TRUST COMPANY MANAGEMENT: WARTS AND ALL

Trusteeships: Only for the Brave

This paper approaches a complex subject in general terms, not attempting to explain or explore too deeply the multi-faceted aspects of the subject. What I hope to do is give the non-specialist reader a broad sense of what is involved, what has to be considered and what are some of the dangers that exist for the professional corporate trustee.

Both as a practitioner and a former bank and trust company regulator I have been approached by businessmen anxious to acquire either a bank or trust company licence. The former seems to be the first choice with the latter often regarded as a consolation prize. In many cases the motives have had more to do with egos than enterprise, as if a licence was a badge of success to be worn with entrepreneurial pride. But if getting a trust licence is perceived to be a consolation prize it is one which may offer little consolation to the holder because the responsibilities it brings can be more onerous, in many respects, than those of the trust company's more regimented cousin, the bank. And the regulatory burden placed on trust companies in recent years is immense. So much so, that the small, family trust company is under threat: in the case of Panama, where regulation of trust companies is most severe, there has been closures and consolidations; only the fittest can survive; even those companies having held a license for more than 30 years have had to undergo an accreditation process before their license is confirmed.

Vanity aside, anyone who is seriously involved in managing trust companies needs to be constantly aware of the pitfalls and problems, irrespective of new supervisory controls, which are unique to the business In this way they can make sure that they implement the right procedures and practices. Even if the shareholders of a trust company do not have a thorough knowledge of the business (and it is not always necessary that they should) they need to have management in place which does: sponsorship of an orchestra when you are tone deaf is of no consequence because it is the conductor who is responsible for the pitch as well as instilling the discipline and control. This principle, of course, applies to many business endeavours.

Caution should always be exercised before engaging a trust company and, conversely, trust companies must be equally mindful in their choice of clientele. The ubiquitous know-your-customer catchphrase has literal emphasis for trustees: they require personal, and not just business, background information, which perhaps includes many other family members as well. Consequently, belligerent beneficiaries, rather than money launderers, can be a headache for the trustee who, like Clint Eastwood in his cowboy film, must often confront the good, the bad and the ugly.

Besides having their wits about them, management needs to have sound operating policies and good systems of control. For specific comments on this, please see our website article "The Order of the Hammer". In some cases in the past a government's laissez faire attitude has enabled trust companies in a jurisdiction to be left to their own devices, a dangerous temptation for the less reputable practitioner. Ironically, to this day this can be seen in many onshore jurisdictions, but not generally so offshore. Character, regardless of other factors, is an essential consideration in business dealings with others and it has been said that a man's honesty is judged by his actions

when they are unknown to others. The corollary of this must surely be that professional trustees need not worry if the light of increased regulation is suddenly shone upon them if they already follow good practice. The necessary corporate discipline and control is being reinforced through regulation as a matter of public policy – albeit as I suggest, in an uneven fashion, depending upon the particular jurisdiction concerned. In Switzerland only in the second decade of this century is the control of trustees under consideration. It must be said, however, that operating a trust company with scant or no statutory regulation raises the issue – whether cynically or not – as to the propriety of management being located in an environment which does not have a regulatory authority. That said, good trustees, regardless of the weight of regulation, will be conducting their affairs professionally anyway; those with shortcomings, however, would be wise to review their practices as regulation is, like an incoming tide, on the rise because there is a recognition that supervision has become a necessity, if only from the mercenary standpoint of encouraging business to come to a jurisdiction; so it has the inevitability of night following day.

Trust companies wishing to be successful for the long haul have to be concerned with the quality of the administration applied to both the trusts they manage and their own operations. Quality of the client, too, is paramount and every trust company should have an independent compliance desk which reports to the board of directors, the majority of whom should not be involved in the daily operations. Operating policies and systems, especially financial controls, of the trust company underpin the management of the trusts and must be sound. You may think that I am adept at stating the obvious, but the number of court cases which highlight the absence of this awareness suggests to me that many have failed either through ignorance or wilfulness to recognise the importance of these policies and systems. Management should ensure that accounting and administration procedures are, as far as possible, independently checked within the company. A trust company's balance sheet is important and annual external audits (whether or not mandated by regulators) by a quality firm of accountants are a sine qua non. On the question of audits, I do not think that it is good enough to forgo internal audits on the strength of those checks made by the external auditors who may have possible time constraints and (more provocatively) might lack the necessary specialist knowledge. The trust company's capital should be commensurate with the volume and nature of business and the size of the capital base must be weighed against the quality of the company's other assets. Liquidity is also important and within the boundaries of prudent accountancy, capital reserves and provisions for losses must be put in place. The dimensions of all these accounting considerations will be, of course, subject to the operating environment of the trust company.

No Greater Duty

In addition to financial stability, a trust company must have a reservoir of technical ability. I have already said that the business of trust management cannot be fully covered in a short paper because it requires a lengthy dissertation and so my brevity belies the depth of the subject. It has been said that the common law knows no greater duty than that of trustee and the principles behind the office have certainly been pervasive throughout commercial activities. It is worth noting, for instance, that although the function of a company director is, by contrast, a creation of statute, the duties stem from in the precepts of trustee law.

But let me start by saying that central to the management of the trusts themselves is an ability to understand clearly the provisions of each trust deed – not only what is said, but what is not. One

needs an equal portion of knowledge of common law and the ability to exercise common sense. Additionally, it may require reference to either legislation or to common law which, because of the lineage of the trust principle, can traverse centuries of precedent. It is a history with antecedents even before time immemorial, that date determined in the Middle Ages as the limit of legal memory (which was, in fact, 3rd September, 1189, when the reign of King Richard in England began). Rome gave us the will and not trusts, but there is clear evidence that even in the Roman law of contract, in force during Cicero's time, there existed a form of pact by which a transferee of property would promise to fulfil an obligation after transfer (even if, perhaps, the obligation would create only an in personam claim rather than one enforceable by the courts). In England the trust's predecessor, the use, began to feature in law in the second half of the 14th century. Even then, one of the objectives of the use was to avoid taxes, much to the chagrin of the Crown. Nothing's changed. It was eventually replaced by the trust in the early part of the 17th century, which, as we all know, made the matter of taxes even more vexatious, and to this day continues to do so, compounded by the confusing Common Reporting Standard and its requirement to determine not just a trust's beneficiaries, but who is a defined controlling person. You might smile and respond by saying that it has to be the trustee, of course; you would be wrong. Nothing is what it seems.

From Casablanca to the Pierian Spring

Unquestionably, the trustee's duties far outweigh the privileges and, because of this, the express provisions of the trust deed can become crucial to a trustee's protection. A diligent trustee periodically reviews the salient parts of the trust deed to ensure his management of the trust stays on course. The management of a trust should be viewed from several critical aspects, embracing the general terms of the trust, the specific trust powers (and who can exercise them) and then the provisions covering the appointment and removal of trustees, the choice of the proper law, the place of administration and the trustee's administrative powers. Equally important are considerations covering the possible revocation and amendment of the terms of the trust, as well as the trustee's relationship with the beneficiaries. Following on from this, the trustee needs to ensure that he avoids conflicts of interest, sees that he has a right to recover his expenses, as well as be indemnified, when appropriate, against liabilities, and be exceedingly careful to avoid breaches of trust claims. Pages, rather than paragraphs, could be devoted to each of these issues.

There is also the matter of whether the trust being managed is genuine in that neither the client nor a third party can exercise control not contemplated or allowed by the trust deed. On this point alone, a vast number of offshore trusts are void ab initio. Often, the new controlling person test, mentioned earlier, will reveal all. I personally classify trusts as either placebo (not the real thing) or Casablanca (the fundamental things apply, as the memorable tune from the famous film assures us). There is a growing source of sham trust precedents and if you are administering one, then be aware of your role as merely a bare trustee and make sure that the putative settlor also understands the position. Sadly, cases exist where, because of unschooled trust managers, neither party realises the reality of the situation. Good trust officers are not always easily found but they are worth their weight in gold, especially in the case of small trust companies where there may not be a broad base of knowledge. It is foolish indeed to assume that a basic trust background can be supplemented by learning-on-the-job. Management may take the view that if complicated legal problems do arise, they can always rely on a local law firm to bail them out.

However, this hand-holding can be deceptive – particularly where either the lawyer is detached from the overall specifics of the trust or he is brought in too late. Even where the trust company heeds legal advice it can still be found liable by the court, as some trust companies, to their great cost, have learned. It is a sad fact that whilst a trustee can obtain indemnification from following the guidance of the courts it does not follow that the courts will indemnify the trustee whose actions are based on legal advice received. Don't engage a lawyer whose specialty is not trusts and it is only a secondary service offered. As in medicine, it is sometimes wise to get a second opinion. I believe that a material consideration for the court in considering culpability is whether or not a fee-charging professional or lay trustee is involved. If the court considers that the lay trustee has acted honestly, there would probably be a preponderance of sympathy, whereas a professional trustee, such as a trust company, will be subject to a less tolerant judgement. This important distinction should never be lost sight of.

Looking more closely at the subject of indemnification, the trust company's directors should be aware that the exculpatory clauses in trust deeds are not automatically the panacea which they appear to be. These indemnification clauses usually cover various features of administration (appointment of agents and investment of trust funds are examples) and they will always be strictly interpreted by the court against the trustee. Regardless of the trust deed, it will be exceptional for the court to excuse a professional trustee from doing nothing where there was knowledge that steps should have been taken to protect the assets of the trust. Another important issue is the extent of a client's knowledge of the indemnification clauses. Where a surrogate (nominee) settlor is used to sign the deed the issue becomes even more acute. There again, even where the settlor does sign the trust deed, if the exculpatory clauses are not explained fully to him it is doubtful as to whether or not a trustee can rely on them. Making passing reference to such clauses as "just being standard provisions" as one skims through a deed with a client will not do.

Conflicts of interest are another problem for trust companies and often centre on remuneration, retention of profits and self-dealing. Unless provided for in the trust deed, the courts will be tough on trustees and, in some jurisdictions, in a draconian fashion. Charging unauthorised professional fees or acquiring trust property for the trust company's own account, for example, is taboo. Trust companies should also understand that the same conditions apply to their parent or subsidiary companies and, what is more, dealings between trusts managed by the same trust company are no exception. My personal policy calls for a trustee to be scrupulously transparent and to not receive any commissions whatsoever as a result of placing assets with another institution, for example. This ensures that a conflict of interest charge can never be proven.

Breaches of trust can never be condoned or covered by indemnity provisions in a trust deed where a professional trustee has not acted appropriately. The only hope (and a slim one) that a trustee has of avoiding a claim is if he receives either exoneration or consent from the beneficiaries. Even where the trustee resigns because he knows that a breach is intended to be committed, he can be subsequently held guilty as an accessory before the fact. Looking the other way is no defence. And remember, there is usually no time limit on bringing an action based on fraud or concealment prior to the plaintiff becoming aware of the breach.

So there is much to think about before, and after, one becomes involved in the business of professional trust management. It is an enterprise which, perversely, illustrates the folly of finding bliss in ignorance as a trustee; and false comfort for a settlor who relies alone on outward appearances, rather than ensuring the presence of a core of competence. I am reminded of Alexander Pope: "A little learning is a dangerous thing, drink deep, or taste not the Pierian Spring". Those wishing to administer trusts as a profession need to acquire a real thirst for the work. They should not just drink, but think, deep.

Contact Us

Courier Address: Edificio Balboa Plaza, Oficina 522, Avenida Balboa Panama, Republic of Panama
Telephone: (507) 269-2438, (507) 263-5252
Fax: (507) 269-9138, (507) 269-4922
E-mail: enquiries@trustserv.com