

## **The Use of Trust Protectors**

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Perhaps 50% of the trusts I prepare for estate planning clients contain multi-generational provisions. That is, the trust will continue for the benefit of three or more generations. The reasons are sound:

- The share of the trust may be excluded from the gross estate of the beneficiary.
- The share of the trust may be more effectively protected from the claims of creditors and former spouses of the beneficiary.
- The share may be distributed in ways designed to address perceived frailties of the beneficiary (for example, the spendthrift, the developmentally disabled, the especially gifted, the one whose interests and talents fall in areas socially valuable but economically unrewarding).

Since individual trustees have a bad habit of dying, becoming incapacitated, or losing interest in the job, we inevitably name a corporate fiduciary to take over after friends and family. That corporate fiduciary may be your favorite bank, or a standalone trust company. It will have resources and it (or its successors) will outlive all the beneficiaries. Moreover, it will almost always do a professional and cost-effective job of establishing and maintaining proper records, investing, and reporting taxes.

The only problem is that some beneficiaries require more attention than a corporate fiduciary can provide. The assigned trust officer under a trust providing discretionary distributions to a particular beneficiary will typically hold a personal meeting annually or more often. At that meeting, the trust officer will learn the needs of the beneficiary, identify his or her other resources, and agree on a specific amount or pattern of distribution that meets beneficiary needs. If the beneficiary is entitled to public social services, such as Medi-Cal, SSI, or Regional Center programs, the trust officer will have a working knowledge of those benefits so as to meet the beneficiary needs without losing the public benefits.

But clients worry that the trust officer might not be able to spend the time to closely monitor the care and needs of the beneficiary, or those in future generations. The solution is often to name a close relative to interact between the beneficiary and the trust officer in order to be certain that the trustee is fully aware

of those needs, thus informing distribution decisions. That person may be called a “special co-trustee” or a “protector.” Similarly, a trust advisory committee may be named, with provisions for replacement in the ordinary course of time so that the function is carried out for as long as the need exists. In order to avoid imposing fiduciary liability on the friend or family member so named, the role is usually one to advise, rather than order the trustee. Where more authority is desired for the protector, it is always subject to the fiduciary duties of the trustee; *i.e.*, the trustee may not be forced to break the law or breach its fiduciary obligations to the beneficiary. As an example, following is a provision from my form file for a share held for a developmentally disabled beneficiary, using a trust advisory committee:

“ B. **Trust Advisory Committee.** Because Trustee is unable to maintain close, personal attention to the evolving needs of Beneficiary, and because state and federal law dealing with the means-tested programs described above change often and with profound effect on the eligibility of their participants, the Committee able to address those needs is appointed as provided below:

(1). [ ] and [ ] are appointed the initial members of the Committee. The number of members shall be determined by the Committee, but in no event shall it have fewer than two members. All actions of the Committee shall be by unanimous vote of its members acting from time to time. However, if the members of the Committee cannot agree by unanimous vote, the court shall make the final decision pursuant to a *Petition for Instructions* in accord with *Probate Code* Section 17200(b)(10). Any member of the Committee may resign at any time. The remaining member or members may appoint a new member to the vacancy so created, and *shall* appoint a new member if failure to do so would reduce the number of acting members to one. The Committee may, by majority vote, remove a member of the Committee with the approval of the court having jurisdiction over the Trust.

(2) The Committee shall advise Trustee concerning the payments or distributions that would serve the best interests and special needs of Beneficiary during [his/her] lifetime; provided, however, that the duty of Trustee

to act on such advice shall at all times be governed by the provisions of *Probate Code* Section 16012, and members of the Committee as putative co-trustees shall be relieved of all duties as such described at *Probate Code* Section 16013.”

Another context in which protectors are frequently employed is with multi-generational irrevocable trusts. In order to lawfully avoid U.S. taxation on retained trust income earned after the settlor’s death, and to avoid legal limits on the length of the trust term, such trusts are often located in an offshore financial center. Both there and with domestic trusts, the principal concern is flexibility in dealing with changes in the law, taxation, or political stability. A not-so-minor issue is often the desire to deal with a complacent trustee. Here, for example, is a protector provision from my form file for an offshore trust designed to last for several generations:

“9. **Trust Protectors.** Following are the provisions dealing with trust protectors:

A. Because the laws of the countries touched by the presence of this Trust, its Settlor and its beneficiaries regularly change, often in ways affecting the purposes of this Trust, a means of securing those purposes is necessary. Therefore, a committee of trust protectors (individually, Trust Protectors, and collectively, Committee) shall be appointed or otherwise take office concurrently with expiration of the Beneficiary Exclusion Period. The function of the Committee is to give advice to Trustee in accord with the powers set forth in this Section 9; provided, however, that the Committee shall have the absolute and sole power and right to release or to any extent restrict any of its powers. The release or restriction of any such powers shall be effective upon the date it is communicated to Trustee in writing. No power of the Committee shall be exercisable by or for the benefit of a U.S. Beneficiary.

B. The Committee shall have no more than three members. The initial members of the Committee are listed below:

[List names and addresses.]

Each Trust Protector shall hold office until such time as he or she dies, becomes legally disabled, resigns or is removed as provided in this Section 9. A Trust Protector shall be replaced by the remaining Trust Protectors, or if none remain, by Trustee, upon death, incapacity, resignation or removal. The Committee shall appoint one of their number to chair each meeting and one to keep the minutes.

C. All actions taken and advice given by the Committee shall be by majority vote if more than one Trust Protector is serving. All actions and advice shall be in the form of minutes of meetings, or by unanimous consent to actions by written resolution, proxy, or otherwise. Each Trust Protector shall have one vote; provided, however, the chairperson shall have two votes if an additional vote is needed to break a tie vote.

D. Once the Committee is established, Trustee may remove any Trust Protector who, in its opinion, is unable or unwilling to act as such. In making this determination, Trustee shall act in good faith and in the best interests of this Trust and its beneficiaries. It shall consider all relevant evidence, including without limitation medical evidence and any evidence of financial wrongdoing. Trustee's decision to remove a Trust Protector shall be evidenced by a written notice to all members of the Committee, and the removal shall be effective immediately upon receipt. During Settlor's lifetime, thus prior to establishment of the Committee, Settlor may name a replacement for any person named above who indicates an unwillingness to serve, an inability to serve, dies before Settlor or becomes incapacitated; provided, however, that no one appointed by either Trustee or Settlor shall be a "related or subordinate party" as defined at *United States Internal Revenue Code of 1986*, Section 672(c).

E. The Committee may amend, delete and supplement the Trust if and to the extent necessary to correct drafting errors and to address or anticipate changes in law or the tax regime applicable to it, or to provide a remedy if the provisions at Section 6D fails to function in a manner serving the Trust purposes; provided, however, that no such change shall have

the effect of changing the testamentary intent of Settlor or to permit distributions prior to expiration of the Beneficiary Exclusion Period.

F. The Committee may add to or delete from the list of criteria for distributions set forth at Section 6C(1) hereof; provided, however, that no such change shall have the effect of changing the testamentary intent of Settlor or to permit distributions prior to expiration of the Beneficiary Exclusion Period.

G. Trustee may decline to follow any recommendation or instruction of the Committee if and to the extent Trustee disagrees or deems a proposed distribution a breach of trust; provided, however, that Trustee *shall* comply with any instruction to transfer the Trust domicile to another jurisdiction. Trustee shall incur no liability for such compliance, nor shall Trustee incur any liability for failure to act when no proper instructions are provided.

H. Neither Trustee nor the Committee shall incur any liability for any act or omission, except for fraud, willful misconduct, gross negligence, or reckless indifference to the interests of one or more beneficiaries. Neither Trustee nor any member of the Committee shall incur liability for any act, omission, or default of any predecessor Trustee or Committee member.

I. All powers here granted to the Committee are collateral to its office and none shall constitute a fiduciary or trust power.

J. All decisions or actions of the Committee shall be memorialized in writing and, in the discretion of the Committee, shall be acknowledged, witnessed, or validated in a manner rendering such decision or action effective so as to result in the most effective and economical operation of the Trust.”

Use of these arrangements in domestic trusts is fairly rare, but growing. Consequently, the provisions are often written by lawyers with limited experience

in their practical application. It appears, however, that protector, committee, and special co-trustee provisions will soon become an important tool for estate planning professionals.