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Expert Analysis

Time for a Second Look: Revisiting New York's Proposed Directed Trust Statute

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The last several years have seen a flurry of activity on the directed trust front. Since 2014, at least seven states have enacted directed trust statutes for the first time and at least three states have amended their already-existing statutes. Several states have taken notice of the potential utility—and business development opportunities—offered by flexible directed trust statutes and have proposed statutes. Perhaps the most indicative of this trend is the recent promulgation of the Uniform Directed Trust Act by the National Conference of Commissioners on Uniform State Laws on July 19, 2017. With the dust still settling on the relatively recent and diverse changes affecting directed trusts throughout the United States, New York's proposed directed trust statute has remained stalled in the Judiciary Committee since it was first introduced in 2015. N.Y. Legis. S. 1635. Reg. Sess. 2015-2016 (2015). As a result, New York is currently one of the few states without a directed trust statute. (Currently, New York, California, Connecticut, Louisiana, and Rhode Island are the only five states without such a statute.) As other states consider whether to adopt the Uniform Directed Trust Act, it is an opportune time to take a second look at New York's proposed directed trust statute. Fortunately, the New York State Legislature is presently reviewing directed trust legislation.

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Directed Trusts Explained

The use of directed trusts has become an increasingly common arrangement in contemporary estate planning and asset management. A directed trust is a trust in which the traditional responsibilities of the trustee are divided between trustees and non-trustee individuals or entities performing different discrete, specialized functions and having varying fiduciary responsibilities and corresponding liability. In a directed trust, the trustee (called a "directed trustee") is to follow the direction of, or seek consent from, a non-trustee (called a "trust advisor") with respect to such a discrete function. This bifurcated structure is intended to capitalize on a particular non-trustee powerholders' expertise, often by granting responsibility for investments, distributions, and administration to distinct parties.

It is an opportune time to take a second look at New York's proposed directed trust statute.

Directed trusts have risen in popularity because of the great degree of flexibility and control they offer to settlors. For example, a settlor may have specific objectives with respect to the

management and investment of trust assets that a corporate trustee might find problematic. Often, settlor's create trusts for the purpose of holding nontraditional and specialty assets, such as real estate, art work, mineral resources, or a concentrated position in a family business, without the diversification of those assets. While the trustee would consider the settlor's objectives, the prudent person rule, rules requiring diversification, and the trustee's fiduciary obligations may deter or even prevent the trustee from following through with those objectives. Alternatively, a settlor who has a long-standing and trusted relationship with a successful investment manager may want that manager (not the corporate trustee) to make investment decisions of trust assets. The use of directed trusts in estate planning has developed as a strategy to address the conflict between the settlor's intent with respect to the assets of the trust and the common law and statutory duty regarding management of such assets. In any of these situations, a directed trust can help facilitate the objectives of a settlor where the trustee is unable or unwilling to do so.

When the traditional trustee functions are taken away from the trustee and given to a trust advisor, the trustee will generally charge a reduced fee to reflect the reduced responsibility. The quid pro quo for lower fees is that the directed trust agreement exculpates the corporate trustee from all acts and omissions by the trust advisor to the fullest extent permitted by law. Even if a trust directs the trustee to make investments or distributions on the direction of a non-trustee and relieves it from liability for following such directions, the trustee might have considerable monitoring or other responsibilities under New York law.

Current N.Y. Law

There is limited decisional law in New York recognizing the validity of directed trusteeship. In *Matter of Will of Rubin*, 143 Misc. 2d 303 (Sur. Ct Nassau Co. 1989), I upheld the validity of a codicil clause that required executors to follow the direction of third persons. On review, I first noted that while co-executors ordinarily have a joint and entire authority over the property so that any one of them may act in the administration of the estate, such power can be limited. The law is well settled that "a grantor or testator may give his gift subject to any terms and conditions he chooses, unless the terms are contrary to public policy or some restriction applies." Following this rationale, I determined that imposition of restriction on fiduciaries which required them to follow the directions of third persons was valid since such a restriction was neither unlawful nor against public policy; in fact, the court went on to applaud the potential benefits of directed trust structures.

While New York courts have upheld the validity of bifurcated trustee responsibilities, New York courts have invalidated a settlor's attempt to bifurcate varying fiduciary responsibilities and assign corresponding liability between a trust advisor and directed trustee. In *Matter of Rivas*, 30 Misc. 3d 1207(A) (Sur. 2011), aff'd, 93 A.D.3d 1233 (2012), the court invalidated the bifurcation of liabilities between a trust advisor and directed trustee on the grounds that it was inconsistent with the nature of a trust and against public policy since it could "give rise to an impermissible division of fiduciary loyalties." According to the court, "[t]he members of the Advisory Committee, with a conferred fiduciary status, owe a duty of undivided and undiluted loyalty to those who interests [ ] the fiduciary is to protect. This rule is sensitive and inflexible." Further, while the trustee is under a duty to comply with the directions of the committee with respect to investment decisions, the trustee cannot ignore its fiduciary responsibilities and could be held liable for abiding by the direction of the Advisory Committee where there may be reason to believe that the advisory committee, as a de facto co-trustee, is not fulfilling its fiduciary duty.

N.Y.'s Proposed Directed Trust Statute

While New York courts have recognized the validity of directed trusteeship, there is no body of law which provides guidance as to how such trusteeship should function. As a result, in 2015, the New York State

legislature referred a bill to its Judiciary Committee that would expressly allow grantors to establish directed trusts in New York State and set out general parameters for such trust. N.Y. Legis. S. 1635. Reg. Sess. 2015-2016 (2015). The New York State Senate justified the proposed legislation in its memorandum as follows:

> "this legislation is designed to remedy a gap in the State's judicial fabric by providing guidance for courts, grantors, and fiduciaries as to the governing law, in the absence of provisions in the trust instrument to the contrary, for directed trusteeships .... It clarifies matters of definition, court jurisdiction, compensation, fiduciary liability and responsibility of administrative trustees and advisors or protectors .... This bill is designed to help New York fiduciaries compete for trust business, which is increasingly flowing to states with more modern trust laws"

The proposed bill amends the Estates, Powers and Trusts Law (EPTL) by adding a new §11-2.2-a.

Under the proposed §11-2.2-a, any non-trustee given the power or authority to direct, consent to or disapprove a trustee's actual or proposed investment decisions, distribution decisions or other decision of the fiduciary is considered to be an "advisor" to the trust. "Investment decisions" are defined to mean, with respect to any investment, the retention, purchase, sale, exchange, tender or other transaction affecting the ownership thereof or rights therein. If the trust advisor is given the authority to make investment decisions, that advisor is referred to as an "investment advisor." The proposed statute also defines the term "advisor" to include someone identified as a trust "protector."

The main contribution of the proposed statute is to address the many complications created by giving a power of direction to a trust advisor, specifying the fiduciary duties owed by the trust advisor and the directed trustee. The proposed statute makes it expressly clear that the advisor acts in a fiduciary capacity when exercising that authority, unless the trust agreement provides otherwise. A directed trustee who acts in accordance with the direction of an advisor is not liable for any loss resulting directly or indirectly from that act, except in cases of willful misconduct. Further, except in cases of willful misconduct or gross negligence, if the terms of the trust agreement provide that the trustee must make decisions with the consent of an advisor, the trustee will not be liable for any loss resulting from the advisor's failure to provide the required consent, provided the trustee has requested that the advisor give consent. Finally, if the terms of the trust provide that the trustee must act in accordance with the direction of an advisor with respect to investment decisions, distribution decisions or any other decision of the trustee, unless the trust agreement provides otherwise, the trustee has no duty to monitor the conduct of the advisor, to provide advice or to consult with the advisor, or to communicate with or warn any beneficiary to third party that the trustee would or might have made a different decision.

These proposed changes to New York law gives a settlor more flexibility to bifurcate responsibilities between the trustee and the trust advisor.

Conclusion

The proposed New York directed trust statute not only offers estate planners and their clients another strategy and tool to be considered in carrying out their clients wishes and goals but also clarifies existing law about the fiduciary status of a non-trustee that has power over a trust and about the fiduciary responsibility of a trustee with regard to actions directed or taken (or not taken) by the non-trustee. These proposed changes to New York law gives a settlor more flexibility to bifurcate responsibilities between the trustee and the trust advisor. That flexibility is intended to encourage the establishment of directed trusts under New York law by making New York more competitive with states like Delaware, which have had directed trust statutes for several years.

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