

Trust Protector!

The Plastic Man of the Fiduciary Justice League



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As trusts have evolved to address a myriad of needs and objectives other than ensuring property is passed down through family lines, the role of fiduciary has taken on more complexity and in many cases has become furcated to addresses these new challenges. In fact, today trusts are often overseen by a Justice League of fiduciaries (and sometimes nonfiduciaries): trustees, investment advisers, distribution advisers, special needs advisers, etc. Within this framework, a “trust protector” is like Plastic Man from the DC Comics, seeming to have the properties of rubber: it can stretch, bend and mold itself into any sort of role the trust creator wants or the circumstances around the trust and beneficiaries warrant.

The role is so flexible that as trust protectors have gained in popularity, various states have enacted statutes addressing the role, or a version of the Uniform Trust Code incorporating the role, leading to a sort of patchwork

quilt of definitions, duties and responsibilities. Further, there is very little jurisprudence to provide clarity. The Uniform Law Commission has recently convened a committee to study the status of the law governing the role of trust protector and to determine whether a new uniform law or changes to existing uniform laws are advisable. In its description of the committee, the Commission broadly defines a protector as “a person other than the trustee, beneficiary or settlor who holds power over some aspect of a trust, such as the power to direct investments, remove or replace trustees, or amend the trust.”

Traditionally used in the realm of offshore asset protection trusts to satisfy the grantor’s desire to maintain some control over the offshore trustee, the protector’s duties were usually limited to removing the foreign trustee or directing the trustee to make distributions of trust property. The modern trust protector may be given one or both of these powers, or any number of others: approval of the accounting of a trustee, vetoing distributions to

beneficiaries, adding or removing beneficiaries, mediating disputes between co-trustees, granting a beneficiary a power of appointment, modifying the terms of a trust, or terminating a trust altogether. To date, statutes that govern protectors do not attempt to restrict the possible powers to be given, recognizing that this newfound plasticity is an overall strength. However, even Plastic Man had his weaknesses, and so too does the trust protector.

Delaware is one of approximately half the states that has a statute regarding the role of protector, found in Section 3313 of the Code which provides: “the term ‘adviser’ shall include a ‘protector’ who shall have all of the power and authority granted to the protector by the terms of the governing instrument, which may include but shall not be limited to: (1) The power to remove and appoint trustees, advisers, trust committee members, and other protectors; (2) The power to modify or amend the governing instrument to achieve favorable tax status or to facilitate the efficient administration of the trust; and (3) The power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the governing instrument.” Like many instances of Delaware statutory trust law, the law is clear, but not restrictive, thus allowing it to accommodate and respond to changes in tax law and advancements in estate and asset protection planning.

Of the states that have included the role of trust protector in

their statutes, most have done so by enacting the Uniform Trust Code. Although not expressly defined in the Code itself, the comments to section 808(b) – (d) make clear that the role of directed trust adviser encompasses that of trust protector. The comments go on to distinguish the role of trust protector from trust adviser as connoting a grant of powers exceeding those of an adviser to direct the trustee. However, the comments also imply that these greater powers are simply the ability to modify or terminate a trust by referring to section 808(c).

Because a trust protector could take on any number of “personas” depending on the particulars of the trust in which it is being included, the term “trust protector” may be best defined in the negative: a protector is not responsible for the administration of the trust (accountings, taxes, decisions regarding principal and income, record-keeping, etc.) which is left to the trustee; and the protector is not responsible for directing the trustee with respect to a particular facet of what traditionally was a part of the trustee’s duties (investments, distributions, etc.) which is left to an adviser. Instead, a trust protector is often empowered with responsibilities which were never a part of the traditional trustee role (the most “super” of the “Justice League”).

Another aspect of the protector that escapes strict definition is whether it is a fiduciary or not. Most statutes that address

(continued on p. 12)

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(continued from p. 11)

the issue presume that a trust protector is a fiduciary, including Delaware. The presumption may be overcome by a contrary statement in the trust instrument as to all powers or only certain ones. If the trust instrument is silent, the presumption may still be rebutted depending on the particular characteristics of the role, such as who is appointed and what powers are given. For example, if the trust instrument names the grantor's attorney as protector with the ability to modify the terms of the trust, the protector will likely be deemed a fiduciary even absent a statutory presumption or statement in the trust. On the other hand, if the trust instrument names one of the beneficiaries as protector with the ability to add or remove beneficiaries, then this power is likely to be considered personal and may be exercised in a way that is not necessarily in the best interests of the trust or any other beneficiaries.

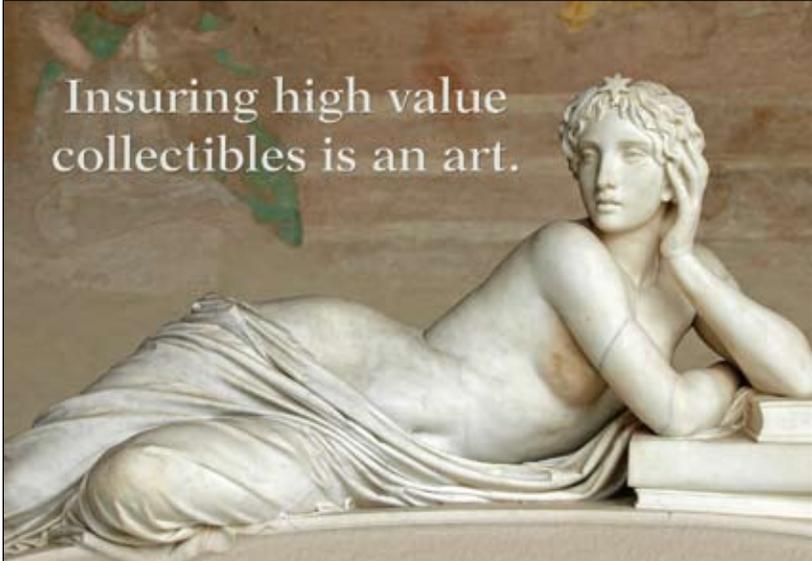
By contrast, South Dakota recently enacted legislation which provides that a trust protector "may not be considered to be acting in a fiduciary capacity except to the extent the governing instrument provides otherwise," unless it is exercising the authority of an investment adviser or a distribution adviser. S.D. Cod. Laws § 55-1B-1(2).

The lack of a restrictive definition opens the role of trust protector to almost endless possibilities. This plasticity allows us as planners to address the long-term needs of a trust by having

someone who can address future changes in state laws affecting trusts, state and federal tax laws, changes to the trustee, fluctuation in trust assets and the beneficiaries' personal circumstances (assets outside of trust, substance abuse, gambling problems, debt, disability). For a trustee, especially those in Delaware who may be prevented by distance from seeing the grantor and the grantor's family regularly, having a protector named in the trust can relieve it of some or all of the responsibility of monitoring and investigating the beneficiaries' personal lives. A grantor may find the idea of naming a protector attractive as a way to ensure that someone trusted by the family can provide a system of checks and balances between the trustee and beneficiaries.

With all of these advantages, many potential downsides lurk. If not carefully drafted, a trust instrument containing a trust protector may inadvertently cause negative tax consequences. (Of course, sometimes the use of a protector to trigger a "negative" tax consequence is entirely intentional.) If the relationship among the various fiduciaries is not clearly considered, and memorialized with careful drafting, introducing a trust protector will create the potential for additional conflict. As discussed above, statutory law may provide a presumption that a protector is a fiduciary, and may even go so far as to say that fiduciaries do not have to monitor the conduct of a protector. However, it is often not clear what duties the protector may have to monitor the activities of the other fiduciaries, particularly when authorized to remove and appoint them. It is also not clear what the responsibilities of various fiduciaries are to monitor or act as a check on the protector who is not a fiduciary. Delaware's statute makes it clear that a fiduciary does not have a duty to monitor the conduct of an adviser, provide advice to or consult with the adviser or communicate with a beneficiary or third party in instances in which the fiduciary would act differently than the adviser. 12 Del. Code 3313(e). The statute, however, is silent on whether an adviser or protector has duties to monitor the activities of a trustee.

In the only case to deal directly with the issue of a protector's liability, an appellate court in Missouri found that the trust protector may be held liable if found by the trial court on remand to have acted in bad faith. See *Robert T. McLean Irrevocable Trust U/A/D March 31, 1999 v. Patrick Davis*, 283 S.W. 3d 786 (S.D. Mo. 2009). In this case, the trust protector was named to a special needs trust established with proceeds from the settlement of a personal injury case arising from an automobile accident that left the beneficiary severely disabled. The initial protector was the attorney who ultimately settled the case. The only power of the protector was to remove and appoint trustees, which the trust specified must be done in good faith. After



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the initial corporate trustee resigned, the protector appointed the attorneys and law firm who had referred him the case (a common practice between them, with fee splitting). The beneficiary's grandmother informed the protector that the new trustees were inappropriately spending trust funds, at which time the trustees and the protector resigned and the protector appointed the grandmother as trustee. She then sued the prior trustees and protector for breach of fiduciary duty. The former protector argued that he had no duty to monitor or report the expenditures of the trustees to the beneficiary and his representatives. The Court's holding that the protector may be held liable was based on language in trust instrument describing the protector as a fiduciary and specifying that the protector must act in good faith.

For now, this lack of case law means that the role of protector can continue to be almost anything a trust calls for. As the law around trust protectors develops, we will see whether the Plastic Man of the trust world maintains its place in the justice league of fiduciaries, or if it will be defined and restricted by case law into a mere mortal.

The decision whether to include a trust protector will depend on the type of trust, the expected duration of the trust, the parties involved, and the intentions of the grantor. Whenever invoking the role, the drafter must be careful when granting powers to the protector, how and possibly when those powers

are to be exercised, how the exercise of those powers may affect the responsibilities and duties of other fiduciaries, what duties and responsibilities the protector may have vis-à-vis other fiduciaries, whether the protector is a fiduciary or not or whether the protector is to act in a fiduciary capacity as to some powers but not all, whether the protector is to be compensated and what standard of conduct must the protector meet to avoid liability.



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