



**PRUDENT INVESTOR ACT:**

**UNDERSTANDING THE REPSONSIBILITIES AND AVOIDING THE RISKS**

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**INTRODUCTION**

As an attorney, you are aware of the substantial responsibilities and risks that come with becoming a trustee. But what about your clients who may be called to serve as trustees? Are they aware of responsibilities imposed by New York's Prudent Investor Act (NY EPTL 11-2.3)? Whether your client is a surviving spouse called to serve as successor or co-trustee for a decedent spouse's revocable trust or a sibling, parent, or other relative being asked to oversee a life insurance trust (e.g. ILIT) or special needs trust, your client trustees need to be properly counselled not only on compliance, but also on who they can and should seek out for investment and risk management advice.

Subsection (b) (1) of the Act states, "The prudent investor rule requires a standard of conduct, not an outcome or performance. Compliance with the prudent investor rule is determined in light of facts and circumstances prevailing at the time of the decision and action of the trustee. A trustee is not liable to a beneficiary the extent the trustee acted in substantial compliance with the prudent investor standard or in reasonable reliance on the express terms and provisions of the governing instrument."

Subsection (b) (2) of the Act states, "A trustee shall exercise reasonable care, skill, and caution to implement investment and management decisions as a prudent investor would for the entire portfolio, taking into account the purposes and terms and provisions of the governing documents."

We will show you how the financial planning process as promoted by the CFP Board and practiced by Certified Financial Planner™ professionals aligns with the Prudent Investor Act. We will explain how the comprehensive approach of the Certified Financial Planner™ professional mirrors the Prudent Investor Act language in viewing the entire portfolio versus single investments, having an overall investment strategy, and considering beneficiary distribution requirements both now and in the



future. We will show how Certified Financial Planner™ professionals have the detail knowledge to advise trustees on variety of complexities involved with different trusts and their holdings.

For example, trustees of insurance trusts face far reaching responsibilities regarding trust owned life insurance (TOLI). It is more than just know when to send out crummy letters. Life insurance policies are increasingly complex and trustees can be held liable for the failure or perceived failure to manage and monitor policies held in a trust. The life insurance industry has undergone many changes in the last decade and economic conditions over the past several years have made it prudent to review all financial instruments, including life insurance policies. As the average life span continues to rise, the cost of life insurance decreases. New more efficient policies have been introduced as the marketplace evolves to highly competitive environment brought on by mergers, demutualization within the life insurance industry and increased consumer sophistication.

The Elder Law and Special Needs Section has an excellent guide for trustees at

<http://www.nysba.org/Sections/Elder/Articles, Reports and Resources/Guidelines for Trustees of First Party Supplemental Needs Trusts.html>.

Another guide for trustees is available from the Consumer Financial Protection Bureau at

[http://files.consumerfinance.gov/f/201310\\_cfpb\\_lay\\_fiduciary\\_guides\\_trustees.pdf](http://files.consumerfinance.gov/f/201310_cfpb_lay_fiduciary_guides_trustees.pdf).

Rather than repeat these discussions, we are going to focus on investment and risk management and why it's important to advise your client trustees to choose a financial advisor to assist in the management of trusts. We are going to show you why certain financial advisors, specifically Certified Financial Planner™ professionals and Registered Investment Advisor who operate under the same fiduciary standard as espoused in New York's Prudent Investor standard are best aligned to help serve your client trustees and why having these knowledgeable financial advisors can provide trustees the best protection and greatest piece of mind.



We will review:

- Trustee's responsibilities
- Delegation of investment authority
- Difference between suitability and fiduciary standard (i.e., putting the client's and beneficiary's interests first)
- Types of and differences between financial advisors, brokers, registered investment advisors, and financial planners
- How financial advisors are compensated and why that matters
- Risk management, rate of return, and cash flow requirements
- Investment policy statements and asset allocation

### **TRUSTEE'S RESPONSIBILITIES**

A copy of the New York's Prudent Investor Act, NY EPTL 11-2.3 can be found at <http://codes.lp.findlaw.com/nycode/EPT/11/2/11-2.3>.

The trustee must understand the governing instrument, the parties, its requirements, and possible duration. The Prudent Investor Act requires the trustee to pursue an overall investment strategy that will enable them to make required distributions.



At subsection (b) (3) (B), the Act goes on to enumerate a number of factors the trustee must understand and consider in the management of the assets of the trust, such as;

- Size of portfolio,
- Timeframes,
- Needs of the beneficiaries,
- Distribution requirements,
- Liquidity requirements,
- General economic conditions,
- Possible effects of inflation and deflation,
- Tax consequences investment decisions and distributions,
- Role of each investment within the overall portfolio,
- Whether and when to diversify assets,
- Risk and return objectives, and
- Total return of portfolio

Having a process and a methodology to handle all the required factors to consider is critical as is being able to document the decision making process.

Subsection (b)(3)(D) requires the trustee to, within a reasonable amount time, determine whether to retain or dispose of the initial assets.

As a fiduciary, the trustee's personal interest cannot run contrary to those of the trust. Trustees must take care that no conflict of interest arises – with their own investing choices, for instance – and they must not use their position to benefit themselves. They should not purchase assets from the trust, even if they pay market value.

### **DELEGATION OF INVESTMENT AUTHORITY**

Fortunately, the New York's Prudent Investor Act specifically allows the trustee to delegate the investment and management functions in subsection (b) (4) (C). Trustees may incur costs of the trust for this management but they must be reasonable. Supervision is required as the



trustee cannot abdicate their ultimate responsibility and hide behind those he or she hires to manage the trust.

It is important that the trustee insure that he or she truly delegated investment authority. Has the trustee truly delegated authority to the investment professional or does the investment professional still require the trustee's approval for each buy and sell? Does the trustee understand who the investment advisor is? Is it a broker merely making suggestions? Who is making investment decisions?

It is also important to understand the type of account established by the investment professional and whether the trustee has delegated discretion to that professional. A simple brokerage account may not be a sufficient delegation of authority especially if the investment professional requires the trustee's approval on every investment decision.

### **FIDUCIARY STANDARD**

As you are well aware, a trustee is a fiduciary and is required to act in the beneficiary's best interest putting the beneficiary's interest ahead of their own. The trustee must treat all beneficiaries equally and not favor one over another.

Registered Investment Advisors and Certified Financial Planner™ professionals operate under a very similar fiduciary standard, putting the client interest's first and doing what is best for the client.

Stockbrokers, insurance agents, and other financial advisors are not obligated to operate under this standard. Brokers may operate under a suitability rule which says that a specific investment may be suitable for a given situation.

Let's first review the variety of financial advisors that a trustee may encounter. Then under our discussion of compensation and fees we will revisit the fiduciary standard.



### **FINANCIAL ADVISORS**

There are many kinds of financial advisors out there. But we contend that the New York Prudent Investor Act requires more than mere investment management. We believe a more comprehensive approach is required to save trustees from running afoul of their requirements. Let's review several types of financial advisors.

*Financial Planners* who hold the CFP® certification have met education, examination, experience, ethical requirements. Only those that have fulfilled the certification and renewal requirements of the CFP Board can display the CFP® certification marks, which represent a high level of competency, ethics, and professionalism.

CFP® certification education requirements are comprehensive and evolve around the CFP Board's principal subject areas:

- General Principles of Financial Planning
- Insurance Planning
- Investment Planning
- Income Tax Planning
- Retirement Planning
- Estate Planning
- Interpersonal Communication
- Professional Conduct & Fiduciary Responsibility

These principle subject areas are further subdivided into 78 core competencies= (see <http://www.cfp.net/docs/cfp-certification---cfp-exam-requirement/principal-topics.pdf?sfvrsn=4> for the complete list):

Certified Financial Planner™ professionals can be found at <http://www.letsmakeaplan.org/choose-a-cfp-professional/find-a-cfp-professional>. Trustees can verify CFP certification status and view a CFP's background at <http://www.letsmakeaplan.org/choose-a-cfp-professional/verify-a-cfp-professional>.

*Investment Advisors* are individuals or firms that provide securities advice for compensation as a regular business. They must register with the Securities and Exchange Commission (SEC) or appropriate state securities



agencies, unless specifically exempted. Because financial planners often advise people on securities-based investments, many are registered as investment advisors. Investment advisors cannot sell securities products without a securities license. For that, you must use a licensed securities representative, such as a stockbroker.

*Stockbroker* or registered representatives are licensed by the state(s) in which they practice to buy and sell securities products such as stocks, bonds, and mutual funds. They generally earn a commission on all of their transactions. Stockbrokers must be registered with a company that is a member of FINRA and pass FINRA –administered securities exams. Some stocker brokers are also licensed as registered investment advisors and in that capacity they may charge a fee on assets under management.

Trustees should consult with several professionals. Ask about their: registrations and licenses, areas of specialization, products and services, investment experience, professional credentials. They should use the Financial Industry Regulatory Authority's (FINRA) Broker check at <http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/> to make sure the investment professional and their firm is properly registered. Also consult the Investment Advisor website at [http://www.adviserinfo.sec.gov/IAPD/Content/Search/iapd\\_Search.aspx](http://www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_Search.aspx).

Another option trustees may consider is to enlist a corporate trustee. These tend to be large institutions that provide far less personal attention or involvement. In most cases, they tend to send out decisions to committees that may not be able to offer the personal attention and independent thinking that a situation may demand.

Although paid by the trust, fees charged by a corporate trustee may be much higher. A more reasonable approach might come in the form of an individual financial advisor that partners with a corporate fiduciary. This is something we have done at RDM Financial Group. The corporate fiduciary handles the administration of the trust while the financial advisor handles the financial planning aspects of the relationship and the investment management of the trust. This relationship provides a higher level of comfort than two professionals working together and monitoring each other.



Depending upon the type of trust, trustees should insure that those advising them have expertise that the trust requires as in the case of special needs trust or insurance trust.

Insurance planning and risk management are also part of the Certified Financial Planner™ professional's education and can assist the trustee with a periodic insurance review of the trust owned insurance policies.

Certain Certified Financial Planner™ professionals also specialize in such areas as charitable trust, Medicare, Medicaid, Social Security (retirement and disability) and Veterans Benefits.

### **COMPENSATION**

Financial Advisors are typically paid in one (or more than one) of the following ways: an hourly fee, a flat fee, a commission on the investment products they sell, a percentage of the value of the assets they manage, or a combination of fees and commissions.

Why does this matter?

Rather than focus on the fee, we believe one should focus on whether the advisor is a fiduciary and operates under a fiduciary standard throughout the entire relationship. Some Financial Advisors may be able to change hats and may not have to adhere to the fiduciary standard of doing what is best for the client throughout the entire relationship.

### **RISK, RETURN, & REQUIREMENTS (CASH FLOW)**

Actually the heading seems backwards to us as financial planners. It should read 'requirements, return, and risk'. It may also seem strange that a discussion that started out with investment management responsibilities is now concerned with requirements. But that is the essence of the financial planning process – understanding what the client needs or in the case of a trust, what the trust agreement provides for the beneficiaries.





What follows is a short anatomy of our planning process. It starts with getting to know the client by building a balance sheet. Account types and titling are important. A trust should be treated the same.

Once you have a handle on what you have, you need to review income and expenses and build the cash flow.

Tax considerations are very important from a number of aspects. The highest marginal rate, 39.6%, for a non-grantor trust is triggered at just \$12,150 of income. Trust distributions to income beneficiaries, usually in lower tax brackets, can reduce the tax on the trust.

For beneficiaries, the advisor should have an awareness of their tax brackets especially now when additional taxes are added at certain thresholds and certain deductions go away at others (i.e., 3.8% investment tax, PEASE phase outs, 39.6% tax bracket, and 20% capital gains tax).

While we always want to be careful not to let the tax tail wag the dog, the financial advisor should be considering the tax consequences of each investment decision and beneficiary distribution.

Now the analysis can begin with a series of projections that we at RDM call Financial Independence Projections. This allows us to determine at what rate of return the trust or the beneficiaries need to make the money last. That in turn tells us what level of risk may be required. If too much risk or an unreasonable level of is required then we need to take another look at the incomes and expenses determine what adjustments may be made and how that will affect the beneficiaries.

For more on the Financial Planning process see the CFP Board's Consumer Guide to Financial Planning at

<http://www.letsmakeaplan.org/docs/publications/consumer-guide-to-financial-planning.pdf?sfvrsn=4>.

### **INVESTMENT POLICY STATEMENT & ASSET ALLOCATION**

Asset allocation ties into the power to diversify provided by the Prudent Investor Act allowing flexibility to allocate the assets of the trust between



safe investments (traditionally bonds) and riskier investments (traditionally stocks).

The power to adjust distributions to income beneficiary between traditional income (dividends and interest) appreciation also allows for more flexibility in the asset allocation.

Once the financial advisor understands the beneficiaries and remaindermen requirements, current and future, and determined an appropriate and realistic rate of return they can recommend an asset allocation.

Using this approach of understanding the relationship, determining beneficiary distribution requirements, analyzing incomes and expenses, evaluating various alternatives, and then recommending, implementing, and monitoring a series of recommendations, the investment policy statement becomes the documentation of the process and provides a guide for monitoring the process.

## **CONCLUSION**

As required by the Prudent Investor Act, trustees need to pursue an overall investment strategy. This requires a methodical and well thought out approach in the management of the trust for which they have a fiduciary responsibility. Trusts are attractive piles of money that some beneficiaries would like to attack for a failure to diversify or incorrect distribution decision. Trustees need to partner with the right financial advisor to protect them.

Retirement Design & Management, Inc. is a registered investment advisor.

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## **BIOGRAPHIES**

### **Ronald D. Weiner, CFP®**

President & CEO

RDM Financial Group, Inc.

Retirement Design & Management, Inc.

Ron Weiner has been in the investment industry for over 35 years. Among the various senior level positions held prior to founding RDM, Ron served as the Senior Vice President of the Retirement Group at Cowen and Company. He was the Creator and Director of the Financial Planning Department of Oppenheimer & Company.

Upon leaving Wall Street, Ron established a branch office of Raymond James Financial Services (RJFS) in 1991. His branch had the distinction of being the fastest growing branch in Raymond James history. He was a member of the RJFS Chairman's Council each year from 1994 until his leaving RJFS in 2001 to create RDM Investment Services, Inc., an independent broker dealer.

Barron's Magazine has named Ron one of America's top brokers or independent financial advisors seven times. In 2004 RDM Financial Group, Inc. was named among the top 15 advisor teams in America in *Research Magazine's* article "The Winner's Circle," and in September 2003, was named one of the top 70 advisory teams in America. Ron was also ranked as one of "The Top 100 Independent Advisors in America" by *Registered Rep* magazine. Ron has been a frequent speaker and presenter at both the Barron's Top 100 Brokers in America and the Barron's Top 100 Independent Advisors conferences. In 2011 and 2012, the Connecticut Law Tribune voted RDM the Best Financial Planning firm in CT. In 2014, RDM was ranked among the top RIA firms by *Financial Advisor* magazine.

Ron has taught continuing education for the NYS Bar Trust & Estate Law Section. In addition, Ron has been a speaker numerous times at the NYS Bar Elder Law Section meetings. Ron was honored at the 2014 New York State Bar Association Elder Lawyers' Section Annual Meeting as a "Friend of the Elder Law Section". This was the first time that a non-attorney received this honor.



Ron appears often on CNBC and Fox Business News as well as being quoted in the financial press including The Wall Street Journal, CNBC.com, Market Watch, Reuters, Forbes and many others.

Ron's professional designations include Registered Principal, General Securities Representative, Direct Participation Programs Representative, General Securities Principal, Municipal Securities Principal, and Uniform Securities Agent and Operations Professional (Series 7, 22, 24, 53, 63 and 99). Ron is the chairman of his firm's investment committee. He is also a Certified Financial Planner™ practitioner and has been a member of the International Association for Financial Planning (now known as the FPA) since 1976, having served six terms as an FPA chapter officer and seven years as a board member. He has also been a member of the Institute of Investment Management Consultants since 1992.

The following are some very kind words from R.J. Shook, the author of the *Research Magazine* article:

"Ron has assembled a team that provides an extraordinary platform for first class advice and service for his high net-worth clients; this is the direct result of a dedication to clients, uncompromised integrity, and the highest levels of professionalism. It's no wonder he's ranked as one of the best advisors in the country."



**Andrew S. Weissman, JD, CFP®**

Senior Vice President, Financial Planning  
RDM Financial Group, Inc.  
Retirement Design & Management, Inc.

Andrew S. Weissman is a Certified Financial Planner™ professional who excels at developing and explaining concepts, strategies, and tools that improve the client experience and keep them fully engaged in the management of their financial resources and estate plans.

Prior to joining RDM Financial, Andrew spent 22 years at US Trust, first in Technology where he managed a number of departments including their Data Center and PC Desktop Technology. Senior management noted his great success improving customer service and asked him to join Wealth Management as a Business Manager overseeing the daily operations of one and then two of its division. As a member of Wealth Management, Andrew also served as a Client Relationship Manager on over 60 family relationships where he refined his financial and estate planning skills.

As a member of the New York State bar since 1986, Andrew uses his legal training to educate clients on how the titling of assets, the use of trusts, and their estate plans interact and affect their financial plans. He also uses his background in Technology to help clients develop and use automated tools to better track their finances and measure the attainment of their financial goals.

After leaving US Trust in 2008, Andrew worked with two investment management teams at Morgan Stanley supplying financial and estate planning expertise to provide a more comprehensive wealth management experience and bring to clients knowledge and proficiency in retirement planning, education planning, trusts, and tax efficient wealth transfer strategies.

Andrew received his JD from Brooklyn Law School and is a member of the New York State Bar Association's Trust & Estates and Elder Law sections. He received both his BS and MBA from New York University's Stern School of Business. Andrew holds Series 7, 66, and NYS Life/Health Insurance licenses.