

• COMPARISON OF INVESTMENT OF TRUST OR FOUNDATION ASSETS AND THE RISKS ASSOCIATED

INTRODUCTION

In the present economic turmoil, trustees and foundation councils have to be more mindful than ever of the manner in which they invest assets. Beneficiaries suffering investment losses might question whether their trustees did everything reasonably possible to protect the trust fund against such losses. Similarly, a foundation's guardian may require the foundation council to account for their administration of foundation assets and any suffered losses. Consequently, when making investments, it is essential for trustees and foundation councils to understand their investment powers, duties, and investment policy in order to manage and minimise the potential risk of liability due to investments which may under perform or cause significant losses.

POWERS AS TO INVESTMENT

The Trusts (Jersey) Law 1984 (the "Trusts Law") and modern Jersey trust instruments prescribe wide investment powers upon trustees, but are limited by the duty to exercise those powers in the interests of the beneficiaries and in accordance with the terms of the trust.

In contrast, due to the corporate status of a foundation, the Foundations (Jersey) Law 2009 (the "Foundations Law") prescribes investment powers by virtue of its regulations. Regulations will usually contain wide investment powers, but in any event the capacity of a foundation is not limited by anything in its regulations. However, a foundation council has the duty to exercise the foundation's investment powers in the best interests of the foundation and in accordance with the foundation's charter and regulations.

Accordingly, it is essential that trustees and councils act within the limitations of their powers which may require the consent of a third party (e.g. a protector of a trust or a guardian of a foundation, whose appointment is compulsory under the Foundations Law).

INVESTMENT POLICY

Trustees and councils must: (i) understand what is meant by "investment"; (ii) adopt an appropriate investment policy; (iii) understand their duties; and (iv) implement a system for monitoring investment performance.

It is accepted that an investment asset can be non-income producing and solely appreciate in capital value. This allows for any type of investment, but trustees and councils of a Jersey trust or foundation should remember that neither trustees or a foundation can directly acquire, hold or dispose of immovable property in Jersey. Furthermore a Jersey foundation cannot directly engage in commercial trading that is not incidental to the attainment of its objects, but it can own companies or other vehicles that do so.

When devising an investment policy, trustees and councils must take into consideration the purpose of the trust or the foundation's objects, investment objectives, restrictions and performance benchmarks. In respect of trusts, the nature of beneficiaries' interests are crucial; for example if there are vested or discretionary interests. However, beneficiaries of a foundation do not have an interest in foundation assets and no duties are owed to them. Therefore the foundation's objects are crucial. Despite the difference, there may be common investment considerations for both trustees and councils such as tax, religious prohibitions, ages, education requirements, attitude to risk, liquidity and capital needs.

DUTIES AS TO INVESTMENT

Once the investment policy is set, trustees and councils must be aware of their statutory duties when exercising investment powers. In both cases these duties cannot be excluded by the terms of the trust or the foundation

regulations. Whilst the statutory language used to describe these duties is not identical, their practical effect is similar in nature.

Trustees must act "with due diligence, as would a prudent person, to the best of his ability and skill and observe the utmost good faith" whereas council members are required to "act honestly and in good faith with a view to the best interests of the foundation and exercise the care, diligence and skill that reasonably prudent persons would exercise in comparable circumstances." Thus trustees and councils are required to act with prudence, diligence and good faith when making investments. The principal difference between their respective duties being that trustees must act in the best interests of the beneficiaries whereas councils must act with a view to the best interests of the foundation.

Prudence is a duty which dictates diversification of investments in order to lower the risk of losses and to preserve the value of assets. Neither the Trusts Law or the Foundations Law contain an express duty to diversify assets and diversification can only be implied by the duty to preserve. Yet, the trustee statutory duties to preserve and enhance the value of the trust fund are subject to the terms of the trust and the Foundations Law is silent as to such duty. Therefore such duty is only applicable if not excluded by the trust instrument or drafted into the foundation's regulations. Consequently, the trust instrument or the

foundation regulations may expressly alter the duties of trustees or councils depending upon the settlor's requirements or the foundation's objects and the investment policy. Nevertheless, it is arguable that no prudent trustee or council would invest all assets in one investment, particularly if it is high risk. Therefore trustees and councils must consider the suitability of the investments to the investment policy and the appropriateness of the exercise of the power in all the circumstances.

POWER TO DELEGATE AND EMPLOY MANAGERS

If trustees or councils do not possess investment expertise or understanding, they should seek advice on such matters and, when receiving that advice, act with the same degree of prudence. In such circumstances it would be prudent and reasonable to employ or delegate the management and investment of assets to a professional investment manager. This would be acting in the best interests of either the beneficiaries or the foundation and would serve as an attempt at mitigating risk for any losses.

Specifically in relation to investment, the Trusts Law allows trustees, except where the terms of the trust specifically provide to the contrary, to delegate management of trust property to and employ investment managers to manage the investment of trust property. The Foundations Law provides that regulations determine whether councils may delegate to or employ investment managers.

The effect of a power to delegate investment does not mean trustees or councils can abdicate all investment responsibility to a manager. The Trusts Law provides trustees with a duty to ensure that they only delegate or employ investment managers in "good faith and without neglect" who they reasonably consider "competent and qualified to manage the investment of trust property." However, the Foundations Law is silent on

the matter. Despite this silence, it would be argued that a council's overriding duty to act in the best interests of the foundation and exercise the care, diligence and skill of reasonably prudent persons in comparable circumstances would practically amount to an equivalent duty of the trustees' duty above.

Therefore, before any formal appointment, trustees and councils must be reasonable in their deliberation and selection process of managers, undertaking a quantitative and qualitative due diligence exercise to ensure that any manager has the appropriate qualifications and investment experience in the required areas. A manager should be selected from a group of potentials (sometimes appointing more than one) who demonstrate the required understanding of the investment policy. Once the manager is selected, the trustees, or the foundation, and the manager should execute an investment management agreement outlining inter alia the services to be provided and the investment objectives.

Thereafter it is essential that trustees and councils regularly review the performance of the manager. Trustees have an express, and councils an implied, duty not to permit the continued delegation or appointment of a manager if his performance is not acceptable. The investment management agreement should require the manager to provide performance reports (usually quarterly, but as required in all the circumstances) to assess the investment manager against: (i) the official cash rate prevailing during the period; (ii) the benchmarks agreed at the asset allocation stage; and (iii) the performance of other comparable investment portfolios under different management. Where the investment manager has underperformed, then it might be necessary for the trustees or the council to remove him and restart the appointment process or potentially be in breach of their duties.

LIABILITY AND EXONERATION FOR INVESTMENT LOSSES

Trustees who invest imprudently resulting in losses will be in breach of trust. They will be personally liable for the loss or depreciation in value to the trust property and the profit (if any) which would have accrued to the trust property. However, trust instruments will often include an exoneration clause which, in accordance with the Trusts Law, can validly relieve, trustees from all liability for breach of trust apart from liability arising from their own fraud wilful misconduct or gross negligence.

The Foundations Law does not contain similar provisions to the Trusts Law in respect of council members being personally liable for the loss or depreciation in value to the foundation's assets. Personal liability might possibly be implied by the councils' duty to account to the guardian for the administration of foundation assets and their overriding duty to act prudently with the foundation's assets. However, the Foundations Law specifies that regulations may contain an exoneration clause to relieve council members from all personal liability apart from liability arising from their own fraud, wilful misconduct or gross negligence.

A principal difference between trusts and foundations in this area is that trustees may be also be relieved or indemnified for breaches of trust by beneficiaries, to whom trustees are accountable, or by the Royal Court of Jersey. As a foundation council does not owe any duty (fiduciary or otherwise) to beneficiaries, no beneficiary of a foundation can relieve or indemnify a council or its members for liability. Also, due to the corporate status of a foundation, there is no ability for a council to apply to the Royal Court of Jersey for relief of liability by court order. Furthermore there is no ability for a foundation's guardian, to whom the council is accountable, to provide such relief or indemnification to council members.

Therefore if a trust suffers investment losses, the trustees may be exonerated for the losses by the terms of the trust, the beneficiaries or court order subject to such liability not arising from the trustees' own fraud wilful misconduct or gross negligence. However, because a foundation has corporate status, any investment losses are encapsulated within the foundation meaning that council members will not be liable for investment losses in the first instance unless such losses arise due to the council member's own fraud, wilful misconduct or gross negligence.

CONCLUSION

Whilst the mechanics of trusts and foundations and the duties upon trustees and councils are different, the practical effect of these duties in respect of investment of assets is similar, if not identical.

These duties as to investment do not change because of harsh economic climates. Therefore it is essential that trustees and councils demonstrate that they have at all times acted in accordance with their duties, the terms of the trust or regulations, the investment policy and have carried out all that would be expected of them as prudent businessmen.

Where trustees or foundations have failed investments or are experiencing problems, it is important they show reasonable and reasoned decisions based upon inter alia appropriate research, risk and analysis reports, independent credit ratings, professional advice and regular reviews of performance. This will assist to demonstrate to any third party that any losses are not due to the conduct of trustees or the council and therefore reduce the risk of any claim for liability.

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