

UNIFORM DIRECTED TRUSTS

Geoffrey Madsen
Chairman
Independent Trust Company

Overview

- Trust Commonalities
- Trusts & Risk
- Types of Personal Trusts
- Who is Involved in Trusts
- Directed Trusts: A Deep Dive
- Exposure and Consequences

Directed, Discretionary and Delegated trusts all
have one thing in common:

RISK

Risk is a part of everyday life and as it pertains to trust, it's possible to live with it. We can manage risk by identifying and mitigating if we are going to sleep well at night

- Manage
- Mitigate
- Insure
- Live with it

Manage Risk:

“We are what we repeatedly do. Excellence, then, is not an act, but a habit.”

Aristotle

Mitigate Risk:

“Anticipate the difficult by managing the easy.”

Lao Tzu

Insure Against:

"Named must your fear be before banish it you can."

YODA, from Star Wars: The Empire Strikes Back

Live with it:

“Only when the tide goes out do you discover who’s been swimming naked.”

Warren Buffett

TYPES OF PERSONAL TRUSTS

PERSONAL TRUSTS

- Discretionary Trusts
- Delegated Trusts
- Directed Trusts

WHO IS INVOLVED IN TRUSTS?

- Discretionary Trustees
- Delegated Trustees
- Directed Trustees
- Trust Directors, Protectors and Investment Advisors

Discretionary Trusts

Definition: responsibility, authority and execution

- The role of a Discretionary Trustee:
 - Sole Discretion or Shared with
 - Co-trustees
 - Named Parties in Instrument

All duties performed by trustee under one umbrella:

- Administration
- Distributions
- **Investment Management**

Delegated Trusts

Definition: responsibility and authority (sort of)

“You can delegate authority but not responsibility.”

- *Brigadier General Frank Quinlan, USMC 2010*

Selection, Delegation & Monitoring under UPIA Section 9a

- Section 9. Delegation of Investment and Management Functions
 - (a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in:
 - (1) **selecting an agent;**
 - (2) establishing the **scope and terms of the delegation**, consistent with the purposes and terms of the trust; and
 - (3) **periodically reviewing** the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.

Selection, Delegation & Monitoring under UPIA Section 9b&c

- Section 9. Delegation of Investment and Management Functions (continued)
 - (b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.
 - (c) A trustee who complies with the requirements of subsection (a) *is not liable to the beneficiaries of to the trust for the decisions or actions of the agent to whom the function was delegated.*

Delegated Trusts

- A trust that is considered delegated is one where the trustee delegates certain function(s) to a qualified agent (approved vendor).
- Trust documents can give the trustee authority to delegate certain functions to experts that act as agents in the trust's administration.

Delegated Trusts

- Functions commonly delegated can include:
 - investment manager
 - tax preparation
 - unique asset management

Hiring agents can allow trustees access to specialized skill sets and management.

Directed Trusts

Definition: responsibility for specific, limited functions

- A “directed trust” is one in which *the trust document dictates or mandates* that a trustee **must accept direction** from another party concerning various aspects of a trust’s administration, including how the trust’s assets should be invested.

Directed Trusts

Definition: responsibility for specific, limited functions

- A co-trustee or non-trustee fiduciary of a Directed Trust can also have the title of Trust Director, Trust Protector or Trust Advisor
- They are empowered to direct the trustee holding the legal title to the trust assets to execute the trust's directives concerning discretionary investment and/or distribution powers

Directed Trust

- In addition to implementing directives, a Directed Trustee performs administration functions such as:
 - Record keeping
 - Maintaining principal and income accounts
 - Preparing and filing tax returns
- Directed Trustee can operate like Agent for Trustees or Administrative trustees

Directed Trusts

- Benefits to a Directed Trust (make bullet points as you see fit but these are the main points I took from that first long paragraph)
 - Highly utilitarian
 - Cost effective
 - Limited (*theoretically*) risk requires fewer risk management processes
 - Lower number of administrative personnel

Directed Trust

- Benefits to Directed Trusts:
 - Lower annual fee commensurate with corresponding levels of risk
 - Allows co-fiduciaries with higher risk roles like investment or distribution functions to charge a *lower fee for specifically limited services / exposures*
 - Total fees paid for an unbundled trustee typically lower

Directed Trusts

The big picture:

- Keeping pace with increasing demand for open architecture estate structures
- Some states who have adopted directed trust legislation have benefited from increased labor force, more tax revenue, etc.
- The Short List: Alaska, Delaware, Nevada, New Hampshire, South Dakota & Wyoming

Directed Trusts

Make sure you understand the home field advantage.

- States who are friendly to Directed Trusts have built sufficient legislative legal infrastructure in the three critical areas necessary to sustain a competitive local directed trust industry.

Directed Trusts

The directed trust “friendly” states have, to one degree or another, built sufficient *legislative* legal infrastructure in the three critical areas necessary to sustain a competitive local directed trust industry.

Directed Trusts

- “Friendly State” elements of Successful Directed Trusts
 - Clear Roles
 - Clear Responsibilities
 - Clear Boundaries...

Directed Trusts

...more on Clear Boundaries

- Most directed trust-friendly states satisfy this critical requirement by defining a directed trustee as an “excluded fiduciary” *with no duties* to:
 - Question whether the empowered party is acting with their scope of authority
 - Intervene to address or redress breach
 - Warn beneficiaries that any given direction exceeds the empowered party’s authority or otherwise constitutes a breach

Directed Trusts

Trust Directors

- Historically, the concept of a protector developed in offshore jurisdictions where settlors were concerned about appointing a trust company in a small, distant country as sole trustee of an offshore trust that holds a great deal of the settlor's wealth.
- However, protectors now form a part of mainstream tax planning in most jurisdictions which recognize trusts.

Directed Trusts

Trust Directors & the Success of a Directed Trust – importance of clarity

- The authority of a trust director *can vary with the grantor's intent*. Some examples include:
 - remove and appoint trustees
 - approve a change of proper law
 - approve the addition or removal of beneficiaries
 - approve proposed trust distributions
 - approve the appointment of an agent or advisor either generally or in relation to specific matters
 - approve investment recommendations
 - appoint replacement protectors
 - terminate the trust or approve the termination of the trust
 - Etc.

Directed Trusts

- Why a Trust Director is Appointed
 - Trust Directors allow a great degree of flexibility when dealing with changes in circumstances.
 - including both factual circumstances (death, premature divorce, previously unknown children) and
 - legal changes (any legal changes, but most frequently changes to applicable revenue laws);
 - the settlor may be concerned that the trustee may not pay sufficient attention to his wishes;
 - the settlor may wish certain powers to be withheld from the trustees; or
 - the settlor may wish a third party to act as a main point of contact between the beneficiaries and the trustees.

RISK & IDENTIFYING EXPOSURES

The Big 3: Areas of Risk

- Parties who don't understand (act within) their roles
- Poor documentation
- Lack of situs discipline

Conclusion

Directed trusts aren't for everyone.

Understanding the risks and rewards is key to long term success for trustees and families.

Thank You!

For follow up inquiries:

Geoffrey Madsen
Chairman
geoff@itcoa.com

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