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# Trust Protectors: The Role Continues to Evolve

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The trust protector's role is relatively new in modern trusts. Generally, trust protectors provide oversight of certain decisions and allow for a degree of flexibility not easily accommodated by the traditional parties to a trust. Although the trust protector's role can be very useful, its role is not precisely defined. For attorney-drafters, settlors, and trustees alike, ambiguity in defining the role can be a difficult challenge because statutes among the states are diverse, inconsistent, and, arguably, incomplete. There is a dearth of domestic case law interpreting state statutes, and identifying whether the trust protector is a fiduciary (or not) can be problematic. The purpose of this article is to provide a broad overview of the role and to identify some of the challenges and opportunities inherent with using trust protectors.

## **What Is a Trust Protector?**

The role of trust protector is a function that carries out enumerated administrative and strategic purposes generally not reserved to the trustee, settlor, or beneficiaries. There is no mandate that the trust protector actually "protect" the trust. The name itself could be anything and has no inherent meaning.

To help interpret the intricacies of the trust protector's role, commentators look to the variety of statutory and case law that exists in the United States regarding "trust advisors," although there seems to be some question about how similar the roles of trust protectors and trust advisors are. Also, there is international common law jurisprudence that can be used for reference purposes.

In structuring a trust, generally the attorney delineates the relative rights and powers of the parties. For instance, the trust generally addresses matters such as whether the settlor

(and beneficiaries, after the settlor's death or incapacity) will have the right to remove or replace a trustee. Further, the powers of the trustee regarding many matters, including investment and distribution, are also generally addressed. Beyond these basics, sometimes more profound issues are not easily addressed by the traditional roles. For example, questions can arise over whether to change the legal situs, governing provisions, or beneficiaries of the trust. These are the instances in which the role of the trust protector is most helpful.

## Brief History of the Trust Protector Role in the United States

Third-party oversight has been part of U.S. trust law for many years. Before the trust protector's emergence, the trust advisor was (and continues to be) used to bifurcate some of a trustee's duties. In the 1980s, the use of trust protectors began to rise in popularity in the context of U.S. settlors who created trusts in foreign jurisdictions for asset protection purposes. A major concern for U.S. settlors was the need to relinquish control over trust assets to an unknown professional trustee in an often unfamiliar country. The role of trust protector emerged as a tool to alleviate some of this concern. It was not uncommon to name a trusted family friend, attorney, or other close associate in the role of trust protector, with important powers, including power to change the jurisdiction of the trust or the identity of the trustee. Richard C. Ausness, *The Role of Trust Protectors in American Trust Law*, 45 Real Prop Tr. & Est. L.J. 319 (Summer 2010).

## How to Differentiate Between Trust Advisors and Trust Protectors

What is the difference is between the protector and advisor?

There is no inherent definition of either label. What really matters is how the roles are defined in the trust instrument and state law. Some commentators view the roles as nearly identical in definition, which is "a person who has power to control a trustee in the exercise in some or all of his powers." Alexander A. Bove Jr., *Trust Protectors: A Practice Manual with Forms*, ch. 2.3 (2014), quoting *Trust Advisors*, 78 Harv. L. Rev. 1230 (1965). This approach is not definitive, and recent thought leadership in this area argues that the nomenclature between the two labels should be given meaning in practice.

To help differentiate the roles, think of trust advisors as third-party decision makers who "have the power to control the trustee's exercise of some or all of the trustee's powers, generally with respect to investment decisions but at times with respect to distribution decisions ... [and] have usually been found to have *the same* fiduciary duties as a trustee. These trust advisors were usually exercising one or more of the powers inherently a part of the role of trustee." Kathleen R. Sherby, *In Protectors We Trust: The Nature and Effective Use of "Trust Protectors" as Third Party Decision Makers*, § 2.2, University of Miami Heckerling Institute on Estate Planning (2015) (emphasis added).

By comparison, a trust protector "has been used much more recently as the person given the power to perform certain delineated non-administrative decisions relating to the trust but not otherwise inherently a part of a Trustee's role. Most often the trust instrument

provides that the trust protector is not acting as a fiduciary, because the powers given to the trust protector are not typically traditional trustee powers.” See Sherby, § 2.2, referring to *Trust Advisors*, 78 Harv. L. Rev. 1230 (1965).

Such a differentiation between the terms can be helpful in practice when explaining concepts to clients and when interpreting trust documents.

## Is the Trust Protector a Fiduciary?

### *Why Does This Matter?*

If the role of trust protector is fiduciary in nature, then certain duties of care are owed to the trust beneficiaries, and liabilities may attach for breach of such duties. If the role is not a fiduciary role, then what is it? A nonfiduciary power is said to be “personal” to the one wielding it. That is, the power can be exercised without reasonableness, *provided* exercising the power does not contradict the settlor’s intentions or the governing instrument.

For example, suppose the settlor names his friend, Jordan, as a trust protector with the power to appoint or eliminate trust beneficiaries among the settlor’s issue. Without additional information, is this power a fiduciary or personal power? Because the settlor specifically names Jordan, perhaps the power is strictly personal and can be exercised based on Jordan’s individual inclination. Personal powers can be exercised for whatever reason, provided the exercise is not a fraud on the power. That is to say, the power cannot be used in contravention of the settlor’s clear instructions, even though the power is technically available. For example, a trust protector with the power to change beneficiaries cannot remove the settlor’s family and name the trust protector’s family as beneficiaries. Such abuse would be an obvious fraud on the power to which a settlor would have never agreed.

What if the trust protector (as in the “office” of trust protector) as opposed to a named individual is given power? This could be in the nature of a fiduciary. Why else would a settlor give powers to a possibly unknown individual unless it was to further the settlor’s intentions? See Bove, ch. 3.7.

Suffice it to say that the classification of the trust protector as a fiduciary or nonfiduciary is critical for establishing the standard of care owed to the trust and its beneficiaries and possible exposure to liability.

### *Schools of Thought*

There are three primary schools of thought on how to classify the trust protector role. First, one trend in the United States is to create a statutory default assumption that the trust protector is not a fiduciary. Rationales for this approach vary. One argument is that it encourages people (or trust companies) to serve without the fear of litigation exposure. Some argue that it allows for competition among the states for trust administration business.

A second trend is that trust protectors are to be treated as fiduciaries by default. The primary rationale is that a settlor would not want to appoint someone with great power over the trust who is unaccountable to the courts and possibly to the beneficiaries.

A third trend is for statutes to be silent, or if a default is stated, to be ambiguous in application. This approach contemplates the trust protector as a fiduciary, a non-fiduciary, or a quasi-fiduciary. One must look to the powers granted in the trust and statute to determine the appropriate categorization. Matthew T. McClintock, LISI Est. Plan. Newsl. #2439 (July 21, 2016), at <http://www.leimbergservices.com>.

The bottom line: be careful and know the state law that applies to your circumstances. In most cases, the trust can be drafted to overcome most deficiencies in the statute. If that is not possible, consider another jurisdiction.

### *Uniform Trust Code Approach—Power to Direct Is a Fiduciary Power*

Many states that adopted the Uniform Trust Code (UTC) now have some guidance, vague though it is, on the treatment of trust protectors by virtue of Section 808 regarding directed trusts. The UTC approach is to clearly enumerate that a power to direct is fiduciary in nature. The power to direct can include various actions, such as power over investments, modification, or termination of a trust.

Yet, only by looking at the comments to the model statute do we find mention of the term trust protector, as follows:

“Advisers” have long been used for certain trustee functions, such as the power to direct investments or manage a closely-held business. “Trust Protector,” a term largely associated with offshore trust practice, is more recent and usually connotes the grant of greater powers, sometimes including the power to amend or terminate the trust.

UTC § 808, cmt.

What about the power to veto a decision by the trustee? The UTC approach seems to treat the power holder as a co-fiduciary.

The comments provide that the provisions of UTC § 808 can be modified in the trust. Only by carefully examining the laws of the particular state under which a trust is governed can the efficacy of this commentary be ascertained.

### *Sampling of State Laws*

With the UTC as the base line scenario, one can quickly see the disparate treatment of directed trusts in many of the states that have adopted the UTC as well as many of the non-UTC states. Although examining each state’s laws is beyond the scope of this article, four primary trends regarding directed trusts among the states have emerged.

**States That Have Adopted Section 808 of the UTC in Whole or in Part.** Since inception, the UTC has been adopted in approximately 30 states. Among these states several use Section 808 as sole guidance regarding trust protectors, meaning that there is a rebuttable presumption that third-party power holders are fiduciaries. According to Sherby's *All States Comparison Chart Trust Protector/Advisor and Directed Trusts* at University of Miami Heckerling Institute on Estate Planning (2015), beginning on page 40, 15 states have adopted Section 808 as sole guidance: Alabama, Arkansas, Florida, Kansas, Kentucky, Maine, Maryland, Massachusetts, Montana, Nebraska, New Mexico, North Dakota, Ohio, Pennsylvania, and West Virginia.

**States That Have Adopted a Modified Version of Section 808.** A number of UTC states have not only enacted Section 808 but also provide further statutory guidance for trust protectors. For example, Ariz. Rev. Stat. § 14-10818 states, in part, that a trust may provide for the appointment of a protector. Importantly, Arizona's statute creates a default treatment of the trust protector as nonfiduciary. By comparison, N.H. Rev. Stat. § 564-B:12-1201 et seq. (Trust Protectors and Trust Advisors) provides a single definition of trust protector and trust advisor. Regarding the treatment as a fiduciary, New Hampshire adopts a general rule that a trust protector is a fiduciary but provides for nonfiduciary treatment for each power granted to or reserved exclusively by another trustee, trust advisor, or trust protector. As another comparison, N.C. Gen. Stat. § 36C-8A-3 calls the third-party power holder, simply enough, a "power holder." The term trust protector is not used. Importantly, the presumption as a fiduciary exists except for three enumerated powers. Even among some of the states that have additional statutory provisions dealing with trust protectors, questions still remain because of lack of cross-referencing or clarity on which provisions govern.

**States That Have Not Adopted the UTC But Have Incorporated Some Provisions for Third-Party Advisors into Their Trust Laws.** At least two states, Washington and Texas, have not adopted the UTC but include provisions for third-party power holders that are similar in concept to that of UTC § 808. See Texas Property Code § 114.0031 and Wash. Rev. Code § 11.100.130.

**States That Have Not Adopted the UTC or Contemplated Third-Party Power Holders Such as Trust Protectors or Trust Advisors.** Several states, including California, Colorado, Connecticut, Hawaii, Iowa, Louisiana, Minnesota, New Jersey, New York, Oklahoma, and Utah, have yet to enact any statutes governing trust advisors or trust protectors, and many states still do not differentiate between the two roles.

### *How to Deal with Ambiguous Guidance*

One should not shy away from the use of trust protectors when the role is needed, but it is best to proceed carefully through the fog of uncertainty because of the inconsistency among state statutes and the dearth of domestic case law interpretations. This is not to say that there is no case law. For example, in *Robert T. McLean Irrevocable Trust v. Ponder*, 418 S.W.3d 482 (Mo. Ct. App. 2013), the Missouri Court of Appeals held that a trust protector did not have any powers or duties (actual or implied) to monitor the activities of

a trustee in determining whether or not to remove a trustee. *McLean* was a case of first impression in Missouri, and the holding should not be viewed as creating a general rule. In addition to *McLean*, there are a number of cases involving trust advisors.

This leaves us with the challenge of planning and drafting once the determination is made that a trust protector is needed. There are strategies to keep in mind:

- Clearly document the settlor's intentions for each enumerated power granted to the trust protector.
- Research the state law very carefully to determine whether

—a UTC or other approach has been adopted;

—a trust protector is presumed to be a fiduciary or not a fiduciary;

—the powers enumerated in the statute are exclusive or only illustrative;

—the statutorily presumptive treatment as a fiduciary or nonfiduciary can be overcome through appropriate drafting;

—there is a difference in state law between trust advisor and trust protector;

—to what extent a standard of care is owed by the trust protector, whether as a fiduciary or nonfiduciary;

—if a standard of care is present, what the liability exposure is if the trust protector is found to breach it; and

—whether an alternative state's laws should be used, based on the circumstances.

### When to Consider Using a Trust Protector

In many circumstances, a trust advisor or trust protector is unnecessary. Decisions regarding distributions, investment management, hiring outside professional advisors (for example, investment managers), and balancing the interests between current and remainder beneficiaries or even the relative interests of current beneficiaries all can and should be managed by the trustee. With a trustee (and even a trust advisor), there is settled law on the applicable fiduciary standard and court oversight.

Thus, the question remains: when should a trust protector be considered? What follows is a brief list of some of the more common situations giving rise to the possible need of a third-party power holder.

### *When the Settlor Wants to Reduce Future Court Involvement, Add Privacy to Trust Matters, or Is Sensitive to Tax Issues*

Consider the situation in which the settlor is creating a dynasty trust and wants to include flexibility in light of an uncertain future yet also wants to avoid the necessity of seeking court resolution when disputes arise. The following sampling of powers can be considered similar to the powers of a court, and consequently it is difficult to argue that the power holder should be treated as a fiduciary:

- arbitrate disputes between trustees and beneficiaries or between beneficiaries;
- modify the trust agreement for purposes of correcting mistakes and taking advantage of tax laws;
- construe terms of the trust and advise the trustee and beneficiary of the same;
- alter a beneficiary's interest in the trust;
- terminate a trust;
- remove and replace trustees;
- add or remove beneficiaries to a trust;
- interpret the rights of a beneficiary to accountings and other trust information;
- grant, modify, or revoke a beneficiary's power of appointment;
- change the distribution standard; and
- approve trust accountings and trustee compensation.

Considering the nature of each of the above powers, it would be difficult or impossible for a settlor or trustee to retain any of these powers. The settlor could not retain the powers for tax reasons, such as the risk of estate tax inclusion. The trustee could not hold most of these powers because they would create conflicts or be difficult to exercise as a fiduciary. That leaves the court, which is a nonfiduciary. As an alternative to going to court, a trust protector may be the better solution. State law has to be researched, and the trust agreement itself should clarify the nature of each power and the standard of care involved.

### *When the Settlor Wants to Bifurcate the Role of Trustee*

There are times when a settlor may want to bifurcate a trustee's duties. For example, the assets of the trust might be highly concentrated, thus, giving professional or corporate trustees concern that holding such assets exposes them to undue risk. In such a case, the settlor may want to bifurcate the investment duties from the administrative duties. By further example, in cases in which a trust holds special assets such as a closely-held business or artwork, the professional trustee may not have sufficient expertise to manage such assets. In this case, the settlor might wish to bifurcate the duty to hold those assets by delegating the responsibility to others with such expertise. These are just two common examples in which bifurcation or delegation of duties is desired.

The powers below are some (but not all) of the traditional trustee-like powers that can be carved out and assigned to another person:

- advise as to the exercise and timing of discretionary distributions by a corporate trustee;
- direct or veto the allocation of sale proceeds to income;
- direct or veto the sale of specific assets;
- direct or advise the trustee in making investment decisions;
- advise the trustee on investments generally;
- run a business owned by the trust; and
- vote shares of trust-owned businesses or securities.

Since the powers above are generally trustee-like, fiduciary duties can be attached to them. For purposes of consistent nomenclature, these powers ought to be assigned to a trust advisor.

### *When the Settlor Can Retain (or Give Beneficiaries) Certain Powers But Chooses Not To*

Certain powers can be held by the settlor or beneficiary without adverse tax consequences or management concerns, but for whatever reason, the settlor may choose not to retain or grant such powers. Some of these include the power to:

- determine or negotiate trustee compensation;
- remove and replace the trustee;
- fill trustee vacancies;
- change the governing law or situs of administration; and
- approve trustee accountings and waive trustee liability.

Each of these powers can have far-reaching and unknown consequences to the beneficiaries, and as such, the settlor's intention should be defined by the trust agreement as either a fiduciary or nonfiduciary power.

### **Some Tips and Traps**

Are best practices emerging for the use of trust protectors? Fortunately, it seems so, but there is still a long way to go before this becomes a settled part of the trust law landscape. A few things to keep in mind include:

- Remember that state law is still unclear and inconsistent.
- Be clear in the trust document which powers apply and what standard of care is owed to each.
- Do not use blanket exoneration clauses, and consider liability questions power by power.
- Avoid using state law that presumes (or forces) fiduciary treatment for the trust protector, if the settlor so wishes.
- Use consistent nomenclature, that is, "trust protector" for nonfiduciary powers and "trust advisor" for bifurcated trustee powers.
- Give the trust protector discretionary powers, not mandatory powers.



- Use a letter of wishes.
- Give the trust protector power to access the trust document, accountings, and all relevant trust information.
- Include a path to removing and replacing the trust protector, and set forth guidelines as to the qualifications of a trust protector.

In addition, keep an eye on the continuing project by the Uniform Law Commission to develop a Directed Trust Act. It is hoped that the project will result in further clarification to the division of powers in contemporary trust planning.

## Conclusion

The use of trust protectors in modern domestic trust planning has outpaced the body of law governing the role. There is little case law dealing specifically with trust protectors, and state statutes are often inconsistent or confusing. In most situations, it is likely that trust protectors are not needed. Still, many circumstances arise in which the use of trust protectors can aid in enhancing the oversight of trust matters and reduce the potential for litigation. Hopefully, the future will bring better-drafted uniform statutes and case law to shed further light on the use of trust protectors.