



# Comparing the Discretionary, Delegated and Directed Trustee's Role and the Trust Protector

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**Wednesday**

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**1:00 pm central**

## **Paying Caregivers and Employees from a Trust: Staying Out of Hot Water**

*Rachel Green and Cheryl Severson,  
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# Winner's Minute - Mac Hammond



# Today's Presenter



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# Comparing the Discretionary, Delegated, & Directed Trustee's Roles and the Trust Protector

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# Directed and Delegated Trusts

## Learning Objectives:

1. What is Delegation
  - a. Types of delegation
2. What is a Direction
3. How is the trustee's role affected
4. How is the trustee's risk affected
5. What are the business realities
6. The role of a Trust Protector



# Why Do I Care?

An Advisor comes to you and says “I have a client...” that “needs a trustee”. “They will direct the Trustee to use me as the Investment Advisor.”

A client comes to you and says “I need a trust... but I want to stay with my current investment advisor.” “I’ve been reading about how I can direct a Trust to use my Advisor.”

The Uniform Directed Trust Act has been enacted in 13 states and is introduced in a 14<sup>th</sup> state.

A Board Member says “I’ve been reading - Is the relationship we have with (3<sup>rd</sup> party) a Directed Trust Relationship or a Delegated Relationship”.

# Defining the Models

1. Discretionary Trust
2. Delegation in a Trust
3. Direction in a Trust

## Two very different models....

- Delegation is a UPIA concept
- Direction is a Restatement of Trusts/ UTC concept
  - Increasingly a Uniform Directed Trust Act concept.

# Defining the Models

1. Discretion in a Trust
  - ▶ Delegation in a Trust
2. Direction in a Trust

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# Delegation in a Trust

# Delegation

- ▶ Three types of “delegation”

1. Internal Staff
2. Third Party registered investment advisor (RIA) that is in the business of advising Trustees
3. Individual Investment Advisor Representative (IAR)
  - ▶ And the RIA employing that IAR

# Delegation

## Uniform Prudent Investor Act

### The Uniform Prudent Investor Act states:

- A. A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The fiduciary shall exercise reasonable care, skill and caution in all of the following:
1. Selecting an agent
  2. Establishing the scope and terms of the delegation, consistent with the purposes and terms of the estate, trust, conservatorship, or guardianship.
  3. Periodically reviewing the agent's actions to monitor the agent's performance and compliance with the terms of the delegation.
- 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 A. of this section is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.

# Delegation

## Uniform Prudent Investor Act

A: “A trustee may delegate investment and management functions that a prudent trustee of comparables skills could properly delegate under the circumstances.”

- The most important word is "functions". Delegating the investment function is simply having someone else complete some of the work on your behalf.
- The Trustee delegates, giving authority (may include discretion) to the RIA. You are delegating the work of managing the assets and if applicable, to exercise discretion.

# Delegation

## Uniform Prudent Investor Act.

### A 1: “Selecting an agent.”

1. This is a requirement that the fiduciary must take seriously. A due diligence process is necessary on the RIA that goes beyond a cursory review of their ADV.
2. The due diligence process needs to be in-depth. The due diligence is the same whether dealing with a local IAR / RIA or an RIA Firm focused on trust asset management.
  - a. When you are considering an IAR remember that the IAR is a representative of an RIA. You have to do due diligence on both the IAR and the RIA.
3. You need a process and policy to conduct the Due Diligence on an annual basis.
  - a. What will you do if the IAR or the RIA has a "black mark" on their record?
4. Be cautious about dealing with strangers!



# Delegation

## Uniform Prudent Investor Act

**A 2: “Establishing the scope and terms of the delegation, consistent with the purposes and terms of the estate, trust, conservatorship, or guardianship.”**

- ▶ Requirement, but practical as well. You - the trustee - and the IAR - and the RIA firm - and the client need to be very clear as to who is doing what and what this delegation really means.
- ▶ It should be in writing and preferably in a contract signed by all parties. This is sometimes structured as a three way service agreement. (Trustee, IAR and RIA - but in delegation not the client / beneficiaries)
- ▶ Examples of the communication issues:
  - You as the trustee/ administrator may need cash available for client needs.
  - How do you coordinate with the investment advisor?
  - How are client meetings conducted? Jointly? Each their own?

# Delegation

## Uniform Prudent Investor Act

**A 3: “Periodically reviewing the agent's actions to monitor the agent's performance and compliance with the terms of the delegation.”**

- ▶ The discharge of fiduciary duty requires the Trustee to take full responsibility for the investment management function regardless of delegation.
- ▶ Address possible regulator reactions. While delegating to retail RIA's has become more common, many regulators have expressed concerns.
- ▶ Regularly reviewing the RIA's actions to monitor the IAR's performance and compliance with the terms of the delegation.
  - ▶ Annual is inadequate, -- daily or weekly

# Delegation

## Uniform Prudent Investor Act

**B: “In performing a delegated function, an Advisor owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.”**

- Simple sounding but how are you going to monitor "compliance with the terms of the delegation".
  - ▶ The terms of the delegation are not the terms of the governing document.
  - ▶ The terms of the delegation must be in writing (contractually) and any changes in those terms would also have to be in writing.
- And, what if the IAR or RIA isn't complying?
  - Is simply informing the client enough? What if the client says it is ok? Can the client waive your fiduciary responsibility?
- The enforcer of the delegation to a third party is NOT the client / beneficiaries.
- The only enforcer of the contractual delegation is the Trustee

# Delegation

## Uniform Prudent Investor Act

C: “A trustee who complies with the requirements of A. of this section is not liable to the beneficiaries or to the trust for the decisions or actions of the Advisor to whom the function was delegated.”

- ▶ This seems rather clear.. almost like a directed trust where you don't have the responsibility.
- ▶ But, 1) you have to fulfill those requirements and that could create debate about whether those requirements are fulfilled adequately. Your duty is all consuming and easily challenged.
- ▶ And 2) it is very clear that the Trustee has a fundamental duty to oversee ALL of the investment activity - without limitation - in a delegated trust.

# Choosing to Delegate

## Business Considerations:

- ▶ Who has primary customer relationship
- ▶ What if the IAR leaves the RIA
- ▶ Custody of Assets
  - ▶ Access to Assets
  - ▶ Ability to move or disburse funds
- ▶ IAR and or RIA's ability to exercise discretion.
- ▶ Profitability is an open question.
  - ▶ Delegated managers fee schedule.
  - ▶ Monitoring and due diligence requirements are almost as much work (cost) as if you were doing the investments yourself.
- ▶ Professional investment management reduces fixed costs in favor of variable costs.

# Choosing to Delegate

## Business Considerations: *continued*

- ▶ For many, 2020 is a powerful example of the value of a high quality professional manager.
- ▶ Vendor Management on the “delegated advisor”
  - ▶ Definitely the RIA
  - ▶ In many cases the IAR also.
- ▶ Are your policies and procedures adequate
- ▶ “One-off” deals are expensive...

# Choosing to Delegate

## Best tools for you to address the business considerations

- ▶ Delegation Contract
- ▶ Well thought out policies and procedures
- ▶ Internal Consistency
  - ▶ Education and training.
- ▶ Direct relationship and interaction with the custodian
  - ▶ Data feed, at least daily
  - ▶ Restrictions on withdrawals and transfers by the RIA / IAR.

# Accepting a Trust with a Power to Direct



# Direction in a Trust

A Directed Trust occurs when:

1. the grantor clearly directs the trustee to use a 3<sup>rd</sup> party investment advisor; and
2. through the terms of the governing document,
3. in combination with the state statutes; and,
4. relieves the Trustee of responsibility for the activities and results of the Advisor.

# Accepting a Directed Trust

- ▶ Documents must be drawn up in line with the statutes in your state. They must clearly define the situation as a Directed Trust.
- ▶ Your legal counsel should review every Directed Trust document carefully.

This is new law in many states.

- ▶ Some - very few - Trust departments are trying to assess an acceptance fee for Directed accounts to cover the cost of the legal and risk review necessary.

Aligning income with expenses is wise.

# Directed Trusts - State Law

Statutes vary considerably from state to state

1. Section 185 of the Restatement (Second) of Trusts
2. Uniform Trust Code § 808
3. More aggressive drafting of Restatement Section 185 or UTC §808
4. Uniform Directed Trust Act - 2017

▶ Case Law varies considerable from state to state

- ▶ States with a newer Directed Trust statutes may have no case law

# Directed Trusts - State Law

## 1. Section 185 of the Restatement (Second) of Trusts provides as follows:

“If under the terms of the trust a person has power to control the action of the trustee in certain respects, the trustee is under a duty to act in accordance with the exercise of such power, unless the attempted exercise of the power violates the terms of the trust or is a violation of a fiduciary duty to which such person is subject in the exercise of the power.”

States where the state statute is based upon Section 185

- ▶ Iowa
- ▶ Indiana enacted the [Uniform Directed Trust Act](#) in 2019

# Directed Trusts - State Law

## 2. Uniform Trust Code § 808 provides:

“If the terms of a trust confer upon a person other than the settlor of a revocable trust power to direct certain actions of the trustee, the trustee shall act in accordance with an exercise of the power unless the attempted exercise is manifestly contrary to the terms of the trust or the trustee knows the attempted exercise would constitute a serious breach of a fiduciary duty that the *person holding the power owes* to the beneficiaries of the trust.”

States where the state statute is based upon Uniform Trust Code UTC § 808

- ▣ Alabama, District of Columbia, Florida, Kansas, Maryland, Massachusetts, Mississippi, Montana, North Dakota, Oregon, Pennsylvania, South Carolina, Texas, Vermont.
- ▣ Arkansas, Maine, Michigan, Nebraska, New Mexico, Virginia and West Virginia have adopted the [Uniform Directed Trust Act](#).

# Directed Trusts - State Law

## 3. More aggressive approach in allowing directed trusts

Some states have gone beyond the language of the Restatement of Trusts and that of the Uniform Trust Code generally by providing greater protection to the trustee.

- ▶ States where the state statute is more aggressive in supporting Directed Trusts:
- ▶ Arizona, Delaware, Florida, Idaho, Illinois, Kentucky, Minnesota, Missouri, Nevada, New Hampshire, North Carolina, Ohio, Oklahoma, South Dakota, Tennessee, Utah, Wisconsin, and Wyoming.
  - ▶ Colorado, Georgia, Indiana, Utah, Virginia, Washington have adopted the [Uniform Directed Trust Act](#).

# Directed Trusts - State Law

## 4. Uniform Directed Trust Act.

States that have adopted:

<u>Jurisdiction</u>	<u>Year</u>	<u>Bill Number</u>
Arkansas	2019	HB 1765
Colorado	2019	SB 105
Georgia	2018	HB 121
Indiana	2019	SB 265
Maine	2019	LD 1468
Michigan	2019	HB 6130
Nebraska	2019	LB 536
New Mexico	2018	SB 101
Utah	2019	HB 314
Virginia	2020	HB 1380
Washington	2020	SB 6029
West Virginia	2020	SB 213

Introduced in Rhode Island currently - HB 7710 / SB 2688

# Accepting a Directed Trust

- ▶ Directed Trust statutes are relatively new in many states.
- ▶ Directed Trust statutes vary considerably from state to state
- ▶ There is debate as to whether a document executed before the statutes were approved can be modified to comply with the statutes.
  - ▶ many of our client's legal counsel have come down strongly on the side that a document needs to be restated and re-executed to address the new Directed Trust Statutes.
  - ▶ Re-writing and re-executing the documents - if it is even possible - are expensive to the client.
  - ▶ Does the state with jurisdiction allow “decanting”



# Accepting a Directed Trust

## Strategic Decision - Not a Casual Decision

- ▶ Just because your state has approved Directed Trust statutes does not mean that your organization must or should enter this line of business.
- ▶ You should conduct a line of business risk assessment and must prepare a new set of policies and procedures relating to this product line.

## Directed Trusts, by definition, raise the question of who is in control

- ▶ The trustee, or the party who has the power to direct.

# Accepting a Directed Trust

## Due Diligence on the IAR and the RIA

Non regulatory due diligence

## Reputational Risk

- ▶ Is the IAR / RIA someone you want to be associated with?
- ▶ Do they have a pattern of client complaints?
- ▶ Will the IAR / RIA use this arrangement against you competitively?

## Operational and Administrative / Efficiency Risk Assessment

- ▶ Does the Advisor really understand the Trust/Fiduciary world in which you operate?
- ▶ Who will be the custodian? What about trade execution?
- ▶ Can (or will) the IAR be provided access to your trading system without hassles?
  - ▶ Hint: “One-off” situations are expensive.

# Accepting a trust containing a Trust Protector

# Trust Protector

The Trust Protector role is increasingly being recognized by states.

- ▶ 41 states and the District of Columbia had some form of Trust Protector role.
- ▶ Trust Protector is recognized in the Uniform Trust Code.
- ▶ Trust Protector (using the term Trust Director) is fundamental to the Uniform Directed Trust Act.

However, there is not yet any common law or other accepted description of a Trust Protector's role, powers and responsibilities.

# Trust Protector

The Uniform Directed Trust Act defines a “trust director” as:

“a person that is granted a power of direction by the terms of a trust to the extent the power is exercisable while the person is not serving as a trustee.”

The person is a trust director whether or not the terms of the trust refer to the person as a trust director and whether or not the person is a beneficiary or settlor of the trust.

# Trust Protector

## DUTY AND LIABILITY OF DIRECTED TRUSTEE. - Uniform Directed Trust Act.

- (a) Subject to subsection (b), a directed trustee shall take reasonable action to comply with a trust director's exercise or non-exercise of a power of direction or further power under Section 6(b)(1), and the trustee is not liable for the action.
  
- (b) A directed trustee must not comply with a trust director's exercise or non-exercise of a power of direction or further power under Section 6(b)(1) to the extent that by complying the trustee would engage in willful misconduct.

# Trust Protector

1. Oversees a trust to ensure that the administration by the trustee is in keeping with the settlor's intent.
2. Has no day-to-day responsibilities for management of the trust.
  - A trust protector can be of value for long-term irrevocable trusts.
    - Protecting the settlor's intent over generations.
  - Provides a third party to monitor the Trust / Trustee based upon a specific need.
    - Family needs, issues, dynamics
    - Social, Political, Cultural interests

# Trust Protector - Powers

Trust protectors can be given as few or as many powers as the trust creator desires.

- Should only be given powers that insure the purposes of the trust creator are fulfilled.
- Powers could include:
  - Removing or replacing trustees
  - Expanding or limiting trustees' powers
  - Resolving disputes between trustees, or between trustees and beneficiaries
  - Amending the trust, terminating the trust, or changing where the trust is located due to changes in the law
  - Changing the rules for distributions due to changes in the beneficiaries' circumstances
  - Adding new beneficiaries when additional children are born
  - Vetoing distributions or investment decisions



# Conclusion

## Discretionary

- ▶ Delegation
- ▶ Involves a decision by the trustee to delegate a function to a third party.

## Directed Trusts

- ▶ The governing document directs the trustee to handle a duty under the trust in a particular manner.
- ▶ Trust Protectors
  - ▶ The governing document authorizes a third party to have power over certain responsibilities under the trust.

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# ***THANK YOU!***

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