Folks:

Take-Away: The future may well entail the use of *directed* trusts, especially if the Trust is to continue for several generations designed to avoid federal estate and generation skipping transfer taxes.

Background: Back in 2019 the Michigan Trust Code (MTC) was amended to authorize the use of separate trustees, *directed trustees, trust directors* (formerly called trust protectors), rules of construction regarding *powers of direction* to trustees, and divided Trusts. [MCL 700.7703a and MCL 700.7703b.] Three bills were part of this combined package of legislation that was modeled, in part, on the Uniform Directed Trust Act. These amendments to the Michigan Trust Code (MTC) follow much, but not all, of that model Uniform Act. Most of these statutes are default rules that a settlor is free to adopt, vary or depart from, when creating a Trust.

However, there are a couple of nonmodifiable provisions that ensure that some minimum fiduciary standard will always apply. [MCL 700.7703a(4)(5) and (8).] As a broad generalization, these MTC provisions impose a minimum level of *fiduciary* obligations on *directed trustees* and *trust directors* , which is not always the case in other states that have adopted their own version of Uniform Directed Trust Act. Over 40 states now authorize some aspect of directed trusts, and 16 states have adopted their versions of the Uniform Directed Trust Act.

Aside: The MTC *directed trust* provisions will not be summarized in any detail, primarily because they are long and complex (or, dare I say, mind-numbing?) Rather, the purpose of this 'missive' is only to provide a brief background on *why, now, the modern* Trust of the 21st Century is a *directed trust*, and what this *modern Trust* might look like in the years to come?

Origins- Repeal of the Rule Against Perpetuities: The rise in interest in the *directed trust* in recent decades is tied to the elimination (or modification) of the Rule Against Perpetuities in several states, which was prompted by the desire of wealthy individuals who wanted to adopt dynasty-type Trusts to avoid federal estate and generation skipping transfer taxes (the GST tax goes back to 1986.) With many states 'jumping on the bandwagon' to repeal or drastically modify their Rule Against Perpetuity statutes, that resulted in multi-generational Trusts that might exist for well over 100 years. Thus arose the need to integrate into these new dynasty-type Trusts *directed trust* features due to the reality that the named trust fiduciaries would not outlive the Trusts that they administered. The goal was to provide greater fiduciary collaboration, flexibility, and control compared to the traditional delegated Trust that was needed to administer a long-term Trust.

Delegated Trust: Prior to the appearance of *directed trust* statutes, sophisticated Trusts were drafted as delegated Trusts. A delegated Trust is one in which the trustee delegates a fiduciary function, like investment advisory and management, to another fiduciary or to a third-party agent. The problem with the delegated Trust structure is that the delegating trustee generally continues to be responsible for the due diligence as well as ongoing monitoring of the agent and/or fiduciary to whom the trustee delegated the discrete tasks. As a result, while the trustee was able to delegate a function of the trustee's role with regard to trust administration, the trustee was not able to delegate away all of the liability risks, which left the delegating trustee very uncomfortable, which in turn prompted the delegating trustee to charge fiduciary fees sufficient to cover their costs of continuing to assume these liability risks including monitoring the agent to whom the tasks were delegated.

Uniform Principal and Income Act (UPIA): The Uniform Principal and Income Act (UPIA) was passed in 1994. The UPIA requires trustees to pursue an overall investment strategy rather than focus on individual investment performance when formulating an investment program. This is commonly known as the *prudent investor rule.* Michigan, as a default rule, requires trustees to follow the standards of the *prudent investor rule.* [MCL 700.7803; 700.1501-15.] The

UPIA imposes a general duty to diversify trust assets unless the purpose of the Trust is better served without diversification, e.g., low-basis assets are held in trust, where their sale by the trustee would trigger substantial capital gains taxes; closely held family business interests are the corpus of the Trust. While Trust instruments might authorize the trustee to *permit, encourage, or require* the non-diversified investment holding, that language often did not fully protect the trustee from subsequent liability when the trustee's investment performance, with the benefit of hindsight, did not satisfy trust beneficiaries. Consequently, as another generalization, most *directed trust* statutes provide for the ability of the settlor to override the UPIA. As a result, most *directed trusts* clearly do not require the diversification of trust assets by the trustee.

Enter Directed Trusts: One of the key reasons for the growth in *directed trusts* was, and remains, the amount of economic uncertainty that we have experienced over the past two decades. An investment committee, or a trust director, may decide to hold a large undiversified position in cash, Treasury bills, or public/private securities to deal with this high level of economic uncertainty, contrary to what the UPIA would otherwise require. Therefore, a *directed trust* will often trifurcate the traditional trustee role into: (i) trust administration; (ii) trust investments; and (iii) trust distributions. These disparate roles can either be served by committees or by an individual.

MTC: These three roles are titled under the MTC a *trust director,* formerly called a trust protector. [MCL 700.7703a(24)(f).] A *trust director* holds a *power of direction* over a *directed trustee* under the MTC. [MCL 700.7703a(24)(b).] A *power of direction* is defined by the statute as follows:

> *'Power of direction' means a power over a trust granted by the terms of the trust to the extent the power is exercisable while the person to whom it is granted is not serving as a trustee. Power of direction includes a power over the investment, management, or distribution of trust property or other matters of trust administration. Power of direction does not include powers described in subsection (1)* [which consists of a long list of identified powers, e.g. power to appoint or remove a trustee; settlor's power to revoke the trust; a power of appointment held by the donee in

a nonfiduciary capacity.] [MCL 700.7703a(24)(e).]

Directed Trust Advantages: Some of the perceived advantages of using a *directed trust* include:

Administrative Fees: Many assert that the overall fiduciary fees incurred to administer a Trust can be reduced by using a *directed trust* structure, since a fiduciary's exposure to some aspects of liability will be shifted to other fiduciaries, so that the cost (i.e., fees) to insure against those delegated risks will be less. Fiduciaries in an investment or distribution role are generally subject to a gross negligence and willful misconduct liability standard, not the reasonable care standard that is typically associated with a delegated Trust.

Control: The belief is that by structuring a Trust with these discrete role-players, a family can maximize flexibility and retain some level of control regarding a Trust's asset allocation, diversification, non-diversification, investment management, and distributions. For example, the settlor of the *directed Trust* may also be a member of the investment committee without any estate tax inclusion exposure issues under IRC 2036 or 2038. Or the settlor may want to continue to do his/her own trading on behalf of the Trust while alive and with the requisite capacity to make investment decisions. However, there continue to be some risks if the settlor participates in some investment capacity decisions, e.g., a special investment *trust director* may still have to serve to accommodate life insurance that is held in the Trust on the settlor's life, or a family business is held in the Trust where the settlor continues as a direct owner.

Collaboration: There is also the belief that a *directed trust* provides a collaborative structure that involves family members and their advisors. Younger family members might be appointed to serve on some advisory committees to the investment *trust director*, which might provide helpful financial education to that young family member and give to trust beneficiaries a voice in meeting their investment priorities. Or a

Millennial trust beneficiary may want to serve as a *trust director* to influence impact or EGS investments held in their Trust or their respective trust share.

The Next Step in Directed Trusts? Some of the more 'super-sophisticated' *directed trusts* now use what is called an investment management limited liability company. (IMLLC.) The investment committee of a *directed trust* typically directs the administrative *directed trustee* to hold the IMLLC which is responsible for the investment management and investment advice of the Trust's assets. The *directed trustee* acts as the sole member of the IMLLC, i.e. the LLC's sole owner. The IMLLC then serves as the Trust's investment holding company for the family's Trust assets. A family member is named as the manager of the IMLLC, who oversees the underlying IMLLC assets and reports to both the *directed trustee* and to the investment committee (the *trust director.*) This is intended to streamline the administrative efficiency of the *directed trust*, while it allows the family to retain control of how the Trust's assets will be invested. Sometimes IMLLCs can be created for each asset class, or all trust assets can be titled in one IMLLC, e.g. one can be formed to hold commercial real estate, another created to hold private equity investments, and yet another is created for private placement life insurance. Moreover, an IMLLC owned by the *directed trustee* usually does not have to be established in the same state as the situs of the *directed trust*, but doing so may provide an important advantage from an asset protection and/or tax standpoint. Some states have LLC statutes that expressly provide for 'charging order' protection as the sole and exclusive remedy for creditors claims against the LLC. In sum, an IMLLC can provide an important second layer of asset protection to the *directed trust's* assets.

Conclusion: As more lifetime gifts flow into irrevocable Trusts prior to 2026, expect those Trust donees to be set-up as *directed trusts,* especially if one of the principal motivations for the lifetime gift is to exploit the donor's large applicable exemption amount and to avoid the family's future estate and GST tax liabilities in perpetuity. Becoming familiar with the *directed trust* structure is something that we will need to do in the next couple of years.

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