D.C. Estate Planning Council

Grantor Intent & Fiduciary Flexibility: Drafting for the Long Haul

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I. Trust Duration

II. Demographic Changes

III. Trust Design & Grantor Intent

IV. Trust Design & Beneficial Interests

V. Trust Management: Planning for Unique Assets

VI. Trust Management: Selection of Fiduciaries and Advisors

VII. Trust Modification
**Trust Duration**

<table>
<thead>
<tr>
<th>Marital Trusts</th>
<th>Family Trusts</th>
<th>Special Needs Trusts</th>
<th>Life Estate Trusts</th>
<th>Special Purpose Trusts</th>
<th>Dynasty Trusts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shortest Duration</td>
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<tr>
<td>Longest Duration</td>
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</table>

D.C. Estate Planning Council
Introduction

- Under current law, 2015 represents a continuing opportunity to transfer substantial wealth by gift to family members, particularly through long term trusts designed to be exempt from the Rule Against Perpetuities.
- The Tax Reform Act of 2010 unified both exemptions and rates under the Federal Estate, Gift, and Generation Skipping Transfer Taxes. ATRA preserved the unified exemption and rate structure, with a modest marginal rate increase.

<table>
<thead>
<tr>
<th></th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
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</thead>
<tbody>
<tr>
<td>Exemptions</td>
<td>$5,000,000</td>
<td>$5,120,000</td>
<td>$5,250,000</td>
<td>$5,340,000</td>
<td>$5,430,000</td>
</tr>
<tr>
<td>Rate on Excess</td>
<td>35%</td>
<td>35%</td>
<td>40%</td>
<td>40%</td>
<td>40%</td>
</tr>
</tbody>
</table>

- Leveraged wealth transfer strategies such as the use of valuation discounts for unmarketable and minority interests, short-term grantor retained annuity trusts, defined value clauses, installment sales, and self-cancelling installment notes, among others.
- The ability to obtain grantor trust treatment for fiduciary income tax purposes. See Revenue Ruling 85-13, 1985-1 Cum. Bul 184. See also Sections 671 et seq. of the Internal Revenue Code.

*American Taxpayer Relief Act of 2012*
Rule Against Perpetuities

- Approximately 31 states have either repealed, optioned or extended the permissible period under the common law Rule Against Perpetuities (See Table A) making these states a logical choice for the situs of a long-term family (or “dynasty”) trust. Threats to perpetual trusts exist on several fronts:

  - President Obama has proposed, in the General Explanations of the Administration’s Fiscal Year 2015 Revenue Proposals (commonly referred to as the “Green Book”) that the Federal GST exemption to be limited in duration to a period of ninety years.

  - The American Law Institute’s Restatement Third of Property (Wills and Other Donative Transfers) – Volume 3 proposes limiting long-term trusts to no more than two generations below the transferor. This approach is explained and amplified in the “The American Law Institute Proposes a New Approach to Perpetuities: Limiting The Dead Hand to Two Younger Generations.” Lawrence W. Waggoner, University of Michigan Law School, Public Law and Legal Theory Working Paper Series, Working Paper 200 (Revised July, 2010).
Rule Against Perpetuities (continued)

### State Perpetuities Statutes

<table>
<thead>
<tr>
<th>RULE**</th>
<th>STATES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Permit Perpetual Trusts</td>
<td>Delaware (for trusts of personal property), District of Columbia, Hawaii, Idaho, Illinois, Kentucky, Maine, Maryland, Michigan, Missouri, Nebraska, New Hampshire, New Jersey, North Carolina, Ohio, Pennsylvania, Rhode Island, South Dakota, Virginia, and Wisconsin</td>
</tr>
<tr>
<td>Permit Very Long Trusts</td>
<td>Alabama (360 years), Alaska (1000 years), Arizona (500 years), Colorado (1,000 years), Florida (360 years), Nevada (365 years), Tennessee (360 years), Utah (1,000 years), Washington (150 years), and Wyoming (1,000 years)</td>
</tr>
<tr>
<td>Follows Common-Law RAP</td>
<td>Iowa, Mississippi, New York, Oklahoma, Texas, and Vermont</td>
</tr>
<tr>
<td>Termination at Later of Death of Last Income Beneficiary or 20 years after Grantor’s Death</td>
<td>Louisiana</td>
</tr>
</tbody>
</table>

**January, 2015**
Financial Sustainability

- Financial Sustainability
  - Financial Modeling
    - Many financial models used to illustrate the asset accumulation in long-term trusts inadequately assess the impact of the two critical phenomena in trust management:
      - The expansion of beneficial interests through generations
      - The timing and extent of trust distributions tied to beneficiaries' life stages
  - Reproductive Data
    - The mean age of a mother at first birth is 25.2 years in the United States.
    - Significant differences in age at first birth exist among U. S. States and among racial and ethnic groups:
      - Massachusetts has the highest average maternal age at first birth – 27.7 years
      - Mississippi has the lowest average maternal age at first birth – 22.6 years
      - Asia Pacific Islander women had the oldest maternal age at first birth - 28.5 years
      - Alaskan native women had the youngest maternal age at first birth - 21.9
Fertility rates in the United States have declined over the last three generations, from a high of 3.0 births per women, for women born in 1935, to 2.0 births per woman, for women born in 1960.

- The total fertility rate (TFR) for the United States in 2013 was 1.86 births per woman.

Statistical data on the average age difference between siblings are difficult to interpolate from census data. I have assumed a three year gap between first and second children for modeling purposes.
Demographic Changes

- Increased Life Expectancies
- Greater Diversity in Domicile
- Situs Selection & Modification
- Changes in Family Composition
- Generational Overlap
- Expansion of Marriage and Definition of Spouse
- Diversity of Cultural Perspectives on Estate Planning and Inheritance
- Changing Economic and Market Conditions: Investment Practices
- Reproductive Variables
Traditional Trust Portfolio (Pre-Prudent Investor Rule)

- Large Cap Domestic Stocks: 50%
- Domestic Bonds and Cash: 50%
Diversified Trust Portfolio - Post-Prudent Investor Rule*

- Large Cap Stocks: 20%
- Mid Cap Stocks: 3%
- Small Cap Stocks: 2%
- Developed International Stocks: 18%
- Emerging Market Stocks: 11%
- Investment Grade Bonds: 16%
- Global Real Estate: 5%
- Natural Resources: 6%
- High Yield Bonds: 5%
- Private Equity: 8%
- Cash: 2%
- Hedge Fund: 4%
- Tips: 1%
Demographic Changes

◆ Reproductive Variables

Conception

In Utero
Ex Utero
Inter Vivos
Posthumous

Husband
His sperm
Donor sperm

Wife
Her egg
Donor egg

Pregnancy
Wife’s womb
Surrogate’s womb

ART Children and Inheritance
- Uniform Probate Code §2-120 (As Amended, 2008)
Tax – Driven Estate Planning Paradigm
Navigating the Estate Planning Minefield

Assets
- Grantor Retained Annuity Trusts
- QPRT’s
- Personal Financial Statements

Irrevocable Life Insurance Trusts
- Beneficiary Designations

CRT’S

Family Birth Dates, Addresses, Marital Status

Revocable Trusts
- QTIP’s

Charitable Remainder Trusts

Qualified Terminable Interest Property Trusts
- GRAT’s
- FLP’s

Qualified Personal Residence Trusts

Title Insurance Policies

Liabilities

Pour-Over Wills

ILIT’s
Mr. and Mrs. N. Family

Mr. N

Mrs. N

Daughter 1
Age 43

Daughter 2
Age 40

Grandchild 1

Grandchild 2

Grandchild 3

Grandchild 4
Mr. and Mrs. N. Family Reality

- Mr. N
- Mrs. N

Daughter 1
  - Age 43
  - Grandchild 1
  - Grandchild 2
  - Grandchild 3
  - "Drug Problem"

Daughter 2
  - Age 40
  - Grandchild 4
  - "Spending Issue"
  - "Cult Involvement"

- "Control Freak"
Family Wealth (Redefined*)

- Human Capital
  - Family members’ personalities, gifts, vocations

- Intellectual Capital
  - Learning, communication, decision making

- Social Capital
  - Family’s engagement with society

- Financial Capital
  - Assets and property

*Wealth in Families, Charles W. Collier, Harvard University, 2006
Estate Planning - Essential Questions

- To Whom
- How Much
- When
  - To Give
  - To Discuss
- In What Form
  - Outright or in Trust
  - Distribution Standards

“Freedom of disposition, or donative freedom, encompasses several distinct yet related ideas – the right to give property away during life and to pass it on at death, the right to choose who gets it, the right to choose the form in which they get it, and the right to give another person the right to make those choices even after your death.”

Tension Between Settlor Control, Beneficial Interests, and Flexibility

Evolution of Standards for Early Termination and Trust Modification

- The Claflin Doctrine: Early termination of a trust may be allowed so long as it does not frustrate a Material Purpose of the settlor. Claflin v. Claflin (20 N.E. 454, Mass.1889).

- Restatement (Third) §65: Material Purposes are not readily to be inferred

- The Uniform Trust Code requires determination of a trust’s Material Purpose for:
  - §111: Non-Judicial Settlement Agreements
  - §411: Modification or Termination by Consent
  - §412: Modification of Termination Because of Unanticipated Circumstances
Statements of Intent

- Instructions to the Trustee (and Other Fiduciaries)
  - Letters of Wishes
  - Precatory Language
  - Statement of Intent
    - Demonstrates unique grantor intent
    - Ties that intent to the trust (material purpose)
    - Expresses grantor’s view on modification and termination
  - Public Policy Limitations
Communications to Beneficiaries

- Wills and Trusts as a Form of Personal Communication
- Ethical Wills
- Family Mission Statements
- Statements of Intent
  - Formulation
    - Inductive Method
    - Deductive Method
  - Examples
Trust Design: Beneficial Interests

♦ Income

♦ Discretionary Principal

♦ Unitrust Interests

♦ Withdrawal Rights
  - Staged
  - 5 x 5 Powers

♦ Mandatory Distributions

♦ Use of Trust Assets

♦ Powers of Appointment
  - Inter-Vivos
  - Testamentary
    - Limited
    - General
Discretionary Distribution Standards

Narrow
- Emergencies
  - Medical Needs
    - Uninsured Medical Expenses, Job Loss
    - Medical Bills, Medications, Insurance Premiums
- Health
  - Medical Needs and Psychological/Psychiatric care, Rehabilitation
  - Tuition, Room & Board, Fees for College or Professional School, Grad School?
- Education
  - Normal Living Expenses (housing, food, clothing, medical care)
- Maintenance & Support
  - Best Interest & Welfare
  - All Normal Living Expenses plus Expenses for Lifestyle, Tax Planning

Broad
- Comfort
  - Pleasure/Happiness
  - Distributions for Enjoyment, Satisfaction
- Trustee’s Sole Discretion

Best Interest & Welfare
- All Normal Living Expenses plus Expenses for Lifestyle, Tax Planning

Comfort
- Pleasure/Happiness
- Distributions for Enjoyment, Satisfaction

Maintenance & Support
- Best Interest & Welfare
- All Normal Living Expenses plus Expenses for Lifestyle, Tax Planning

Education
- Normal Living Expenses (housing, food, clothing, medical care)
- Tuition, Room & Board, Fees for College or Professional School, Grad School?

Health
- Medical Needs and Psychological/Psychiatric care, Rehabilitation
- Tuition, Room & Board, Fees for College or Professional School, Grad School?

Emergencies
- Medical Needs
  - Uninsured Medical Expenses, Job Loss
  - Medical Bills, Medications, Insurance Premiums
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Best Interest & Welfare
- All Normal Living Expenses plus Expenses for Lifestyle, Tax Planning

Comfort
- Pleasure/Happiness
- Distributions for Enjoyment, Satisfaction

Trustee’s Sole Discretion

Maintenance & Support
- Best Interest & Welfare
- All Normal Living Expenses plus Expenses for Lifestyle, Tax Planning

Education
- Normal Living Expenses (housing, food, clothing, medical care)
- Tuition, Room & Board, Fees for College or Professional School, Grad School?

Health
- Medical Needs and Psychological/Psychiatric care, Rehabilitation
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Best Interest & Welfare
- All Normal Living Expenses plus Expenses for Lifestyle, Tax Planning

Comfort
- Pleasure/Happiness
- Distributions for Enjoyment, Satisfaction

Trustee’s Sole Discretion
Sample Statement of Intent Governing Discretion

In determining whether to distribute or accumulate such income and principal, the Trustee shall take into consideration (a) the income and principal (known to the Trustee) which such child may then have available from all other sources, (b) the tax laws then in effect or about to become in effect, (c) the economics of maintaining the trust created for such child and (d) what in the opinion of the Trustee will make such child a useful and productive member of society, will encourage such child to realize such child’s full potential and will not be detrimental to such child’s own sense of self-reliance.
Liquidity Issues

Special Purpose Trusts

Asset Concentrations
Liquidity Issues

- Trust Assets Presenting Liquidity/Cash Flow Issues
  - Real Estate
  - Venture Capital, Private Equity
  - Operating Mineral Interests
  - Non Marketable Entities
  - Tangible Personality and Collections
  - Intellectual Property

- Consider Endowing “Income Consuming” Assets to Facilitate Administration and Management

- Contributions to GST Exempt Trusts to Discharge Expenses of Non-Income Producing Assets Present a Risk of Tainting
Unique Assets: Special Purpose Trusts

- Non-Charitable Purpose Trusts
  - 12 Del. C. §3556
  - Uniform Trust Code §409: Non-charitable Trusts Without Ascertainable Beneficiary

- Examples of Special Purposes
  - Maintaining a Vacation Property
  - Perpetual Care for Family Cemetery
  - Maintaining Control Over a Family Enterprise
  - Maintaining a Collection
Uniform Prudent Investor Act, Section 3. Diversification

A trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.

Restatement Third, Trusts §91F

Whether and to what extent a specific investment authorization may affect the normal duty to diversify the trust portfolio (see §90, Comment g) can be a difficult question of interpretation. Because permissive provisions do not abrogate the trustee’s duty to act prudently and because diversification is fundamental to prudent risk management, trust provisions are strictly construed against dispensing with that requirement altogether. Nevertheless, a relaxation in the degree of diversification may be justified under such an authorization by special opportunities for the trust or by special objectives of the settlor.


A trustee’s duty to diversify may be expanded, restricted, eliminated, or otherwise altered by the terms of the trust. But this statement is true only if the instrument creating the trust clearly indicates an intention to abrogate the common law, now statutory, duty to diversity.
Concerns About Diversification

- Adverse Income Tax Consequences
- Unfamiliarity with Other Asset Classes
- Loss of Control
- Performance Expectations
- Impact on Portfolio Yield
- Legacy Holdings
- Fees
Reasons for Non-Diversification

- Purpose of Trust
- Legacy Holdings
- Termination Date of Trust
  - Interests of Beneficiaries
  - Step-Up in Basis
- Illiquidity
- Loss of Controlling Interest
- Related Trusts
- Beneficiaries’ Assets
- Adverse Income Tax Consequences
Grantor Intent - Trust Terms on Retention

- Silent Document
- Retention of Assets Acquired from Grantor is Permissible
- Retention of a Particular Asset is Permissible
- Retention of a Particular Asset is Preferred
- Retention of a Particular Asset is Mandatory
Retention Language

- Identify the Asset
- Explicitly Waive the Duty to Diversify
- Articulate the Reasons for Retention
- Address Asset “Conversion” Issues
  - Equities: Mergers, Acquisitions, Spin-offs
  - Real Estate: Sale, Reinvestment
- Carefully Consider the Fiduciary’s Standard of Care
  - Conventional Trusts
  - Directed Trusts
- Endow Operating/Holding Costs for Non-Income Producing Assets
- Provide a Means for Dispute Resolution
- Protect the Fiduciary
I. Policy
Follow trust terms or state Prudent Investor Rule

II. Process
The trustee must have a process for identifying and evaluating concentrations

III. Review
Determine grantor intent and fiduciary responsibility

IV. Evaluation
Evaluate retention and diversification strategies

V. Consultation
Consult with beneficiaries, their counsel, and trustee’s counsel

VI. Implementation
Implement appropriate strategies

VII. Documentation
Memorialize the process
## Unique Trust Assets - Examples

<table>
<thead>
<tr>
<th>Bolivian Tin Mine</th>
<th>Emu Farm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bombay Cement Factory</td>
<td>Llama Farm</td>
</tr>
<tr>
<td>Sewage Plant</td>
<td>Race Horse</td>
</tr>
<tr>
<td>Bingo Parlor</td>
<td>½ Race Horse</td>
</tr>
<tr>
<td>Las Vegas Casino</td>
<td>Animal Reproductive Material</td>
</tr>
<tr>
<td></td>
<td>Animal Hospital</td>
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<tr>
<td></td>
<td>Pet Cemetery</td>
</tr>
</tbody>
</table>

- Hemp Factory
- Methadone Clinic

- Nudist Colony
- Indonesian Brothel
- Motel with Hourly Rates
- Las Vegas Wedding Chapel
## Select Your Advisors and Your Fiduciary With Care

<table>
<thead>
<tr>
<th>Duty to make Assets productive</th>
<th>Duty to Collect and Keep control of the assets</th>
<th>Duty to Administer trust according to its terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Duty to Enforce claims</td>
<td>Duty to keep property separate</td>
<td>Duty to deal Impartially with the beneficiaries</td>
</tr>
<tr>
<td>Duty to exercise reasonable care and skill</td>
<td>Duty to preserve trust property</td>
<td>Duty to furnish information</td>
</tr>
<tr>
<td>Duty regarding delegation</td>
<td>Duty to keep trust property separate</td>
<td>Duty to keep accounts</td>
</tr>
<tr>
<td></td>
<td>Duty to defend actions</td>
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</tbody>
</table>
Conventional Trusts v. Directed (Administrative) Trusts
Fiduciary Responsibility - Conventional Trust

- General Asset Management
- Specialized Asset Management
- Discretionary Administration
- Beneficiary Communications
- Tax Planning and Compliance
- Custody and Reporting

TRUSTEE(s)
Fiduciary Responsibility - Directed Trust

- Beneficiary Communications
- Discretionary Administration
- Tax Planning and Compliance
- Custody and Reporting
- Administrative Trustee
- Investment Advisor
- General Asset Management
- Specialized Asset Management
Changes In Trust Design - Enterprise Trust

Discretionary Administration
Beneficiary
Communication, Custody, Reporting, Oversight

Disc. Committee
Admin Trustee

Special Assets Advisor
Trust Protector

Investment Advisor
Tax Advisor

Trust Modification
Fiduciary Removal

Special Asset Management
Asset Managers

Investment Consultant
Tax Planning
& Compliance
Changes in Trust Design - The Fractionalized Fiduciary

- Trustee Remover
- Family Trustee
- Independent Trustee
- Investment Advisor
- Investment Director
- Administrative Trustee
- Trust Protector
- Trustee Appointer
Delaware Administrative Trust (12 Del. C.§3313(b) & (e))

The directed trustee under a Delaware administrative trust has **no** duty to:

- Monitor the advisor’s conduct;
- Provide advice to or consult with the advisor;
- Warn or apprise beneficiaries about the advisor’s directions

The directed trustee, under the Delaware statute, following an advisor’s direction is liable for losses only for the trustee’s own “willful misconduct.”
Fiduciary Responsibility

Directed Trusts Under the Uniform Trust Code

- Settlors may allocate trust functions among the primary trustee and advisors as they provide in the trust document (UTC §808)
- The primary trustee’s standard for review of the advisor’s actions will depend on local law or the trust terms
  - Uniform Trust Code: the trustee must act as directed unless the advisor’s action is:
    - Manifestly contrary to trust terms
    - A serious breach of fiduciary duty

Directed Trusts Under the Restatement (Second) of Trusts §185

- If under the terms of the trust a person has power to control the action of the trustee in certain respects, the trustee is under a duty to act in accordance with the exercise of such power, unless the attempted exercise of the power
  - Violates the terms of the trust
  - Is a violation of a fiduciary duty to which such person is subject in the exercise of the power
Fiduciary Responsibility

- Drafting to Allocate Responsibility to an Advisor*
  - Define the scope and terms of the advisor’s responsibility
  - Set the standard of review to which the advisor’s actions will be subjected by the primary trustee
  - Specify whether the advisor’s power is fiduciary or personal in nature (if allowed under state law)
  - Specify the standard of care to which the advisor’s actions will be subject
  - Specify governing law
  - Address vacancies and succession, mode of decision making for shared powers, compensation for advisors

- Case Law
  - Rollins v. Branch Banking & Trust Co. of VA (56 VA. Cir 174, 2001)

* “The term “adviser” should be used in a trust instrument for the person to whom one or more powers are given to direct the trustee in carrying out the trustee’s traditional trustee duties, and the term “trust protector” should be used in the trust instrument for the person to whom one or more powers have been given that relate to one or more specific trust matters but do not involve or infringe on the trustee’s performance of traditional trustee duties. In Protectors We Trust: The Nature and Effective Use of “Trust Protectors” as Thirdy Party Decision Makers, Kathleen R. Sherby. 2015 Heckerling Institute on Estate Planning.
Trust Modification

- Non-Judicial Settlement
- Court Modification – Equitable Deviation
- Decanting
- Role of Protectors
Non-Judicial Settlement Agreements

Uniform Trust Code §111:
- Permits interested persons to enter into a binding Non-Judicial Settlement Agreement (“NJSA”) with respect to any matter involving a trust.

- Agreement is valid to the extent:
  - It does not violate a *material purpose* of the trust
  - It includes terms and conditions that could be properly approved by a court

- Matters that may be the object of a NJSA:
  - Interpretation or construction
  - Approval of accountings
  - Directions regarding trustee powers
  - Trustee resignation or appointment
  - Change of trust’s principal place of administration
  - Trustee liability
Uniform Trust Code §411:

(a) “A non-charitable irrevocable trust may be modified or terminated upon consent of the settlor and all beneficiaries, even if...inconsistent with a material purpose of the trust.”

(b) A non-charitable irrevocable trust may be terminated upon consent of all the beneficiaries if the court concludes that the continuance of the trust is not necessary to achieve any material purpose of the trust.

(c) A spendthrift provision...is not presumed to constitute a material purpose of the trust.
Modification or Termination Because of Unanticipated Circumstances or Inability to Administer Trust Effectively

Uniform Trust Code §412

(a) The court may modify the administrative or dispositive terms of a trust or terminate the trust if, because circumstances not anticipated by the settlor, modification or termination will further the purposes of the trust.

(b) The court may modify the administrative terms of a trust if continuation of the trust …would be impracticable or wasteful or impair the trust’s administration.
1992  New York Adopts First Decanting Statute

2014  The Following Statutes have Adopted Decanting Statutes:


Statutes in effect as of 8/22/2014. See Summaries of State Decanting Statutes, Susan T. Bart, Sidley Austin LLP. 2014
Non-Statutory Decanting

Common Law:
- Restatement (Second) of Property: Donative Transfers §11.1
- Restatement (Third) of Property: Wills and Other Donative Transfers §74 (2), Comment g.

Case Law
- Phipps v. Palm Beach Trust Co. 196 So. 299 (Fla. 1940)
- In re Estate of Spencer 232 N.W. 2d 491 (Iowa 1975)

Express Authority in Trust Agreement
Uniform Trust Code §808 (b) – Powers to Direct
- §808 Comment: “subsections (b)-(d) ratify the use of trust protectors and advisors.”

Case Law
- Robert T. McClean Irrevocable Trust v. Davis 283 S. W. 3d 786 (Missouri App. 2009)

Potential Powers
- Trustee Supervision or Advice
- Modification of Trust Terms
- Discretionary Oversight
- Dispute Resolution

Protectors: Fiduciary Duties, Standard of Conduct
Thank You