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'Trust me': From here to indemnity

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The 'Trust me' series from Collas Crill's Guernsey International Private Client and Trust team is intended to highlight key considerations and provide practical pointers for professional trustees and corporate service providers on a variety of topics.

Indemnities can be a trustee's best friend or worst nightmare. They come into play in a variety of situations. In this guide, we look at the common instances where contractual indemnities should be sought, why they are so often a point of negotiation and the importance of getting them right.

What is an indemnity?

Simply put, an indemnity is security or protection against liabilities or losses which may arise.

Why do trustees need them?

A trust is not a legal entity, so trustees act in a personal capacity. Therefore, trustees can in some circumstances be personally liable for liabilities arising from their office as trustee. Provided a trustee has acted within the scope of its powers, not in breach of trust and within the realms of any statutory limitations, they can call upon the trust assets to meet liabilities. However, in certain circumstances, the trustee may not be able to call upon the trust fund to meet liabilities, or the trust fund is insufficient to meet potential liabilities. To mitigate such circumstances, a trustee would seek an indemnity to ensure it can be sufficiently recompensed.

When would you usually require one?

Trustees would most commonly seek an indemnity:

1. Upon transfer of trusteeship - a retiring trustee would usually seek an indemnity from an incoming trustee. This would be an express clause in an instrument of retirement and appointment of trustee, commonly known as a 'DORA'.
2. Upon the appointment of assets to a beneficiary or another trustee – a trustee would seek an indemnity from the recipient of the assets. Again, this would usually be an express clause within the instrument of appointment of assets.

In both of the above scenarios, the trustee is divesting itself of trust assets and reducing (or completely losing) the 'pot' it can call upon to meet liabilities.

When else might a trustee consider seeking an indemnity?

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Practically speaking, whenever the trustee wants to rely on a third party to compensate it for potential liabilities or losses when it cannot or wishes not to call upon the trust fund of the trust. For example, a contractual indemnity with a third party service provider, such as a property agent or an investment adviser. A trustee may also seek an indemnity in relation to a specific transaction it enters into.

When can they go wrong?

Indemnities can be inappropriately drafted so as to be either too broad or too narrow in scope.

To put it bluntly, indemnities may only be worth what the person giving them is worth. So if you know there is a risk that if you pursue that beneficiary he is unlikely to be able to meet any claim against him, there remains a risk to the trustee.

For a new or incoming trustee giving an indemnity to outgoing trustees, an indemnity that is too broad or the terms too onerous can pose various problems or risks and be administratively unworkable.

What specific points should trustees look out for?

There are some key aspects of an indemnity that trustees should look out for.

When receiving the benefit of an indemnity, eg when retiring as trustee or appointing assets out to a beneficiary:

- Who is being indemnified? Is the scope of the 'indemnified persons' appropriate? For example, should it cover a officers, employees and directors of a corporate trustee or heirs and estates of an individual?
- What limitations are imposed, eg are limitations on value of the indemnity and duration of the indemnity reasonable? Do they work in relation to that particular trust and its known value, activities and risks?

When giving an indemnity (or taking on the burden of an indemnity) e.g. when being appointed as new trustee and indemnifying the outgoing trustee:

- The duration of the indemnity – ensure this is not unlimited in time. It is common practice to negotiate a period of between six and ten years (sometimes up to 18 years), after which time the indemnity 'expires'. The duration chosen will depend on factors such as value, risk and the limitation period for possible claims.
- Limitations on the indemnity – it is important to ensure when you are giving an indemnity as trustee, that your liability is limited to the value of the trust fund in your possession and/or under your control from time to time. If liability exceeds the value of the trust fund, the indemnitee may seek to claim against a trustee personally.
- The indemnity does not go further than permitted under statute – section 43 of the Trusts (Guernsey) Law, 2007 (as amended) (the **Law**) relates to outgoing trustees and contemplates an outgoing trustee may require reasonable security, including an indemnity. However, s43(2) provides that the indemnity shall not, except with leave of the Royal Court or consent of all beneficiaries, be greater than that to which the trustee would have been entitled had it remained trustee.

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- Ability to pay out trust funds up to a set percentage (often around ten per cent) without having to seek an indemnity from the appointee in favour of a previous trustee. This is primarily for administrative ease.

Other points to watch for:

- Chain indemnities in favour of previous trustees – ensure they are not missed by checking all previous supplemental trust instruments, particularly DORAs.
- Negligence or gross negligence? Pursuant to Guernsey law, indemnities should not extend to liabilities for breach of trust arising from fraud, wilful misconduct or gross negligence on the part of the trustee. Often these are expressly carved out of an indemnity, but occasionally a point of negotiation is whether the standard '*negligence*' or '*gross negligence*' should be applied. The distinction can be important. The wording 'fraud, wilful misconduct or gross negligence' is directly lifted from section 39 of the Law, so the usual standard to apply in Guernsey is 'gross negligence', but advice should be sought on a case by case basis.
- Does a previous trustee need to be a party? Section 43(4) of the Law allows, in circumstances set out therein, for a previous trustee to enforce an indemnity in its favour notwithstanding that previous trustee is not a party to or signatory of that indemnity. DORAs are therefore able to contain chain indemnities in favour of previous trustees without the previous trustee being a party to the DORA. This can ease the administrative burden of having to involve a long-since retired trustee in current transfers. However, as with all matters, caution should be exercised around this area and advice taken.

Contractual indemnity versus lien

Section 44 of the Law provides trustees with a statutory non-possessory lien over trust property, which is another form of protection potentially allowing a trustee to reimburse itself from trust property. However, this is clearly a different protection to that of a contractual indemnity as the means of recompense differ. The section 44 lien is the right of the trustee, where it is not reimbursed from the trust property, to follow, recover and appropriate the trust property for the purposes of realisation, payment and reimbursement. Whereas under a contractual indemnity, a trustee would not seek reimbursement from the trust property, but would claim against the party that gave the indemnity. A possessory lien (i.e. physically holding on to/retaining ownership or control of trust assets) is another form of security a trustee may consider.

In our experience...

Thankfully, in practice indemnities are rarely called upon . However, they serve an important protection in what can be a risk-laden industry.

STEP do have standard form templates for indemnities that can be usefully consulted. But be aware that standardised, boilerplate indemnity clauses may not offer sufficient or appropriate protection. To make sure an indemnity would be enforceable and appropriate in scope, particularly where there are known or potentially foreseeable risks or liabilities or where values involved are significant, it is worth taking legal advice.

Read our previous guide 'Trust me' - what to inspect when you are expecting... a trust.

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