

Directed Trusts

Enabling greater control and flexibility through multi-participant trust structures

Trust law in the United States is evolving, with New Hampshire and South Dakota having enacted some of the most progressive trust laws in the country. Part of this progression includes the development of open architecture techniques for trust governance. Careful and thoughtful use of Directed Trust structures will provide new opportunities that will empower families and provide comfort to fiduciaries.

Evolution of the laws applicable to multi-participant trusts

The use of trusts with more than one trustee or non-trustee participants was not widespread in the U.S. until the last decade or so. The move away from the traditional fully empowered unitary trustee model began with the increased use of co-trustees.

Co-trusteeships initially rose in popularity to overcome a single trustee's inability to administer property in multiple jurisdictions (i.e. where the primary trustee was not legally competent to act outside of the state of its residence or charter). Later, co-trustees provided specific competence not possessed by the primary trustee – for example, the use of special trustees to administer closely held business assets, or to participate in distribution decisions that an interested primary trustee could not make without risking adverse wealth transfer tax consequences.

The increased use of multiple trustees prompted some key legislative changes concerning the duties and responsibilities of co-trustees, both among themselves and in relation to beneficiaries, which have been instrumental in shaping the current laws relating to multi-participant trusts.

Allocation of responsibilities

Generally, if the terms of a trust with more than one trustee stipulate that one or more of the trustees will possess exclusive authority with respect to trust administration, the other trustee ordinarily has no duty to participate in the matters exclusively delegated to the empowered trustee. If, however, a non-participating trustee believes that the empowered trustee may be in breach of trust, the non-participating trustee has a duty to take reasonable steps to investigate and prevent a breach, if possible.

Trustee action

The common law default rule initially required unanimous decision-making among co-trustees. The law evolved over time and replaced the unanimity requirement with a majority rule standard, but a deadlock among trustees could only be resolved by court intervention. These were default rules that could be modified by specific provision in a trust agreement. For instance, even if a document empowered one of many co-trustees to decide specified questions or take actions as the controlling trustee in the event of deadlock, the courts required that all trustees participate in decision-making with respect to those matters and to be an informed fiduciary participant in all trustee deliberations (including those exclusively delegated to another co-trustee). This is sometimes referred to as a “duty to consult”.

The duty of each trustee to use reasonable care to prevent a breach by the controlling trustee was considered to be non-waivable by a contrary instruction in the trust agreement.

Co-trustee liability

Co-trustee liability is generally joint and several. A co-trustee is not liable to a beneficiary for a breach of trust committed by another trustee unless such co-trustee: (i) participated in the breach; (ii) improperly delegated the administration of the trust to the acting trustee; (iii) approved, acquiesced in, or concealed the breach; (iv) enabled the co-trustee to commit the breach through failure to exercise reasonable care in the trust's administration; or (v) neglected to take proper steps to compel the acting co-trustee to redress the breach. Thus, by common law, most jurisdictions did not allow a trustee to avoid liability merely by remaining inactive in the administration of the trust. When a co-trustee dissents, however, the dissenting trustee is often able to avoid liability.

The influence of prudent investor legislation

Many states, including New Hampshire and South Dakota, have adopted legislation modeled after the Uniform Prudent Investor Act (UPIA), which paved the way for multi-participant trust structures. The UPIA reflects modern portfolio theory and a total return approach to the exercise of trustee investment powers and discretions. Most states

have enacted some form of the UPIA that allows the trustee to acquire most types of investments, as opposed to the traditional trustee investment laws, such as the prudent person standard, which limited choices among conservative alternatives said to be of “trust quality”.

The UPIA measures investment performance by assessing the entire portfolio, replacing the asset-by-asset analysis required by the predecessor prudent person standards. UPIA’s prudent investor standard may require trustees to delegate investment authority to co-trustees or agents if the trustee does not have sufficient expertise to perform that function for a particular trust. Even a trustee with investment skill may delegate certain investment functions.

The emergence of “Directed” and “Delegated” trust arrangements

Perhaps more than any other development, the widespread adoption of prudent investor standards has fueled the popularity of what have come to be known as “Directed” and “Delegated” trusts. These terms are sometimes incorrectly used interchangeably. Each type of trust has, however, important characteristics that distinguish one arrangement from the other.

Delegated Trusts

Generally, a Delegated Trust is one in which the trustee hires a third party to perform some or all of the trustee’s discretionary investment management functions. The relationship between the delegating trustee and the third party is generally one of principal and agent. The trustee of a Delegated Trust has a duty to select the investment manager with care and to exercise prudence in monitoring the manager’s activities.

Directed Trusts

A directed trustee, also often referred to as an “administrative trustee”, follows the directions of other empowered parties on actions like investments and distributions. Directed trustees are typically directed on investments, and they may be directed on distributions. The empowered party’s powers to direct are expressed in the trust agreement. Unlike the delegated trustee, when directed, the trustee does not have any selection or monitoring responsibilities over the

actions of the investment or distribution advisor. In those instances, the directed trustee’s only obligation is to ensure the accomplishment of the settlor’s intent as expressed in the trust agreement and to carry out their expressed duties.

Recognition of multi-participant structures in the Uniform Trust Code

Before the enactment of directed trustee statutes, the few courts that had occasion to address the issue generally found that a trustee would not be held liable for following the instructions of a person empowered by the trust instrument. They faced challenges, however, defining the extent, if any, of a directed trustee’s affirmative duties to the beneficiaries. A consensus emerged from the few decided cases: the trustee must ensure that following those instructions does not violate the trust agreement or fiduciary duties owed to the beneficiaries and must intervene to prevent a breach (or at least warn the beneficiaries so that they themselves can take timely action).

Although the legislatures have taken time to codify and improve on this narrow and sometimes conflicted body of common law, from the beginning the Uniform Trust Code (UTC) model law recognized that a regime imposing duties to investigate and intervene does not always align well with the increased use of directed and delegated trust arrangements.

The anatomy of a modern, open-architecture Directed Trust

The importance of clear drafting beyond statutory default rules

New Hampshire, South Dakota and a few other progressive trust jurisdictions have taken the lead in building upon the UTC’s recognition of Directed Trusts with comprehensive statutory default rules that provide further clarity on directed trustee’s residual responsibilities. Still, the estate planning attorney charged with drafting a modern Directed Trust under New Hampshire or South Dakota legislation (or the laws of any other state, whether or not the governing law expressly sanctions Directed Trusts) will benefit from carefully crafting the trust’s provisions to remove the passive trustee’s duties and discretions as to distributions and/or investments and give them

to an investment committee/trustee, distribution committee/trustee, and/or trust advisor or trust protector. Generally, it is advisable to address these issues explicitly rather than relying solely on the default rules.

Defining the participants and their respective roles

The directed trustee's duties should specifically be defined, for example to include taking title and ownership of the trust assets, establishing and maintaining a trust bank account, preparing or signing the trust tax returns, preparing and sending trust accounts and other statements, making distributions and receiving contributions, as directed by the empowered party. The directed trustee also will orchestrate things among the multiple participants so that the provisions of the trust agreement are strictly followed. What follows is a sample of the usual participants in a modern Directed Trust structure.

- **Investment committees and advisors**

The participants possessing specifically allocated investment powers are typically the settlor's family members, investment advisors, consultants and investment management professionals. Investment direction is not an estate or tax sensitive power, so the settlor or beneficiary may retain that control over the structure. Family members, advisors or consultants often work together and comprise an investment committee that provides directions to the directed trustee. The investment committee often will manage insurance, closely held stock, partnerships, limited liability companies, real estate, art, commodities, vacation homes and other illiquid "special assets" that may be held in the trust. Wealth management professionals typically do not serve as named investment directors because of onerous audit and compliance requirements that they must comply with. Instead, the named investment director or committee directs the trustee to work with the wealth management group of choice.

- **Distribution committees and advisors**

Discretionary distribution decisions often are handled in a similar fashion. The trust agreement will establish a distribution committee composed of both family and independent members. The independent

members are important for avoiding the imputation of wealth transfer tax-sensitive discretionary actions to committee members who are beneficiaries. Such tax-sensitive distributions generally require a non-related or subordinate person to make discretionary distributions to keep the trust assets out of the trust settlor's and the beneficiaries' gross estates under the federal estate tax laws.

- **Trust protectors**

Trust protectors are often used in tandem with Directed Trusts' investment and distribution committees. Estate planning attorneys in states without trust protector statutes are drafting the trust protector function into trust agreements governed by the laws of those states (although such structures may present additional considerations for the directed trustee and the trust protector in states that do not specifically recognize the office of trust protector).

A trust protector typically is given one or more of several duties:

- Amend or modify the trust agreement to take advantage of laws relating to the administration of the trust, restraints on alienation, and the distribution of trust property
- Increase or decrease the interests of trust beneficiaries
- Grant, revoke and modify the terms of beneficiary-held powers of appointment
- Remove and appoint trustees, trust advisors and investment and distribution committee members
- Terminate the trust
- Veto or direct trust distributions
- Change the situs or governing law of the trust, or both
- Appoint their own successors as trust protectors
- Interpret ambiguous terms of the trust agreement as may be requested by the trustees
- Advise the trustee on matters concerning one or more trust beneficiaries.

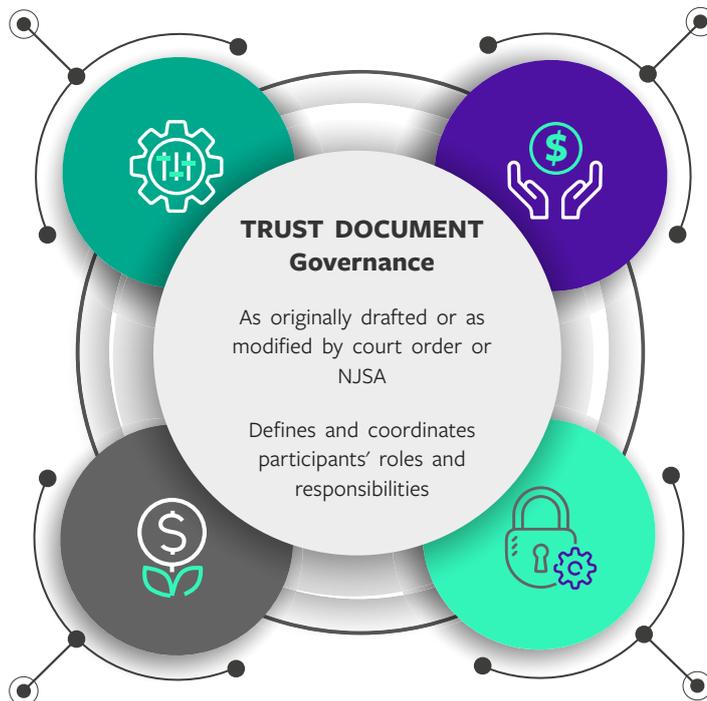
IQ-EQ serving as directed trustee in a multi-participant trust:

Distribution advisor

- Empowered by trust to make discretionary decisions regarding distributions to beneficiaries
- Instructs directed trustee on distributions

Directed trustee

- Hold legal title to trust assets, integrate with wealth managers' custodial agents
- Not responsible for investment decisions
- Process contributions and distribution payments as directed
- Provide fiduciary and tax accounting information



Investment advisor

- Authority to make investment decisions (often is the grantor or a beneficiary)
- Can contract with other investment wealth managers (RIAs)

Optional trust protector

- Authority to remove a trustee and appoint a successor
- May amend a trust for favorable tax treatment or changes in laws
- Veto certain decisions
- Can modify a beneficiary's interest
- Can change trust situs

IQ EQ Trust Company, U.S. key facts and figures*

U.S. assets under administration

\$10⁺bn

U.S. jurisdictions

**New Hampshire
and
South Dakota**

Asset administration experience

- Liquid securities
- Private equity
- Concentrated stock positions
- Art
- Hedge funds
- Private company shares
- Real estate
- Domestic and foreign holding entities

IQ EQ Trust Company, U.S. operates from two of the nation's top jurisdictions, New Hampshire and South Dakota. The broader IQ-EQ Group is a global firm with unparalleled client resources and experience administering traditional and non-traditional assets in trust.

* Information correct as of February 2026

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