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Typical trust administrative clauses

Synopsis: Extending/overriding statutory and common law provisions.

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Any trust would normally include the dispositive powers of the trustees, that is, powers over trust income and capital as well as administrative powers, i.e. those necessary for the trustees to be able to carry out the day-to-day duties involved in the administration of the trust. The most important of those are the investment powers and these are considered separately.

Apart from that, a typical trust would include the clauses discussed below. It is important to remember that it is essential that express provisions in the trust are included to grant these powers to the trustees as they may not be available under general trust law.

Power to lend to beneficiaries

Trustees should be able to make loans to the beneficiaries as well as appoint capital to them. Loans will usually be interest-free repayable on demand and the debt will form part of the trust property - preserving it for the next generation of beneficiaries rather than lose it from the trust altogether by distribution as capital.

A loan to a beneficiary will also usually constitute a debt of that beneficiary, which may be useful in inheritance tax planning as it would reduce the estate of that beneficiary for inheritance tax purposes. This would not be the case if an appointment of capital was made to that beneficiary.

Power to borrow

Although generally speaking trustees would be ill advised to borrow money since they would be personally liable for any amount borrowed, it may be useful and important for practical reasons that trustees have specific power to borrow to purchase investments permitting the trust fund to be used as security. This may be particularly useful if the trust is to buy a residence for a beneficiary.

Power to appropriate assets

Sometimes it may be more convenient or tax efficient to advance an asset in specie to a beneficiary rather than for the trustees to encash an asset and advance cash to the beneficiary. This is particularly the case with trustees holding investment bonds where assessment to income tax on encashment of the bond will depend on whether at the time of encashment the bond is still held by the trustees (in which case the assessment will be on the settlor or the trustees) or has been assigned in specie to an adult beneficiary in which case the assessment will be on the beneficiary.

To ensure that trustees can assign an asset in specie to a beneficiary then ideally an express power to do so should be included in the trust.

Power to allow a beneficiary to occupy a residence

Prior to the Trustee Act 2000, in England and Wales a residence could only be purchased for use by a beneficiary if specific power was given in the trust document. Section 8 of the Trustee Act 2000 empowers trustees to acquire freehold or leasehold land in the UK either as an investment or for occupation by a beneficiary or for any other reason.

However, the statutory power does not allow the purchase of land outside the UK and so, ideally, a wide express power to acquire a residence anywhere in the world and allow a beneficiary to occupy it should be included. The trustees should also be given wide powers over the terms under which the residence may be occupied, e.g. rent-free, etc.

Power to insure

Section 34 Trustee Act 2000 replaced section 19 Trustee Act 1925 which allowed the trustees to insure only certain assets up to three quarters of their value and only against fire.

The new statutory power confers on all trustees the power to insure any trust property against such risks as they think fit. This power is subject to the general duty of care. It is therefore no longer so important to include an express power to insure.

Receipt clause

Where there are minor beneficiaries, they will not be able to give a good receipt to the trustees and so a trust document would normally include a clause which will allow the trustees to accept as good a receipt and discharge from a parent or guardian of any minor beneficiary.

Power to export the trust and to change the proper trust law

Unless express powers are given to this effect the trustees may have difficulty in exporting the trusts or appointing overseas trustees.

Trustee benefits and remuneration

Until the Trustee Act 2000 came into force there was a common law rule which generally prohibited trustees from benefiting in any way from the trust. This meant the trustees could not charge fees unless expressly authorised by the trust document. It was common therefore to include a trustee charging clause in a trust, particularly where the trust document was drafted by a solicitor or an accountant who may be a trustee.

Under the Trustee Act 2000 certain trustees are entitled to receive reasonable remuneration. This includes a trust corporation in all cases, a professional trustee (other than a sole trustee) who may receive reasonable remuneration if each of the co-trustees agrees in writing and this includes remuneration for services which could have been provided by a lay trustee. A sole professional trustee where no

charging clause exists still cannot charge any fee, but of course in such a case he should consider appointing a co-trustee.

Where a trustee acts as an investment adviser the rules will also apply but it will be important, if relevant, to include a separate clause allowing a trustee to keep any commission in respect of any insurance or investment recommended for the trust fund, otherwise the commission would have to be paid to the trust.

Ideally, of course, a wide remuneration clause should be included which will be preferable to depending on the statutory provisions.

Trustee liability

Under general trust law trustees may be liable for any breach of trust resulting in a loss to the trust.

It is generally common to include a trustee indemnity clause which will ensure that the trustee will not be liable, for example, for bona fide negligence or for anything else except for their own fraud or wilful default or wrongdoing.

The Trustee Act 2000 does not make any attempt to regulate the use of trustee exemption clauses, the inclusion of which in trust documents has become more common in recent years. Indeed, the Trustee Act 2000 even expressly allows trust documents to exclude the application of the statutory duty of care. When the statutory duty of care is excluded, the trustees would still be subject to duty of care under the general law, which has always applied, but again, subject to any exclusion of liability that is incorporated in the trust document.

This is consistent with the general principles of English trust law under which in private trusts it is generally up to the settlor to decide the provisions of the trust as well as the trustees´ powers and duties. The very few areas where the settlor´s discretion is fettered in this respect are the prohibition of perpetuities (and until recently accumulations) and the non-excludable duties in connection with investment of the trust fund introduced in the Trustee Act 2000.

The general rule is that, in the absence of an exclusion clause, the trustees are personally liable for breaches of trust (i.e. failure to carry out their duties under the trust) if they result in a loss to the beneficiaries. This relatively unrestricted nature of trustees´ liabilities has resulted in the use of common form clauses in trust documents which exclude or limit this liability.

Unsurprisingly perhaps, exemption clauses are most common where the trustees are professional trustees such as solicitors or accountants. The increasing use of the exemption clauses means that the question arises whether this is now seriously prejudicial to the interests of trust beneficiaries, i.e. those whom the trust relationship is directed to promote. It has been argued that the whole idea of exclusion of liability clauses is repugnant to the concept of the trust.

Problems of fairly wide exemption clauses have been addressed by the Courts. In the leading case of Armitage –v- Nurse [1998]Ch 241 the Court of Appeal stated

that a clause could exclude the trustee from liability for loss or damage to the trust property "no matter how indolent, imprudent, lacking in diligence, negligent or wilful he may have been, so long as he has not acted dishonestly". It is then now settled law in England and Wales that trustee exemption clauses can validly exempt trustees from liability for breaches of trust except fraud.

The Court of Appeal decision in Wight -v- Olswang [1999]All ER(D)436CA decided that the professional trustee was liable in relation to the failure to complete a sale of half a portfolio of shares. The trust document in that case provided that no trustee should be held liable for any loss or damage accruing as a result of the trustees concurring or failing to concur in the exercise of any discretion or power conferred on them. The Court decided that this clause should have a very narrow construction and that the clause did not provide an exemption to a trustee from liability for a breach of trust committed in the course of the exercise or non-exercise of a power or discretion.

However, the present law has been severely criticised on a number of grounds. Even in Armitage –v- Nurse, Millet LJ noted that "the view is widely held that these clauses have gone too far, and that trustees who charge for their services and who, as professional men, would not dream of excluding liability for ordinary professional negligence should not be able to rely on a trustee exemption clause excluding liability for gross negligence".

In June 1999, the Trust Law Committee issued a consultation paper in which it recommended that the law should provide that a trustee remunerated for their services as trustee may not rely on an exemption clause excluding liability for breach of trust arising from negligence (and worse) in all cases where the trustee cannot prove that prior independent advice was given to the settlor. It is the issue of negligence that is of key importance in the debate.

Negligence is the most common cause of loss to trust funds and the Law Commission´s view is that it is particularly inequitable that the risk of loss through negligence of professional trustees should be borne by beneficiaries.

This was also the view of the Trust Law Committee in 1999: "there is much to be said for trust corporations and professional individuals paid for their services as trustees (like solicitors, barristers and accountants) to accept a price of liability for negligence in acting as a paid trustee and to insure against such risk, with the premiums being reflected (like other overheads) in the fees for the services provided. After all, solicitors, barristers, accountants and doctors proud of their expertise accept liability for negligence in exercising their professions and insure against such risk".

In other jurisdictions there is sometimes a distinction between gross negligence and ordinary negligence (e.g. in Scotland, Jersey, Guernsey etc). In England, while such a distinction exists in criminal law, it does not exist in the law of tort. The Law Commission does not propose to introduce reform based upon a distinction between ordinary and gross negligence. This point is of interest to those involved

with trust arrangements, as occasionally they may come across a trust drafted under the law of Jersey or Guernsey, for example.

With regard to exclusion clauses, the Jersey trust law was amended in 1989 by what is now Article 26 (9) of the Trust (Jersey) Law 1984. This states "nothing in the terms of a trust shall relieve, release or exonerate a trustee from liability for breach of trust arising from his own fraud, wilful misconduct or gross negligence."

In 1990 Guernsey amended its trust law to prohibit exclusion of gross negligence thereby bringing it in line with that of Jersey.

Typically, then, trusts governed by the law of those jurisdictions would frequently have an exclusion clause exculpating a trustee from everything except their own fraud, wilful misconduct or gross negligence.

In England and Wales a typical trustee exemption clause may be even wider, reading for example "no trustee shall be liable for any loss or damage which may happen otherwise than as a result of his fraud". Under the principle in Armitage -v- Nurse this would be considered acceptable. However, given the comments in connection with the responsibilities of professional trustees during discussion about negligence, it would be more typical to see an exemption clause more in line with the spirit of the proposed reform which will not be as wide as that quoted.

In 2002, the Law Commission issued a Consultation Paper on trustee exemption clauses. The paper argued that the law governing trustee exemption clauses was in need of reform and made wide-ranging proposals for legislative intervention. The central provisional proposals were as follows...

- All trustees should be given power to make payments out of the trust fund to purchase indemnity insurance to cover their liability for breach of trust;
- Professional trustees should not be able to rely on clauses which exclude their liability for breach of trust arising from negligence;
- Insofar as professional trustees may not exclude liability for breach of trust they should not be permitted to claim indemnity from the trust fund;
- In determining whether professional trustees have been negligent, the Court should have power to disapply any exclusion clauses or extended powers clauses where reliance on such clauses would be inconsistent with the overall purposes of the trust and it would be unreasonable in the circumstances for the trustee to rely on them.

Following consultation, the Law Commission's report containing their final recommendations on trustee exemption clauses was published in July 2006.

The report recommended that, instead of introducing legislation to deal with the matter, the trust industry adopt a non-statutory rule of practice and that this should be enforced by the regulatory and professional bodies who govern and influence trustees and the drafters of trusts.

The rule of practice governs the disclosure and explanation of clauses in trust instruments which have the effect of limiting or excluding liability for negligence and requires paid trustees to take reasonable steps to ensure that settlors understand the meaning and effect of such clauses before including them in trust instruments.

The Law Society and the Institute of Chartered Accountants in England and Wales have both incorporated the rule into member guidance while the Society of Trust and Estate Practitioners ("STEP") has published a version of the rule that will bind its members in England and Wales.

Majority decisions

Under the law of England and Wales the general principle is that the trustees must act unanimously whenever exercising their powers. (Compare with Scots law provisions where the general principle is that a simple majority of trustees will suffice). However, where there are more than two trustees, it may be appropriate for the trustees to be able to exercise their powers by a majority. This can only happen if a specific provision is included in the trust document to allow this.

Delegation

Until the Trustee Act 2000 and the Trustee Delegation Act 1999 came into force the general rule was that the office of trustee was personal and could not be delegated nor could the exercise of a trustee's powers and duties. Delegation by individual trustees is now dealt with under the Trustee Delegation Act 1999 whilst the trustees` collective powers of delegation are dealt with under the Trustee Act 2000.

The statutory provisions are complex and it will generally still be preferred to include an express power for the trustees to be able to delegate as well as a power to allow investments to be held in nominee accounts.

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