operation of trust law. First, trustees have a duty of good faith and loyalty. This means that a trustee must act in the beneficiaries' best interest, not the trustee's own interest. Second, there is a duty of reasonable skill and diligence which means that a trustee must manage the trust in the same way that a prudent person would. Third, trustees must give personal attention to all trust matters. But I also should note that it is just fine for a trustee to delegate some functions, for example by hiring a professional investment advisor. And fourth, trustees have a duty to keep and render accounts covering all transactions that involve the trust property.

KA: So in layman's terms, a trustee has the job of managing the trust property responsibly for the beneficiaries. This includes investing the property in a diversified manner, or hiring an investment professional to do it for you, making impartial unbiased decisions about when and how to make distributions, filing tax returns for the trust, and generally keeping the trust property safe and accounted for. Depending on the language in the trust the trustee might have other jobs as well such as reporting to certain beneficiaries but not others and consulting with the beneficiaries regularly about what they might need. A very important point to emphasize here is that the trust instrument controls, it sets out the ground rules and a trustee must be familiar with the trust terms and must carry them out.

RL: Kristin let me ask you a question that we frequently hear from our clients. Can a trust invest in assets beyond just publicly-traded securities like stocks and bonds? Meaning, for example, could a trust be a shareholder in a privately held company or participate in private equity or hedge funds?

KA: Great question and you're exactly right, we do get this all the time and in fact, a lot of the trusts we manage at Choate do invest in assets like these. So the short answer is that a trust can invest in any asset class as long as the trust overall investment portfolio is prudent and reasonable. So that's sort of a squishy standard and it just means you need to be thinking about these

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things holistically, the portfolio as a whole. The rule of thumb is that illiquid or unusually risky investments should make up a relatively smaller percentage of the trust assets. It's also important to diversify. All of these points, and your question about hedge funds and private equity, those are all esoteric some would say unusual investments for some people, but they are appropriate for trusts and this highlights why it's a good idea to have as your trustee someone who's familiar with modern investment vehicles and principles.

RL: That's great, thank you, Kristin. Let's talk a moment about a different subject which is the beneficiaries of a trust and how the trustee figures out which beneficiaries to consider and when. In almost every trust there are two distinct types of beneficiaries. First, there are beneficiaries that are entitled to receive distributions now and second there is a group of beneficiaries who may receive distributions in the future referred to as the remainder beneficiaries. These remainder beneficiaries may be able to get distributions after the current beneficiaries have died or after some other future event. A very important point that all trustees must keep in mind is that even that the remainder beneficiaries can't receive distributions at present, and in fact might not even be alive at present, they nevertheless have a real beneficial interest in the trust. With many individual trustees who are not professional trustees don't realize is that trustees owe exactly the same duties to the current beneficiaries and to the remainder beneficiaries. As you can probably see this inevitably sets up tension between the two groups. A great example is that if the trustee decides to make a distribution to a current beneficiary that necessarily leaves less in the trust for the benefit of the remainder beneficiaries. Another example is investments. Current beneficiaries may want the trustees to invest in something that produces current income, such as bonds or dividend-paying stocks. Whereas remainder beneficiaries may prefer the trustees to invest more aggressively so the trust assets will grow more over time.

KA: Yes, those are all really great points Renat, and balancing those different interests of all the beneficiaries, current and remainder, is one of the trustee's most difficult jobs. So let's talk now about who's qualified for this difficult job. There are two principal types of trustees. First, there are non-professional trustees. Think here of family and friends and second, there are professional trustees, people who do this work for a living. Included within the broad category of professional trustees are banks and trust companies and also professional individuals like lawyers and accountants who regularly serve in the trustee role. At Choate, our law partners in the wealth management group do this work all the time. We serve as trustees for our clients and it's actually a significant part of our legal practice. And as you can probably tell the reason why that's relevant is there are so many legal duties that come with being a trustee. It's actually quite helpful to have a lawyer in the role and again at Choate we've been doing this for a long time and we're very familiar with the different duties and liabilities and all the oversight responsibilities that come with being a trustee.

RL: Got it Kristin and that's very true. But still, you know, many of our clients do ask us you know, "If I'm the client, why wouldn't I just choose my sibling for example as my trustee on the theory that my sibling knows me, knows my family, and knows my wishes. Doesn't that make sense?"

KA: It's a really great question and you're exactly right, we do get that question from clients all of the time and it's simply very well may be an appropriate choice and we would never say that they weren't by the way. But I think what we're trying to get across here is that serving as a trustee carries with it a real legal liability and you should ask yourself if you actually want to put your sibling in that position. The reason is that if your trustee, your sibling in this example, doesn't fully understand her obligations under the trust, and under the law, and doesn't properly follow the trustee instrument or properly exercise her fiduciary duties to the beneficiaries, a trustee can actually be sued. It's just something to keep in mind, a conversation we should always have with our clients and our clients should have with their trustees. Because the job carries real legal risk, what a lot of families choose to do is pair a family trustee with a professional trustee and rely on the professional to advise the family member on all the legal requirements and administrative tasks. Another important point on this general liability topic is that professional trustees carry liability insurance, which is helpful in the sense that if there ever is a lawsuit, the trust and the beneficiaries know there is insurance there to cover that loss. It's not something that going to be a loss that no one can ever get back. You know if a trustee does something wrong. One last thing to note is that professional trustees take their job very seriously and give it time and attention and for that reason, professional trustees of whatever sort, corporate or individual, charge for their services and that's just something to keep in mind. It's usually a percentage of the trust assets.

RL: Thanks, Kristin. This has been a very informative discussion and I hope our listeners enjoyed it.

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Kristin T. Abati
Attorney | Partner

Renat V. Lumpau
Attorney | Partner

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