

**THE NEW TEXAS DIRECTED TRUST STATUTE:
Managing Directed Trusts & Lessons Learned from Other
Jurisdictions**

**Robert M. Weylandt¹
JPMorgan Private Bank
Houston, Texas**

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ROBERT M. WEYLANDT
MANAGING DIRECTOR AND WEALTH ADVISOR
JPMORGAN PRIVATE BANK
707 Travis Street, 11th Floor
Houston, Texas 77002
Tel: 713.216.4688
Fax: 713.216.7006
e-mail address: robert.m.weylandt@jpmorgan.com

Robert M. (Bob) Weylandt is a Managing Director and Wealth Advisor for the JPMorgan Private Bank in Houston, Texas, covering the Houston and Central Texas, Louisiana and Mississippi markets.

Bob joined the JPMorgan Private Bank after practicing law in Houston at Baker Botts, L.L.P. for 20 twenty years, where he was a partner for twelve years and head of the Business & Estate Planning Practice Group for eight years.

Bob is a Fellow in the American College of Trust & Estate Counsel and currently serves on the Charitable Planning & Exempt Organizations and the Estate & Gift Tax Committees for the College. He is Board Certified in Estate Planning & Probate Law by the Texas Board of Legal Specialization. He is a past President and Director of the Houston Estate & Financial Forum and is a past Chair of the Probate, Trust & Estate Law Section of the Houston Bar Association.

Bob serves on and is a past Chair of the Gift Planning Advisory Council for the University of Texas, and he currently serves on and is Chair of the Houston Local Advisory Council for Local Initiatives Support Corporation, a national nonprofit organization providing support to neighborhood revitalization efforts. He also is a Director of the I Am Waters Foundation, a nonprofit organization dedicated to providing fresh, clean drinking water to the homeless.

Bob received his B.B.A. in 1979 and his J.D. in 1982, both from the University of Texas at Austin.

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THE NEW TEXAS DIRECTED TRUST STATUTE

I. INTRODUCTION

On June 19, 2015, Governor Abbott signed into law House Bill 3190, amending Texas Property Code §114.003, *Powers to Direct*, and adding a new §114.0031, *Directed Trusts; Advisors*. This new section is applicable to all trusts other than charitable trusts¹, and it is intended to bring Texas more in line with other states that have adopted directed trust statutes.

The changes made by H.B. 3190 were effective immediately, and apply to all trusts created before, on or after the effective date, and governs actions taken or not taken on or after September 1, 2015. Any action taken or not taken prior to September 1, 2015, will be governed by the law in effect prior to the effective date of the new legislation, unless the terms of the trust provide otherwise.²

Only nine states have not enacted some form of a directed trust statute, and several of those states are considering legislation to adopt a directed trust statute. Section 808 of the Uniform Trust Code contains a directed trust concept.

Why have directed trusts become so popular? Directed trusts have risen in popularity because modern estate planning has evolved to include very specialized trusts, often created to operate in contradiction of the common and statutory fiduciary duties under the prudent investor rule, including the duty of diversification. Frequently, trusts are created to hold concentrated, single stock positions, particularly of privately-held companies in anticipation of a transaction with respect to that company, whether it be an initial public offering, a sale to a public company, or a sale to a private equity firm. Additionally, trusts are often created for the purpose of holding an interest in a family limited partnership or limited liability company. While the family limited partnership or LLC may, in turn, own a diversified pool of investments, from the trust's perspective, it will be holding a concentrated position, possibly in contrast to the duty to diversify. Finally, the trust may be intended to hold other specialty assets, such as real estate or mineral interests, without diversification of those assets.

The bifurcation of fiduciary responsibilities between a trustee who will perform the traditional trust administration duties, possibly including the discretionary distribution responsibilities, and an investment advisor to carry out the trust investment function 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 mandates with respect to trust investments.

Directed trusts are the tool developed to implement the strategy of bifurcating responsibilities. But directed trusts, like any other tool, are best utilized with a full understanding of the consequences of bifurcating the responsibilities, and should not be seen a tool to be used for every circumstance.

¹ Additionally, H.B. 3190 amended existing §114.003, retitling it, *Powers to Direct: Charitable Trusts*, and making it applicable only to charitable trusts, as defined in Tex. Prop. Code §123.001.

² The terms of a trust agreement in effect prior to June 19, 2015, can override the application of the new legislation to that trust.

A properly drafted and implemented directed trust with an investment advisor often times will have the effect of shifting responsibility for the investment decisions to a party with less deep pockets. The settlor of the trust should fully understand that potential consequence, and the investment advisor should be fully aware of the responsibilities and potential liability he, she or it is assuming.

Additionally, a directed trust that is not clearly drafted – with a clear bifurcation of duties and responsibilities – may create ongoing ambiguity and uncertainty as to how trust decisions are to be made. That ambiguity and uncertainty may lead to second-guessing and conflict between the trustee and the advisor, contrary to the settlor’s intent. To avoid any uncertainty or ambiguity, a directed trust should clearly set forth which fiduciary duties are exercised at the direction of an advisor and which are not. Further, in the administration of a directed trust, the direction letter or instructions should leave no room for ambiguity, clearly setting forth the actions to be taken by the trustee.

Finally, a well-drafted directed trust should address the potential issues between the trustee’s retained duties and responsibilities and those assigned to the advisor. For example, while the trust agreement may clearly assign the investment responsibility to an investment advisor, does that assignment also eliminate the trustee’s common law and statutory duty to notify and keep the beneficiaries informed of all matters affecting the trust?

II. AN OVERVIEW OF TEXAS §114.0031

Under §114.0031, any person given the power or authority to direct, consent to, or disapprove a trustee’s actual or proposed “investment decisions, distribution decisions, or other decisions” is considered to be an advisor to the trust. The statute also makes it expressly clear that the advisor acts in a fiduciary capacity when exercising that authority, unless the terms of the trust agreement provide that the advisor acts in a nonfiduciary capacity. “Investment decisions” are defined to mean, with respect to any investment, the retention, purchase, sale, exchange, tender, or other transaction affecting the ownership of or rights in the investment. Further, with respect to any nonpublicly traded investment, “investment decisions” include and decision affecting the valuation of the investment. If the advisor is given the authority to make investment decisions, that advisor is referred to as an “investment advisor.”

The new statute also defines the term “advisor” to include someone identified as a trust “protector.” Pursuant to §114.0031, a “protector” has all of the powers and authority given to the protector by the terms of the trust agreement, which may include (i) the power to remove and appoint trustees, advisors, committee members, and other protectors; (ii) the power to modify or amend the trust terms to achieve a more favorable tax status or to facilitate efficient trust administration; and (iii) the power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary of the trust.

A 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 the 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 to or consult with the advisor, or to communicate with or warn any beneficiary or third party that the trustee would or might have made a different decision.

The statute provides that, unless there is clear evidence to the contrary, if the trustee acts within the scope of the advisor's authority, those actions of the trustee are presumed to be administrative actions and are not considered to constitute an undertaking by the trustee to monitor or otherwise participate in the decisions of the advisor.

These changes in Texas law give a grantor or settlor of a trust more flexibility to bifurcate responsibilities between the trustee and the advisor or protector. That flexibility is intended to encourage the establishment of directed trusts under Texas law by making Texas competitive with states like Delaware, which have had directed trust statutes for several years.

The new Texas legislation requires new thinking about how trusts are administered and trustee selection.

III. COMPARISON OF THE TEXAS STATUTE TO DELAWARE

A. Excluded Fiduciary

- a. **Delaware:** "Fiduciary" means "trustees." – DEL. CODE TIT. 12, §3301(d) Delaware statutes do not use the term "excluded fiduciary."
- b. **Texas:** The Texas statute does not use the term "excluded fiduciary." Texas refers to a trustee who acts in accordance with the direction of an advisor or a trustee who must make decisions with the consent of the advisor. – TEX. PROP. CODE § 114.0031(f) and (g).

B. Governing Instrument

- a. **Delaware:** A will, trust agreement or declaration, court order or other instrument that creates or defines the duties and powers of a fiduciary. – DEL. CODE TIT. 12, §3301(e).
- b. **Texas:** A trust created before, on, or after the effective date of the Act.

C. Fiduciary Status of Adviser, Trust Advisor and Trust Protector

- a. **Delaware:** "Adviser" is considered to be a fiduciary unless the governing instrument provides that the adviser (including a protector) acts in a nonfiduciary capacity. – DEL. CODE TIT. 12, §3313(a).
- b. **Texas:** "Adviser" includes protector. - TEX. PROP. CODE § 114.0031(a)(1). An advisor with authority with respect to investment decisions is an investment advisor. - TEX. PROP. CODE §114.0031(c).

D. Duty & Liability of Directing Party

- a. **Delaware:** The statute is silent.
- b. **Texas:** A person, other than a beneficiary, who holds a power to direct with respect to a charitable trust is presumptively a fiduciary. - TEX. PROP. CODE § 114.003(c). A person with a power to direct, consent to, or disapprove a trustee's actual or proposed investment decisions, distribution decisions, or other decisions is a fiduciary except where the trust terms provide the person acts in a nonfiduciary capacity. – TEX. PROP. CODE § 114.0031(e).

E. Liability of Fiduciary or Excluded Fiduciary for Following Direction of Adviser or Directing Party per Terms of Governing Instrument

- a. **Delaware:** If a governing instrument provides that a fiduciary is to follow the direction of an adviser, and the fiduciary acts in accordance with such a direction, then except in cases of willful misconduct on the part of the fiduciary so directed, the fiduciary shall not be liable for any loss resulting directly or indirectly from any such act. – DEL. CODE TIT. 12, § 3313(b).

“Willful misconduct” means intentional wrongdoing, not mere negligence, gross negligence or recklessness, and “wrongdoing” means malicious conduct or conduct designed to defraud or seek an unconscionable advantage. – DEL. CODE TIT. 12 §3301(g), (h)(4)

- b. **Texas:** A trustee who acts in accordance with the direction of an advisor, as prescribed by the trust terms, is not liable, except in cases of willful misconduct on the part of the trustee so directed, for any loss resulting directly or indirectly from that act. - TEX. PROP. CODE §114.0031(f).

If the terms of a charitable trust give a person the power to direct certain actions of the trustee, the trustee shall act in accordance with the person's direction unless:

- (1) the direction is manifestly contrary to the terms of the trust; or
- (2) the trustee knows the direction would constitute a serious breach of a fiduciary duty that the person holding the power to direct owes to the beneficiaries of the trust. - TEX. PROP. CODE §114.003(b)(1) and (2).

F. Fiduciary's or Excluded Fiduciary's Liability for Making Decisions without Consent of Adviser or Directing Party

- a. **Delaware:** If the governing instrument provides that a fiduciary is to make decisions with the consent of an adviser, then except in cases of willful misconduct or gross negligence on the part of fiduciary, the fiduciary is not liable for any loss resulting directly or indirectly from any act taken or omitted as a result of an adviser's failure to provide consent after having been requested to do so by the directed fiduciary. – DEL. CODE TIT. 12, §3313(c).

- b. **Texas:** If the trust terms provide that a trustee must make decisions with the consent of an advisor, the trustee is not liable, except in cases of willful misconduct or gross negligence on the part of the trustee, for any loss resulting directly or indirectly from any act taken or not taken as a result of the advisor's failure to provide the required consent after having been requested to do so by the trustee. – TEX. PROP. CODE §114.0031(g).

G. Duty to Inform Excluded Fiduciary

- a. **Delaware:** The statute is silent.
- b. **Texas:** The statute is silent.

H. Fiduciary's or Excluded Fiduciary's Duty to Monitor or Warn Adviser, Trust Advisor, Trust Protector, Beneficiary, or Third Party

- a. **Delaware:** Where governing instrument provides that a fiduciary is to follow the direction of an adviser with respect to investment decisions, distribution decisions, or other decisions of the fiduciary, then except to the extent the governing instrument provides otherwise, the directed fiduciary has no duty to: (1) monitor the conduct of the adviser; (2) provide advice to or consult with the adviser; or (3) communicate with or warn or apprise any beneficiary or third party concerning instances in which the directed fiduciary would or might have exercised the directed fiduciary's own discretion in a manner different from the manner directed by the adviser. – DEL. CODE TIT. 12, §3313(e).
- b. **Texas:** If the trust terms provide that a trustee must act in accordance with the direction of an advisor with respect to investment decisions, distribution decisions, or other decisions of the trustee, the trustee does not, except to the extent the trust terms provide otherwise, have the duty to: (1) monitor the conduct of the advisor; (2) provide advice to the advisor or consult with the advisor; or (3) communicate with or warn or apprise any beneficiary or third party concerning instances in which the trustee would or might have exercised the trustee's own discretion in a manner different from the manner directed by the advisor. - TEX. PROP. CODE §114.0031(h)

I. Administrative Actions

- a. **Delaware:** Absent clear and convincing evidence to contrary, fiduciary actions pertaining to matters within the scope of the adviser's authority (such as confirming that adviser's directions have been carried out and recording and reporting actions taken at adviser's direction), shall be presumed to be administrative actions taken by the fiduciary solely to all the fiduciary to perform those duties assigned to the fiduciary under governing instrument and such administrative actions shall not be deemed to constitute an undertaking by the fiduciary to monitor the adviser or otherwise participate in actions within the scope of adviser's authority. – DEL. CODE TIT. 12, § 3313(e).

- b. **Texas:** Absent clear and convincing evidence to the contrary, the actions of a trustee pertaining to matters within the scope of the advisor's authority, such as confirming that the advisor's directions have been carried out and recording and reporting actions taken at the advisor's direction, are presumed to be administrative actions taken by the trustee solely to allow the trustee to perform those duties assigned to the trustee under the trust terms, and such administrative actions are not considered to constitute an undertaking by the trustee to monitor the advisor or otherwise participate in actions within the scope of the advisor's authority. - TEX. PROP. CODE §114.0031(i).

J. Adviser's or Directing Party's Submission to Court Jurisdiction

- a. **Delaware:** Subject to court jurisdiction.
- b. **Texas:** Presumably subject to court jurisdiction; statute does not directly address.

K. Powers of Adviser or Trust Protector

- a. **Delaware:** If provided for in the governing instrument, to direct, consent to or disapprove a fiduciary's actual or approved investment decisions (retention, purchase, sale, exchange, tender or other transaction affecting ownership thereof or rights therein, and with respect to non-publicly traded investments the valuation thereof), distribution decisions, and other fiduciary decisions. – DEL. CODE TIT. 12, § 3313(a) and (d).
- b. **Texas:** A protector has all the power and authority granted to the protector by the trust terms, which may include: (1) the power to remove and appoint trustees, advisors, trust committee members, and other protectors; (2) the power to modify or amend the trust terms to achieve favorable tax status or to facilitate the efficient administration of the trust; and (3) the power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the trust terms. - TEX. PROP. CODE § 114.0031(d)(1) - (3).

L. Adviser's or Investment Trust Advisor's Investment Powers

- a. **Delaware:** "Adviser" is a person given authority by terms of a governing instrument to direct, consent to or disapprove a fiduciary's actual or proposed investment decisions (retention, purchase, sale, exchange, tender or other transaction affecting ownership thereof or rights therein, and with respect to non-publicly traded investments the valuation thereof). – DEL. CODE TIT. 12, §3313(a).
- b. **Texas:** If the terms of a trust give a person the authority to direct, consent to, or disapprove a trustee's actual or proposed investment decisions (retention, purchase, sale, exchange, tender or other transaction affecting the ownership of the investment or rights in the investment and, with respect to non-publicly traded investment, the valuation of the investment), distribution decisions, or other decisions, the person is considered to be an advisor and a fiduciary when exercising that authority except that the trust terms may provide that an advisor acts in a nonfiduciary capacity. - TEX. PROP. CODE §114.0031(e).

M. Distribution Trust Advisor’s Powers

- a. **Delaware:** The statute is silent.
- b. **Texas:** The terms of a trust may give a person the authority to direct, consent to, or disapprove a trustee’s actual or proposed distribution decisions. – TEX. PROP. CODE § 114.0031(e).

N. Removal of Adviser and Other Directing Parties

- a. **Delaware:** The statute is silent.
- b. **Texas:** A protector has the power and authority granted to the protector by the trust terms, which may include the power to remove and appoint advisors, trust committee members, and other protectors. - TEX. PROP. CODE § 114.0031 (d)(1).

O. Vacancy in Office of Adviser, Trust Advisor, or Trust Protector

- a. **Delaware:** The statute is silent.
- b. **Texas:** A protector has the power and authority granted to the protector by the trust terms, which may include the power to remove and appoint trustees, advisors, trust committee members, and other protectors. - TEX. PROP. CODE § 114.0031 (d)(1).

P. Power of Appointment

- a. **Delaware:** The protector has the power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the governing instrument. - DEL. CODE TIT. 12, § 3313 (f)(3).
- b. **Texas:** The protector has the power and authority to the power to modify, expand, or restrict the terms of a power of appointment granted to a beneficiary by the trust terms. - TEX. PROP. CODE § 114.0031(d)(3).

Q. Achieve Favorable Tax Status

- a. **Delaware:** The protector has the power to modify or amend the governing instrument to achieve favorable tax status or to facilitate the efficient administration of the trust. - DEL. CODE TIT. 12, § 3313(f)(2).
- b. **Texas:** The protector has the power and authority to modify or amend the trust terms to achieve favorable tax status or to facilitate the efficient administration of the trust. - TEX. PROP. CODE § 114.0031 (d)(2).

IV. ADMINISTRATIVE REQUIREMENTS RESERVED FOR TRUSTEE

Certain administrative duties and responsibilities should be reserved for the trustee:

- (1) To maintain accounts for the trust;
- (2) To provide custody and safekeeping of the trust assets;
- (3) To receive trust income and contributions;
- (4) To make trust expenditures and distributions;
- (5) To maintain storage of trust tangible personal property;
- (6) To maintain evidence of trust intangible property;
- (7) To maintain trust records and to originate, facilitate, and review any required trust accountings;
- (8) To execute all documents related to trust transactions;
- (9) To prepare and file tax returns for the trust; and
- (10) To retain accountants, attorneys, agents and other advisers in connection with the performance of its administrative duties.

V. DOES A DIRECTED TRUST STATUTE REALLY PROTECT THE TRUSTEE & THE ADVISERS – A REVIEW OF THE CASE LAW.

A. *Rollins v. Branch Banking and Trust Company*, 56 Va. Cir. 147; 2001 Va. Cir. LEXIS 146 (Va. Cir. Ct., April 30, 2001)

The beneficiaries of two irrevocable trusts created in 1977 brought suit against the trustee for (1) breach of contract, (2) negligence, and (3) breach of fiduciary duty.

The trusts were set up by the grantors for the benefit of their children and grandchildren and were funded with a concentrated stock position. The trust agreement gave the trustee the broad power to make investments. The terms of the trust agreement, however, limited the trustee's investment power by expressly providing that, "Investment decisions as to the retention, sale, or purchase of any assets of the Trust Fund shall likewise be decided by such living children or beneficiaries, as the case may be."

Initially, the trustee obtained the written authority of the beneficiaries to hold the concentrated position, and the trustee continued to hold that concentrated position until 1997, when the trustee sold the stock, which had dropped in value to 1/20th of its highest value.

The Virginia trust statutes provided:

Whenever the instrument under which a fiduciary or fiduciaries are acting reserves unto the trustor, testator, or creator or vests in an advisory or investment committee or any other person or persons, including a cofiduciary, to the exclusion of one or more of the fiduciaries, authority to direct the making or retention of investments, or any investment, the excluded fiduciary or cofiduciary

shall be liable, if at all, only as a ministerial agent and shall not be liable as a fiduciary or cofiduciary for any loss resulting from the making or retention of any investment pursuant to such authorized direction. *Va. Code § 26-5.2*

When considering the breach of fiduciary duty claim brought by the beneficiaries against the trustee, the court found that the plain language of the trust agreement vested the investment power in the beneficiaries. The court further found that the basic principal of the statute was that a trustee cannot be held liable for decisions that it did not and could not have made. Therefore, the court dismissed the beneficiaries' claim for breach of fiduciary duty for failure to diversify the trust assets.

The court did go on to address the trustee's duty to keep the beneficiaries informed and to impart on the beneficiaries any knowledge that the trustee may have which affects the beneficiaries' interest. The court classified this duty as the "duty to warn." With respect to this duty to warn, the court stated:

"[T]he prohibition on recovery does not excuse a trustee from liability for failing to participate in the administration of the trust or for failing to attempt to prevent a breach of trust."

Thus, the court did not dismiss the beneficiaries' claim for breach of fiduciary duty arising from the duty to warn.

B. *Duemler v. Wilmington Trust Company, C.A. No. 20033 NC; 2004 Del. Ch. LEXIS 478 (Oct. 28, 2004)*

The Court's decision was not reported in this case, as the Court ruled from the bench. The Court, however, did report an Amended Pre-Trial Stipulation and Order Pursuant to Rule 16(c), which is cited above, and a transcript of the decision is available. The description of this case is taken from the Order cited above and the available transcript.

The plaintiff was a beneficiary and co-trustee of a trust created for his benefit by his father in 1985. The trust agreement expressly provided that Wilmington Trust Company was to act according to the investment advice of the plaintiff, who, the court noted, was an attorney with over 40 years of experience in securities and tax law.

The stipulated facts show that Wilmington Trust Company notified the plaintiff of an exchange offer received with respect to a high yield bond held in the trust and that the plaintiff elected not to participate in the exchange offer. Interestingly, out of \$225 million of outstanding bonds, \$224,870,000 (99.9%) were tendered in the exchange offer. Of the \$130,000 not tendered, the trust held \$100,000. Shortly thereafter, the issuer of the bonds filed for bankruptcy.

Section 3313(b) of the Delaware trust statutes provided that where a governing instrument provides that a fiduciary is to make investment decisions at the direction of an advisor, and the fiduciary acts in accordance with such direction, then the fiduciary cannot be liable for any loss resulting from such acts, except in cases of willful misconduct on the part of the fiduciary.

In ruling against the plaintiff, the Court found that the statute protected Wilmington Trust Company from liability for the investment decisions of the investment advisor, except in instances of willful misconduct and that no allegation of willful misconduct had been made.

C. *Mennen v. Wilmington Trust Company*, C.A. No. 8432-ML; 2015 Del Ch. LEXIS 122 (April 24, 2015)

The case was brought by the beneficiaries of the trust against the corporate trustee of the trust and the individual trustee, who also acted as investment advisor. The suit was challenging twenty years of investment decisions made with respect to the trust. The facts showed that the trust was once valued at over \$100 million, but it had been diminished in value to close to \$25 million. That reduction in value was largely attributable to a series of investments made in two private companies. The Court noted that, “There can be no doubt that the investments were astonishing failures.” But the Court further noted that the issue was whether the investment decisions exposed the trustees to liability to the beneficiaries. The Court stated the issue as follows:

“Because the trust agreement modified the trustees’ default duties and exculpated the trustees from liability unless they acted in bad faith or with willful misconduct, a showing that the trustees committed a lesser breach of trust will not result in the judgment the beneficiaries seek.”

Wilmington Trust Company believed that it acted at all times with respect to investments at the direction of the investment advisor, but when Wilmington became concerned that the beneficiaries would sue over the investment decisions, it filed a petition seeking to remove the individual trustee and for the appointment of a successor individual trustee. Subsequently, the beneficiaries brought claims against both the corporate trustee and the investment advisor. Ultimately, the proceedings involved a complex array of claims and counterclaims. The claims brought against the corporate trustee were settled out of court, and a judgment for \$72,448,299 was entered against the investment advisor.

Since the claims against Wilmington were settled out of court, it cannot be determined with certainty that the protections of the Delaware directed trust statute provided the corporate trustee with absolute protection except for instances of willful misconduct, but a reasonable inference to that effect can be drawn.

VI. CONCLUSION

The new Texas directed trust statute offers estate planners and their clients another strategy and tool to be considered in carrying out the client’s wishes and goals, but the use of the strategy should be carefully considered by both the planner and the client. A directed trust instrument should clearly set forth those responsibilities, duties and powers that are assigned to the advisor and those that are retained by the trustee, and it should address the impact of the bifurcation on the trustee’s retained responsibilities. And, finally, the administration of the trust should be consistent with the settlor’s intent and the provisions of the trust instrument so as to not inadvertently undermine the reasons for which the directed trust strategy was chosen. If all of those factors exist, the new Texas directed trust statute is a welcome addition.

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