

# Implementing a Trustor's (and Estate Planner's) Vision

Managing challenging assets and challenging personalities ....  
and a few tips learned along the way



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# Roadmap

1. Preplanning
  - a) How's a trustee going to read this? Three options:
    - Let the trustee wing it
    - Letters of Intent
    - Name someone for the trustee to talk with
  - b) Directed Trustees for Funky Assets
2. After the Fact
  1. Nonjudicial Settlement Agreement
  2. Decanting
  3. "IRL"
3. Practical tips and tricks learned along the way

# PREPLANNING

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## What the heck is HEMS?

1. ... a standard you can drive a truck through
2. But what did the grantor mean?
  - Let the trustee wing it
  - Letters of Intent
  - Name someone for the trustee to talk to

## Let the Trustee Wing It

1. Some state statues define what a reasonable distribution is – typically 3-5%
2. Trustees are not created equal
  - What Grantors think they are getting...



- What they often get...



## Letters of Intent - addressed to Trustee

- Examples of what it might include:
  - Hopes for family legacy
  - Wishes around family values
    - This can get pretty detailed – Is the first car a used Accord or a Porsche?
    - Are distributions more limited during formative years?
  - Explanation of your estate plan
  - Information about a beneficiary's special needs
  - Careful not to contradict the trust documents
  - Allow for flexibility

## Name a person for the trustee to talk with

- Non-fiduciary
- Someone at the Thanksgiving table
- Someone who shares the grantor's values
- Especially important with mental health or substance abuse issues

# PLANNING FOR FUNKY ASSETS:

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- Closely held business
- Real estate
- Oil and gas



Who wants a bank making decisions on funky assets?

**NO ONE!**

But now there is another option...

**The directed trust**

## Directed Trusts – The Concept

- Historically, trustees wore many hats.
  - Distributions
  - Administration (filing taxes, bookkeeping, etc.)
  - Asset/Investment Management
- With Directed Trusts, some of those hats are worn by someone other than the trustee, the “Trust Director.”
- The Trust Director directs the Trustee with respect to the responsibilities given to the Trust Director.
- When a Trust Director wears some of the hats, the Trustee is known as a “Directed Trustee.” (In TN, as to the responsibilities allocated to someone else, the “Excluded Fiduciary”)

## Typical Powers of a Trust Director

- acquire, dispose of, exchange, or retain an investment
- manage a business held in the trust
- make or take loans
- vote proxies for securities held in trust
- modify, reform, terminate, or decant a trust

## The Arizona Statute - ARS § 14-10808

### Powers to direct

**B.** If the trust provides that **the assets** in the trust are subject to the direction of the settlor or a cotrustee, beneficiary or third party, the trustee has no duty to review the directions it is directed to make or to notify the beneficiaries regarding any investment action taken pursuant to the direction. The trustee is not responsible for the purchase, monitoring, retention or sale of assets that are subject to the direction of the settlor or a cotrustee, beneficiary or third party. The trustee is not subject to liability if the trustee acts pursuant to the direction, even if the actions constitute a breach of fiduciary duty, unless the trustee acts in bad faith or with reckless indifference.

**C.** The terms of a trust may confer on a trustee or other person a **power to direct the modification or termination of the trust.**

**D.** Unless the trust instrument provides otherwise, a person, other than a beneficiary, who holds a power to direct **is presumptively a fiduciary who**, as such, is required to act in good faith with regard to the purposes of the trust and the interests of the beneficiaries. The holder of a power to direct is liable for any loss that results from breach of a fiduciary duty.

## How to Create a Directed Trust

- Converting an existing trust
  - Tennessee makes it easy. All of the Qualified Beneficiaries can agree to convert to a directed trust. At Cumberland we call it a “Trustee Direction Agreement.”
  - Arizona doesn’t have this concept. Therefore requires NJSA or Decanting
- Drafting a new trust ...

## Language to create a “Directed Trust”

**Appointment and Removal of Financial Advisor.** \_\_\_\_\_ with \_\_\_\_\_ shall serve as the Financial Advisor (the “Financial Advisor”) of the marketable assets including but not limited to stocks, bonds, and other liquid assets of the trusts created hereunder.\* The person(s) then having the power to remove the Trustee may, without assigning cause, remove the Financial Advisor at any time and from time to time and appoint one or more successor Financial Advisors by giving thirty (30) days’ written notice to the Trustee and the Financial Advisor then serving.\*\* Any Financial Advisor shall have the right to resign by giving thirty (30) days’ written notice to the person(s) then having the power to remove the Trustee.

**Authority of Financial Advisor.** *The Financial Advisor shall exercise all powers referenced in this Will/Trust as being held by the Trustee that are related to the marketable assets,* including but not limited to stocks, bonds, and other liquid assets within the Trust. *The Trustee shall have no responsibility or authority to invest the Trust property or to make investment decisions, except as directed by the Financial Advisor.* Further, Cumberland Trust is hereby directed and authorized to sign the Financial Advisor firm’s paperwork presented to it, regardless of whether the Financial Advisor accepts investment discretion or not and regardless of whether such paperwork includes arbitration as being the sole remedy for any dispute.

*\*Note: If you would rather not name the Financial Advisor in the document, change the first sentence to name an individual that has the power to appoint a Financial Advisor. The sentence would read:*

\_\_\_\_\_ (individual – i.e. Grantor, Beneficiary(ies), or Trust Protector) shall have the power to appoint the initial Financial Advisor (“Financial Advisor”) of the marketable assets including but not limited to stocks, bonds, and other liquid assets of the trusts created hereunder.

*\*\*Note: give thought to if you want the beneficiaries to have the authority to change the FA. Sometimes that’s not appropriate.*

## If there are special assets...

**Removal and Appointment of Property Manager:** *Choose one of the following two choices:*

(1). The *Grantor/Beneficiary(ies)* may appoint one or more “Property Manager(s)” to serve as, and direct the Trust to retain, for so long as the *Grantor/Beneficiary(ies)*, or “Property Manager(s)” deems it advisable to do so, or until directed otherwise, the ownership interests in any specialty or hard-to-value assets(s) that the Trust owns. The “Property Manager” shall manage and act with respect to specialty assets owned by the trust, including but not limited to, making all decisions regarding the purchase, sale, lease, and retention of such specialty asset(s). Cumberland Trust shall act upon the direction or recommendation of the Property Manager. It is expressly agreed that Cumberland Trust will rely upon the direction, instruction, or recommendation of the Property Manager without independent investigation and that Cumberland Trust shall have no investment responsibility or liability with regard to the direction, instruction, recommendation, actions, or inactions of the Property Manager. The *Grantor/Beneficiary(ies)* shall have the sole authority to monitor, remove, and appoint a Property Manager in the same manner as prescribed for the Financial Advisor.

(2) \_\_\_\_\_ is hereby appointed as the “Property Manager” to manage and act with respect to specialty assets owned by the trust, including but not limited to, making all decisions regarding the purchase, sale, lease, and retention of such specialty asset(s). Cumberland Trust shall act upon the direction or recommendation of the Property Manager. It is expressly agreed that Cumberland Trust will rely upon the direction, instruction, or recommendation of the Property Manager without independent investigation and that Cumberland Trust shall have no investment responsibility or liability with regard to the direction, instruction, recommendation, actions, or inactions of the Property Manager. The *Grantor/Beneficiary(ies)* shall have the sole authority to monitor, remove, and appoint a Property Manager in the same manner as prescribed for the Financial Advisor.

## Other considerations with special assets...

- With entities, coordinate successor management provisions in the trust with those in the corporate documents.
  - Never want the Directed Trustee to have to run an active business
  - Is there a self-perpetuating board?
  - Put lots of layers of failsafes in
- In drafting the powers for a Trust Director, one good source to look to is the Tennessee Trust Code § 35-15-1201 - *Powers of trust advisors and trust protectors*. Great laundry list of powers.



## Other considerations with special assets...

- Think about trust liquidity when the sole asset is an entity...

*“Notwithstanding the express separation of investment decision-making from the other fiduciary duties and responsibilities of the Trustee, it is important that my Fiduciaries coordinate their respective roles to further the overall objectives this trust. To this end, upon notice from the Trustee that a distribution will be made to one or more beneficiaries, and that additional liquidity may be required to accommodate said distribution, my Investment Advisor shall take whatever steps are reasonably necessary and appropriate to ensure adequate liquid resources are made available to the Trustee so it may make the subject distribution in a timely manner.”*

## Directed Trusts - The Practical Stuff

1. Don't give the Trustee the power to fill vacancies in Trust Directors – this could cause a “delegated” relationship rather than “directed.”
2. Name a person and not just a financial institution to be the Trust Director – many financial institutions cannot be fiduciaries.

## Directed Trusts - The Practical Stuff

3. Don't say that the Trustee can decide whether to follow the Trust Director – this would not effectively bifurcate the responsibilities between the parties.
4. If you don't originally create a trust as a Directed Trust, consider giving a "Trust Protector" the right to convert it to a Directed Trust/modify the trust. This avoids having to get all the Interested Persons to sign off on it.

## Directed Trusts – In Real Life

**Works great when:**

- Family has a financial advisor they want to stay involved,
- There are “special assets” such as real estate investments or closely held businesses, or
- Family sees value in bifurcating responsibilities between fiduciaries to take a “best of breed” approach

# AFTER THE FACT...

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# NONJUDICIAL SETTLEMENT AGREEMENTS

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## Nonjudicial Settlement Agreements – the Concept

*Anytime you need to alter a trust document...and all the Interested Parties will agree.*

Such as changes to:

- Jurisdiction
- Trustee requirements (Example: huge capital and surplus requirements)
- Ambiguous language
- Create a directed trust

## NJSA – Arizona Statute

### ARS 14-10111 Nonjudicial settlement agreements

- A. Except as otherwise provided in subsection B of this section, and except for modification or termination of a trust as otherwise permitted pursuant to the trust instrument, **interested persons** may enter into a binding nonjudicial settlement agreement with respect to any matter involving a trust.
- B. A nonjudicial settlement agreement is valid only to the extent it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by the court under this chapter or other applicable law.



# DECANTING

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## Decanting – the Concept



## Decanting – Arizona Statute

### ARS § 14-10819. Trustee's Special Power to Appoint to Other Trust

B. This section applies to a trust governed by the laws of this state, including a trust whose governing jurisdiction is transferred to this state.

C. The exercise of the trustee's power to appoint trust property under subsection A of this section is considered to be the exercise of a special power of appointment.

D. The trustee, in the trustee's sole discretion, before or after the exercise of the trustee's power to appoint trust property under subsection A of this section, may request the court to approve the exercise.

E. The trustee may exercise the power to appoint all of the trust property pursuant to subsection A of this section by restating the trust instrument.

## Reasons to Decant

- Converting to a Directed Trust
- Extending the term of the trust
- Changing a support trust into a discretionary trust
- Correcting drafting errors or ambiguous terms
- Changing the governing law of the trust
- Modifying powers of appointment
- Changing trustee provisions
- Combining trusts for greater efficiencies

# WHERE THE RUBBER MEETS THE ROAD: IRL

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## Fact Pattern

- John Client – Age 55, unmarried
  - 3 children – Allie (21), Brian (24), Cody (28)
    - A - Apple of daddy's eye, in college and doing well
    - B – Not employed, active mental health and addiction issues
    - C – Works as an accountant and is stable, but with a history of mental health struggles
  - 3 dogs – John is closer to his dogs than his kids
  - Total Net Worth - \$8M
    - SM LLC with \$5M in commercial real estate (fully rented office park)
    - \$1.5M residence
    - \$1.5M marketable securities
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## John's Estate Plan

- 1<sup>st</sup> Create a pet trust with \$500k and require the trustee to find homes for each of the dogs and continue to distribute funds for the care of the dogs for their lifetimes, remainder to the ASPCA.
- Divide residual estate equally amongst trusts created for each of the three kids.
- All the trusts are lifetime trusts, with HEMS distributions, but B required to undergo drug testing before any distributions.
- C is named as the Executor and the Trustee for each of the 3 trusts. Successor Executor and Trustee is Big Bank and Trust Co. ("BBTC"), a large national bank.
- There is no mention of John's intent for the real estate LLC, but he has made it known to everyone that he doesn't want the "family cash cow" sold.

## John dies...

- C recognizes that his depression is taking a turn for the worse after his dad's death and declines to serve as Executor and as Trustee over A and B's trusts.
- BBTC gets the documents, sees 3 red flags:
  - the pet trust (1<sup>st</sup> red flag),
  - the drug testing requirement (2<sup>nd</sup> red flag), and
  - is told that if the trustee tries to sell the real estate, that the kids will fight them because "that's not what dad wanted." (BBTC is not in the business of holding real estate.)
- BBTC declines to serve, too. Yikes!



## How could this be avoided?

- Talk to BBTC before documents are signed
  - Triggers to get an early review
    - Special assets
    - Mental health/substance abuse
    - Funky provisions – pet trusts?
    - Low asset numbers – most big banks want \$5M before they serve. Even independent trust companies' minimums are growing.

I WISH I KNEW THEN  
WHAT I KNOW NOW...

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## I wish I knew then what I know now...

- Substance Abuse/Mental Health
  - Trust Protectors are AWESOME!
  - Consider naming a family member or family friend as the Trust Protector. Someone at the Thanksgiving table.
  - Drug testing requirements are cumbersome for everyone involved

## I wish I knew then what I know now...

- Have the corporate trustee review testamentary docs/situation anytime:
  - There is a funky family situation
  - There are minimal assets, or
  - The assets are tricky (operating business, pets, complex real estate, etc.)

## I wish I knew then what I know now...

- With special needs beneficiaries (including mental health, diminished capacity, or substance abuse):
  - Have a POA and Healthcare Advanced Directive for the beneficiary
  - Psychiatric Advanced Directive, if applicable

## I wish I knew then what I know now...

- KISS
  - Nonprobate rocks! – Beneficiary designations, POD, JTWROS

## I wish I knew then what I know now...

- NIMCRUTs
  - Consider a corporate trustee from the get-go.
  - The record keeping necessary to track what needs to be distributed is very onerous
  - If an individual trustee does not keep accurate records, it makes it impossible for a successor trustee to administer correctly going forward

## I wish I knew then what I know now...

- Testamentary Residence Trusts
  - Common to leave a house for a surviving spouse in some sort of residence trust...but not leave any liquidity for the trustee to maintain the house or pay taxes. Very difficult to oversee if the occupant is paying what they should to upkeep the property.
  - What about the TPP?



## I wish I knew then what I know now...

- Intestate Heirs as Remainder Beneficiaries...not just takers of last resort
  - The corporate trustee would then have to identify this group...and it's surprising how often this group is contested.