

A Matter of Trust

Directed Trusts



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In recent years, there has been an increased interest in the use of directed trusts. A growing number of wealthy families are creating directed trusts because the power to make sensitive decisions concerning those trusts, such as investments, can remain in the hands of the family’s existing investment and other counselors.

Originally, wealthy families used directed trusts to protect family business interests that they placed in their trusts. In addition to a full-service trustee, these trusts had advisors (a family member or other business advisor) who would direct the trustee in matters related to closely held business interests owned by the trust.

Today, some states, such as Delaware, have enacted statutes that refine and improve the reasons for establishing a directed trust. In its current form, a directed trust is one in which some of the duties traditionally associated with a trustee are instead vested in either an individual or several advisors. While sometimes the roles are simply split amongst the existing trustees, more often these duties are given to individuals who are not trustees. This creates substantial flexibility for grantors regarding how the traditional “trustee” role will be filled.

Trusts may be set up with up to three kinds of advisors. The first is an Investment Advisor who directs the trustee on all matters relating to trust investments. For instance, the use of an Investment Advisor can allow increased flexibility in investment strategy as that advisor will not be tied to one particular firm’s investments or theories, and can eliminate potential conflicts of interest caused by asset value based fees. A second advantage is that the advisor can be replaced without having to change trustees.

A Distribution Advisor (sometimes the advisor is actually a committee) directs the trustee on distributions to trust beneficiaries, thus allowing the grantor to keep distribution decisions in the hands of someone with a more intimate knowledge of the beneficiaries and their particular personal and financial situations than would be known by a trustee.

Finally, a Trust Protector can provide the grantor with a neutral party to make the overriding decisions of the trust such as removal and appointment of the relevant parties to the trust,

the power to amend the trust, and the power to change the trust’s situs. In Delaware, a directed trust can be set up with any of, a combination of, or all of the aforementioned advisors. A properly drafted trust will have successor language for each type of advisor.

So, why is this attractive to a trustee? The directed trust model offers a trustee the ability to mitigate its risk. While the trustee must remain responsible for the administrative functions of the trust, it can take direction from an advisor as to some of the larger ticket liability areas such as investment strategy and discretionary distributions. If that trustee takes direction subject to a directed trustee statute such as that found in Delaware, it can find protection from liability related to that direction so long as the trustee has acted in a manner that did not reflect willful misconduct. A trustee, who follows the direction of an advisor, is not responsible to monitor the conduct of that advisor or provide advice to the advisor or the beneficiaries with regard to that advisor’s decisions. There are currently eleven states that have a form of directed trust statute.

For the grantor of a trust, the concept of a directed trust is particularly attractive to those who (1) have close relationships with their current advisors, (2) own substantial non-traditional assets, such as closely held businesses, that they wish to keep in the family, or (3) are concerned about significant family issues such as spendthrift, substance abuse or competency. The grantor is able to obtain the benefit of a corporate trustee’s administrative expertise while still allowing those close to him or her to maintain control over the investments and distributions. The family is thus able to achieve its goal of keeping decision making close while the corporate trustee is able to concentrate on properly administering the trust. In essence, it is a win-win situation.

In the case of Delaware trusts, the use of a Delaware corporate trustee allows the grantor to access the many benefits of selecting Delaware as the trust’s situs such as the Delaware Chancery Court, the dynasty trust and asset protection trust, and the many income tax advantages. It is particularly good for a family that wants to use Delaware as its trust situs, while keeping its family advisors in place.