Understanding the needs of trustees and clients

In the first of a series of four articles in Private Client Practitioner, UBS Wealth Management examines the importance of investment managers understanding the needs of trustees and working in partnership with trustees in the management of trust portfolios

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A professional trustee's life is not a simple one. The day-to-day management of trusts and the reporting requirements alone are time consuming but trustees also face a number of important additional responsibilities.

Trustees have to keep up with the continual changes and fine-tuning to tax legislation. They need to be aware of the tax implications of structuring and planning in multiple jurisdictions, as an increasing number of family assets are located across the globe.

Settlors and beneficiaries have become more demanding and litigious. Regulation has also become more demanding, with the Third Money Laundering Directive just the latest burden to confront trustees.

As if all of this is not enough to occupy trustees, they are also responsible for the investment management of trust portfolios. For many, investment management may not be an area of core expertise but even so there is no escape from these responsibilities.

Before the Trustee Act 2000 (which came into force on 1 February 2001) trustees have always had a duty of care to ensure the trust's investment objectives are met with the right level of risk over the desired time period. This included achieving capital growth and income distributions when required by beneficiaries.

The Trustee Act, however, introduced a statutory duty of care, raising the level of the standards required of professional trustees.

The previous standard expected was of an ordinary prudent man of business. Now, if the trustee acts in the course of a business or profession a higher standard is required to reflect any special knowledge or experience. This covers appointing, reviewing and changing investments and investment managers.

If trustees appoint investment managers who fail to fulfil the trust mandate and are not adequately monitored then it leaves the trustees open to litigation by beneficiaries. The trustees' responsibility for reviewing investment managers on a regular basis applies even if settlors bring their own managers when establishing a trust.

As well as the Trustee Act 2000, another factor has made investment management a more challenging role for trustees. The investment landscape itself has become infinitely more complicated through globalisation and increased volatility in investment markets.

Bearing in mind all these factors, it becomes even more important for trustees to choose an investment manager who has experience in working closely with trustees and their clients. UBS Wealth Management has been working in the trust arena for many years, across a wide range of clients. Our dedicated team is fully conversant with all the issues faced on a daily basis by trustees and are experienced in delivering best in class investment solutions.

Rather than offer a range of standard products, UBS Wealth Management uses a four-stage approach when talking to trustees about managing their trust portfolios. The first of these stages is about understanding - not just the wider trust environment but also to really understand the profile and objectives of the trustee and client.

Only then does UBS develop an investment proposal and replay their understanding to the trustee to ensure they agree on direction. The solution can be implemented and the management and monitoring of the trust portfolio can commence.

To make the first stage - understanding - as effective as possible, UBS discusses a number of key areas with the trustees of which the trustees' (and their clients') attitude to risk versus return is clearly an important topic. In fact, this will be fundamental in determining both the strategic and tactical asset allocation.

These days, analysing the risk profile of settlors and beneficiaries goes well beyond the traditional risk classifications of low, medium and high.

Diversification of assets is also critical. This is achieved through holding asset classes that have low correlations with each other. Historically, trust portfolios have tended to focus on equities and bonds with many having an equity allocation of 70% or more. With today's sophisticated markets, investment managers need to employ a wider number of asset classes to more closely match the objectives and risk profile of each client. This is more important than ever as academic studies suggest the major equity markets are becoming more highly correlated, which means they rise and fall in value at the same time.

Using the wider range of asset classes available, including property, hedge funds, commodities, private equity and cash, experienced investment managers can reduce risk. The result is that, over the long term, clients should be able to achieve a higher return for the same level of risk or a similar return for lower risk.

There are other ways to use these different asset classes. For example, if a client does not want to suffer a negative return in any one year but still wants the potential for positive returns, structured products may be more appropriate than equities as they can provide 100% capital protection as well as giving exposure to the underlying investment.

Intuitively, it might feel very difficult for trustees to appoint a single manager to run the portfolio. In increasingly complex markets, no single manager can possibly be an expert in all asset classes, from equities through property to hedge funds. This explains the growing popularity of "open architecture", where investment managers apply their expertise to select the best companies in each asset class.

Appointing and monitoring investment managers is a time-consuming responsibility. This includes evaluating the investment approach and risk profile of each manager, how they complement other managers within the portfolio, whether all the managers meet the client's objectives and risk profile and how changes in the market environment affect the risk level of each manager.

This is without mentioning the importance of drawing up and reviewing the asset allocation. UBS has a well-established market-leading open architecture approach to managing trustee portfolios and selecting best in class managers.

To summarise, there are a number of questions trustees and investment managers should work together to resolve. While the risk profile for the investment portfolio is a subjective measure and therefore hard to quantify, there are a number of methods employed at UBS to make this analysis as effective as possible. These include whether the client will need to make any capital withdrawals over the next five years and for how long the portfolio will be invested.

It is important also to quantify how much income clients will require over the next 10 years and how much of the portfolio can be put in assets with a minimum investment period of five years. Finally, one of the more important questions is over what period of time is the client prepared to accept a substantial loss of capital.

The key for trustees is to find an investment manager who they feel can work with them in managing their trust portfolios and thus helping them to meet their responsibilities.

This article has examined the importance of investment managers understanding the requirements of trustees and their clients, including their objectives and risk profile. In the next three articles, UBS Wealth Management will analyse how investment managers can draw up investment proposals and solutions, implement these proposals and then manage and review the trust portfolios on an ongoing basis.

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