Pennsylvania Directed Trust Act

This fall, Pennsylvania's new Directed Trust Act (Act 64 of 2024) went into effect and modernized the administration of trusts in Pennsylvania. The Directed Trust Act created three new fiduciaries positions for trusts in Pennsylvania: a trust director, a trust protector, and a trust director for investments. By creating these new fiduciary positions, settlors now have more flexibility to structure and assign fiduciary responsibilities within a trust beyond the traditional trustee role.

As defined by the Directed Trust Act, a "directed trust" is a trust in which the terms of a trust grant a power of direction. A power of direction is a power granted to a person under the trust which is exercisable while the person is not serving as a trustee, is a power over the investment, management, or distribution of trust property or other matters of trust administration, including the power to modify the terms of a trust, and includes an incidental power that is appropriate and necessary to the exercise or nonexercise of a power of direction.

Trust Directors

A trust director is a non trustee who is granted a power of direction over a trust. A trust director may have the ability to direct trust investments, manage trust assets, determine distributions to beneficiaries, and in some cases, modify the terms of a trust. A settlor could chose to divide each of the roles of a trust director among multiple individuals

combine the roles into a single trust director, or grant a single role to a single trust director. The ability to separate responsibilities can be particularly helpful if a settlor wants a specific person to manage a discrete function within a trust. A settlor or a beneficiary could serve as a trust director, but one should be cautious in utilizing the settlor or beneficiary in such a role to avoid potential estate tax inclusion or maintain creditor protection.

Trust Protectors

A trust protector is a specific type of trust director who has the authority to modify the terms of a trust. The trust protector may also be granted specific powers under the terms of a trust. For example, the Directed Trust Act outlines 12 specific powers that may be granted to a trust protector: the power to increase, decrease or modify what is distributable to the beneficiaries of a trust; to terminate a trust and direct how the trustee should distribute trust property, to expand, modify, limit, or terminate a power of appointment or grant a power of appointment to a trust beneficiary; to adjust between income and principal or convert a trust to a unitrust; to convert a trust to a special needs trust; to appoint or remove trustees, investment advisors, investment managers, and prescribe a plan of succession; to appoint or remove trust directors, specify their powers, and modify the powers of trust directors; to appoint successor trust protectors and prescribe a plan of succession; to renounce, release, limit, or modify any power given to a trustee; to resolve disagreements among trustees; to change the trust's situs or governing law or both; and to apply to a court of competent jurisdiction to interpret the terms of a trust. In addition, the settlor may expressly authorize the trust protector to take additional actions under the terms of a trust, however the trust protector may not exercise a power in a manner that would personally benefit the trust protector or vest in the trust protect a taxable power of appointment.

Unless the terms of the trust otherwise provide, the trust protector must notify the qualified beneficiaries of the trust in writing of the trust protector's exercise of power with respect to the trust. Thus, the trust could conceivably authorize the trust protector to take actions without first notifying the qualified beneficiaries of the trust. Requiring notice, however, is a good way to ensure that a trust protector's actions do not go unchecked.

As illustrated above, a trust protector's powers are vast and can be further expanded or refined if a settlor decides additional powers are required to carry out the purpose of the trust. One of the potentially most useful powers that Trust Protectors have relate to their ability to modify trust provisions, such as the ability to modify powers of appointments and distribution standards. The ability to modify the terms of the trust can be particularly useful when circumstances have changed and there might be a need to change the terms of a trust due to issues arising among the beneficiaries. For example, if a beneficiary is having drug issues or is unable to manage his or her funds and the trust requires all of the income to be distributed to the beneficiary, it may be beneficial for the Trust Protector to remove this mandatory distribution. Or, a trust might grant a beneficiary a limited power of appointment over the trust, but due to changes in the tax law or the beneficiary not having any children, it might be in the beneficiary's best interest if the Trust Protector expands the power of appointment.

Trust Directors for Investments

The act also creates a trust director for investments. A trust director for investments has the power to direct the trustee or veto the trustee's investment recommendations and voting proxies. The trust director for investments may also select, change, or determine reasonable compensation for the investment advisers or managers, determine the frequency and methodology for valuing trust assets. Finally, the trust director for investments may exercise or veto any other investment power of the trustee or perform any other acts relating to the investments of the trust's assets.

The trust director for investments can be especially useful in situations where the beneficiaries desire that the trust invest in certain assets, such as a closely held business interest, but the trustee does not want the liability of holding a large concentration of a single asset. By creating this new fiduciary position, the settlor may grant the trust director for investments the power to direct the trustee to invest in the closely held business interest so that the trustee is relieved of liability for the investment decisions within the trust.

Duties and Liabilities of Trust Directors

It is important to note that a trust director has the same fiduciary duties and liabilities in the exercise or non exercise of a power that a trustee in a similar position would otherwise have. Thus, if a trust director for investments made a negligent investment decision, the trust director for investments would be liable for such a negligent decision. If the trust director for investments made an investment decision based on his or her own self-dealing or personal interests, such decision would be a breach of his or her fiduciary duty.

A directed trustee, however, is not responsible for the actions of a trust director, even if the directed trustee acts pursuant to the direction of the trust director. A directed trustee is not even required to monitor the actions of the trust directors or inform the settlor, beneficiaries, co-trustees, or other trust directors as to any matter in which the directed trustee did not act but a trust director did act. However, a directed trustee shall not comply with a trust director's exercise or non- exercise of a power of direction if such direction would cause the directed trustee to engage in willful misconduct. Thus, the directed trustee may not blindly follow the directions of the trust director without fear of liability.

Should My Trust Have a Trust Director?

With the enactment of the Directed Trust Act, individuals and their advisers should be considering whether it is useful or necessary to modify existing trusts to insert trust directors or draft new trusts to include trust directors. The use of trust directors is not a one-size-fits-all solution for trusts. There will be situations where the presence of a trust director, trust protector, or trust director for investments will be very useful and create flexibility for a trust. On the other hand, the added complexity of a trust director may be unnecessary in certain trusts. Ultimately, the fiduciary roles created by the Directed Trust Act give practitioners a great tool for creating flexibility in new and existing trusts.