Step Speech

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Good day ladies and gentlemen;

Today I want to explore the topic: *Protectors – "Good or bad guys"*

Over the past 20 years the provision for a protector has been included in many trust arrangements. This presentation will examine:

- why settlors like to include protector provisions in their trust deeds.

- Why they often fail to appoint a protector or themselves as the first protector.

- When or what action the protector is taking in a fiduciary capacity.

- What to do if the protector will not give his consent.

In short, I want to talk about how as a trust officer you can ensure that the appointment of a protector can have a positive effect on your administration of the trust.

Whilst throughout this presentation I use the term protector – they are also known as Trust Advisers (US) Supervisory Committees, Surrogates and Nominators

Some jurisdictions provide for protectors in the legislation whilst others allude to a protector and many more are silent on the issue. Of the jurisdictions that have given legislative sanction the following is a sample of the either definitions or the clause in the respective act if no definition exist. Bahamas you will be pleased to know has both a definition and a detailed clause – so the following shows the diversity that exists.

Cook Islands

> "protector" in relation to an international trust means a person who, by whatever name or title -

(a) has the power to appoint or remove a trustee, or
(b) directly or indirectly controls, whether by power of veto or otherwise, the trustees' exercise of one or more of their powers, functions or discretions under the trust, or
(c) holds the office of protector in accordance with subsection 20(1);

Bahamas
"protector" means any person appointed as such pursuant to the terms of the trust instrument, including any persons designated as advisers, surrogates, nominators or as a committee or by any other name having such functions and duties as may be prescribed by the trust instrument or other deed or document effecting their appointment, but excluding persons holding trust property;

Protector of trusts. 81.

(1) A trust instrument may contain provisions by virtue of which the exercise by the trustees of any of their powers and discretions shall be subject to the previous consent of the settlor or of some other person as protector, and if so provided in the trust instrument the trustees shall not he liable for any loss caused by their actions if the previous consent was given and they acted in good faith.

(2) The trust instrument may confer on the settlor or on any protectors any powers including (without limitation) power to do any one or more of the following-

a) determine the law of which jurisdiction shall be the proper law of the trust;
b) change the forum of administration of the trust;
c) remove trustees;
d) appoint new or additional trustees;
e) exclude any beneficiary as a beneficiary of the trust;
f) add any person (including the settlor and any private or charitable trust or foundation) as a beneficiary of the trust in addition to any existing beneficiary of the trust;
g) give or withhold consent to specified actions of the trustee either conditionally or unconditionally; and
h) release any of the protectors' powers.

(3) A person exercising any one or more of the powers set forth in paragraphs (a) to (h) of subsection (2) shall not by virtue only of such exercise be deemed to be a trustee and, unless otherwise provided in the trust instrument, is not liable to the beneficiaries for the bona fide exercise of the power.

(4) A person shall not charge any remuneration for his services as protector unless otherwise provided in the trust instrument.

Other jurisdictions that have a statutory provision for protectors are:

Belize
British Virgin Islands
Brunei Darussalam
Jersey and Guernsey (almost)
Labuan
Malta
Nevis
St Vincent & the Grenadines
Turks & Caicos Islands

So why do settlors include protector provisions in there trusts?

I think it would be fair to say that in the majority of cases the settlor is not living in the jurisdiction which will be chosen as the proper law of the trust nor where the trust assets will be held. Furthermore, trusts may not be completely familiar to the settlor. As a result of his or her remoteness and unfamiliarity with the trust concept the settlor quite naturally seeks to build in safe guards to the trust arrangement.

In addition, it might be desirable to create the position of protector so that a trusted advisor can have an official role in the arrangement.

The trust deed may not give the settlor the legal right to all the information that he may wish to have – it is normal however for the protector to be provided with copies of key legal documents, financial statements etc. which again is attractive to the settlor (in fact to all parties).

It may be helpful at this point to reaffirm what actions commonly require the consent of the protector:

- actions which the protector can often instigate by his own actions

- powers that are uncommonly conferred on the protector.

Common powers which the trustees require the consent of the protector are:

- Adding or removing beneficiaries
- Distributions of capital
- Change in proper law of trust
- Termination of the trust
- Significant changes to the investment policy

Of the what I call uncommon powers would be to consent to the distribution of income, payment of expenses of the trust and deciding whether a flee clause has been triggered.

The most commonly seen power where the protector is proactive would be the power to remove or appoint additional trustees.

It is accepted that trust deeds may specify a different approach for different powers.

A word of caution if the sole purpose of incorporating a protector in a trust arrangement is for the protector to become a third arm or alter ego to the settlor then this could contribute to the trust being regarded as a sham. Now I do appreciate that clause 3 of our Trustee Act 1989 anticipates and provides a defense – but this clause has not been tested in a court of law and so I would recommend it should be regarded by a trust draftsman as a last defense much less the first.

It will be quickly understood - I think by all in the room that the inclusion of a protector in a trust arrangement can and will give a shy settlor all the comfort that he or she requires to transfer assets to a trust.

For these powers are the powers that they would like to keep for themselves and it is hard to fault any settlor for wanting to take this course of action. I think each of us would probably do the same.

At this point it is important to differentiate between a settlor, regardless of whether he or she comes from a civil or common law background that takes appropriate professional be it legal or tax advice before he or she establishes their trust. For the sake of this discussion we are not talking about trusts or foundations where no advice was taken.

As we have learnt from the definitions / applicable clauses in the various bills there is no legal impediment to a settlor acting as protector so why would nonetheless I advise against it?

Before I answer the original question I would also like to add the other (ill-conceived) options that might be considered.

1) Appointing the protector at a later date
2) Requesting the trustees appoint a protector through the letter of wishes.

Getting back to the question; can the protector appoint his or her self? One has to ask why bother? In many cases I think it would be easier to give the powers to the settlor. But this (despite our excellently drafted trust act and your proper administration of the trust, It might smack of a sham) so why not only have the powers of the protector effective upon the death of the settlor.

But then as has already been stated the giving of these key powers to the protector was what gave the settlor the confidence to settle the trust in the first place.

What if he or she becomes incapacitated? This must be the very moment when a protector would be of most use.

If he appoints himself and reserved to himself many powers he may find if he becomes involved in a legal or tax dispute that a judge of revenue authority may conclude that the settlor / protector in fact controls the trust.

If an appointment is to be effective upon the settlor's death it is quite conceivable that the protector may not wish to act.

a) by virtue of living in the wrong country
b) because they think they have a conflict of interest

c) they may not be interested in taking on a fiduciary responsibility – particularly if they are not familiar with the jurisdiction of the trust.

With regards to Letters of wishes I am quite surprised that these have survived as long as the have.

Best practice dictates that they should:

- not be dated the same day as the trust deed is executed,
- they must be addresses to the trustees and be marked private and confidential so they do not for part of the trust records.
- They must specify that the settlor understands that they are not legal binding

and in this shaky document a settlor is proposing to recommend who should be appointed as protector of his trust. Well I am sorry, but death and divorce bring out the worst in many and I would anticipate that beneficiaries will and should challenge the appointment of a protector so appointed. Particularly if that person is a beneficiary of the trust or in the opinion of the beneficiaries will not regard their interests in a manner which they want – for the protector owes a duty to them and to no one else.

It is quite common in my experience for settlors to appoint a member of the family or a close business friend or a professional adviser.

In many cases any of the above may seems the best solution – but we are not hear today to examine the perfect world.

I would argue that the appointment of a protector should be considered as much, if not more than, the appointment of trustees which in many cases is dictated by the settlor's wish to select a particular bank or fund manager as the investment advisor to the trust assets.

Now to the question of which powers are lightly to place the protector into a position of acting as a fiduciary?

In very general terms it is my view that if you are acting in a professional capacity

- are a 3rd party to the trust - are charging for your services
– have been appointed by the settlor to oversee the administration

– have an indemnity under the terms of the trust or have been provided one separately by the trustees – then you are almost certainly acting in a fiduciary capacity.

Some older trust instruments actually state that the protector is not acting as a fiduciary. It is a point worth noting that if the protector is not acting as a fiduciary does he have the right, for example, to an indemnity or to charge fees?

It is my view that it is better to have language in the deed that clearly states that the protector is acting as a fiduciary.

If the settlor specifically wishes to ensure that his protector is not – I would suggest only powers of veto are given and no remuneration is offered. You may ask who would take such an appointment – and I can guarantee you it would probably only be a family member or friend.

However this may ensure that the powers are personal powers and the beneficiary can decide whether to exercise them or not without regard to the interest of all the beneficiaries.

So what happens if the protector will not give his consent – or does not even respond?

In the old days you did indeed hear of protectors that just did not respond to trustees. Many of these trust instruments provided if the trustees had not had a response from the protector within a reasonable time (say 90 days) they could act without his consent. I think in today's environment the beneficiaries (and certainly a court) would take a dim view of a protector who for no good reason did not respond either positively or negatively or was not able to provide a reason for so acting.

What if the protector does not agree with the actions of the trustees or if the trustees do not agree with the actions of the protector.

A last resort of course is to go to court – but I would expect that a simple reminder of the roles and responsibilities of a protector and an assessment of whether you think he or she is acting as a fiduciary will quickly prompt the protector to either reply or resign.

Are there any benefits to the trustees that the protector be appointed?

I am sure there are many – but one of them would be if the protector is acting in a fiduciary capacity - then if a trustee accepts a protector's positive directions or negative withholding of consent then the trustees would be in a strong position to claim exemption from any liability if it transpires that a breach of trust had been committed. This would not apply if the trustees have information knowing that the protector's actions assist a breach of fiduciary duty.

My purpose is not to convince you that protectors are either necessary or required rather to arm you with the tools necessary to properly guide a settlor in deciding if a protector is either required or necessary

The terms and role of the protector is an invention of the offshore trust industry. I think we can conclude that they are here to stay. Many lessons good and bad will be learnt in the years to come both in court and out about the do's and don't regarding the powers of protectors and who are appropriate to be appointed. I hope today I have stimulated you to discuss fully with your clients what he or she expects from the appointment. I hope I have stimulated you to persuade your settlor to fill the position once it is created.

I would like to thank you for your time and I am pleased to answer any questions you may have.