

New Illinois Legislation: Directed Trustees

On August 10th, the Governor signed Public Act 97-0921 (former HB 4662 and 4663) making Illinois one of a growing number of states with statutes that address directed trusts and trust decanting. These new statutes will go into effect January 1, 2013. This client alert covers the directed trust statute.

Section 16.3 is the new section added to the Illinois Trusts and Trustees Act (the "Act," codified at 760 ILCS et seq.) on directed trusts. Unlike some states who have directed trust statutes that only address an investment advisor, the Illinois statute covers various roles that may be given to an advisor to the trustee, including an investment advisor, distribution advisor or trust protectors (each defined to be a "Directing Party"). The new statute defines the roles of these various advisors, lists the powers and authority that these advisors will have, subject to the terms of the governing instrument, and addresses the responsibility and liability of these advisors and the trustee. Importantly, the statute expressly states that any Directing Party is a fiduciary with the same responsibility to exercise the authority or power granted to them as a trustee.

Authority of Investment Trust Advisor

Section 16.3(b) addresses the authority of the investment advisor. Under this section, unless the terms of the governing instrument provide otherwise, for the assets over which an investment trust advisor has been appointed, that advisor is authorized to exercise the following powers:

- Direct the retention, sale, purchase, transfer, assignment or *encumbrance* of trust property,
- Control and management of trust property, including exercising voting powers for securities,
- Select and determine the compensation for investment advisors, managers, and consultants,
- Delegate his or her investment authority to third-party advisors or managers (as provided by Section 5.1(b) of the Act, which is the section that addresses a trustee's delegation of investment authority to an agent), and

- Determine the frequency and methodology for valuing any asset for which there is no readily available market value.

Authority of Distribution Trust Advisor

Section 16.3(c) addresses the authority of the distribution advisor. Under this section, unless the terms of the governing instrument provide otherwise, the distribution trust advisor has the authority to direct the trustee on all decisions that relate, directly or indirectly, to discretionary distributions to the beneficiaries. For example, if a trust has a distribution advisor who has discretion over the distribution of income, and if there is a discretionary allocation of a trust receipt or disbursement between income or principal that will affect the funds available for discretionary income distributions to the beneficiary, the advisor should be able to direct the trustee as to the allocation of that receipt or disbursement.

Authority of Trust Protector

Section 16.3(d) addresses the types of trust protectors and the type of authority a trust protector may be granted. Trust protectors will include those who have the authority to:

- Modify or amend the trust instrument, whether for tax reasons or to address restraints on alienation, distribution of trust property, or the administration of the trust;
- Increase, decrease, or modify the interests of a beneficiary;
- Modify the terms of any power of appointment;
- Remove and/or appoint a trustee, investment trust advisor, distribution trust advisor, or another Directing Party;
- Terminate the trust;
- Change the situs and/or governing law of the trust;
- Appoint one or more successor trust protectors;
- Interpret the terms of the trust instrument at the request of the trustee; and
- Advise the trustee on matters concerning a beneficiary.

The statute requires trust protectors for charitable trusts to give 60 days prior notice to the Attorney General before exercising those powers, other than the last three powers and the power to amend for tax purposes.

Directing Party as Fiduciary

As indicated above, the statute expressly provides that a Directing Party is a fiduciary and, as such, is subject to the same duties and standards that are applicable to a trustee, unless the trust agreement provides otherwise. However, the trust instrument may not exonerate or relieve the Directing Party from acting in a manner the Directing Party, in good faith, reasonably believes to be in the best interests of the trust.

As such, under the statute, any Directing Party will have some level of fiduciary responsibility with respect to the power and authority granted to them.

This part of the new directed trust statute takes a similar position as several other states. Michigan's statute, for example, provides that a trust protector (other than a trust protector who is a beneficiary) is a fiduciary to the extent of the powers granted him under the terms of the trust, and even if the trust agreement provides he or she is a nonfiduciary, he or she must act in good faith, in accordance with the terms and purposes of the trust and the interests of the beneficiary. Mich. Comp. Laws § 700.7809(l)(b). South Dakota and Wyoming also have similar statutes. S.D. Stat. § 55-1B-6 (powers of the trust protector must be exercised in the best interest of the trust); and Wy Stat. § 4-10-711 (powers of trust protector may only be exercised if in the best interest of the trust). The Uniform Trust Code, which has been adopted by a number of states, presumes that any person who holds a power to direct certain actions of the trustee is a fiduciary, unless the power is held by a beneficiary. In contrast, Alaska's and Arizona's statutes provide that a trust protector will not be held liable as a fiduciary unless the trust instrument expressly provides that the trust protector is a fiduciary. Alaska Stat. § 13.36.370(d); Ariz. Rev. Stat. § 14-10818(D).

The position taken by the Illinois statute is that the roles of Directing Party and the Excluded Fiduciary (defined below) are really bifurcations of the fiduciary role in ensuring the management and administration of the trust according to the purposes of the trust. The definition of Excluded Fiduciary makes this clear. Under Section 16.3(a)(3), when a governing instrument grants powers to a Directing Party, the statute expressly states that those powers do not belong to the Excluded Fiduciary and the Excluded Fiduciary is precluded from exercising those powers.

Excluded Fiduciary

An Excluded Fiduciary is any fiduciary who is directed to act in accordance with a Directing Party. Section 16.3(e) provides that any Excluded Fiduciary is required to comply with the Directing Party's exercise of the powers granted to him or her. In addition, the statute exonerates or eliminates any duty for the Excluded Fiduciary to "monitor, review, inquire, investigate, recommend, evaluate, or warn" a Directing Party in the exercise or failure to exercise his or her powers. The Excluded Fiduciary is not liable for the actions or inaction of the Directing Party. Specifically, where the terms of an instrument provide that the Excluded Fiduciary is to follow the direction of the Directing Party, the Excluded Fiduciary is not liable for any result of the Directing Party's actions or failures to act unless the Excluded Fiduciary acted with willful misconduct in complying with the direction of the Directing

Party. Similarly, where the terms of an instrument provide that the Excluded Fiduciary is to only act with the consent of a Directing Party, the Excluded Fiduciary is not liable for any result of the Directing Party's declining to consent unless the Excluded Fiduciary acted with willful misconduct.

Other Provisions

The statute requires that a Directing Party keep the Excluded Fiduciary and any other Directing Party reasonably informed regarding the administration of the trust where it is reasonably necessary for the Excluded Fiduciary or other Directing Party to perform its duties. The statute also provides that an Excluded Fiduciary may obtain and rely upon a legal opinion on any matter relevant to the statute.

Applicability and Opt Out

Once effective, the statute applies to all existing and future trusts which have a Directing Party. In addition, the statute is also applicable to any trust which is modified, according to applicable law or the terms of the governing instrument, to appoint a Directing Party. Thus, it may be possible to modify an irrevocable trust to create the role of a Directing

Party, but only if the modification is permitted under Illinois law, by a court proceeding or available under Illinois' non-judicial settlement statute (codified at 760 ILCS 5/16.1). In general, under Illinois law, a modification or reformation of an irrevocable trust agreement is permissible where there has been a mistake, in fact or law, or there has been a change in circumstances unanticipated by the settlor such that the purposes of the trust can no longer be satisfied. A modification of an irrevocable trust agreement that effects only the administrative provisions (also referred to as equitable deviation) is permitted if compliance with the current administrative provisions becomes impossible, illegal or impractical. As with reformation, equitable deviation requires a showing that the purpose of the trust will still be fulfilled if the manner of administration is altered.

The Public Act also adds a new Section 16.7 to the Act. Section 16.7 provides that the directed trust statute is available to any trust that is administered in Illinois under Illinois law or that is governed by Illinois law with respect to the meaning and effect of its terms. In addition, Section 16.7 provides that a grantor or settlor may opt out of the directed trust statute by a specific reference to the statute, such as "The provisions of Section 16.3 of the Trusts and Trustees Act and any corresponding provision of future law may not be used in the administration of this trust."

If you would like to discuss any of the issues addressed in this Client Alert or would simply like to find out more about Chapman, please contact any attorney in Chapman's Trusts and Estates Department or visit us online at chapman.com.

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