A Trustee’s top three – part three

In the first two parts of this three part series, we reviewed some of the common issues to which trustees of Cayman Islands trusts have been exposed as a result of instability in the global economy since 2008. We also discussed recent case law developments, and the renewed sense of optimism which has become evident in the private client arena over the course of 2010.

In the final part of this series, and in the hope that the “green shoots” of recovery will continue to be seen, we look at more fundamental principles to which a trustee should have regard in its day to day interactions with settlors and beneficiaries and other recent developments, both in case law and in legislation.

1. A trust does not have “clients”

While this statement may seem somewhat trite, experience shows that there can be a tendency among less experienced trust administrators to regard the settlor as “the client” of either the trustee or the trust. Often, this mindset has been generated by the settlor, who may not be entirely au fait with the concept of a trust structure. Clearly this can be very dangerous as it fosters a frame of mind wherein the trustee’s role is merely to follow the directions of the settlor.

It is important to remember that, following the settlement of property into the trust, the settlor has divested himself or herself of legal ownership of that property; it can be a very difficult - and unattractive - concept for the settlor to have to grasp, but once settled, the assets are no longer his or her property. While his or her views and wishes may be taken into account, unless the settlor has reserved directive powers in the terms of trust deed, they are not binding on the trustee. Instead, the trustee’s duties will lie in relation to the beneficiaries or other objects of the trust and not the settlor.
There is clearly a balance to be struck between shutting out the settlor entirely and acting slavishly at his direction. The point to appreciate is that treating the settlor as the client can expose the trustee to potential challenge that it is not acting either independently or in the best interests of the beneficiaries. In extreme circumstances, it could result in the trust being found to be little more than a sham.

2. Indemnities and exoneration clauses

A further “hot topic” for trust administrators, particularly in the light of recent global events, is the provision of appropriate indemnity and exoneration provisions in the trust deed.

As a general principle in equity, a trustee has the right to be indemnified against personal liability for the costs and expenses which it incurs in the course of its office, provided those costs and expenses have been properly incurred and not in breach of the trustee’s duties. Equally, under the Trusts Law (as revised), a trustee is entitled to be indemnified out of the trust fund against liabilities which it has properly incurred in its capacity as trustee, including for the costs of defending any claims or actions involving trust property.

In addition to these implied indemnities, it is the usual practice for trust instruments to contain express indemnity and exoneration provisions in favour of the trustee. Typically, these clauses are drafted in very wide terms in an attempt to cover any and all types of liabilities which may arise. For these reasons, these clauses are often the subject of great scrutiny. The validity and enforceability of such clauses has been confirmed in the well-known English case of *Armitage v Nurse* [1998] Ch 241. This confirmation was, nonetheless, given subject to the proviso that the trustee must draw the indemnity and exoneration provisions in the trust deed to the attention of the settlor at the time of drafting of the trust deed in order that the settlor might be given an opportunity to take independent legal advice as to their consequences.

As a matter of good practice, trustees should ensure that the indemnity and exoneration clauses – and trustee remuneration provisions - in their standard trust deeds are brought to the attention of the settlor, and agreed by him in writing, at the time the trust is set up. Failure to do so, may lead to scuffles later on and, ultimately, could result in the trustee being unable to rely on the provisions.
3. Terminating the trust

In the uncertainty of the past two years, we have seen a steady stream of instructions to dismantle trust structures. The motivation for termination varies; often a change in structure is needed to address a change in the settlor’s investment needs or personal circumstances. In other cases, the trust has simply served its purpose.

A proposal to terminate a trust should be considered by the trustee with the utmost care, particularly if the act of termination is to be carried out by the trustee itself using one of its discretionary powers. In line with our comments above, the trustee may not be in a position simply to comply with an instruction from the settlor to terminate the trust simply because he has changed his mind and wants his money back. As with all its powers, the trustee holds its dispositive powers in a fiduciary capacity. When confronted with a request to terminate the trust, the trustee should weigh up a number of factors including the reasons why the settlor established the trust in the first place. Have the original objectives been achieved? What effect will termination have on the beneficiaries? Is termination in their best interests?

It may be that the decision to terminate is out of the hands of the trustees. The settlor may have reserved a power of revocation in the trust deed. The ordinary effect of revocation is that the trust property will revert back to the settlor and the beneficial interests created by the settlement will come to an end. If the settlor purports to revoke the trust, the trustee will need to satisfy itself, firstly, that such a power is actually vested in him and, secondly, that the exercise of the power is effective. Usually the trust deed will stipulate that revocation should be made by deed. If it does not, the trustee should insist on receiving notice of revocation in writing. If consents are required, make sure they have been obtained and that they are in writing. The trustee should also consider if there are any other circumstances – for example, incapacity, duress, undue influence – which may affect the settlor’s decision to revoke. If there are, the trustee may have to seek directions from the Grand Court.

4. Other recent developments

(a) Further developments in the Hastings Bass rule

In part 2 of this series, we discussed the Hastings-Bass principle and its use in extricating trustees from the unintended consequences of their decisions. The recent decision of the English Court of Appeal in Pitt v Holt and Futter v Futter, released on 9 March 2011, overrides previous English authorities and is likely to restrict
dramatically the scope for trustees to unwind actions that have resulted in unforeseen and unfortunate consequences.

In the Pitt/Futter case, the trustees had sought to set aside a decision they had made on the grounds of mistake and in reliance on the Hastings-Bass principle. In considering the facts, the English Court of Appeal confirmed the already established position that to set aside a voluntary transaction for mistake: there had to have been either a mistake as to the legal effect of the transaction or a relevant mistake as to a material fact. However, the court went on to state that if the trustee had sought advice from an apparently competent professional as to the implications of the act and followed that advice, then the trustee would not be in breach of its fiduciary duty by failing to have regard to relevant matters if the failure occurs from the advice being wrong. Accordingly any acts done in reliance on that advice could not be considered nullified by the error and will not be voidable (as they have been in the past).

This judgment is at odds with current case law in Cayman. If the judgment is approved by the Cayman courts in due course, it will be much more difficult for Cayman trustees to undo their mistakes in reliance on the rule in Hastings Bass. Provided they have the necessary fighting fund and taste for litigation, trustees may well be left to recover their losses from their professional advisers if the loss has been caused as a result of incorrect advice.

(b) FATCA
In our last article we also discussed the US Hiring Incentives to Restore Employment Act (“the HIRE Act”), which was signed by President Obama law year. The HIRE Act also sounds a further legislative warning bell in the form of the Foreign Account Tax Compliance Act 2009 (“FATCA”).

FATCA is the latest attempt by the US authorities to prevent the avoidance of tax on income from assets held abroad. FATCA aims, among other things, to impose new rules for taxing certain benefits received from foreign trusts by US persons and will introduce strict new reporting, disclosure, and compliance obligations.

FATCA directly impacts on a variety of persons connected with offshore trusts: investment managers of trusts into which US persons have settled assets, trustees or directors of a company within an offshore trust structure (provided they meet the definition of a “non-financial foreign entity”), and those falling within the defined term “material advisors” – that term seemingly covering cover trustees, lawyers, and other professional advisors outside the US.
Any failure on the part of these persons to comply with the new reporting regimes will give rise to a withholding tax of 30% on any withholdable payments of US-source income made to such entities. Any person required to deduct and withhold that tax would be personally liable for the tax.

The effective date for FATCA has been identified as 1 January 2013. We anticipate that FATCA will have a widespread impact on US investment in the offshore community, although the extent of that impact will only be seen in due course.

*Bernadette Carey participated in the drafting of this article.*

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This article is not intended to be a substitute for legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and give general information.

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