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## DIVISION OF BANKING

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## MEMORANDUM

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NUMBER: 10-005 & 20-004

DATE: 04/26/07

TO: SOUTH DAKOTA TRUST COMPANIES AND BANK TRUST DEPARTMENTS

FROM: BRET AFDAHL, Division Counsel and Trust Examiner

RE: NEW LEGISLATION

The 2007 legislative session was an active one for changes in South Dakota trust law. The following is a summary of the bills followed by the Division during this session. If you would like to read the text of any bills discussed in this memo, please go to <http://legis.state.sd.us/sessions/2007/index.aspx> and type in the bill number and hit "Get Bill(s)." Please view or download the enrolled version of the bill at the bottom of the page. If you would like additional information regarding any of these bills or have any questions you can contact the Division at 605-773-3421 and we will do our best to answer your questions and if need be will direct you to someone outside the Division if we are unable to fully answer your questions.

### Senate Bill 97<sup>1</sup>:

The bill includes various changes and additions to South Dakota trust law, some substantive and some to clean up existing law. Several existing statutes were amended to change references to children existing at a decedent's death or born within 10 months after such death. SB 97 § 1, 2, 3, 4.

A two year statute of limitations was established for actions to recover for breach of trust against a qualified person, absent fraud, intentional misrepresentation, or material omission, in which case the period does not commence until the breach of trust is discovered. SB 97 § 5. Existing law was amended by declaring that trust provisions that attempt to relieve trustees of liability for breaches of trust committed in bad faith or as a result of gross negligence are unenforceable. SB 97 § 10. South Dakota courts have exclusive jurisdiction for actions based upon transfers of property to a trust as authorized by SDCL 55-16-13. SB 97 § 12.

Trustees were given the authority to invest in affiliate investments. The law was amended to add definitions for: investments; affiliates; affiliated investments; and fees or commissions. SB 97 § 6, 7.

Existing law was amended to use the term "settlor" instead of "trustor." SB 97 § 8. A new section was added to clarify the duty of a trustee to keep the settlor and interested beneficiaries in certain situations reasonably informed. SB 97 § 9.

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<sup>1</sup> Senate Bills 97, 98, and 99 were introduced by Senator Knudson on behalf of the Governor's Task Force on Trust Administration.

The definition of a trust instrument provided in SDCL 55-16-2 was amended to add a pour back provision. The amendment authorizes trust provisions that will allow trust assets to pour back to a transferor's will or revocable trust. SB 97 § 11.

Senate Bill 98:

The bill adds several new sections to Title 55 and at the same time repeals several others. In general, SB 98 sought to codify existing South Dakota trust law in certain areas. Definitions are provided for: beneficial interest; beneficiary; current beneficiary; current distribution interest; power of appointment; remainder interest; and reserved power. SB 98 § 1. A new section was added to maintain the common law distinction between discretionary and support trusts and to give the courts guidance on interpreting certain aspects of South Dakota trust law. SB 98 § 2.

New sections were added to SDCL 55-1 regarding the rights, duties, and powers of creditors. No beneficial interest, power of appointment, or reserved power in a trust may be foreclosed by a court. Creditors must wait until funds are distributed from a trust to attach the funds, and no power of appointment is a property interest. SB 98 § 3. Remainder interests may not be considered a property interest unless it is certain that there will be a distribution of that interest within one year. SB 98 § 4.

A new section was added to prohibit a creditor from attaching a beneficiary's right to remove a trustee, to prohibit a creditor from exercising the right to remove, and to prohibit any court from ordering the exercise of such power. Creditors are further prohibited from reaching the interest of a beneficiary merely by the fact that the beneficiary is also a trustee or co-trustee. SB 98 § 5.

New sections were added to protect trust property from the obligations of a trustee, even during a trustee's bankruptcy or insolvency, and to protect current and future distributions from equitable division in divorce proceedings. Unless otherwise required by the trust document, trustees do not need to consider the resources of beneficiaries before making a distribution. SB 98 § 6, 7, 8.

A new section was added to list specific factors that cannot be considered dominion and control over a trust by a settlor or beneficiary for purposes of establishing that person's influence over the trust. SB 98 § 9. A similar section was added to list factors that are not to be considered for purposes of deeming a settlor of an irrevocable trust as in control of a trust or as an alter ego of a trustee. SB 98 § 10.

Several new sections were added to deal with the voluntary or involuntary transfer of interests in income, principal, or both by a settlor. SB 98 § 11, 12, 13. Spendthrift provisions are to be considered material provisions and apply to both current and remainder distribution interests. SB 98 § 14.

Definitions were established for three types of current distribution interests; mandatory, support, and discretionary. A process was also established to bifurcate or divide the various types of interests according to the terms of the trust. Example language was provided to establish the various types of beneficial interests. A provision was added to prevent a creditor from attaching at the trust level any present or future mandatory distributions that are part of a spendthrift provision. Specific criteria were set out for administering support and discretionary interests. SB 98 § 15, 16, 17, 18, 19, 20.

Sections 21 through 26 of SB 98 repeal various provisions related to the transfer of beneficiary interests, spendthrift provisions, creditor rights, powers conferred upon trustees, and dealing with rents and profits from real estate held in trust.

Senate Bill 99:

The bill adopted the Uniform Principal and Income Act (1997 version) for use in South Dakota. The Act is approved by the American Bar Association; South Dakota is the forty-second state to adopt the Act.

The Act provides procedures for trustees to separate principal from income in the administration of trusts and to ensure that the intention of the trust settlor is the guiding principle for trustees.

House Bill 1257:

The bill amended SDCL 51A-6A-13 to require a minimum of three members to sit on the governing board of any trust company. Before amendment this section required a minimum of five board members.

House Bill 1288:

The bill authorizes trustees of a trust governed by South Dakota law to “decant” the trust assets of one trust to another trust(s) so long as certain conditions are satisfied. “Decanting” means the removal or appointment of all or a portion of the trust assets from an existing trust to a different trust. Typically this technique would be used where the second trust contains more desirable trust provisions. The decanting authority might be used to achieve a variety of goals, including altering trust administrative provisions, altering trustee provisions, extending or shortening the term of the trust, correcting drafting errors, dividing a single trust into multiple trusts, or moving trust assets to a new trust that has more desirable tax or creditor protection provisions. In order to have the ability to decant trust assets, the trustee must have the ability, under the first trust document, to make a distribution to a beneficiary of the interest which is then being decanted to the second trust for the benefit of the same beneficiary.

The legislation does provide certain limitations on the ability to “decant” from an existing trust (first trust) to a new trust (second trust). These include:

1. The first trust must not prohibit decanting
2. The first trust must contain a provision granting the trustee the discretionary authority to make principal or interest distributions from the first trust
3. The second trust must only have one or more beneficiaries named in the first trust as beneficiaries in the second trust
4. Decanting is not permitted if it would result in increased trust distributions to the trustee of the first trust
5. Decanting is not permitted if it would result in removal of restrictions on discretionary distributions contained in the first trust, except those related to health, education, maintenance or support of a beneficiary