

Regulation and Compliance—Guidelines for Trust Protectors

Trust Protectors initially gained popularity in connection with offshore asset protection trusts. Those Trust Protectors are typically expected to remove and replace fiduciaries or change the situs of a trust in an attempt to stay one step ahead of a settlor's creditors. The role of the domestic Trust Protector is not as clearly defined as only a few states have legally recognized the dual existence of Trustee and Trust Protector.

The power of the Trust Protector is derived from the Trust Agreement. The Agreement sets forth the dual roles of the Trustee and the Trust Protector. While the Trustee can be a bank or trust company, or another financial institution, the Trust Protector is usually a person close to the family, a CPA, accountant, lawyer, or other financial advisor.

In general, the Trust Protector may be empowered to:

- Remove or replace the Trustee. Although the Trustee can be fired at will, removal and replacement of the Trustee is often due to failure to execute the Trust Agreement for the benefit of all Beneficiaries, changes in the Corporate Trustee's management, or poor investment performance.
- Change the Trust's situs. A change in situs might be appropriate if Beneficiaries move from high tax states to low tax states or if other state law changes challenge the operation and purpose of the trust in the current situs.
- Resolve deadlocks between co-trustees or disagreements between the Trustee and/or Beneficiaries.
- Control spending in excess of a designated certain amount. The Trust Agreement might limit trust distributions in excess of a designated amount unless both the Trustee and Trust Protector sign-off on the distribution.
- Veto distributions to Beneficiaries. A Trust Protector might have access to information that the Trustee would not that might cause veto of a distribution. For example, the Trust Protector might know that a Beneficiary is being sued, is in the midst of divorce proceedings, or is otherwise under duress, incompetent, or untrustworthy.
- Veto investment decisions. This power provides an additional level of protection to Beneficiaries, assuring that changes in risk tolerance, time horizon, and liquidity needs are adequately reflected in the Trustee's investment strategy.
- Sue and defend lawsuits against the Trust assets. This power is in addition to the Trustee's fiduciary obligation to protect trust assets and enforce claims on behalf of Beneficiaries.

- Terminate the Trust. The Trust Protector may terminate the trust if, in his or her opinion, there are insufficient funds or the cost of administration is greater than the benefit of continuing the trust.

Along with such powers and their exercise (or non-exercise) comes the potential for liability. A recent case, *McLean Revocable Trust v. Patrick Davis, P.C.*, 283 S.W.3d 786 (Mo. Ct. App. 2009), explores the limits of a Trust Protector’s liability.

Background

At stake in the case was the liability of a Trust Protector named in a revocable inter vivos supplemental/special needs trust created on behalf of a disabled Beneficiary. Regarded by the court as a case of first impression in Missouri, it raises important questions nationwide about the duties and liability Trust Protectors.

In *McLean*, the Trust Protector was authorized to remove and replace trustees and to appoint successor trustees to fill any vacancy. The Trust Protector also was authorized to appoint a successor Trust Protector.

The trust held the settlement proceeds of a personal injury recovery. The Trust Protector was the lawyer who handled the personal injury lawsuit. The successor trustees were the lawyers (and their law firm) who referred the litigation to the Trust Protector. An allegation in the lawsuit against the Trust Protector on behalf of the beneficiary stated that the law firm and its lawyers “referred many legal clients to [the Trust Protector] over the years and those referrals had netted [the Trust Protector] substantial fees, a portion of which were then shared back with [the law firm and its lawyers].” If proven, this allegation would raise conflict of interest concerns for both legal ethics and fiduciary liability purposes.

The trust document, which provided that “[t]he Trust Protector’s authority hereunder is conferred in a fiduciary capacity and shall be so exercised, but the Trust Protector shall not be liable for any action taken in good faith.” The defendant claimed that Missouri law imposes no duties on a Trust Protector and that, as a result, there was no duty to supervise the trustees, nor to monitor or direct them, and therefore no liability for their malfeasance, if any.

An allegation in the lawsuit against the Trust Protector on behalf of the beneficiary stated that the law firm and its lawyers “referred many legal clients to [the Trust Protector] over the years and those referrals had netted [the Trust Protector] substantial fees, a portion of which were then shared back with [the law firm and its lawyers].” If proven, this allegation would raise conflict of interest concerns for both legal ethics and fiduciary liability purposes.

The Court's Conclusion

The lower court granted summary judgment and dismissed the case.

On appeal, however, the appeals court reversed the grant of summary judgment in favor of the defendant, allowing the case to go forward. According to the appeals court, lacking any duties imposed by state law, resolution of the case turned on whether the document generated fiduciary duties on the Trust Protector. The court concluded that this was a legitimate issue of genuine fact. Although the court did not opine as to what those duties might be, the opinion does suggest that the document's use of "fiduciary capacity" implied "at least the basic duties of undivided loyalty and confidentiality . . . [and] the existence of at least some duty of care."

Bottom Line

The important lesson to learn from *McLean* at this point in the litigation is that in instances where the Trust Protector concept is used, the draftsman should clearly define the role and the extent of the Trust Protector's fiduciary liability. In the absence of such clarity, the courts are likely to intervene.

Regulation and Compliance plus similar topics are covered in great detail in many of Cannon's professional development solutions. To find out more visit: www.cannonfinancial.com.

Copyright ©2010 Cannon Financial Institute - All Rights Reserved

Subscribe to Cannon Insights at <http://www.cannonfinancial.com/newsletter/subscribe>

Disclaimer: The materials and information contained herein are intended for educational purposes, to stimulate thought and discussion so as to provide the reader with useful ideas in the area of wealth management planning. These materials and information do not constitute and should not be considered to be tax, accounting, investment, or legal advice regarding the use of any particular wealth management, estate planning, or other technique, device, or suggestion, nor any of the legal, accounting, tax, or other consequences associated with them.

While the content herein is based upon information believed to be reliable, no representation or warranty is given as to its accuracy or completeness. For this reason, the program of study should not be relied upon as such. Although effort has been made to ensure the accuracy of these materials, you should verify independently all statements made in the materials before applying them to your particular fact pattern with a client. You should also determine independently the legal, investment, accounting, tax, and other consequences of using any particular device, technique, or suggestions, and before using them in your own wealth management planning or with a client or prospect. Information, concepts, and opinions provided herein are subject to change without notice.

The strategies contained within these materials may not be suitable for all clients. For many concepts discussed herein, clients are strongly urged to consult with their own advisors regarding any potential strategy and will need to discuss their particular circumstances with their legal and tax advisors beforehand to determine whether a particular strategy described herein is suitable for their particular circumstances.

Examples, provided throughout these materials, are for illustrative purposes only, and no representation is being made that a client will or is likely to achieve the results shown. The examples shown are purely fictional and are not based upon any particular client's circumstances.