Why won’t my trustee let me keep control?

Nerine Trust Company Limited

16 March 2016

The challenge

As a trustee, we are often charged with the responsibility of looking after significant proportion of a family’s wealth. Quite often, this will include owning treasured family businesses, property or works of art. Not surprisingly, this often means that we are asked to allow the family to stay “hands-on” when it comes to managing these assets.

For a number of reasons, this requires a balancing act between allowing the family to stay involved, whilst ensuring that the trustee remains in control. There are many ways that we can accommodate the family’s wishes through the design of the fiduciary structure but, as we will explain, in the trust world, it is rarely the case that you can have your cake and eat it too.

The respective roles of the trustee and the family

In the traditional discretionary trust structure, the role of the family is somewhat limited. A professional trust services provider (TSP) such as Nerine has all the responsibility for preserving and enhancing the value of the trust fund.

It is not uncommon for the family to keep some form of oversight through the appointment of a family member or trusted adviser as a protector. Generally, this office allows the family to have some control over the appointment - and sometimes removal - of the trustee, as well as an ability to veto significant decisions, such as the appointment of income or capital or the purchase or sale of significant assets.

On the whole, TSPs like ourselves will want to work closely with the family in any event, as we appreciate how important some of these decisions can be. When push comes to shove, however, in these traditional structures, the buck stops with the trustee and from time to time we may have to make decisions that are not necessarily popular with some or all of the beneficiaries.

In circumstances like that, trustees will often needs to take extensive legal advice and, where they feel the consequences of the decision are particularly momentous, seek directions from the court. Obviously this is an expensive and time-consuming exercise, therefore the trustees will normally hope that they can reach a consensus beforehand.

One of the critical factors that we take into account in these circumstances, is the commercial awareness and experience of the family members themselves. Where we are still dealing with the settlor of a trust, we realise the value that they can bring. The funds settled into the trust in the first place were generated through their efforts. Accordingly, it would be entirely reasonable to take their views into account – especially in their particular field of expertise. This allows the settlor a sensible and reasonable degree of influence, without having actual control.

Where there is a family business or an array of operating companies, we will often see our role as akin to that of an engaged shareholder. When the business is doing well, we leave the day-to-day management to its directors - family members or otherwise. As long as we

understand the business of the company, and are kept in the loop when any major strategic decisions are being made, we don't need or want to get in the way. Clearly, if things aren't going quite so well, we might need to become more actively involved.

There was a time in the 1990s when TSPs were a little nervous about allowing the family to hold any form of influence, for fear that this would leave them open to allegations that the trust was a sham, or in some way more a nominee arrangement than a proper trust. It was seen as particularly dangerous to refer to the settlor as a "client", to describe requests as "instructions" and to never say "no" to any request that he or she might make. Whilst TSPs are well advised to ensure that they always exercise independent judgement in relation to any interaction with the family, the modern approach is to take a more pragmatic and empathetic stance. What matters is whether the requests they receive are reasonable, not whether it might be regarded as prudent to say "no" now and again for the sake of good form.

Where families are looking for more than just influence on trust affairs, other options are available to them. For example, Guernsey has introduced provisions into its trust law that allows settlors to reserve a wide range of powers to themselves in respect of the management of the trust. In the BVI, a Vista trust allows the settlor to fully control the activities of a BVI company owned by the trust, without the trustees having a fiduciary responsibility to participate. In the right circumstances, this is obviously an attractive compromise for both TSPs and the families they look after.

A further option, for higher value relationships, is for the family to establish a Private Trust Company (PTC). The PTC will act as trustee exclusively for trusts established for the family. Family members and/or their advisers may sit on the PTC board alongside a TSP, or the family may be happy having the TSP on the board, knowing that they have the ability to control the composition of the board should they need to. Families need to approach the PTC option with care however. Owning the trustee does not remove the obligation to act in the best interests of the beneficiaries – in fact, it places that obligation more directly on the family rather than on, say, a regulated TSP.

What could go wrong?

For trustees, there are probably three main risks that follow from giving the settlor/client too much control over a structure:

- If the form of the trust document is such that it gives the settlor more or less "absolute dominion and control" over the trust assets, there is a risk that it will be regarded as not really being a trust at all. This is a risk, even where there are reserved powers provisions in the home jurisdiction, and even more so if there are family members or assets in other jurisdictions with courts that are less friendly to international finance centres or who do not understand common law concepts. In a recent case in Bermuda, the terms of the trust that applied during the settlor's lifetime were so comprehensively within the settlor's control, the court decided that it was essentially a will trust and the trust was made null and void following the subsequent marriage of the settlor.
- If the trust document itself is more vanilla, but the trustee and the settlor agree from the outset that they will play by different rules, with the intention of misleading the world as to the reality, then the trust will be vulnerable to an attack on the basis that it is a sham. Whilst sham arguments were common 1990s, the concept as it has now developed in England and beyond is such that it is hard to see how a professional TSP – especially in the highly regulated environment that exists offshore – could ever agree to or recklessly go along with such an arrangement. Perhaps the more likely scenario would be that whilst the trustee regards the trust as a bona fide arrangement, the settlor has a different view. Such a situation would not be enough to represent a sham, but might call into question one of the fundamental requirements for a trust to be valid: namely that the settlor had the necessary intention to create a trust. The result of this is that the trust could fail, and its assets fall back into the settlor's estate. It is crucial that trustees and advisers are clear in their marketing and their discussions with clients and their advisers exactly what is involved with settling funds into a trust. This is particularly important if the client is from a country that does not recognise trusts and/or if they are not a confident English-speaker.
- If there is no issue about the trust being a sham, but the trustees fall into the habit of simply doing whatever they are asked to do by the settlor and/or beneficiaries, then they run the risk of committing a breach of trust. If that breach of trust leads to the trust making a loss, then they may well find themselves being asked to reimburse the trust fund – even though they were doing what the "client" asked them to do. As noted above, that does not mean that they can't agree with every request or suggestion – only that they need to exercise independent judgment before they say yes to what they determine is a reasonable suggestion or request.

What's the worst that could happen – I really want to stay "hands on"?

When deciding to establish a trust, clients will be attracted by the benefits that it brings. A properly constituted trust will separate a proportion of the settlor's wealth from his estate. This brings a number of advantages in terms of tax and succession planning. It also allows them to insulate the trust funds from things that might go unexpectedly wrong in their personal or professional life later on.

Crucially, however, the extent of this "insulation" will depend to a great extent on the amount of distance between the settlor/family and the decision-making of the trustee. If a trustee is essentially little more than a custodian, acting purely to execute the instructions of the settlor, then case law suggests that in hostile litigation – be that a commercial dispute or an acrimonious divorce – the trust structure will be extremely vulnerable to attack. The more autonomy and independence that the trustee has, the harder it is to argue that the trust fund should be treated as if it still belonged to the settlor.

Sham arguments really shouldn't succeed if the trustee is a regulated TSP – as the courts have noted, the consequences of a regulated fiduciary being complicit in a scheme to give the world a false impression of the structure are severe. But it is quite possible to create a trust instrument that gives the settlor a lot of control without compromising the trust's validity, taking advantage, for example, of Guernsey's reserved powers provisions. But if those powers are extensive, then the courts in London or elsewhere may see that as evidence that the trust fund is accessible to divorcing spouses or creditors. They may also decide to order the settlor to exercise the power they have to, for example, make capital distributions, appoint trustees or vary the trust in such a way as to bring the trust – or some of its assets – within the reach of that court. The moral of the story appears to be that settlors should think very carefully before they reserve power to themselves as it might be used against them!