Bifurcation of Fiduciary Roles: Directed vs. Delegated Trusts

Today, with the financial sophistication of families and the various choices available to consider when transferring assets to multi-generations and ownership of wealth, families are seeking dynamic estate planning solutions to ensure assets are controlled and maintained on their terms. Wealth may be concentrated in a particular investment, or a function of having a family business, commercial real estate portfolio, or a relatively heavy weighting in alternative investments, such as hedge funds or private equities. While these assets may have served the family well in creating wealth, they can present difficulties in implementing effective estate planning or asset protection strategies.

Trust creators or trust beneficiaries may wish to "bifurcate" the responsibility for trust administration and investment management. Utilizing the beneficial features of Tennessee trust statutes, trustees like Wealthspire Trust can partner with financial advisors to offer a flexible approach to trust administration and investment management.

With a Tennessee directed trust, a trust agreement may be drafted so that a "trust advisor," who is appointed in the agreement, is given the authority to direct the trustee regarding investment decisions. This law relieves the directed trustee from virtually all liability for decisions in which it is directed by the trust advisor. By removing investment decisions from the directed trustee, the tension between a trustee's duty to diversify assets and the family's desire to plan to use concentrated or difficult to manage assets is excluded. The result is the autonomy and flexibility to implement almost any estate planning strategy that utilizes a trust—dynasty trusts, marital trusts, credit shelter trusts, charitable remainder trusts, qualified personal residence trusts, intentionally defective grantor trusts, etc.—to achieve desired goals.

The trust creator (also known as grantor, settlor or trustor) may serve as a trust advisor to direct the trustee to utilize the services of a 3rd party investment manager. In some scenarios, the trust advisor can be a trust beneficiary or other individual who had a close relationship with the trust settlor. A directed trust can allow an existing wealth advisor to continue managing trust assets based on the authority of the directing party, while releasing the trustee from the responsibility of how the money is invested. In a directed trust, the trustee is legally required to follow the investment directives of the investment direction advisor (except for acts of willful misconduct).

BENEFITS OF DIRECTED TRUSTS

1. Investment Flexibility

Given the option, most clients would like to determine what their trust can buy, sell, and hold. They want an advisor they know and trust to manage their investments. They see the value in a corporate trustee administering their trust, but they want the expertise of their trusted financial advisors along the way. Today, many families also have nontraditional assets such as, closely held businesses, family limited partnerships, LLCs, private equity interests, commercial and personal real estate, etc., which may not fit under Wealthspire Trusts' investment parameters. A directed trust allows clients to preserve, protect, and grow these unique assets that are core components to their family's financial success.

2. Greater Control

In estate planning, clients must be willing to give up some level of control, but to the extent they can retain as much as possible, many would prefer it that way. We have discussed giving the client or their trusted financial professional investment discretion in their trust, but some clients also want to give a family member or committee the power to authorize distributions in accordance with distribution language in the trust document. They feel this would give more peace of mind and protection to their beneficiaries. In a directed trust, they can do just that. The distribution advisor or distribution committee will be able to direct Wealthspire Trust on when to make a distribution from the trust to a beneficiary. The distribution advisor, however, cannot be the grantor or a beneficiary of the trust.

3. Lower Trustee Fees

In a directed trust, the investment management responsibility is removed from Wealthspire Trust, thus eliminating the investment liability and in some cases distribution liability from Wealthspire Trust. This is significant because a trustee's liability for the underlying investments and distribution decisions is a major factor in determining trustee fees.

Trust settlors who may not wish to name a directing party can still have a trust drafted that allows a 3rd party investment manager to manage trust assets. The settlor can state their wish for the trustee to delegate investment authority to an outside investment advisor. Delegated trusts give Wealthspire Trust the ability to delegate the investment of trust assets. In a delegated trust, Wealthspire Trust remains responsible for ensuring the investments are suitable for the needs and purposes of the trust.

Delegated trusts tend to be existing trusts that were not drafted with indemnification and bifurcation language allowing for the flexibility to separate trustee duties. Because duties cannot be separated, Wealthspire Trust is responsible for performing due diligence on the advisor, overseeing the chosen investments, monitoring the advisor's investment performance, and managing distributions according to the terms of the trust document. Because of the heightened level of liability and monitoring required with a delegated trust, trustees who accept delegated trusts often charge higher fees for these relationships. Though many older trust documents do not address the appointment of a directing party nor the delegation of investment authority, such issues can often be addressed utilizing what is known as a Non-Judicial Settlement Agreement, or NJSA. An NJSA can be utilized to appoint a trust beneficiary or other individual as the "directing party." The directing party then directs the advisor-friendly trustee to utilize the services of an independent investment advisor to manage trust assets and to utilize the custodian chosen by the advisor. All qualified beneficiaries of the trust must sign off on the NJSA, as their unanimous request is required under the Trust Code. A qualified beneficiary is anyone who is currently entitled to receive distributions from the trust and anyone who would be entitled to distributions from the trust if the current beneficiaries receiving distributions were to pass away.

While a Tennessee's directed trust is extremely powerful, it cannot remove every impediment to using a trust. Besides issues related to fiduciary liability and control, execution of a trust may have estate, gift, and income tax consequences. Use of family members as the advisors who direct a trustee may cause unintended tax consequences. As a result, great care must be exercised when creating a trust that will use a family member or other non-independent individual as an advisor.

Moreover, it is important to be sure that all the parties understand their roles and responsibilities when the components of a trustee's duties are split among the trustee and one or more advisors. It is also helpful to have a plan for dispute resolution. If a committee is appointed for investments or distributions, it is important to think about a governance strategy.

When there is a choice between a directed or delegated trust, it is typically more advantageous to structure a trust to be directed. However, the option to do so may not always be available. While trusts are in the drafting stage, any flexibility for the separation of trustee powers can be incorporated into the trust agreement. However, once an irrevocable trust is drafted, it may be arduous, time consuming, and expensive to make the necessary changes to allow for a directed versus a delegated structure. For these reasons, thoughtful and careful planning is always recommended.

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