

Decoding the Directed Trust



In a number of states, attorneys have been drafting trusts for close to a decade using a version of the directed trust statute to effectively bifurcate the fiduciary duties of the trustee between an “advisor” or “director” (or, in North Carolina and a few other states, a “power holder”) (most commonly referred to as, the “Trust Advisor”) and the Trustee (also referred to as the directed trustee of excluded fiduciary) (the “Directed Trustee”). At its essence, a directed trust structure isolates a fiduciary duty (such as the duty to manage the trust’s assets or to make discretionary distributions to the trust beneficiaries) and assigns that responsibility to the Trust Advisor and relieves the Directed Trustee from the responsibility assigned and assumed by the Trust Advisor. While this sounds fairly simple and straightforward, it does have certain nuances that both attorneys and clients should be aware of when contemplating this structure.

First, and foremost, because the Trust Advisor is assuming a duty that would otherwise fall to the Trustee, the Trust Advisor is a fiduciary under state law. As a fiduciary, the Trust Advisor must execute their assigned responsibility under the general fiduciary obligations applicable to trustees – including the obligation to act solely in the best interests of the trust beneficiaries, to avoid any conflict of interest or act of self dealing, and, with regard to a Trust Advisor responsible for investments, to invest under the prudent investor rule (unless such duties are modified under the trust document, if allowed by applicable state law).

Next, as a fiduciary, the Trust Advisor must have the authority to act as a fiduciary under state regulatory law. Generally, an individual has the authority to act as a fiduciary. However, generally only certain entities may have fiduciary powers and authority under state law – typically just approved banks and trust companies (who have been granted fiduciary powers under state law by application or reciprocity). Registered Investment Advisory firms and Brokerage firms do not have fiduciary powers under state trust laws and therefore cannot be appointed or serve as a Trust Advisor in a directed trust structure.

It is important that all fiduciary duties and responsibilities are allocated and assumed by persons with authority to execute on them. From the Directed Trustee’s perspective, in order to be relieved of the fiduciary duty and corresponding liability for the responsibility assigned to the Trust Advisor, the Trust Advisor must be acting in a fiduciary capacity so that the Directed Trustee is “excluded” from that fiduciary responsibility.

Pulling this together, particularly in the context of bifurcating the investment responsibility of the Trustee when a family desires for the investment advisory firm they have worked with for years to be responsible for managing the trust’s marketable investments, the investment advisory firm cannot be appointed as the Trust Advisor under the trust document. So, how does the directed trust structure work to get to the ultimate objective? It can be accomplished in a few ways, but the most common is:

1. An individual, who may be the grantor or a beneficiary of the trust, is appointed as the initial Trust Advisor with authority to manage the trust’s investments;
2. The Trust Advisor directs the hiring of the investment advisory firm (sometimes referred to as the “Investment Manager”), thereby delegating the Trust Advisor’s fiduciary responsibilities to invest the trust’s marketable investments to the Investment Manager;
3. The Trust Advisor has the duty to oversee the actions of the Investment Manager, execute the investment policy statement and ensure the Investment Manager’s actions are consistent with the trust’s investment strategy.

Typically, the trust agreement will include provisions for both the succession of the Trust Advisor, the removal and replacement of the Investment Manager, as well as what happens in the event there is neither a Trust Advisor nor Investment Manager serving.

Of course, understanding this background, the individual serving as a Trust Advisor may be hesitant to serve in that role as a fiduciary. To the extent that the directed trust structure is administered under Tennessee law, Tennessee's statute has provided an exception to the fiduciary duty standard applicable to Trust Advisors where the individual serving is a beneficiary of the trust. See Tennessee Code Section 35-15-1202(a). Under the Tennessee trust code, a beneficiary is defined to include a person who has a present or future interest in the trust, vested or contingent. See Tennessee Code Section 35-15-103(4). Accordingly, if a beneficiary is serving in the role as a Trust Advisor they are not considered to be acting in a fiduciary capacity and the standard by which they may have liability for their actions in this role is higher than the fiduciary standard, while the Directed Trustee is still excluded from liability for the actions of the Trust Advisor. This is a unique construct facilitated by Tennessee's statute and may be one that families find desirable to allow a family member (who may be a remote contingent beneficiary of a trust) to serve as a Trust Advisor but not held to a heightened fiduciary standard in executing their duties.

This is one of several critically important distinctions and advantages that Tennessee law provides in trust administration. Future insights will highlight and expound on these nuances and how they may be relevant and helpful to your practice and clients.



About the author: Andrea is Managing Director, Charlotte, and Senior Trust Officer. In these roles, she is responsible for managing and building relationships in Charlotte and across North and South Carolina. Andrea works collaboratively with families and their advisors to understand and help define family goals and implement effective fiduciary services that meet those objectives.
E: AChomakos@pendletonsquaretrust.com | T: 980.353.3345