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Reserved powers trusts examined

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Overview

The vast majority of trust structures for High Net Worth Asian families contain reserved powers provisions. Yet too often, sweeping generalisations form the basis for an adviser's recommendation for the choice of an "RPT" jurisdiction.

Summary

When assessing the key differences between the legislations of the leading jurisdictions, Jersey and the Cayman Islands appear to be the best jurisdictions to minimise risk and enable the Settlor most freedom.

Guernsey law, surprisingly, does not permit the Settlor to appoint a non-professional investment manager.

Singapore law is the only jurisdiction to limit "Reserved Powers" to that of investment management only. The others are notably broad.

Singapore law has some pronounced weaknesses – (i) it does not provide for an express indemnity for a trustee who acts in compliance of a direction and (ii) a Settlor cannot grant his reserved power to a third party or to an Investment Committee (at least he cannot under the statute).

The popularity of reserved powers trusts is derived from the Settlor's desire to retain some measure of formal control over the trust property coupled with a trustee's desire to reduce risk.

Whilst most commentators agree that RPT legislation does not, for the most part, create new law, most too would agree that the reason for the enactment of reserved powers laws was to clarify the uncertainty that existed in common law between what is a permitted "reservation of power" and that which could be argued as either a bare trust, testamentary instrument, or sham.

The legal effect of a reservation

Each of Jersey, Guernsey, Singapore and the Cayman Islands legislations provide that the exercise of a reserved power will not invalidate a trust. However, with the exception of Singapore, the other jurisdictions go further and provide a protection to a trustee from an action of breach of trust if the trustee has relied on a reserved power direction.

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It is very important to have this protection. It takes the reservation of power to merely one which does not invalidate the trust to one in which the trustee can be safe to rely on. This reduction of risk to the trustee is critical to ensure that the Settlor can control the trust property in the manner he intends and the trustee can reduce time and cost not being involved in reviewing the exercise of the power.

The wording of the indemnity provisions in Guernsey, Jersey and the Cayman Islands, are different. The Cayman Islands provision refers to an "*otherwise valid exercise*"; Guernsey refers to a "*valid exercise of a power*" whereas Jersey simply provides that "*a trustee who acts in accordance with the exercise of a power is not in breach of trust*".

The use of the words "*valid exercise*" suggests that the trustee has some residual oversight duty to ensure that the power was being exercised validly. However, given the power is likely to be construed to be a personal power, validity might simply mean that a trustee was assured that the Settlor was capable to exercise the power.

Investment management

All of the jurisdictions offering RPT's have a form of wording to permit the Settlor to reserve to himself the powers of investment management of the trust property. Uniquely, the Singapore legislature deliberately limited reserved powers referring to "*any or all powers of investment or asset management functions under the trust or settlement*" (Section 90(5) of the Trustee Act). I am concerned at the vagueness of language adopted which might lead to litigation concerning the exact meaning of the section.

Art 9A(2)(d) of the Trusts (Jersey) Law, Section 15(1)(d) of the Trusts (Guernsey) Law, and section 14(e) of the Cayman Islands Trust law confer on a settlor reserved powers to give "directions" pertaining to "*the purchase, holding or sale of the trust property...*" The Singapore provision is worded slightly differently as noted above.

An area worth focusing on is the power to appoint an investment manager. The Singapore and Cayman Islands laws are silent on this specifically. On the other hand, Guernsey requires a *professional person* for an investment manager function. The Trusts (Guernsey) Law, 2007 limits the "reserved" power of the Settlor to reserving it to himself or, by Section 15(1)(f), the appointment of an "*investment manager or investment adviser or any other professional person...*"

By Article 9A(2)(f) of Jersey's law, contains no such limitation and permits the Settlor to "*appoint or remove an investment manager or investment adviser*" without a requirement of professionalism.

This is a critical point of difference between Guernsey and Jersey. For example, under Guernsey law it the issue is a little more complex. and, potentially, inconsistent. Given that a Guernsey reserved power is expressly a personal power, it is unusual that the Settlor could not appoint a non-professional as an investment manager, especially as the Settlor is free to *grant* any of the reserved powers to anyone, Presumably, if he were to do this, the grantee *could* exercise investment management functions under Section 15(d) without the need for a

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professional – so the scope of the power entirely depends on which subsection of the Law the Settlor chooses to use. Also, this does not accord with common law position.

In any event, it has real implications since the Settlor often delegates his investment management powers to another – including non-professional Investment Committees. It seems under Guernsey law the Trustee may be under a duty to step in if that person is not suitably qualified.

"Reserve to himself or grant to another"

It may come as a surprise to many, but the Singapore law, unlike that of the Cayman Islands, Guernsey and Jersey, does not expressly permit the Settlor to grant his reserved power to another person. Section 90(5) of Singapore Trustee Act enables a Settlor to confer to "himself" reserved powers of investment.

Given that High Net Worth families invariably wish to ensure that their trust survives beyond the Settlor, often with similar reserved powers being vested in a younger family member later, this is a significant omission under Singapore law. Furthermore, in sophisticated trust structures there is often a desire for their to be an Investment Committee, and there is not an obvious mechanism to do this under Section 90(5) of the Singapore Trust law. (perhaps this doesn't matter since no distinct protection afforded to a trustee by Section 90(5) in any event). For this reason, I certainly favours other jurisdictions if Investment Committees are to be used.

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