

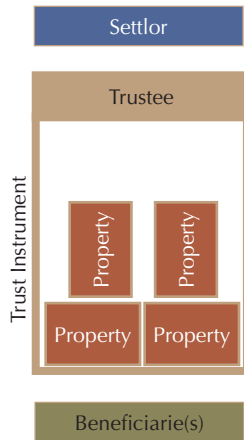
# TRUST PROTECTOR

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## AN INNOVATIVE STRATEGY FOR COMPLEX LONG-TERM TRUSTS

### TRUSTS

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All trusts have five things in common: settlor, trustee, trust instrument, property and beneficiary(s). Trusts are created by the “settlor” who drafts a trust instrument providing detailed instructions on a myriad of topics such as when and how property will be distributed to the beneficiaries, trustee powers, trustee succession, etc. The trustee is the legal owner of the property in the trust and holds it, in a fiduciary capacity, for the beneficiaries.

When creating a trust, settlors typically have a vision on how and to whom they want to leave their property. They will anticipate the the environment and their family’s situation after they are gone, such as tax law, beneficiary health and longevity, competence of the trustee, creditor issues, etc.

Most trusts are “living” or revocable trusts in that the settlor(s) reserve the right to modify or terminate the trust while they are alive. Also, the settlors are almost always the initial trustees of the living trust.

When all settlors are deceased, important changes take place. The trust becomes irrevocable, and there is a new successor trustee.

Most trusts are straight-forward - structured for an immediate distribution of property of easily ascertainable value to well defined beneficiaries (e.g., sell the house, divide the money among the kids). A successor trustee, assisted by an attorney and tax professional, should easily administer a simple trust.

But many trusts are more complex - designed to be long duration. This extended life-span can be due to a myriad of things, such as running the family businesses, manage commercial property, maintain out-of-state or foreign assets, challenging asset valuations, charities, discretionary trusts for children, etc. They invariably involve a lot of money with intricate tax issues.

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Potential issues encountered in long-term complex trusts include:

- need to change situs to take advantage of more favorable state law or for tax avoidance;
- unexpected changes in tax or property law;
- running, selling, or winding down a business;
- disputed property ownership;
- trustee(s) missing or not doing their job;
- issues with investment strategy; or
- beneficiaries become disabled, feud, or have creditor problems.

A typical trustee is a family member familiar with the trust assets and beneficiaries, but not necessarily conversant on the complexities of trust administration. Complicating this could be multiple trustees – e.g., “all my children” or a trustee who is also a beneficiary. As a rule, friends or family are not professional money managers or qualified to make complicated and often controversial decisions. And, as a practical matter, most family trustees have some bias and conflict of interest rendering them unsuitable to administer a complex long-duration trust. Sometimes a trustee can become apathetic, uncooperative, or downright hostile to the interests of a beneficiary. Bottom line, many problems can arise over time which would otherwise require court intervention to resolve – not to mention contributing to significant family dysfunction.

### **COURT INTERVENTION**

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In California, the Probate Court has the authority to deal with a wide variety of trust issues. But going to court is time consuming and always expensive. And who pays the bill? The answer is almost always the trust – which inevitably means some or all the beneficiaries will absorb the cost. And sometimes judges get it wrong, which may necessitate a trip to the Court of Appeal -where it gets really expensive.

And final resolution of a problem can take months or even years.

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### COMPLEX LONG-TERM TRUSTS REQUIRE FLEXIBILITY

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What's needed is flexibility throughout the trust term to address issues without resort to the courts. Enter the trust protector. This is a person you designate who can step in as a surrogate to make high-level decisions – presumably ones you would make if you were still alive.

A trust protector's role is episodic and ad-hoc – typically someone in the background and only called upon when needed. Properly defining this backstage role for the trust protector is important.

The trustee administers the trust. All sorts of things can be going on with the trust property or among beneficiaries and there can be problems the trustee is not able to effectively address. This often leads to bickering and family dysfunction.

The trust protector, being in the background, generally won't be aware of these issues. Absent a specific request, the trust protector's role is dormant. This is similar to a court which has no idea of any problem until someone files an action or petitions the court. Likewise, there is no affirmative duty for the trust protector to intervene or take any action until asked.

Who can call upon the trust protector to act? The obvious candidate is the trustee. However, any direct or contingent beneficiary can request the trust protector to intervene within the scope of the trust protector's designated powers. Or the trust protector may decide on its own to intervene.

### POWERS

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Typically, one or more of the following powers may be bestowed on a trust protector:

- remove, add and replace trustee;
- veto or direct trust distributions;

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- add or delete beneficiaries;
- change the situs and governing law of the trust;
- veto or direct investment decisions;
- consent to exercising a power of appointment;
- resolve disputes among beneficiaries about the trust;
- amend the Trust as to administrative provisions;
- amend the Trust as to dispositive provisions;
- approve Trustee accounts and compensation; and
- terminate the Trust.

### **WHO SHOULD YOU NAME AS A TRUST PROTECTOR?**

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Clearly, the most important criterion is someone you trust implicitly. Your trust protector should be independent – i.e., not related to the trustee or any beneficiaries – and free of any conflicts of interest. It's often advisable to select a professional - such as an attorney or CPA, - who can understand the complexities of trust administration and the assets in the trust. Since the proposed trust will be long term, you want a trust protector who will be available during the trust. In short, the trust protector has to be the adult-in-the-room with the knowledge and universal respect to fix things when needed.

One catch. Nobody, or at least no professional, would ever agree to serve in this capacity unless you minimize potential liability for the trust protector in the trust instrument. While this topic is technical, it is important to designate whether the trust protector will be considered a fiduciary for any given power.

A fiduciary, among other things, owes a strict duty of loyalty to every beneficiary. So, what happens if you give a trust protector the power to add or delete beneficiaries? Could a fiduciary have this power? Clearly not. What could be more detrimental to a beneficiary than to remove their anticipated inheritance. The answer is to delineate whether the trust protector is a fiduciary when exercising each assigned power. In this example, the trust protector would not be a fiduciary when exercising the power to

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add or remove beneficiaries.

Additionally, liability should be limited to only acts of gross negligence or bad faith. Without such a limitation, it would be difficult to find anyone willing to take on this role. Further, should the trust protector be sued for any reason, attorney fees and costs would be paid by the trust.

A related issue - when does the trust protector have a duty to act? Your trustee will manage the day to day activities of the trust. During normal trust administration, the trust protector may be quiescent, in the background, unaware of what is happening day to day- i.e., unaware that trouble is brewing. If the trustee is making horrible investment decisions, does the trust protector have an affirmative duty to monitor these and intervene? Again, the answer is a resounding NO. The trust instrument must contain specific guidance on when and how a trust protector is called upon to perform a service for the trust. Further, even if assistance by the trust protector is requested, the trust protector must agree to act.

For example, assume two beneficiaries become embroiled in a dispute over who gets the family residence after you pass away. Your trustee may be in a difficult position. As a fiduciary, the trustee must be fair and impartial to all beneficiaries. Resolving the issue for one beneficiary may irritate the other. Most trustees in a no-win situation like that would simply let the beneficiaries litigate their case in court – an expensive, time consuming, and frustrating experience for all.

Your trustee or one beneficiary can call upon the trust protector to resolve the issue. But note, two things are required. First, your trustee, or the aggrieved beneficiary, must initiate the request for assistance and second, the trust protector must agree to step in and resolve the dispute. Only then would the trust protector have an affirmative duty to act. The trust protector could then make a decision that will bind the trustee and all beneficiaries.

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### TRUST PROTECTOR SUCCESSION

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Where the position of trust protector is defined in the trust instrument, the settlor will typically name the trust protector – or several people to serve in sequence. But given the long-term nature of the trust, there may be no successor trust protector named or willing to serve when needed. A common practice is to allow a resigning trust protector to name the successor. Another method is to allow all beneficiaries to name the trust protector or petition the court to name one. Regardless, the trust instrument must provide a procedure to name a trust protector when the office is vacant.

### ALTERNATIVES TO A TRUST PROTECTOR

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After the settlor's have passed, trusts typically become irrevocable. That means the trust must be administered by its terms – and typically can't be changed. The reason for this is simple - its irrevocable.

However, California law allows for the amendment, modification or termination of an otherwise irrevocable trust via a petition to the court with unanimous consent of all beneficiaries Probate Code §15403. The obvious problems with this are beneficiary consensus and going to court. It's expensive, time consuming and the ultimate outcome is in the hands of a judge who may be unfamiliar with your situation.

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Some trusts are long duration and involve significant money, complexity and risk. A trust protector may be a great way to provide flexibility and efficiency – especially where there are discretionary distributions or asset protection is an important objective.

The challenge is finding the right person to fill this position with a succession plan to make sure a trust protector is available and willing to act when needed.