

In the Beginning...

- Main objective:
 - protect assets against settlor's creditors
 - check on local trustees in offshore asset-protection trusts
 - then additionally...protect trust assets against actions of chosen trustee
- migrated into ordinary, domestic trusts as response to settlor's future uncertainties
- now: “emerging feature of modern managerial trusts”???

Same Old, Same Old?

- Term “protector” is relatively new, but concept of non-trustees having powers over trust property is old and not indigenous to American trust law

Same Old, Same Old? (cont'd)

- Protector can act “outside” trust while also acting within it with trustee to accomplish settlor’s objectives
- Can provide flexibility/responsiveness to future needs trustee may not be able to or hesitant to do

General Uses

- Approve trust modifications because:
 - tax law developments
 - changes in beneficiary's welfare
 - decisions regarding changes settlor would have made if able

What (exactly?) is a Trust Protector?

- Someone other than trustee who's authorized/required to play a part in trust's administration.
- “Protector” *could* also be called:
 - “Advisor”
 - “Appointor”
 - “Beneficiary Representative,” or even
 - “Management Committee”

What (exactly?) is a Trust Protector ...NOT

- Visitor
- Co-trustee
- Virtual trustee
- Directed trustee
- Corporate directed trustee
- Certified trust advisor
- Trust advisor—yes and no

Trust Advisor?

- In U.S. advisors may not be thought of as “protectors” even though protectors = advisors
- Trust “advisors” nearly always considered fiduciaries/expected to act with same duty of care as trustees

Statutory Recognition

- Cook Islands' International Trusts Act of 1984
 - self-settled spendthrift trusts enforceable
 - creditors may not reach settlor's interest even if settlor can revoke
 - can't attack transfers as fraudulent conveyance
 - no enforcement of foreign judgments
 - 1st offshore statutory definition of “protector” –
Cook Islands - 1989

Statutory Recognition (cont'd) – U.S.

- South Dakota - 1997 1st statute recognizing TPs
- Idaho - 1999
- Alaska and Wyoming - 2003
- Tennessee - 2004
- Alaska and Delaware - 1997
- Most states
 - no statutory provision for protectors
 - no case law defining relationships among protectors, trustees, settlors, & beneficiaries

Fiduciary Laws Allowing Delegation

- Uniform Trustee Powers Act-1964
- Uniform Management of Institutional Funds Act -1972
- Employee Retirement Income Security Act-1974
- Restatement (Third) of Trusts-1992

Uniform Trust Code (UTC)

(last revised or amended 2005)

§ 808 - Powers to Direct

- § 808(c) trust terms may confer upon trustee or other person powers to direct trust modification/termination

Uniform Prudent Investor Act (UPIA) -1994

§ Sec. 9

- Followed modern portfolio theory – emphasized market risks are necessary to yield higher returns
- Allows trustee delegation of discretionary functions
→ third parties
- Allows trustee delegation of investment functions
– little case law

Increasing Use of Trust Protectors

Rule Against Perpetuities

1. More states have:
 - adopted unlimited RAP
 - extended period trusts may last, or
 - allow opting out of rule

Increasing Use of Trust Protectors

Domestic Asset Protection Trusts

2. At least 9 states permit some form of irrevocable trust giving settlors spendthrift protection
 - stringent requirements
3. Settlers want mechanisms unforeseen circumstances

What's the attraction?...
is there a need?...is it all good?

super flexibility to consider conceivable
future circumstances

A Look at the “Good”

- Helps ensure trustee acts for settlor’s expectations
 - Encourages compliance with settlor instructions...
because it subjects trustee to potential liability for breach of fiduciary duty
 - Reassures discretionary trustee observes settlor’s non-binding distribution wishes
 - Can provide primary responsibility for monitoring trustee

A Look at the “Good” (cont’d)

- Involves someone with knowledge about settlor’s family
- Currency of trust tax planning
 - trustees may be happy for other’s tax responsibility
- Provides trustee & beneficiary liaison
 - may reduce beneficiary-trustee conflicts (?)

Overall “Good”

- Guards from hazards threatening trust objectives
- Improves trust functions when poor trustee performance
- Permits trust to go where trustees dare not???

Now the “Bad”

- Legal position uncertain
 - Numerous reported cases about dispositive powers held by non-trustees - fewer regarding administrative powers
 - TP device can backfire when settlor named self/family member as TP
 - courts may impute control over trust to settlor
 - *Anderson case*

Criticisms

- Creates greater administrative burden → →
→ increases trust expenses
 - Opposite claim when settlor appoints trusted friend/confidant to monitor trustee's management
 - Usually: overall net agency expenses reduced
- Creates own agency costs → may offset cost reductions associated with trustee's position
- Delay
 - Trustees waiting for TP consent before exercising powers/discretions

Solution to Criticisms

- Provisions re: TP's rights/responsibilities
 - Examples:
 - fees and expenses
 - ability to employ assistance to carry out TP responsibilities
 - access to trust records/accounts
 - appointment/removal of successor TP (if necessary)
 - Shouldn't avoid unavoidable issues

Why Not DPOA instead of TP?

Only some states allow a DPOA agent authority to amend an estate

- ability to use attorney-in-fact to amend estate plans varies state to state

but...

- ability to name a TP does not

Duties - Trustee

Generally: trustee must follow TP's instructions

except:

- TP's instruction manifestly contrary to trust terms
or
- trustee knows instruction = serious breach of TP's fiduciary duty to beneficiaries

TP Duties

Presumption:

TP = a fiduciary required to act in good faith for trust purposes and beneficial interests

Selection

Who can do the job?

- Best: someone familiar with settlor's intentions/with beneficiaries
 - Independent party TP - to avoid adverse tax consequences
- Settlor:
 - Could be...but generally not good idea
 - §§ 2036/2038 retained powers issues

Selection

Who can do the job? (cont'd)

- Relative/close friend/or subordinate party
 - Motives:
 - respect for judgment
 - show esteem
 - employ someone closer to family than company/bank trust officer
 - caution necessary
 - risk IRS could argue TP under grantor's control or pre-understanding

Selection

Who can do the job? (cont'd)

- Professional advisor of settlor (attorney, CPA, etc.)
- Professional TP ...individual or corporation
 - Ex.: some law firms have TP companies to look after clients' trusts
- Combination – acting as committee

Can't Decide...???

- No one in whom settlor has sufficient confidence
 - Solution (?) - trust terms permitting beneficiaries/others to name TP if/when future events warrant change

TP Powers

- Power = (mere) authorization to perform
 - permissive
- Duty = obligation
 - mandatory !
 - neat/clear except when duties are discretionary

Direction v. Consent/Veto Powers

- Direction powers
 - safeguards often advisable
- Consent and veto powers
 - Issues:
 - Are all of trustee's transactions subject to TP's veto?
 - What happens when TP does not respond?
 - “Blanket consent” until TP withdraws consent(??)

Dispositive v. Administrative Powers

- Not always clear distinction - can overlap
- Dispositive powers:
 - typically involve beneficial arrangements
 - who beneficiaries are
 - what/when beneficiaries receive
- Administrative powers:
 - involve (again broadly) investment or management matters

Middle of Both Power Roads

For instance:

- Direction power to:
 - make loans to beneficiaries
 - = both an investment of trust fund and a benefit to borrowing beneficiary
- Consent power to:
 - acquire new investments
 - = administrative but acquisition can benefit income beneficiaries (higher income) or remaindermen (capital appreciation)

Concerning TP Powers...

No established “standard” powers for TP position

Common Powers and Uses

- Add and/or delete beneficiaries
- Add, replace, and remove trustees
- Change trust situs (trust's governing law)
- Affect trust distributions through veto or directive powers
 - Approve self-dealing by trustees
- Veto beneficiary rights
 - Ex.: right to trust accounts/information

Common Powers and Uses (cont'd)

- Amend trust administrative provisions
- Consent to exercise of powers of appointment
- Dispositive powers
- Affect investment decisions through vetoes or directives
- Approve trustee accounts
- Approve trustee's remuneration
- Release trustees from liability for breach

Common Powers and Uses (cont'd)

- Nominate auditors
- Terminate trust by commencing a final vesting provision
- Enforce trust by legal proceedings
- Enforce trusts for care of pets
- Request/receive information in lieu of beneficiaries

Powers (cont'd)

- Temptation:
 - powers gone **wild** to achieve greatest flexibility
 - myriad of powers for sake of powers
 - not advisable
- Best recipe:
 - reasonably anticipate powers most likely to carry out trust purposes
 - thorough consideration/understanding consequences of powers granted

Forbidden TP Powers

- Furtherance of illegal purpose
- Against public policy
- *Possible* public policy no-no's
(ie., go against very grain of trust premises)

To Be or Not to Be...a Fiduciary

- Relationship & roles between TP and trustee dependent upon determination of:
 - Whether TP = fiduciary or acts in nonfiduciary capacity
 - if nonfiduciary - merely personal powers
- Roles of two functions different depending on answer

If Not a Fiduciary

- TP holds purely personal powers
 - Can't really be forced to exercise powers
 - Possibilities abound: capricious use of personal powersor worse
 - At very least TP expected to have right to acquire information needed to exercise powers

If a Fiduciary

- Generally more likely role for TPs
- Trustee now in more sensitive position than if TP is nonfiduciary
 - Even when trust terms exculpate trustee from liability for abiding by TP's decisions
- TP subject to appropriate court's supervision
 - Court (presumably) can surcharge/remove/appoint a TP in some circumstances
 - *Steele v. Paz Ltd.* - 1995 Isle of Man case

Powers & Money Matters

- Compensation
 - Distinguishing characteristic of fiduciary v. nonfiduciary personal powers
 - Noncompensated trustees
 - held to same fiduciary standards as other trustees
 -follows that TPs can't escape liability because of no compensation

To Be or Not to Be...a Fiduciary (cont'd)

- Directional powers: (typically) deemed fiduciaries
- Consent & veto powers
 - Consent authority → viewed as fiduciary...
 - TP's perspective
 - » if TP = fiduciary, same rights as a fiduciary?
 - » if T P = nonfiduciary, without any rights?

To Be or Not to Be...a Fiduciary

How to Tell...

- Degree of empowerment = Best way to tell...perhaps
 - Ex.: fiduciary standards generally more applicable to TP with extensive directive powers over trust investments compared to TP with main task to sooth ruffled feathers of beneficiaries
 - One size fiduciary standards (if any) does not fit all

To Be or Not to Be...a Fiduciary

How to Tell... (cont'd)

- TP-settlor relationship
 - TP = close family member/object of settlor's bounty
 - Logical presumption → personal powers
 - TP = advisory relationship to settlor
 - Logical presumption → fiduciary role

Liabilities of TPs

- Regulation of TP should specified by settlor in trust document
- Where trust terms silent/incomplete -
 - courts need to develop (eventually) default rules
 - Not limited to damages against TP

Remedies

- Trustee & TP at odds:
 - Trustee fears TP's direction will cause trustee breach of fiduciary duty
 - Trustee can:
 1. Follow the protector's direction
 2. Seek judicial approval to follow TP's directions
 3. Seek beneficiaries' approval

Remedies (cont'd)

- Beneficiaries & TP at odds:
 - Beneficiaries can:
 1. Seek to compel TP to take specified action
 2. Seek to remove TP
 3. Seek damages - breach of fiduciary duty

Issues

Employed for Benefit of Settlor

Are solely for purpose of protecting settlor's wishes and intentions separate/apart from beneficiaries' interests?

TP caught in middle? – Ex. *Pulitzer* type situation

Are TPs only security blankets for some settlors (???)

Issues (cont'd)

What guarantee TP acts as settlor would want?

- no obvious market mechanism for assuring TP follows settlor's instructions –
even with detailed instructions

Issues (cont'd)

Employed for Benefit of Beneficiaries

Roles:

Corporate Board of Directors

Judicial

Issues (cont'd)

- Is trustee completely absolved from following TP's direction even if clearly improper?
- Is trustee in clear if trustee acts improperly when action required and received TP's consent?
- What happens when trustee may not act without TP's approval and TP doesn't act?

Issues (cont'd)

- What if TP persistently refuses to consent to a proposed action trustee considers necessary for protection/best interests of trust?
 - *In re Cross*
- What if TP has directional powers but trustee knows/should know TP is violating duty to beneficiaries or other great misstep?

Issues (cont'd)

- Where TP has consent/veto powers over trustee's decisions, will trustee expend energy/time persuading TP of trustee's decisions?
 - diverting energies from appropriate trustee decisions
- Because TP reviews trustee's decisions, will trustee expend less decision-making care?

Issues (cont'd)

- What are social welfare costs/benefits of adding TPs to settlor tool boxes?

Enforcement Issues

TP doesn't do what he's supposed to do:

Who enforces?...

Who watches TP?

Who has right of enforcement?

- Trustee/beneficiary & even TP can apply to court for decision

Enforcement Issues (cont'd)

- Can't necessarily count on court being willing or able to enforce matters
- Ways court tests propriety of TP's conduct (apart from express terms of his powers)

Determine:

- (1) whether TP acted for proper purpose and
- (2) whether TP has obligation to serve - if so, whether TP did best to do so
 - Presumption: settlor doesn't want court interference

Exculpatory Provisions

- Exculpatory provisions will not relieve a fiduciary of liability if provision:
 - Doesn't cover the breach of duty involved
 - Is against public policy, or
 - Inserted in document without settlor's knowledge/consent
- General Rule:
 - Exculpatory provisions strictly construed against fiduciary

Tax Consequences/Considerations

- If TP has one/more personal powers and can exercise powers for own benefit = general GPOA
- If TP cannot benefit self by exercising personal or fiduciary powers = SPOA
– generally avoids tax ramifications
- TP who = fiduciary generally - no general power

Conclusion

- TP:
Position can be uniquely useful and worth consideration when flexibility/outside advice are desired
- But:
Is it really possible to draft for all circumstances for 100 years into the future, let alone 1,000 years down the road?

Conclusion (cont'd)

- Estimates conclude that average married couple with 2.1 children would have:
 - more than 100 descendants 150 years after a trust is created
 - producing approximately 2,500 beneficiaries 250 years after the trust is created
 - 45,000 beneficiaries 350 years into the trust, and
 - 3.4 million beneficiaries after 500 years