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Settlor reserved powers

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It is inherent to the creation of a trust that ownership of assets passes from the existing owner (settlor) to the trustee. Historically transfer of ownership also meant more or less complete transfer of control of the trust assets to the trustee.

How to ensure proper management of trust assets no longer under their ownership or control was not an uncommon dilemma for individuals considering the establishment a trust structure to hold their wealth. Especially if the nature of the assets, for example a family business, meant that hands-on day- to-day asset administration would sit better with the existing management than with the trustees.

This can be particularly important for settlors who are successful entrepreneurs and/ or who wish to protect their “crown jewel” assets. Such individuals often realise that their vision of strategic business and wealth creation does not sit easily with trustees’ wide discretionary powers who are bound by duties of prudence and conservative investment.

Also in some jurisdictions, such as the USA where such trusts are known as “grantor trusts”, there might be tax advantages where the settlor can, for example, distribute income to beneficiaries without taxation consequences (it should be noted that we understand the US Government is looking at changing the tax rules relating to grantor trusts). However, tax advantages are by no means a primary reason for the use of reserved powers.

That duty of prudent investment and asset management imposed on trustees by law also meant that fiduciary businesses feared exposure to breach of trust claims if they assumed trusteeship of trust structures for which the settlor’s expectation was no, or very limited, diversification of the trust assets. Cases such a Bartlett v Barclays Bank Trust Co Ltd [1980] 1 Ch 51, made it clear that trustees would not necessarily avoid such breach of trust claims simply by placing trust assets in an underlying corporate vehicle.

Implementation of reserved power into Law

A number of offshore finance jurisdictions therefore sought to address that conundrum by implementing legislation which accommodates an element of control over administration of trust assets being retained with the settlor (or granted to another), and which removes or limits the trustees’ duty to interfere in the management of those assets (notably, the Star Trust in the Cayman Islands and the VISTA trust in the BVI).

Similarly, in 2006 the Trusts (Jersey) Law 1984 (“**Law**”) was amended to introduce a statutory ability for a settlor to either reserve to himself or grant to another (such as a protector) certain powers, therefore allowing

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Jersey trusts to be as flexible as possible in an ever competitive market place.

In fact, so called “settlor reserved powers” had been drafted into Jersey trust instruments for many years before 2006. However, such powers had never been tested before the Jersey Courts. Consequently, lawyers had some reservations as to whether such powers would be upheld as valid before the Courts. To address this, Article 9A of the Law was introduced to confirm that a reservation or grant by a settlor of such powers as are specified in the Law shall not affect the validity of a Jersey trust nor delay it taking effect.

What are the powers that can be reserved or granted by the Law?

Article 9A(2) of the Law provides that a settlor may reserve or grant the following powers:

- to revoke, vary or amend the terms of a trust or any trusts or powers arising wholly or partly under it;
- to advance, appoint, pay or apply income or capital of the trust property or to give directions for the making of such advancement, appointment, payment or application;
- to act as, or give binding directions as to the appointment or removal of, a director or officer of any corporation wholly or partly owned by the trust;
- to give binding directions to the trustee in connection with the purchase, retention, sale, management, lending, pledging or charging of the trust property or the exercise of any powers or rights arising from such property;
- to appoint or remove any trustee, enforcer or beneficiary, or any other person who holds a power, discretion or right in connection with the trust or in relation to trust property;
- to appoint or remove an investment manager or investment adviser;
- to change the proper law of the trust;
- to restrict the exercise of any powers or discretions of a trustee by requiring that they shall only be exercisable with the consent of the settlor or any other person specified in the terms of the trust

Whilst the aforementioned powers are extensive, it should be noted that the Law also gives the States of Jersey power to implement Regulations which amend (and so extend) that list of powers.

Is there a limitation on the nature or number of powers which may be reserved or granted?

Article 9A(1)(b) provides that a settlor may reserve or grant “any of the powers” specified at Article 9A(2) and, furthermore, the preamble wording to Article 9A(2) stipulates that “The powers are” [emphasis added]. Taken together, the wording at Articles 9A(1) (b) and 9A(2) suggest that the only powers in relation to a trust which are capable of being granted or reserved are those powers expressly set out at Article 9A(2)(a) to (h), but that all or one or more of those powers which are so specified may be reserved or granted. What if the settlor wishes to reserve or grant a power which is not included in Article 9A(2), can he do so?

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Article 9A does not expressly prohibit other powers not specified at Article 9A(2) being reserved or granted. Nevertheless, a prohibition might be implied twofold, first, by the aforementioned use of language to the preamble of Article 9A(2) being unequivocal and, second, by Article 9A(4) providing that the States of Jersey may amend the list of powers at 9A(2). Taken together this perhaps suggests the list of powers is fixed unless amended by the States of Jersey. Consequently, if a settlor wished to reserve or grant a power not specified at Article 9A(2), he should do so with a degree of caution and solely on the understanding that such a reservation or grant may not be valid.

Scope of powers reserved

Theoretically, a settlor might reserve or grant all the powers specified at Article 9A(2). However, unless the intention is to create a bare trust, (so that the trustees act as the nominee, dealing with the trust assets at the settlor's direction), to do so would not be advisable.

Conversely, if it is important that the trust is discretionary, so that the trustees are vested with discretion as to the application of trust assets, an extensive reservation or grant of powers potentially exposes the trust to allegations that it is a "sham".

The Jersey case of re Esteem Settlement [2003] JRC092 (paragraph 54) is authority that a sham will exists if there is a common intention of the settlor and trustee that the true position should be otherwise than as set out in the trust instrument which they both executed.

Accordingly, if overly extensive powers are reserved by the settlor, it may enable a third party seeking to undermine the trust to assert that no true discretion was ever intended to be exercised by the trustees (even if the trust terms vest the trustees with such discretion) which always act as directed by the settlor in exercise of his / her reserved powers. For that reason, best practice would be for a settlor to reserve or grant only those powers which are absolutely necessary for the settlor's purposes in his individual circumstances.

It is worth adding that accommodating a formalised role for the settlor within the trust terms by way of properly drafted reserved powers which are carefully adhered to by the settlor, is likely to make the trust less susceptible to accusations of sham than if the trustees simply permit the settlor to exercise indirect influence or control which is not contemplated by the trust terms.

Trustee liability

Article 9A(3) of the Law provides that any trustee who acts in accordance with any such direction, reservation or grant of power by a settlor will not be found to be acting in breach of trust. However, if the trustees are vested with a separate power exercisable concurrently with equivalent powers reserved / granted by the settlor, then failure to exercise those powers in the interests of the beneficiaries may render the trustees liable for breach of trust, so defeating the protection which Article 9A(3) might otherwise afford the trustees. Accordingly, to protect the trustees, it is generally advisable that the trust terms reflect that any such

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equivalent powers vested in the trustees are only exercisable when those powers reserved / granted are no longer operative.

Furthermore the trust instrument should, to the extent permitted by Law, stipulate that the trustees or any person connected with the trustees (including the directors, employees or agents or any corporate trustee) shall (for example) not be:

- liable for any loss or loss of profit to the trust fund resulting directly or indirectly with the exercise of any of reserved power;
- under any duty to preserve and/or enhance the value of the trust fund;
- under any fiduciary or other duty to review or to see that any exercise of any reserved power is in the best interests of the beneficiaries;
- under any duty to act upon any information received in respect of reserved powers or to make any enquiries as to the desirability of the exercise of any reserved power.

The effectiveness of the above type provisions to protect trustees from liability rely upon Article 9A(3) of the Law, but how effective are such provisions?

We have no judicial authority in Jersey on this point, but, arguably, Article 9A(3) and the terms of the trust instrument will not operate to absolve trustees who breach their fundamental duties of good faith, diligence, prudence and accountability to beneficiaries.

For example, if a trustee is aware that reserved powers are being exercised in a manner clearly detrimental to the beneficiaries or that the person with those powers is acting irrationally or in bad faith, it seems doubtful the courts would uphold a decision by the trustee to do nothing, in reliance on exculpation from liability afforded by Article 9A(3). Ultimately, even if the trustee is not empowered by the trust terms to intervene, the Law enables it to apply to the Jersey courts to do so.

Consequently, and despite Article 9A(3) of the Law and the terms of the trust instrument, prudence suggests that trustees should undertake an active monitoring of the exercise of reserved powers. Such monitoring can only go to protect the trustees' position: a professional trustee ignorant of the activities of the trust it administers is unlikely to find favour with the court or the financial services regulator.

The trustees can further protect their position by seeking indemnification from the settlor and/or beneficiaries in respect of the reserved or granted powers, and by having the settlor and/or beneficiaries waive any rights of claim they might have against the trustees in respect of any actions taken, and consequences arising from, reserved powers being exercised. However, indemnification is only as good as the worth of the indemnifier, and such waivers may be susceptible to limitation in so far as the extent to which the Law will allow trustees to be absolved from liability for breach of trust.

Practical considerations

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Before establishing a reserved power trust consideration should be given to, for example, the following matters:

- Taxation – due to the residence of the settlor, it might be inappropriate for certain powers to be reserved to him and there might also be a risk that the settlor can be considered a co-trustee which might also have adverse consequences for the tax residence of the trust. Therefore appropriate tax advice should be taken at the outset.
- Sham – as mentioned above, if a substantial number of powers are reserved, then there might not be a discretionary trust at all because the number of reserved powers show a lack of requisite intention to create anything more than a nomineeship. Also, it is essential that legal title to assets is properly transferred to and under the control of the trustees, and that the trust is properly administered, to ensure that the assets have ceased to be within the settlor's personal ownership.
- Succession Planning – how will the incapacity or death of persons holding reserved powers be dealt with? Should such powers cease to exist, or alternatively does the settlor want to grant control, upon his incapacity or death, to another person (such as a family member or business partner) who is more experienced and/or knowledgeable than the trustees in dealing with certain trust property. In such circumstances reserved powers can be used in succession planning, for example, to facilitate continuity in management of "crown jewel" assets.
- Investments – if investment of the trust fund is reserved or delegated outside of the control of the trustees, will persons with the responsibility for investments be appropriately qualified with sufficient and appropriate experience to make such investments? Trustees are under a statutory duty to ensure any person they appoint as investment advisers or managers are "competent and qualified to manage the investment of trust property" and not to allow such delegation to continue if that is not the case. Removing the trustees' discretion to appoint or remove investment advisers / managers while the reserved powers are operative is one way of addressing that.
- Non-Standard Assets – related to investments, if the trust fund comprises of assets requiring specialist knowledge and experience (for example art work or classic cars), how will the reserved powers be passed to future persons where that specialist knowledge and experience is essential to maintain the value of the trust property?

Disclosure by settlor with reserved powers

In the matter of HHH [2011] JRC235 the Royal Court of Jersey discussed beneficiaries' right to disclosure of trust documents from the trustee and also the settlor who retained reserved powers (including the power to appoint new trustees and protectors). It was asserted by a beneficiary that the settlor had certain fiduciary duties owed to the beneficiaries because of his reserved powers, but the settlor denied he had a trustee's duty of disclosure. The Royal Court held that the settlor did not have any stewardship of the trust property upon which the duty to account, and hence disclosure, was founded. Therefore the settlor was not under any duty to disclose documentation to the beneficiary.

Conclusions

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Settlor reserved trusts can, potentially, be advantageous in the correct circumstances, but arguably are an absolute must if the specialist nature of the trust assets are such that it is essential the settlor or another with requisite expertise can exercise control or influence over their administration. However, it is essential that both settlor and trustees understand and know precisely their respective positions and powers and precise drafting of the trust instrument is crucial to achieving this.

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