The Role of the Trust Protector: Should Every Trust Have One?

STEP MIAMI MEETING

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Agenda

- What is a protector?
- Why do you need a Protector?
- In whose interest is the Protector acting?
- What does it matter?
  - Personal right v Fiduciary
- Rights of a Protector
- Who should serve as Protector?
- Protectors abusing their role?
- Protectors versus Enforcers
- Transparency
- Additional Issues to Consider
- Summary
What is a Protector?

- Historical background
- Not a “term of art”
- Generally not defined in statutes
What is a Protector in the U.S.?

- Historic background – adoption from offshore trust practices

- May be defined in statutes
  - Uniform Trust Code §808 (b) – (d) provisions may apply where states have adopted UTC
  - The following non-UTC states have permit the use of trust protectors
    - Alaska, Delaware, Georgia, Illinois, Indiana, Nevada, Rhode island, South Dakota, Texas, and Washington

- Might be drafted into trust instrument even without statutory provision
Why do you need a Protector?

– Perhaps you do not?
– Sample powers:
  ▪ change trustee
  ▪ consent or veto decisions
  ▪ appoint investment managers
  ▪ give directions
Why might you need a Protector in a U.S. trust?

- Dynastic trusts may need a Protector to modify the trust as times change over the years

- There are various powers that a corporate trustee might not want

- Provides added flexibility, especially useful for long term trusts
## Protector powers – two categories

<table>
<thead>
<tr>
<th>Powers related to the trustee</th>
<th>Powers unrelated to the trustee</th>
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<tbody>
<tr>
<td>Power to remove and replace an acting trustee</td>
<td>Power to change the situs of the trust</td>
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<td>Power to appoint additional trustees</td>
<td>Power to change the governing law of the trust</td>
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<td>Power to act as a tiebreaker when multiple trustees reach an impasse</td>
<td>Power to terminate the trust under certain defined conditions</td>
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<td>Approval authority for discretionary distributions or the sale or management of specific assets</td>
<td>Power to amend the trust for any valid purpose, such as to respond to changes in federal or state tax law</td>
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<tr>
<td>Power to veto decisions made by the trustee</td>
<td>Power to alter the beneficial interests in the trust, such as to add or remove beneficiaries</td>
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Some trust protector statutes specify the powers – Nevada statute

**NRS 163.5553 provides for the powers of a trust protector**

1. A trust protector may exercise the powers provided to the trust protector in the instrument in the best interests of the trust. The powers exercised by a trust protector are at the sole discretion of the trust protector and are binding on all other persons. The powers granted to a trust protector may include, without limitation, the power to:

   (a) Modify or amend the instrument to achieve a more favorable tax status or to respond to changes in federal or state law.

   (b) Modify or amend the instrument to take advantage of changes in the rule against perpetuities, restraints on alienation or other state laws restricting the terms of a trust, the distribution of trust property or the administration of the trust.

   (c) Increase or decrease the interests of any beneficiary under the trust.

   (d) Modify the terms of any power of appointment granted by the trust. A modification or amendment may not grant a beneficial interest to a person which was not specifically provided for under the trust instrument.

   (e) Remove and appoint a trustee, trust adviser, investment committee member or distribution committee member.

   (f) Terminate the trust.

   (g) Direct or veto trust distributions.

   (h) Change the location or governing law of the trust.

   (i) Appoint a successor trust protector or trust adviser.

   (j) Interpret terms of the instrument at the request of the trustee.

   (k) Advise the trustee on matters concerning a beneficiary.

   (l) Review and approve a trustee’s reports or accounting.
Source of the specific powers

Some statutes do not provide specific powers – **Florida statute**

- F.S. 736.0808 – “Powers to Direct”

  - Florida appellate court sanctioned the use of trust protectors in a Florida trust proceeding
In whose interest is the Protector acting?

– Fiduciary versus personal powers
– Is Protector a Fiduciary?
  ▪ Early cases:
    Bahamas: Rawson Trust v Perlman – 1995 Supreme Court of Bahamas
      ▪ Protector’s power to consent to trustee resettling trust
      ▪ Held  Not Fiduciary
    Bermuda Von Knieriem v Bermuda Trust Co. Ltd. – 1994 Supreme Court of Bermuda
      ▪ Protector exercises power to remove trustee to prevent settlor being removed as a director of a company held under the trust
      ▪ Held  Fiduciary
In whose interest is the Protector acting? (continued)

- Modern cases:
  - Look to trust document
  - Consider whether protector is acting purely for himself or for others

Re: Jasmine Trustees Limited [2015] JRC 16

- Significant family dispute between father and 2 sons on one side and daughter on the other.
- Father required daughter to waive all her rights to the trust and father’s estate in exchange for a loan to buy a London flat.
- Daughter commenced proceeding against brothers in New York and Vermont to protect her interests in 3 entities.
- Father’s appointment of sons as his successor Protector held invalid as being “irrational”
What does it matter?

- If personal right – then unrestricted
  - tantamount to personal property:
    - TMSFV Merrill Lynch Bank and Trust Company (Cayman) Ltd [2011] UK PC 17

- Can you sell or assign the right?

- Tax consequences
  - Possible general power of appointment included in your U.S. estate
If Fiduciary

- If Fiduciary
  - must exercise
    1. for reasons for which the power was provided; and
    2. in the interest of beneficiaries

- Court has inherent power to supervise

  In the matters of the A and B Trusts (Jersey) 2012 – JRC 169A
  - Protector of 2 Jersey trusts
  - Relationship between Protector and great majority of beneficiaries had broken down
    - Protector viewed his role as to ensure that the wishes of the settlor were carried out and as a result played an “over active management role” in the trust
  - Court ordered removal of Protector, making it clear Protector, like the Settlor, had no more right to determine how the trust should be managed
Is the protector a fiduciary?

- UTC – establishes a presumption that a trust protector is a fiduciary, UTC §808 (d). Although this is a default rule which may be waived, the trust instrument may not relieve the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries, UTC §§105 and 1008

- Alaska provides that a trust protector is not a fiduciary, unless otherwise provided by the trust instrument, Alaska Stat. Ann. §13.36.370

- Delaware and Illinois both provide that that a trust protector is a fiduciary, unless otherwise provided in the trust instrument, 12 Del. C. §3313(a) and 760 ILCS §§16.3,16.7
Rights of a Protector

- Largely dependant on the terms of the Trust Deed
  - Right to charge
  - Right to be indemnified
  - Right to sue
- Conflicts?
- Problem: old or badly drafted trusts
Standard of conduct

- This standard of conduct by which the Trust Protector is judged should be specified in the trust instrument

- Typically the *minimum* standard of conduct is *good faith* and the *best interest* of the beneficiary and the purposes of the trust

- What about *willful misconduct* and other higher standards?
Who should serve as Protector?

- Friends?
- Family members?
- Family Lawyer?
- Professional Protector?
Choosing a Trust Protector

- Too often this is an afterthought – a very important decision that should be considered early in the drafting process.

- Consider drafting in the role with the ability to fill it at a later date if the grantor cannot identify someone currently.

- The powers given to the Protector can have an impact on who should be considered.

  - Power to modify trust - consider tax implications to grantor and to person being considered for Protector
  
  - Power to add beneficiaries – choose appropriate person to have this responsibility
Protectors abusing their role?

Freiburg Trust [2004] JLR-N13
- Protector convicted of fraud and sentenced to imprisonment, for inter alia, misappropriating monies from the trust

Representation of Centre Trustees [2009] JRC 109
- Business partners appoint each other as Protector of the other’s family trust, each owning 50% of business
- Following death of first partner, Protector of his trust attempted to force a sale to Protector’s family trust
- Court ordered removal of the Protector
Protectors versus Enforcers

- Enforcer: statutory concept
- Protector: generally not statutory
- Can sole Enforcer be the Protector?
Transparency

- Will Protector be reported?
  - FATCA – Controlling person
  - CRS – Controlling person
  - Local Jurisdiction – Possible requirement to report
Additional Issues to Consider

- Careful consideration needs to be given
  - Powers
  - Role
  - Individual to be appointed
  - Appointment of Successor Protector
  - Who can Remove a Protector?
Summary

- Protector, like a trustee, should be a friend
- Like a trustee, appointment of Protector needs to be carefully chosen
- Unlike a trustee
  - Role of Protector is relatively recent, often undefined
  - Often individual chosen may be inappropriate for the job
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