<u>Title</u>

Asset securitization, multi-generational asset management over time, and allocation of an asset's exposure to creditor reach: Just a few of the myriad functions that the classic trust can perform

<u>Text</u>

The Anglo-American trust has convenient non-commercial and commercial applications that are difficult to replicate via the laws of agency and contract, operating either in tandem or alone.

The trust's most convenient non-commercial application is the effective bestowal on persons not yet conceived, e.g., settlor's currently non-existent issue, of enforceable equitable property rights, to include the imposition of enforceable conditions on enjoyment over time. To jerry-rig an agency-contract hybrid into an enforceable relationship between a fiduciary-equivalent and someone yet to be conceived (or otherwise currently unascertainable) would seem a heavy lift. Death terminates the classic agency. The standard third-party-beneficiary contract would need some serious *ad hoc* retro-fitting, assuming functional approximation of the Anglo-American trust is even achievable when it comes to multi-generational asset management over time.

The Anglo-American trust relationship has convenient commercial applications, as well, such as securitization of illiquid property rights and the securing of property rights.

As to securitization, think transfer of an illiquid parcel of real estate to trustee of a nominee trust in exchange for fully vested, non-spendthrifted shares of beneficial/equitable interest. Via the trust the economic interest is now readily divisible and transferable. Or instead of real estate think transfer of portfolio of stocks/bonds to trustee in exchange for vested shares of beneficial/equitable interests in "*the fund.*" The economic interest in "*the fund"* is now readily divisible and transferable. No wonder most mutual funds on this side of Atlantic are trusts.

As to the securing function, the trust is tailor-made to protect one's property rights from the reach of someone else's creditors. Take the defined benefit plan sponsored by a corporation for the benefit of its employees. Associated with plan is a trust to hold and administer corporation's contributions to plan. Here the trust performs not a securitization function but a securing function. The fund, comprised of employer's contributions and internal earnings, is segregated from the general assets of the company and thus insulated from the reach of the company's creditors in the event of the company's insolvency, assuming fraudulent-conveyance doctrine is not implicated. "Particularly, trust law allows the parties to the trust to partition off a discrete set of assets for separate treatment in relationships formed with creditors." Hansmann & Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U.L. Rev. 434 (1998). As to how the trust is employed to secure property interests of beneficiaries of qualified employee benefit plans, to include a brief mention of ERISA's federal spendthrift preemption feature, see §9.5.1 of *Loring and Rounds: A Trustee's Handbook* (2023), which section is reproduced in the appendix below. The Handbook is available for purchase at

https://law-store.wolterskluwer.com/s/product/loring-rounds-trustees-hanbook-2023e/01t4R00000Ojr97QAB.

Appendix

§9.5.1 *The Employee Benefit Trust (Tax Qualified)* [from *Loring and Rounds: A Trustee's Handbook* (2023), available for purchase at https://law-store.wolterskluwer.com/s/product/loring-rounds-trustees-hanbook-2023e/01t4R00000Ojr97QAB].

When an employer in the United States establishes a retirement "plan" for its employees it is usually of the "qualified" variety. If it is a qualified plan, the employer can take its contributions to the plan as a tax deduction.[2] Under certain circumstances, contributions by or on behalf of an employee are not taxed as income to the employee at the time the contributions are made.[3] Taxation on income generated by plan assets may also be deferred.[4] Plan distributions at retirement or at some other time, on the other hand, may have tax consequences.[5] The reader interested in a comprehensive and practical discussion of those consequences is referred to Natalie B. Choate.[6] For a discussion of the complex and time-sensitive mechanics of funding a trust with distributions from a qualified defined contribution plan account or IRA after the account owner's death, the reader is referred to Grassi and Welber.[7]

For a plan to be qualified it must meet certain requirements set forth in the Internal Revenue Code and elsewhere.[8] Congress, by means of the Employee Retirement Income Security Act of 1974 (ERISA), articulated a comprehensive federal statutory framework for the design and administration of qualified plans.[9]

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[2]*See generally* Bogert §§255, 270.20.

[3]*See generally* Bogert §§255, 270.20.

[4]*See generally* Bogert §§255, 270.20.

[5]*See generally* Bogert §264.7.

[6]Life and Death Planning for Retirement Benefits (published by Ataxplan Publications, P.O. Box 51371, Boston, MA 02205-1371). Information on how to obtain text and updates is *available at* <www.ataxplan.com> (last visited Sept. 4, 2020).

[7]Sebastian V. Grassi, Jr. & Nancy H. Welber, *Special Planning Is Needed for Retirement Benefits Payable to a Disabled Special-Needs Child*, J. Prac. Est. Plan. 51 (June–July 2010) ("Many of the concepts discussed in this article are also applicable where the beneficiary child is not a special-needs child").

[8]*See generally* Bogert §255.

[9]*See generally* Bogert §255. The Supremacy Clause, found in Article VI, Section 2 of the U.S. Constitution, provides in relevant part as follows: "This Constitution, and the laws of the United States which shall be made in Pursuance thereof…shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." The federal pre-emption doctrine is derived from the Supremacy Clause. Under the

With the exception of so-called *insured plans*, for a plan to be qualified it must have associated with it a trust that serves as a receptacle for the plan's assets. Unfortunately, the establishment of a plan often requires a consortium of actuaries, pension lawyers, tax lawyers, labor lawyers, human resource lawyers, and SEC lawyers in order to determine what property may enter the trust. The common law trust lawyers, that is, those who are familiar with the common law rules applicable once property finds its way into the hands of a trustee, are left out of the process altogether. Moreover, most if asked would prefer not to get involved.

When confronted with an employee benefit trust, the trustee should first examine it from the perspective of the common law and general equitable principles.[10] Most likely, it will be a trust with several trustees. Depending upon the type of plan, it could have many settlors (the employees and, to the extent of any overfunding, the employer),[11] many beneficiaries (perhaps retirees entitled to annuitized payments), and many remaindermen (employees and retirees). To the extent a particular benefit is actually consideration for services rendered, in equity it is the employee, not the employer, who is the trust settlor.[12] In many instances, a plan participant will have obtained from human resources and filled out a form designating who is to take at death whatever remains of the participant's equitable interest. A participant's right to so direct the equitable interest is tantamount to a power of appointment.[13] "When federalizing the administration of pension and

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Supremacy Clause, any state law, however clearly within a State's acknowledged power, which interferes with or is contrary to federal law, must yield. *See* Gade v. Nat'l Solid Wastes Mgmt. Ass'n, 505 U.S. 88 (1992). A federal statute can expressly pre-empt state and/or local law, or it can do so by implication. ERISA is an example of the former. Of course, the federal statute itself must be constitutional, an issue that has been all but rendered moot by the Supreme Court's expansive interpretation of the Commerce Clause.

[10]Tittle v. Enron Corp., 284 F. Supp. 2d 511, 546 (S.D. Tex. 2003) (noting that the common law of trusts offers a "starting point" for analysis of ERISA unless it is inconsistent with the language of the statute, its structure, or its purposes). *See, e.g*., Laborers' Pension Fund v. Miscevic, 880 F.3d 927 (7th Cir. 2018), *cert. denied*, 138 S. Ct. 2633 (2018) ("We agree with those courts that have held that ERISA does not preempt…[state]…slayer statutes."). Slayer statutes are taken up generally in §5.5 of this handbook under the heading "homicide."

[11]*See generally* 3 Scott & Ascher §15.4.4 (Determining Who Is the Settlor) (U.S.); §8.43 of this handbook (who is the settlor of the trust?); Lewin ¶5-75 (England) (noting that "…with a defined benefit scheme,…the trusts can properly be regarded as comprising a series of separate settlements, created when individual employees join the scheme, comprising the contributions made by the employee or the company in respect of the employee, and with the employee as a life in being" for purposes of the Rule against Perpetuities).

[12]6 Scott & Ascher §§41.13 (noting that "[i]f a third person gives consideration for a transfer in trust, the third person is the trust's creator, and if the trust fails, a resulting trust ordinarily arises in the third person's favor"), 41.15 (when third person provides consideration for transfer in trust).

[13]"In essence, the power to appoint the 'death-in-employment benefit' is no different from any other power of appointment." Baird v. Baird [1990] 2 AC 548 at 557, PC (Eng.). *See generally* 1 Scott & Ascher §8.2.4 (Compliance with Testamentary Formalities Not Required); §8.1 of this handbook (powers of appointment).

employee benefit plans in ERISA, Congress made a deliberate choice to subject these plans to the pre-existing regime of trust law rather than to invent a new regulatory structure."[14]

Some beneficiaries and remaindermen are likely to have vested interests and some to have interests that are partially vested and partially contingent upon length of time with the employer.[15] Depending upon the type of plan, some beneficiaries and remaindermen (perhaps certain retirees) may well have rights of withdrawal in the nature of general inter vivos powers of appointment.

The employer may have either an equitable contingent remainder or a vested reversionary interest in trust assets to the extent they are not needed to fund benefits.[16] Each employee is probably entitled to complete the dispositive terms with respect to that employee's interest in the trust.[17] (As noted, this is accomplished by the filling out of a beneficiary designation form supplied by the employer's human resources department.) The governing instrument is likely to provide that income generated by the trust assets be periodically added to principal.

Once the trust is looked at in common law terms (*i.e.,* once the governing trust document is analyzed to determine in what respects it requires a *deviation* from the common law regime), the trustee and trust counsel should then turn to ERISA to determine in what respects federal trust law alters and embellishes the common law trust principles discussed in this handbook.[18] They will be surprised to discover that ERISA has codified some long-standing common law trust principles; but, contrary to what they may have heard, the federal gloss has added little that would alarm the conscientious and ethical trustee of an old-fashioned private trust.[19]

Insofar as the trustee is concerned, ERISA has codified and embellished the duty of loyalty by

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[14]John H. Langbein, *What ERISA Means by Equitable: The Supreme Court's Trail of Error in* Russell, Mertens, *and* Great-West, 103 Colum. L. Rev. 1317 (2003).

[15]Bogert §255.

[16]*See, e.g.*, Davis v. Richards & Wallington Indus. Ltd. [1991] 2 All ER 563 (Eng.) (an English case adjudicating the disposition of surplus pension funds where the court imposed a resulting trust and considered but did not apply the doctrine of *bona vacantia*). *See generally* §4.1.1.1 of this handbook (the noncharitable trust; resulting trust defined) and §8.15.46 of this handbook (*bona vacantia* doctrine).

[17]1 Scott & Ascher §8.2.4.

[18]They will find, for example, that ERISA has rendered exculpatory clauses in the employee benefit context unenforceable (*see* §7.2.6 of this handbook) and that employee benefit plan and trust documents may not relieve fiduciaries of those fiduciary duties set forth, expressly or by implication, in ERISA.

[19]*See, e.g.*, Bixler v. Cent. Pa. Teamsters Health & Welfare Fund, 12 F.3d 1292 (3d Cir. 1993) (noting that fiduciary duties articulated in ERISA are not exhaustive and that Congress relied on the common law of trusts to define the general scope of the ERISA trustee's authority and responsibility). *See also* Martin v. Walton, 773 F. Supp. 1524 (S.D. Fla. 1991); Marshall v. Teamsters Local 282 Pension Trust Fund, 458 F. Supp. 986 (E.D.N.Y. 1978). *See* Pegram v. Herdrich, 530 U.S. 211 (2000) (discussing the meaning of the word "fiduciary" as that term is employed in ERISA and distinguishing the duties of a common law trustee from those of an HMO physician). *See generally* Chapter 1 of this handbook (in part discussing the meaning of the word *fiduciary*).

creating a thicket of prohibited transactions.[20] Still, it amounts to little more than an elaborate codification of the common law prohibition against self-dealing by trust fiduciaries.[21] The "Prudent Man Rule" of investment as it applies to employee benefit trusts has been altered by ERISA so that it might better be called the *Federal Prudent Expert Rule*.[22] Again, this is not a particularly radical development as it is unlikely that the common law would have long tolerated an amateur standard for investing the massive aggregation of wealth lodged in the nation's employee benefit trusts.[23] ERISA also has limited the common law rights of a beneficiary's creditors to reach employee benefit trust assets.[24] It has put certain nontrustees on the hot seat—particularly investment managers—by imposing on them fiduciary status. Finally, the area of allocation of fiduciary responsibilities has been elaborated and codified.[25]

Of all ERISA's codifications, the allocation of fiduciary responsibility may be perhaps the most perplexing.[26] Many troubling common law questions lurk behind the codification. For example, if the governing instrument allocates investment responsibility to an investment manager, what common law oversight obligations remain back with the trustee?[27] To what extent has the allocation of responsibility provisions of ERISA altered the common law principles of cofiduciary liability?[28]

The beneficiary designation form is completed by an employee usually without legal advice and usually at the human resources office. It is by means of the form that the terms of the employee benefit trust applicable to that employee are completed and that the link is made between the employee benefit trust and the employee's own estate plan. More wealth is likely to transfer pursuant to the terms of the form than pursuant to the terms of the employee's will,[29] yet much more attention and thought are likely to have gone into the drawing of the will than into the filling

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[20]*See* Wade & Loebl, *Individual Prohibited Transaction Exemptions: The Common Law,* 29 Real Prop. Prob. & Tr. J. 185 (1994).

[21]*See* Wade & Loebl, *Individual Prohibited Transaction Exemptions: The Common Law,* 29 Real Prop. Prob. & Tr. J. 185 (1994).

[22]*See* Wade & Loebl, *Individual Prohibited Transaction Exemptions: The Common Law,* 29 Real Prop. Prob. & Tr. J. 185 (1994).

[23]*Compare* §6.1.4 of this handbook (duty to give personal attention (not to delegate)) (noting that there has been evolving for some time in the common law of trusts a principle that the professional or corporate trustee should be held to a higher standard than that to which an amateur should be held).

[24]ERISA §1056(d)(1); I.R.C. §401(a)(13): For an employee benefit plan to be qualified, an employee's interest in its associated trust may not be assigned or alienated.

[25]*See generally* Bogert §255.

[26]*See, e.g.*, Tittle v. Enron, 284 F. Supp. 2d 511 (S.D. Tex. 2003).

[27]*See generally* §6.1.4 of this handbook (duty to give personal attention (not to delegate)).

[28]*See generally* Tittle v. Enron, 284 F. Supp. 2d 511 (S.D. Tex. 2003).

[29]*See generally* John H. Langbein, *The Nonprobate Revolution and the Future of the Law of Succession*, 97 Harv. L. Rev. 1108 (1984).

out of the form. In any case it is in the interests of all parties that the terms of the beneficiary designation form cover all contingencies and be unambiguous. Unaddressed contingencies and ambiguities, however, are inevitable in a less than perfect world. Accordingly, ERISA trustees and plan administrators would be well advised to review the rules set forth in the official comment to §7.2 of the Restatement (Third) of Property (Wills and Other Donative Transfers), the section that extends certain will doctrines to will substitutes. These are rules that are intended among other things to "inform the federal common law of will substitutes under the Employee Retirement Income Security Act (ERISA)."[30]

All this having been said, the U.S. Supreme Court in a 2020 decision held that when it comes to the beneficiaries of a trust that is associated with an *adequately funded defined-benefit plan*, as opposed to a defined-contribution plan, the rights of the beneficiaries are more contractual in nature than equitable. Thus, the beneficiaries lack the requisite standing to bring an action *in the federal courts* against the trustee for mismanaging the trust's portfolio.[31] And this is the case even in the face of serious allegations of unauthorized fiduciary self-dealing. The common law as enhanced by equity does not subscribe to such an absence of nexus between the beneficiary of a trust and its corpus. The dissent endeavored to bring to the Court's attention that, when it comes to trust doctrine, ERISA was intended merely to tweak the common law as enhanced by equity, not supplant it altogether. We are with the dissent on this one. Under general principles of equity, and as we discuss in §7.2.8 of this handbook, a suffering by a beneficiary of measurable economic harm at the hands of the trustee is not a *sine qua non* to his or her being granted standing to seek judicial remedies for the trustee's breaches of trust.

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[30]Restatement (Third) of Property (Wills and Other Donative Transfers) §7.2 cmt. k.

[31]*See* Thole v. U.S. Bank, N.A., 140 S. Ct. 1615 (=2020).