

## **Risks in Estate and Trust Administration**

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The definition of risk is the probability of loss or adverse consequence caused by an external or internal vulnerability that may be avoided by taking certain actions. An understanding of estate and trust administration risk is not only important to avoid liability; it also helps to determine the pricing of the services offered by an executor or liquidator.

The key risk factors in an estate or trust administration include, but are not limited to, (1) the size of the estate, (2) the number of beneficiaries and the jurisdictions in which they are located, (3) the terms and complexity of the governing document, and (4) the complexity of the assets.

As a general rule, the larger the estate, the greater the amount of care required to administer it. For example, compare the amount of interest that is lost in the course of one day in an estate worth \$25 million (\$685) with the amount of interest that is lost over the same period in an estate worth \$300,000 (\$8).

The number of beneficiaries and the jurisdiction in which they live may increase risk in administering an estate, but there is not necessarily a directly proportional relationship between these factors. When an estate involves beneficiaries who live in different tax jurisdictions, different withholding and reporting requirements apply. While the tax-reporting requirements increase complexity, the risk is largely quantifiable. However, it is more difficult to quantify the risk associated with the number of beneficiaries. The greater the number of beneficiaries, the greater the chance of encountering a disgruntled beneficiary. Often the source of a beneficiary's disgruntlement has nothing to do with the trustee; instead, it is usually related to unresolved issues between the beneficiary and the deceased or between the beneficiary and other beneficiaries. These issues are best mitigated by means of intelligent communication.

The terms and complexity of a will can create one of the more frustrating risks for executors because often they could have been avoided. For example, in the estate of the late John Kaptyn, the executors were in and out of court, arguing about interpretation issues and incurring significant legal and court costs in the process. A lack of specific powers or direction can lead to misinterpretations and loss. It is a misconception that the length of a will is directly related to the complexity and risk involved in the will's administration. Conversely, though, many

practitioners find it miraculous that executors were able to successfully administer the will of the late Frederica Evelyn Stilwell Cook, who died in 1925 in London, England, leaving a 1066-page (95,940-word) will.

The risks associated with complex assets vary widely and are directly related to the type of asset involved -- cash, investment portfolios, personal effects, real estate, or private and operating companies, for example. On a relative scale, the least risky assets are cash (this article is written without reference to digital currencies) and marketable securities. The reduced risk involved with these assets is the result of their liquidity and ease of valuation. Furthermore, in respect of longer-term trusts, various provincial trustee statutes have implemented changes over the past 25 years to permit the delegation of investment management to specialists, and these changes have significantly reduced risk and liability for trustees.

The next most risky asset is real estate, with estate administration cases involving real estate dating back more than 100 years. Real estate is less liquid than other assets and requires independent professional valuation. There are instances in which judgment is required to decide how to divide the proceeds from the sale of real estate. In *Re Earl of Chesterfield's Trusts* (1883), 24 Ch D 643, the court directed the trustee to divide or apportion the proceeds of sale between the income and capital beneficiaries. In addition, there are risks associated with selling real estate at the wrong time when there is insufficient liquidity in the estate to cover maintenance, insurance, and taxes. This type of risk can be mitigated by setting up a trust with cash or marketable securities to cover the potential expenses.

Perhaps the most challenging assets for executors to administer are private and operating companies. The valuations are complex and can include elements of subjectivity. In addition, a lack of liquidity may affect an executor's ability to deal with an estate's liabilities on a timely basis. Other issues and risks become apparent when private or operating companies are held for relatively long periods of time. For example, an executor who is named as a director of an estate-owned operating company may experience a conflict between his or her duty of loyalty to the company and his or her duty of loyalty to the trust. In addition, an executor or trustee must be aware of any lack of diversification and weigh it against the possibility of loss.