The International Family Offices Journal

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June 2017 • www.globelawandbusiness.com

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Trust governance models

Todd D Mayo

Family offices need to understand, and often monitor, the various trusts that family members may have created. Often the governance structure of a trust is not well understood.

A trust's internal governance is one of the most important aspects of trust design. A trust's governance structure affects how well the trust's purposes can be achieved, how well the settlor's intent is respected and how well the beneficiaries' interests are represented. Trusts have become increasingly sophisticated vehicles for managing wealth. Trust laws have evolved to allow more sophisticated governance structures, assigning and sharing the responsibilities among multiple parties. Those sophisticated structures can be advantageous, permitting the assignment of specific responsibilities to the individual or firm who have the skills and experience to carry out those responsibilities effectively and efficiently, facilitating the management of risks associated with carrying out various aspects of trust administration, and generally providing more flexibility.

Overview

As a starting point in examining trust governance structures, there are three key issues to explore:

- First, what powers and duties are involved in governing a trust?
- Secondly, to whom are the powers and duties assigned? This is the cast of characters involved in the governance of a trust.
- Thirdly, what are the four trust governance models? These are the templates for how powers and duties are split, shared or otherwise arranged.

Powers and duties

At its core, a trust's governance structure involves the allocation of the powers and duties necessary to administer the trust. In broad strokes, there are three categories of powers:

- investment powers;
- distribution powers;
- administrative powers.

Investment powers encompass the management of the trust property. Distribution powers encompass the distribution of the trust property to the beneficiaries. In a trust instrument, the dispositive provisions generally define the scope and nature of the distribution powers. Administrative powers include a slew of what are often viewed as clerical tasks, which in fact frequently affect the substantive rights of the beneficiaries and other parties involved in a trust. Administrative powers include record-keeping, providing notices, reports, accounts and other information to the beneficiaries, and tax compliance. In a trust instrument, the administrative provisions generally define the administrative powers. Within each of those broad categories, there are many specific powers, some of which do not fit neatly into one category and many of which interconnect with other related powers.

Cast of characters

A trust's governance structure involves a cast of characters. These are the persons to whom powers and duties are assigned and may include:

- trustee;
- trust adviser;
- protector;
- enforcer;
- settlor;
- beneficiaries.

At a minimum, a trust's governance structure will include a trustee. In a trust that has beneficiaries, the settlor and the beneficiaries may play some role in a trust's governance structure (such as in connection with trustee succession matters), but not necessarily. In a purpose trust – a trust without beneficiaries – the settlor may or may not play a role in the trust's governance structure, and it ideally would include an enforcer (ie, a person empowered to enforce the terms of the trust through judicial or other means).

A more complex trust governance structure may include different classes of trustees, with certain powers assigned to each class of trustee. For example, a trust instrument may create the role of a distribution trustee, who is exclusively vested with discretionary distribution powers, or an investment trustee, who is exclusively vested with the investment powers.

Similarly, a more complex trust governance structure may include trust advisers and protectors. A trust adviser generally refers to a person who has the power to advise or direct the trustee to take certain actions, typically with respect to investments or distributions. In the trust instrument, a trust adviser may have a different title. A person who has

discretionary distribution powers may be called a distribution adviser or distribution director or may be a member of a distribution committee. A person who has investment powers may be called an investment adviser or an investment director or may be a member of an investment committee.

In common parlance, a protector generally refers to a person who has the power to protect the trust, such as by means of removing a trustee, appointing a trustee and commencing judicial proceedings to enforce the terms of the trust. What it means to 'protect the trust' varies, sometimes from practitioner to practitioner and sometimes from trust to trust or jurisdiction to jurisdiction. Sometimes it means acting as the settlor's proxy, exercising powers in the manner that the protector believes that the settlor would wish; sometimes it means acting as the proxy for a hypothetical, rational, emotionally and financially mature beneficiary, exercising powers in the manner that the protector believes are in the beneficiaries' best interests.

Although common language and some cases seem to recognise a distinction between trust advisers and protectors, the distinction has eroded if not evaporated. In the United States the statutory regimes in some of the leading trust jurisdictions treat 'trust adviser' and 'trust protector' as synonymous terms, deferring to the terms of a trust to define those roles. For example, in the state of New Hampshire, the operative statute provides that "a trust protector or trust adviser is any person, other than a trustee, who under the terms of the trust … has a power or duty with respect to a trust".[1]

In a well-designed trust, each character will have a well-defined role. In a poorly designed trust, the characters often have confusing, ill-defined roles. Unsurprisingly, most trust instruments fall somewhere in between, attending well to certain aspects of the governance structure while neglecting other aspects. As long as the trustees, trust advisers, trust protectors and enforcers – collectively, the 'trust officials' – are working well together, ambiguities or other deficiencies in the trust instrument generally are not problematic. The trust officials work through any issues, establishing (either formally or informally by their conduct) clearer assignments of powers and duties and processes by which they coordinate their efforts in administering the trust. When things go bad – the trust officials have disagreements or the beneficiaries are alleging that one or more of the trust officials have breached their duties – the lack of clarity and specificity in the trust instrument can exacerbate the problems.

Four governance models

For trusts, there are four governance models:

- *Unitary trustee*. In the unitary trustee model, the trustee is vested with all of the trustee powers. The trustee has the power to make distributions and the power to invest the trust property. The trustee also has the administrative powers, such as paying the trust's expenses, providing notices and reports to the beneficiaries, preparing and filing the trust's tax returns, and record-keeping.
- *Directed trust.* In a directed trust, the trustee is vested with all of the trustee powers, but, with respect to certain powers, the trustee may act only in accordance with another person's direction. For example, a person other than the trustee may have the power to direct the trustee to make distributions or the power to direct the trustee concerning the investment of the trust property. Although the term 'directed trust' is more commonly used in the United States, it often aptly encompasses a 'reserved powers' trust.
- *Divided trust.* In a divided trust, the trustee is exclusively vested with certain trustee powers, and one or more other persons are exclusively vested with other trustee powers. A common example is the pure administrative trust, in which the trustee is vested with only administrative powers (eg, record-keeping, tax compliance and reporting to the beneficiaries), a trust adviser (perhaps called a distribution adviser or distribution director) is vested with discretionary distribution powers, and another trust adviser (perhaps called an investment adviser or investment director) is vested with the investment powers.
- *Hybrid trust.* A hybrid governance model incorporates elements of a directed trust and a divided trust. For example, a trust instrument may grant to a person the power to direct the trustee to make distributions, while granting to another person the exclusive power to manage the trust property.

Those models represent an evolutionary progression. Beginning with the unitary trustee model, the directed trust emerged in an effort to improve upon the unitary trustee model. Not everyone liked the idea of a having a trustee handle all aspects of a trust administration. A directed trust addressed that issue, providing a mechanism for splitting up the responsibilities. For example, a directed trust addressed a settlor's wish to retain certain powers (such as investment powers) so that, rather than having an institutional trustee manage the trust property, the settlor or a favoured investment management firm could manage the trust property. The divided trust similarly evolved from the directed trust, again in an effort to improve upon its predecessor. The divided trust offered a more efficient division of powers and duties, avoiding some of the

The simplicity of the unitary trustee model is both a benefit and a bane. For a family with modest wealth, uncomplicated investment holdings (such as only cash and publicly traded securities), and an uncomplicated family situation, a unitary trustee model can be a good fit.

administrative inefficiencies of the directed trust structure. Lastly, although it potentially can be a sensible design in some cases, the hybrid model tends to be an evolutionary anomaly. This evolutionary progression has been more pronounced in the leading US jurisdictions.

Unitary trustee

The unitary trustee is the traditional trust governance model. This model has been in use for centuries. In the unitary trustee model, the trustee is vested with all of the trustee powers. The trustee is therefore responsible for all aspects of a trust's administration. A unitary trustee model can involve two or more trustees. If there is more than one trustee, the trustees share the trustee powers. Each co-trustee is vested with all of the trustee powers, and the co-trustees must act unanimously (as was a more common practice and requirement in years past) or by majority vote (as is more common under contemporary law and trust design). Consistent with the fact that the co-trustees share the trustee powers, the unitary trustee model has limited facilities for ring-fencing liabilities. A trustee generally has a duty to prevent a co-trustee's breach of fiduciary duties. A trustee generally is not liable for joining the co-trustees in an action to which that trustee objected, unless the action involves a serious breach of trust.

Delegation

Delegation provides a limited means of facilitating more efficient trust administration. A trustee may delegate certain powers to a co-trustee or an agent. For example, a trustee may delegate investment powers to a professional investment manager. The delegation must be prudent. The trustee must monitor the delegatee, ensuring that the delegatee is acting within the scope of the delegation and ensuring that the delegatee is acting prudently. A trustee who delegates powers thus does not fully absolve itself of liability arising from the exercise (or non-exercise) of the delegated power. To the extent that the delegation may have been imprudent or the trustee fails to monitor adequately the delegatee, the trustee is potentially liable for any harm that the delegatee causes. Significantly, some powers are non-delegable. For example, a trustee generally cannot delegate the power to make discretionary distributions. Thus, delegation is often an imperfect tool for assigning trustee powers among multiple persons.

Advantages and disadvantages

The simplicity of the unitary trustee model is both a benefit and a bane. For a family with modest wealth, uncomplicated investment holdings (such as only cash and publicly traded securities), and an uncomplicated family situation, a unitary trustee model can be a good fit. In those circumstances, a more complicated governance structure may create unnecessary expense and confusion. Although its simplicity is appropriate in many circumstances, the unitary trustee model is often ill-suited for more complex family situations and trust holdings. For example, an institutional trustee may be reticent to serve as the trustee of a trust that holds a privately held operating business; a directed trust or divided trust can insulate the institutional trustee from potential liability arising from a trustee-owned business. The unitary trustee model may also not adequately achieve the settlor's wishes. For example, a settlor may value an institutional trustee's competency in trust administration, while preferring an investment management firm's competency in investment management. A trustee may prefer a directed trust or divided trust over a unitary trustee, because the trustee can avoid the duties and liabilities associated with delegation.

Directed trust

The trustee of a directed trust is vested with all of the trustee powers, but one or more other persons have the power to direct the trustee to exercise (or refrain from exercising) certain powers. For example, the terms of the trust may provide that a person has the power to direct the trustee concerning the investment of the trust property or in making discretionary distributions. At least in theory if not always in practice, a directed trust allows a settlor to assemble a

team of persons who collectively are better able than a single trustee to achieve the settlor's purposes.

In non-US jurisdictions, the reserved powers trust is an example of a directed trust. The Bahamas, the British Virgin Islands, the Cayman Islands, Guernsey and Jersey recognise reserved powers trusts. Under the statutes recognising reserved powers trusts, the settlor generally may reserve certain enumerated powers. In contrast to the leading US jurisdictions, it sometimes can be unclear whether, during the settlor's life, a person other than the settlor may have one or more of the powers and whether, upon the settlor's incapacity or death, another person can succeed the settlor in possessing and exercising a power that the settlor had reserved to himself or herself.

Leading US jurisdictions like Delaware, New Hampshire and South Dakota have comprehensive statutes governing directed trusts, as well as trust advisers and protectors. Each of those states ring-fences each trust official's respective powers and duties. In those states, a trustee generally does not have any duty to monitor a trust adviser's or protector's conduct, any duty to advise a trust adviser or protector, or any duty to warn a beneficiary concerning any matter in which the trustee might exercise a power in a different manner than the trust adviser or protector. To the extent that the terms of the trust provide that a trustee must follow another person's direction, the trustee is not liable for acting in accordance with that direction. A trustee is not liable for a trust adviser's or protector's acts or omissions.

The comprehensive statutory regimes in US jurisdictions like Delaware, New Hampshire and South Dakota importantly provide certainty that is lacking in other states. Most US jurisdictions do not statutorily expressly recognise trust advisers and protectors, and there is a dearth of case law concerning those roles. Many states have adopted the Uniform Trust Code. Section 808(c) of the Uniform Trust Code provides that "the terms of a trust may confer upon a trustee or other person a power to direct the modification or termination of the trust". The Uniform Trust Code, however, does not contain any additional detail concerning directed trusts, trust advisers and protectors. In the absence of developed law in those jurisdictions, there is considerable uncertainty concerning the nature and scope of the duties and powers that a person designated as a trust adviser or protector may have. For example, a court could conclude that the trust adviser or trust protector is a *de facto* trustee.

In the United States, the Uniform Law Commission is working on a uniform act governing directed trusts. The Uniform Law Commission is an association of academics and practitioners who work to develop model laws that US states can adopt. The directed trust act currently is in the drafting phase. The drafting committee anticipates that the commission will promulgate the final act in the summer of 2017. If that timetable holds, US jurisdictions will likely begin considering its adoption in 2018.

Advantages

As a multi-party governance structure, a directed trust offers the potential benefit of assigning trust powers to two or more persons in a manner that better achieves the trust's purposes. A settlor may wish to appoint an institutional trustee to make decisions concerning discretionary distributions and handle administrative matters, such as record-keeping, reporting and tax compliance. The settlor, however, may prefer to have someone else – perhaps an investment management firm with which he or she has a long relationship – manage the trust property. A directed trust allows the settlor to create that structure for governing the trust's internal affairs.

A directed trust avoids the limitations associated with delegation. A trustee generally cannot delegate its discretionary distribution power. With a directed trust, a person other than the trustee can have the power to direct the trustee to make distributions. Thus, a directed trust can achieve a result – effectively assigning the distribution power to a trust official other than the trustee – which a unitary trustee structure cannot achieve. A directed trust avoids or mitigates the risks associated with delegation. A trustee can delegate only to the extent that the delegation is prudent, and the trustee has an ongoing duty to monitor the delegatee. With a directed trust, the trustee typically is not selecting the person exercising a specific power and thus is not liable for an imprudent selection.

Some critics argue that directed trusts (and divided trusts) create confusion, because two or more persons are involved in administering the trust and sometimes it can be unclear who is responsible for what.

Disadvantages

A directed trust poses some administrative inefficiencies, and it may not eliminate the trustee's liability with respect to the powerholder's exercise or non-exercise of the powers that he or she holds. With a directed trust, the trustee is in the middle of the action. A trust adviser or protector directs the trustee to take a certain action – say, make an investment – and the trustee generally must act in accordance with the action. For example, in a directed trust, the settlor may have the power to direct the trustee on matters concerning the investment of the trust property. When the settlor wishes to buy an asset, the settlor must direct the trustee to buy the asset, and the trustee subsequently will take the necessary action to buy the asset. The trustee will execute the requisite documents, deliver the funds to the seller and accept receipt of the newly acquired asset.

This two-step process – direction and action – is administratively less efficient than an arrangement in which the decision-maker is also the person taking the action. Since the trustee is in the middle of each action, the trustee remains an attractive target when something goes wrong. A disgruntled beneficiary is likely to argue that the trustee should have taken steps to prevent the alleged harm caused by the powerholder's action or failure to act or at least taken steps to warn the beneficiary. A trustee, in fact, may be tempted to communicate to the powerholder its concerns about the powerholder's actions; as illustrated by the *Mennen* case, succumbing to that temptation may invite questions about whether the trustee assumed certain duties to the beneficiaries.[2]

In practice, some people bypass the trustee of a directed trust. Under the theory that the powerholder is acting as the trustee's agent or in some cases with less forethought, an accommodating trustee sometimes allows a powerholder to take the action directly (eg, taking the actions necessary to buy the asset). That approach is not without risk. The trustee may be breaching its fiduciary duties depending upon the terms of the trust and the applicable law.

Some critics of directed trusts (and divided trusts) assert that they can eviscerate the concept of a trust. By shifting the decision-making about distributions or investments from a trustee to a person who may or may not be a fiduciary or who may or may not have any liability exposure under the terms of the trust, there may be no one who can be held accountable if something goes awry.

Some critics also argue that directed trusts (and divided trusts) create confusion, because two or more persons are involved in administering the trust and sometimes it can be unclear who is responsible for what. Here again, the criticism is more properly directed towards the design of specific trusts, rather than a broadside against the governance model. In some circumstances, a unitary trustee governance model is optimal. For example, the unitary trustee model is often perfectly adequate for a trust that holds only a modest portfolio of publicly traded securities. As the complexity of the trust's objectives and the value of the trust property increases, however, a more sophisticated governance model is usually warranted.

Divided trust

In a divided trust, the trustee powers are divided among two or more persons. Each trust official is vested with certain powers, and each trust official is generally responsible for the trustee powers with which that trust official is vested. For example, in a divided trust, a trustee may have the discretionary distribution powers and the administrative powers, and an investment director may have the investment powers. The design of a divided trust requires consideration of the division of the powers and duties among those parties, the points at which those parties' duties intersect and how the trust's administration should function at those points, and the manner and extent to which the parties are insulated from the other parties' acts and omissions.

New Hampshire's highest court was the first US court that expressly upheld divided trusts. In the *Tamposi* case decided in 2013, the New Hampshire Supreme Court affirmed the division of investment and distribution powers between two classes of trustee, which, under the terms of the trust, were called "investment directors" and "trustees".[3] Under the terms of the trust, the trustee had the power to make distributions, and the investment directors had the exclusive power to invest and manage the trust property. One of the settlor's daughters sued the trustee and investment directors for breach of trust, alleging in part that the investment directors had improperly managed the trust property. In construing the terms of the trust, the court concluded that the trustee did not have any duty with respect to investment matters, because the investment directors were exclusively vested with the investment powers. The court similarly concluded that the investment directors did not have any duties with respect to distributions, because the trustee was exclusively vested with the discretionary distribution powers.

For complex trust holdings or complex family situations, a divided trust is often the optimal governance structure. For example, a settlor who owns a successful privately held operating business can create a trust, into which the settlor contributes interests in that business. The settlor can appoint an institutional trustee, which would have only administrative powers, such as record-keeping, tax compliance and reporting to the beneficiaries. The settlor can select an institutional trustee that has its office in a favorable trust jurisdiction. For the settlor,

one important consideration will likely be the ability to modify or waive the duty to diversify, so that the settlor can relieve the trustee and other trust officials of the pressure to dispose of the business interests and can insulate the trustee and other trust officials from liability for retaining those business interests. By using an institutional trustee, the settlor gains the benefits of professional administration, which minimises the risks that deficiencies in record-keeping, tax compliance or other administrative functions would undermine the trust's ability to achieve its objectives. The settlor might appoint a close friend as the distribution director (or create a non-bank entity, such as a private trust company, that serves in that role with one or more close friends serving as the entity's directors), so that people with personal familiarity with the settlor's children and other family members are in the position to make decisions concerning distributions. The settlor can potentially serve as the investment director, retaining control over the investment-related decisions affecting the business interests. Using a divided trust, the trustee is insulated from any liability for the settlor's investment decisions, or the distribution director's distribution decisions. Likewise, the distribution director is insulated from the settlor's investment decisions.

Advantages

Divided trusts share the advantages of directed trusts, but are generally more efficient to administer because each person involved in the trust's governance can act directly. Unlike a directed trust in which actions flow through the trustee, a divided trust empowers each person who is a part of the trust's governance to take direct action. In contrast, in a directed trust, a powerholder acts indirectly, directing the trustee to take a specific act. In a divided trust, each powerholder acts independently and acts directly. Thus, for example, a trust adviser who is vested with the investment powers can act in any matter involving the management of the trust property, such as opening a brokerage account, executing the account opening documents, and buying and selling securities in the account. The trust adviser can take those actions without the trustee's involvement, because the trust adviser is vested with the investment powers. A third party who is unfamiliar with a divided trust structure may require the trustee's execution of certain documents, but that is a practical issue rather than a legal issue.

Disadvantages

Divided trusts generally share the disadvantages of directed trusts, except that divided trusts generally avoid the administrative inefficiencies inherent in directed trusts. Divided trusts can be more challenging to draft than directed trusts. In a directed trust, the trustee is vested with all of the trust powers, so the trustee can unilaterally exercise any power to the extent that another person does not have the power to direct the trustee with respect to that power. In a divided trust, there is a risk that the drafting attorney will fail to assign a trust power to a person.

Hybrid model

A hybrid governance model incorporates elements of a directed trust and a divided trust. For example, a trust instrument may grant to a trust adviser the power to direct the trustee to make distributions, while granting to another person the exclusive power to manage the trust property. The trust thus has the characteristics of a directed trust with respect to discretionary distribution powers and the characteristics of a divided trust with respect to investment powers.

A hybrid governance model sometimes accurately reflects a settlor's intent. A settlor may wish certain actions to flow through the trustee, typically when the settlor designs the trust so that the trustee has some supervisory duties. For example, the settlor may want the trustee to confirm that a trust adviser makes distributions only to permissible beneficiaries, while otherwise excluding the trustee from any involvement in deciding whether to make distributions.

Too often, however, a hybrid governance model arises by accident. A hybrid governance model is often the product of unartful drafting. For example, the drafting attorney might attempt to create a divided trust using as a precedent a trust deed for a directed trust, but fails to address fully the division of the trust powers.

Fiduciary status

Another question is whether the trust official is a fiduciary or a non-fiduciary? By tradition, a trustee is a fiduciary, and the terms of the trust should respect that status. A trust adviser or protector potentially can be either a fiduciary or a non-fiduciary. In some jurisdictions, the terms of the trust attempt to govern a trust adviser's or protector's fiduciary status. With fiduciary status, a trust adviser or protector potentially is more accountable to the beneficiaries. With non-fiduciary status, a trust adviser or protector may be less accountable to the beneficiaries and, in some jurisdictions, thus have more flexibility to act in accordance with the settlor's intent.

In designing the governance structure for a directed trust or divided trust, a critical issue is whether a trust adviser or protector is a fiduciary. Designating a trust adviser or protector as a non-fiduciary may be appealing for liability purposes. If a trust adviser or protector is a non-fiduciary, then the trust adviser or protector may have less exposure to liability for the exercise or non-exercise of the powers with which the trust adviser or protector is vested. The terms of the

Unlike a directed trust in which actions flow through the trustee, a divided trust empowers each person who is a part of the trust's governance to take direct action.

trust may impose a standard on the trust adviser's or protector's conduct, even though the standard is less than a fiduciary standard. Although designating a trust adviser or protector as a non-fiduciary may have appeal because it can insulate the trust adviser or protector from liability, fiduciary status and the attendant liability for breaching the fiduciary duties can be an important check and balance in designing the governance structure and ensuring that the trust adviser or protector acts prudently and in accordance with the terms of the trust. In addition, in some jurisdictions, a court may disregard the trust language that someone is not a fiduciary. Some jurisdictions like the Bahamas and New Hampshire statutorily recognise non-fiduciary trust advisers and protectors and have judicial traditions that provide a high degree of confidence that a trust provision governed by those statutes would be respected, but, in other jurisdictions, the lack of well-developed law poses a risk that a trust adviser or protector may have an unwaivable fiduciary status.

A trust adviser or protector may be a fiduciary with respect to some powers, but not others. In some instances, a selective approach to designating fiduciary status might better achieve the settlor's intent and the trust's purposes.

A trust adviser's or trust protector's fiduciary status – as well as the panoply of the trust adviser's or trust protector's powers – may also have a bearing for US state tax law purposes. California, Massachusetts, New York and other states determine a trust's nexus to the state for income tax purposes based in part on the trustee's residence. California specifically considers each 'fiduciary' of a trust. Thus, a trust adviser's or trust protector's fiduciary status may be sufficient to meet that state's criteria for nexus. Massachusetts and New York consider each trustee. A trust adviser's or trust protector's fiduciary status may be a factor that those and similar states would consider in determining whether a trust adviser or protector is a 'trustee' for nexus purposes.

Jurisdictional risks

A multi-party governance structure potentially creates points of vulnerability for a trust. Trust laws vary among jurisdictions. In designing and administering a trust, the laws of a particular jurisdiction may play an important or even critical role, because the jurisdiction allows certain structures or arrangements that are unavailable or uncertain in other jurisdictions. In those other jurisdictions, the laws or courts may yield a result that is inconsistent with or antithetical to the desired result. A jurisdictional risk arises when, through its governance structure, a trust has a connection with a jurisdiction in which the laws or courts may adversely affect the trust or its administration. Through a trust official's residency in a particular jurisdiction, the trust may be susceptible to the authority of that jurisdiction's courts. Under certain conditions, those courts may apply their own jurisdiction's laws to the trust.

When a trust has contacts with multiple jurisdictions, it creates an opportunity for forum shopping. A potential litigant – whether a beneficiary seeking to contest the trust's validity or a trust official's conduct or a creditor seeking to reach trust property – will look for the most favourable jurisdiction in which to initiate a judicial assault on the trust. Like the beneficiary seeking to commence a judicial proceeding in Florida because that state will not enforce a no-contest provision, a beneficiary, creditor or other person in a dispute involving a trust will generally try to exploit the weak points in a trust's structure.

Unitary trustee

A unitary trustee is not necessarily immune from jurisdictional risk. In a unitary trustee model, the jurisdictional risk may arise when an institutional trustee has offices in two or more jurisdictions. Even though the institutional trustee such as a trust company or a bank with trust powers may administer a trust exclusively in one jurisdiction, a court in another jurisdiction may be able to assert jurisdiction over the institutional trustee and hence the trust because the institutional trustee maintains an office in that other jurisdiction. The jurisdictional risk likewise may arise when there are co-trustees, who are residents of different jurisdictions.

Directed trusts and divided trusts

With a directed trust or divided trust, there may be a heightened risk that the trust will become subject to the jurisdiction of the courts in a state that may have unfavourable or less favourable trust laws. A court has personal jurisdiction over the residents of the state in

which the court is located, and that personal jurisdiction potentially enables the court to take jurisdiction over the trust and its administration.

Using a corporation or limited liability company as a trust adviser or trust protector can mitigate the jurisdictional risk. New Hampshire and South Dakota expressly allow a corporation or limited liability company to act as a trust adviser or trust protector. In other states, an entity potentially cannot act as a trust adviser or trust protector unless it obtains a charter as a bank or trust company, because the entity would exercise trust powers.

Allocation of powers and duties

In a directed trust or divided trust, the thoughtful assignment of trustee powers is crucial to the efficient administration of a trust. Otherwise, the trustee, trust advisers and trust protectors may encounter challenges in administering a trust, as they discover that they do not have the powers that they thought that they had. An examination of a few specific powers can illustrate that point.

Use of trust property

A beneficiary who can use trust-owned property enjoys the benefits of that property. The use of trust property is a quasi-distribution. In a directed trust or divided trust, who has the power to decide whether a beneficiary may use trust property? Is it the trust official vested with the investment powers, because those powers typically include the power to rent trust property? Or is it the trust official vested with the discretionary distribution powers, because the use of trust property is a quasi-distribution? Does it matter whether the beneficiary is paying below-market rent? In a directed trust or divided trust, the terms of the trust should address those questions.

Loans to beneficiaries

In a directed trust or divided trust, who has the power to decide whether to make a loan to a beneficiary? Is it the trust official vested with the investment powers, because the loan involves the investment of trust property? Or is it the trust official vested with the discretionary distribution powers? Does it matter whether the loan is commercially reasonable or on more favourable terms? Who has the power to forgive a loan to a beneficiary? Again, is it the trust official vested with the investment powers, because the loan involves the investment of trust property? Or is it the trust official vested with the discretionary distribution powers? In a directed trust or divided trust, the terms of the trust should address those questions.

Power to add beneficiaries

Under the terms of a trust, a trust official may have the power to add beneficiaries. The power to add beneficiaries, which is more commonly seen in non-US-situs trusts than US-situs trusts, provides flexibility. The terms of the trust typically exclude certain persons from the class of permissible additional beneficiaries. For example, the trustee typically is excluded from the class of permissible additional beneficiaries. In some cases, the class of excluded persons is static, hardwired into the trust instrument. In other cases, a trust official has the power to add one or more excluded persons (either revocably or irrevocably).

The power to add beneficiaries is dispositive in nature. Exercising the power expands the class of persons who beneficially enjoy the trust property. Although adding a person as a beneficiary does not necessarily mean that the person will receive distributions from the trust, the person becomes eligible to receive distributions. As a practical matter, a person would usually be added as a beneficiary only if there was some expectation that there would be distributions to that person or that person would be allowed to use trust property.

Who should have a power to add beneficiaries? Given the dispositive nature of the power to add beneficiaries, the trust official vested with the discretionary distribution powers is often vested the power to add beneficiaries. Thus, a trustee who has the discretionary distribution powers may also have the power to add beneficiaries. Some practitioners, however, favour granting the power to add beneficiaries to a protector. They assert that the power to add beneficiaries is a power better suited to a protector. They question whether, in light of the duties of loyalty and impartiality, a trustee can exercise a power to add beneficiaries, because adding a beneficiary potentially diminishes the beneficial interests of the existing beneficiaries.

In some cases, a practitioner's preference

A well-drafted trust instrument will generally include a provision granting to a trust official the power to modify the terms of the trust.

concerning whether a trustee or protector should hold the power reflects the practitioner's attitudes towards institutional trustees. A practitioner who is comfortable with institutional trustees may be inclined towards granting the power to the trustee. A practitioner who is less comfortable with institutional trustees may favour granting the power to a protector.

Power to decant

The power to decant – to 'empty' trust assets into another trust – is a powerful tool in administering a trust. Decanting can correct flaws or inefficiencies in a trust's design. Decanting can also modify the dispositive provisions of a trust. Who should have the power to decant? If the power to decant prohibits changes to the dispositive provisions, then the power is more administrative in nature. In that case, should the trustee have the power? If, on the other hand, the power to decant would allow changes to the provisions governing distributions, then the power may be more dispositive in nature. In that case, should the trust official vested with the distribution power also have the power to decant? Or should a protector have the power?

Power to determine beneficiaries and permissible appointees

Under the terms of a trust, a trust official may have the power to determine whether a particular person qualifies as a beneficiary or a permissible appointee. The power establishes a useful, non-judicial method for resolving questions about who can benefit from the trust. For example, a trust instrument may provide that an individual adopted before attaining 18 years of age will be treated as the child of his or her adoptive parent. Enabling a trust official to assess the appropriate evidence and make a determination of whether an adopted individual qualifies as a beneficiary under the terms of the trust may avoid the cost, delays and possible unpleasantness of litigation.

In a directed trust or divided trust in which different persons have administrative powers and dispositive powers, who should have the power to determine who qualifies as a beneficiary or permissible appointee? The power to determine whether a person qualifies as a beneficiary or a permissible appointee is an administrative-type power insofar as it is construing the terms of the trust, but it is also a dispositive-type power insofar as it affects the beneficial interests within the trust.

Reporting to the beneficiaries

A trustee generally has a duty to keep the beneficiaries reasonably informed about the trust and its administration. The terms of the trust may modify or waive the trustee's duty to inform. For example, the terms of the trust may waive the trustee's duty to inform any beneficiaries other than members of a class of primary beneficiaries, or the terms of the trust may waive the duty during the settlor's life. In a directed trust or divided trust, a trustee may not have direct access to all of the material information concerning the trust. For example, the trustee may not have financial statements and other information concerning the trust property.

The trust instrument should ensure that the trustee is able to fulfil the trustee's duty to keep the beneficiaries informed. Accordingly, under the express terms of the trust, each trust official should have a duty to keep the trustee informed and a duty to provide to the trustee any information that the trustee requests concerning the trust, the trust property and the trust's information.

Power to modify the trust

A well-drafted trust instrument will generally include a provision granting to a trust official the power to modify the terms of the trust. The power may be broad, allowing modification of both dispositive and administrative provisions. Alternatively, the power may be limited to modifying the trust's administrative provisions but not its dispositive provisions, limited to modifying the terms of the trust so that they achieve the settlor's tax objectives, or are otherwise circumscribed. In each case, the power facilitates efficient trust administration, establishing non-judicial procedures for modifying or reforming the trust.

Who should have the power to modify the terms of the trust? To the extent that the power to modify the trust includes modifying the trust's dispositive provisions, it may be advisable to assign the power to the trust official who is vested with the discretionary distribution powers. If the power to modify the trust encompasses modifying the trust's dispositive provisions, then it may be advisable to assign the power to the trust official who is vested with the discretionary distribution powers.

Supervisory duties

In a directed trust or divided trust, it is important to address the extent to which a trust official has a duty to monitor another trust official's actions, a duty to prevent a potential breach by another trust official, or a duty to warn the beneficiaries about another trust official. The persons serving as trust officials – especially institutional trustees – generally prefer to see the terms of the trust waive all of those duties, because they do not want to have any exposure to liability for a breach by someone else. On the other hand, those supervisory duties can serve as a valuable role in providing a check and balance on the trust officials. A trust official who assumes those supervisory duties may seek additional compensation for the additional responsibility that the trust official is assuming.

Veto powers, consent rights, and notice rights

Veto powers and consent rights are approaches for shifting or sharing specific powers. Under the terms of a trust, a trust official may have a specific power, while another trust official has the power to veto the exercise of that power. Similarly, under the terms of a trust, a trust official may have a specific power, but must obtain another trust official's consent to the exercise of the power.

In lieu of shifting or sharing powers through veto powers and consent rights, notice rights can create a process for supervising the exercise of powers. The terms of a trust can provide that, before exercising a specified power, a trust official must notify another person, such as a trust protector. For example, a trust instrument may provide that, before making a distribution to a beneficiary, a distribution trustee must notify the protector, who would have the power to remove the trustee. The protector would not have the power to veto the proposed distribution, and the trustee's exercise of the discretionary distribution power would not require the protector's consent. With this structure, the protector can supervise the trustee's actions, and the protector functionally has a veto power, because the protector can remove a trustee that proposes to take an action to which the trust protector objects. By limiting the protector's affirmative and negative powers, there may be less jurisdictional risk, and, in some cases, it may facilitate more efficient administration.

Practical considerations

Designing a trust's governance structure implicates several practical considerations, especially in the case of a directed trust or divided trust. Those practical considerations include:

- *Number.* How many persons should serve contemporaneously in each role? What is the minimum number? Maximum? If more than one, how do they make decisions? Unanimous agreement? Majority vote? What about tie-breaker provisions? For an administrative trustee, the trust instrument typically should provide that there shall be only one. For distribution advisers, the trust instrument could specify a range – say, one to five. For investment advisers, the trust instrument could specify that the number may be unlimited. For a trust protector, the trust instrument may provide that there shall be only one, or it may specify a range.
- *Term limit.* How long should a person serve in the role? After a person's term expires, can the person serve again after a hiatus? If so, how long must the hiatus last?
- *Age limit.* In the case of an individual, should there be an age limit? If so, at what age should an individual become ineligible to serve as a trust official? In lieu of an age limit, should the terms of the trust include a provision requiring an individual trust official to obtain from a physician an annual certificate of capacity after the trust official attains a certain age?
- *Appointment of additional trust officials*. Who has the power to appoint an additional trust official? Under what conditions is someone ineligible to exercise the appointment power? If someone is unwilling or unable to exercise the appointment power, who is next in line to exercise the power? In some cases, it may be advisable to limit the class of persons who may be appointed as an additional trust official based on who has the power of appointment. For example, under certain circumstances, a beneficiary should perhaps not have the power to appoint his or her university roommate as a trust official.
- *Appointment of successor trust officials*. Who has the power to appoint a successor trust official? Under what conditions is someone ineligible to exercise the appointment power, and, if a person is unwilling or unable to exercise the power, who is next in line to exercise the power?
- *Removal*. Who has the power to remove a trust official? Under what conditions is someone ineligible to exercise the removal power, and, if a person is unwilling or unable to exercise the power, who is next in line to exercise the power? In some instances, it may be worthwhile considering removal for cause only. For example, a settlor may wish to appoint a trust protector who can replace the trustee, because the settlor is concerned that, if the beneficiaries had the power, they would use the power in a manner to appoint a trustee that is predisposed to distributing trust property as the beneficiaries wish and not as the settlor intended. In that case, it may be appropriate to empower the beneficiaries to remove the protector, but allow removal only for cause. It would be an unusual circumstance in which an institutional trustee's removal should be only for cause.
- *Compensation*. Who should determine a trust official's compensation? In some cases, a protector may be the appropriate person to determine a trustee's or trust adviser's compensation. In some cases, the persons who can appoint (or remove) a trustee, trust adviser or protector may be better suited to have the power to set the compensation of a trustee, trust adviser or protector.
- *Conflicts of interest*. Many trust instruments contain blanket waivers of conflicts of interest,

thereby allowing trustees (and sometimes other trust officials) to engage in transactions that may benefit their personal interests. Query whether there is a better way. Should a trust instrument contain procedures for the disclosure and approval of potential conflicts-of-interest transactions? For example, in a directed trust or divided trust, a protector could have the power to review a trustee's or other trust official's conflicts-of-interest transaction. Employing such procedures can better protect the trust, the settlor's intent and the beneficiaries' interests.

- *Meetings*. Should trust officials have a duty to meet periodically? Trust instruments typically do not include any provision for meetings. For trusts with complex holdings, it may be advisable to require quarterly, annual or other periodic meetings. The formality of regular meetings can promote better communication and potentially foster more effective administration of the trust, as well as protecting trust officials from claims of inattention.

Conclusion

Trusts continue to be among the most versatile vehicles for managing wealth, especially for multiple generations. With the global evolution of trust laws allowing for more sophisticated trust design, settlors are better able to achieve their wishes and trusts can be administered more effectively and efficiently. Modern trust laws facilitate a wide range of governance structures, allowing trusts to be tailored to each specific situation. The simple unitary trustee model is suitable for many situations. The divided trust is a dynamic organisational structure that is well-matched for managing complex pools of dynastic wealth. The assignment of powers and duties in a trust – and especially in a complex structure like a divided trust – requires care in design, drafting and implementation. The more the family office understands the variety of choices in trust governance models, the better they are able to match them to the needs of the family.

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1 NH RSA 564-B:12-1201(a).
2 *Mennen v Wilmington Trust Co*, No 8432-ML (Del Ch 24 April 2015). The administrative trustee settled with the beneficiary before trial, so the court did not address whether the administrative trustee had assumed any investment-related duties.
3 *Shelton v Tamposi*, 64 NH 490 (2013).

'Trust governance models' by Todd D Mayo is taken from the fourth issue of *The International Family Offices Journal*, published by Globe Law and Business, http://ifoj16.globelawandbusiness.com.