Viability of 4 Percent Rule and Trust Communications

Trustees and Advisers Should Act

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What is the 4 Percent Rule

- The 4 percent rule was created in the 1990s to provide a quick rule of thumb to determine if a portfolio would sustain a retiree through retirement.
- As such it is a DECUMULATION approach to a pool of funds.
- This never may have been sensible to use for a trust that has current and remainder beneficiaries as in theory it may result in the remainder beneficiaries getting nothing.
- Because the 4 percent rule has been so talked about some individual trustees may have thought it sufficient as a tool to determine distributions from trusts. It isn’t.
- Example a trust of $2 million dollars to benefit specified beneficiaries and then pass to charity when those beneficiaries die. The 4 percent rule might provide for $80,000/year to the current beneficiaries, but it may leave nothing for the charitable remainder beneficiaries exposing the trustees to liability for mismanagement.

What is the Issue for Trustees?

- In the current environment investment returns are more volatile and it may affect what trusts can distribute.
- What has been an historic pattern of distributions may not be currently sustainable, or if it is continued it may impair the interests of remainder beneficiaries.
- Trustees who proactively communicate this to beneficiaries may be protected from later claims.
- Regardless of protection informed and educated beneficiaries are less likely to be unhappy.
- Trustees should review all of this with their investment advisers and trust counsel and act. Investment advisers might prepare forecasts to see the impact long term and provide information to communicate to beneficiaries.

What to Communicate

- Here is what the trust provides….
- Here is what we have been distributing until now…
- Here is how those distributions might change…
- Here is now remainder beneficiaries might be affected….
- Here are some things you might consider doing….

Why Trustees Should Communicate

- Using an outdated rule of thumb (and too simplistic of an approach) to trust distributions may bust the trust and leave nothing for remainder beneficiaries exposing trustees to liability. For individual trustees who have not had professional management this could be a substantial issue and you should get professional help to determine what could occur.
- Trustees should communicate the analysis of this and what it means to the trust beneficiaries.
- Communication to beneficiaries may serve to limit trustee liability.

Additional information

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