TRUSTEE DUTIES
A GUIDE FOR TRUSTEES

1. WHAT ARE TRUSTEE DUTIES?

1.1 **Trustee Duties:** The standards that trustees must observe in the administration and management of a trust arise from the duties that the law imposes on trustees. The law is contained in a strong line of cases argued over the course of many centuries in the Courts of Equity, coupled with the Trustee Act 1956 (New Zealand) ("Act") and cases argued under that statute.

Trustees of a trust generally possess wide discretionary powers and authority. That authority carries with it corresponding responsibility. Trustees owe their duties to the trust beneficiaries and in certain situations can be held accountable for their actions or failures to act.

The following discussion summarises some of the duties imposed on trustees and provides an introduction as to their practical significance to trustees. While the summary is not exhaustive, it may be useful for individuals considering taking up appointment as an independent trustee or becoming a trustee of their own trust.

The following list includes several of the most important duties expressed in general terms:

(a) the duty of efficient management;

(b) the duty to keep and render full and proper accounts to the beneficiaries;

(c) the duty to act personally; and

(d) the duty of loyalty.

1.2 **Duty of Efficient Management:** Trustees must take responsibility to ensure that the trust fund is managed in an efficient and economic manner. This duty can be summarised as follows:

(a) a trustee has a duty to get to know thoroughly the terms of the trust and to obey those terms;

(b) an incoming trustee must enquire into the propriety of the acts of an outgoing trustee;

(c) once appointed, the trustee should "take title" to the trust assets — if title is registered in the names of the trustees, then on the appointment of a new trustee all trustees have the duty to make sure that they hold title to the trust assets as joint tenants;

(d) trustees also have a duty to make sure that the title documents for the trust assets and the trust assets themselves are protected against improper use; and

(e) the most important duty is the general duty to take all those precautions which an ordinary prudent business person would take in managing similar affairs of his or her own.

1.3 Duty to Keep and Render Accounts: Trustees have the duty to keep and render to the beneficiaries a full and proper record of their administration of the trust assets. Some of the most important aspects of this duty are as follows:

(a) the trustees must keep proper accounting records and prepare financial statements relating to appropriate accounting periods;

(b) the trustees' general duties include the duty to provide other information to beneficiaries - beneficiaries are entitled to inspect "trust documents" unless there is good reason why they should not; and

(c) the trustees' duty of disclosure possibly goes beyond the information requested by the beneficiary - the trustees may have a positive duty to inform each beneficiary of full age and capacity of his or her rights under the trust document.

The duty to keep and render accounts is a duty imposed directly on trustees, but trustees do not have to prepare the accounts themselves. Unless trustees have appropriate skills or the trust affairs are very simple, the trustees should use qualified accountants to:

(a) keep accounting records; and

(b) prepare periodic financial statements and tax and associated returns;

for the trust. However, it is for the expert to advise and the trustees to decide. Trustees cannot delegate the exercise of their discretions, even to experts, unless they are specifically authorised to do so by the trust deed or by law.

1.4 Duty to Act Personally: A trustee has the duty to act personally in managing trust affairs. A trustee cannot delegate his or her powers and discretions.

While the non-delegation rule is the fundamental part of the duty to act personally, trustees must remain conscious that they:

(a) do not let others dictate how discretions should be exercised, although trustees are entitled to seek professional advice or to refer to relevant documentation such as the settlor's "memorandum of wishes";

(b) exercise their powers in a timely fashion and with reference to relevant facts and circumstances;

(c) act unanimously (unless the trust deed allows majority rule); and

(d) together are responsible for the trustees' decisions and actions — there is no room for a passive trustee.

There is a small number of exceptions to the general rule that trustees cannot delegate their powers:

(a) the trust deed may authorise delegation (it should also set out the scope of the delegation);

(b) under section 29(2)of the Act, any person may be appointed to act as the trustees' agent in the exercise of the trustees' discretions, trusts and powers relating to any property outside New Zealand; and

(c) under section 31 of the Act, trustees can delegate their trusts, powers and discretions to another where the trustee is incapacitated or absent from New Zealand.

Modern trust deeds normally contain general or specific powers to appoint agents. Typically, however, agents are only appointed to carry out a decision taken personally by the trustees. In appointing agents, there is a duty to make sure that the proper person is appointed and that that person is properly supervised.

It is important to remember that trustees, as the owners of the trust assets and persons responsible for their management, will be personally liable for any liabilities incurred in the performance of the trust. If a trust earns income, income tax will be payable on that income, and it is the trustees who will be personally liable to the IRD to pay that income tax.

1.5 Duty of Loyalty: The duty of loyalty has a number of aspects to it. In summary the trustees must observe the terms of the trust and manage the trust assets in the beneficiaries' best interests. The main aspects of this duty can be stated as follows:

(a) trustees should act exclusively in the best interests of all the beneficiaries of the trust, present and future;

(b) trustees should act impartially as between beneficiaries and in practical terms gain an understanding of the beneficiaries' circumstances;

(c) trustees must not profit from their position as trustee unless:

(i) this is expressly authorised by the trust deed;

(ii) all of the beneficiaries consent; or

(iii) court approval is obtained;

although a trustee may receive benefits from the trust as a beneficiary of the trust, if that trustee is also a beneficiary;

(d) trustees should not purchase trust assets or sell their own assets to the trust unless the above exceptions apply (of course settlors generally sell property to the trusts they have established); and

(e) trustees have a general duty to avoid putting themselves in a position of conflict between:

(i) their duties to the trust and its beneficiaries and their personal interests; or

(ii) their duties to the trust and its beneficiaries and their duties to others.

1.6 Prudential Investment: The Trustee Amendment Act 1988 ("Amendment Act") significantly changed the law relating to trustees' investment of trust funds. Before this amendment, trustees were required to invest in identified trustee approved investments. Now, trustees may under section 13A of the Act "invest any trust funds, whether at the time in a state of investment or not, in any property".

The Amendment Act has created the "prudent person" test to determine whether any particular investment by trustees may be a breach of duty. This test is applied to the trustees' methods used in the investment process rather than the absolute performance of the trust investments.

Failure to maintain the real value of the trust is not necessarily a breach of trust. Events such as the share market crash of 1987 resulted in losses even for the most prudent investors. A loss in these circumstances is not necessarily a breach of trust as long as the trustees have acted prudently in carrying out their duties.

Pointers as to whether trustees have invested prudently include whether they have an investment plan and have diversified their investments appropriately.

In certain circumstances, the settlors' intention behind creating a trust may simply be to preserve a particular asset for future generations. If this is so, thought should be given to specifying this intention in the trust instrument and abrogating the prudential investment requirements introduced by the Amendment Act (by expressing a "contrary intention" in the trust instrument). Otherwise, the trustees' prudential investment obligations may dictate that the asset concerned be sold to maximise both capital growth and income production from the trust assets, an action which may be totally undesirable to the settlors in terms of their original intention.

2. WHAT DOES A BREACH OF DUTY MEAN FOR A TRUSTEE?

2.1 Internal Consequences: For breaches of trust there may be internal consequences. This means the breach will give rise to consequences relating to the duties owed to the beneficiaries and their rights of remedy. These internal consequences are governed largely by the trust deed itself, although it is impossible to completely contract out of liability. Depending on the terms of the trust deed, breaches may have the following potential consequences:

(a) intentional breach of trust:

(i) a breach of trust involving dishonesty or an intentional act known to be a breach will give rise to personal liability to the beneficiaries;

(ii) there is no way of avoiding this consequence, although the effect can be limited by protecting your own assets;

(b) unintentional breach of trust:

(i) if you act honestly and in good faith and breach the terms of the trust, you should not be liable to the beneficiaries for the consequences of that breach provided the trust deed limits your liability appropriately;

(ii) negligence is a grey area and could potentially be treated as an intentional breach; and

(c) default of agent:

(i) you will not be liable for the neglect or default of a professional adviser or agent if they are employed in good faith and if they are adequately supervised.

2.2 External Liability: Trustees can also be liable to other parties whom they contract with as trustees. When you enter into a contract in your own name, you are normally personally liable. However, the right of indemnity contained in the trust deed and terms in the contract can reduce your liability to “trustee liability”.

Ideally:

(a) you will have the right under the trust deed to be indemnified for any liability or obligation that you incur as trustee; and

(b) the contract will contain a term stating that your liability or obligations will be limited to the assets of the trust.

Where you have contracted in your capacity as trustee, the other parties to the contract will not be able to recover against your personal assets to satisfy the obligation under the contract provided the following requirements are met:

(a) the right of indemnity is present and effective (ie, not nullified by any breach);

(b) the other parties to the contract are formally aware:

(i) that you are entering into the contract in your capacity as trustee; and

(ii) of the limited nature and extent of your liability;

(arguably this may be enough, as the other parties could not then claim that you are personally liable – however, consideration needs to be given to the express terms of the contract); and

(c) a limitation of liability clause is included in the contract in which you incur an obligation as trustee, so that the other contracting parties are bound by the exclusion of your personal liability.

Care must be taken with standard pre-printed bank documentation because standard independent trustee clauses do not usually achieve the full limitation of liability desired.

Once a proper trustee limitation of liability clause is included in a contract, your liability under that contract will be limited to the assets you hold in your capacity as trustee. In entering into that contract you should have the right to be indemnified from the trust assets.

2.3 **Potential Liability:** Trustees cannot avoid potential liability when they have lost their right of indemnity (which they will lose in the case of an intentional breach of trust and, arguably, negligence). In this situation you have:

(a) an internal liability to the beneficiaries for any loss to the trust (and possible exemplary damages for breach of trust);

(b) an external liability to any third parties; and

(c) no right of indemnity.

In this case, trustees may have full personal liability, both internal and external.

3. WHAT SHOULD TRUSTEES DO TO PROTECT THEMSELVES?

3.1 **Basic Steps:** Trustees should take the following basic steps to protect themselves against personal liability:

(a) familiarise themselves with the trust deed and any other documents under which they are incurring a liability;

(b) familiarise themselves with assets held by the trust and any liabilities and obligations it has;

(c) satisfy themselves that the trust can perform the obligations given the means and assets of the trust (not unlike satisfying a company solvency test);

(d) include a trustee liability limitation clause in contracts;

(e) possibly seek beneficiary indemnities from known and ascertainable beneficiaries if a transaction or obligation is particularly risky;

(f) actively involve themselves in the trust affairs rather than just passively;

(g) demonstrate obvious compliance by keeping detailed records and ensuring that:

  (i) regular trustee meetings are convened;

  (ii) trustee minutes recording all decisions and reasons for those decisions are signed and retained;

  (iii) the trust assets are insured and that the insurance policies are renewed and kept current (dwellings owned by family trusts and occupied by certain members of the family should be insured in the joint names of the trustees and the occupiers as co-insured as this may preclude the insurance company from seeking to recover loss from the occupiers by subrogation);

  (iv) all trust assets are maintained in good order and repair;

  (v) the income-producing potential of any investment assets is maximised;

  (vi) separate bank accounts are opened for the trust (avoid mixing of personal and trust funds);

  (vii) recommendations or proposals made by the settlors and/or co-trustees are critically reviewed (do not be afraid to express contrary opinions);

  (viii) trust funds are not mixed with other funds (whether of other trusts or not), or, if this is not possible, that costs, expenses and income are correctly apportioned between the trust and other entities;

  (ix) an accountant is employed for preparing the trust accounts; and

  (x) professional advice is taken when necessary (for accounting and investment advice, for example).

While this may seem complicated, the actual time required to administer a trust need not be great. The trustees should meet formally at least once a year to review investment portfolios, strategies, distribution issues, and to consider and approve the trust's accounts and balance sheet. Additional meetings and attendances may be required, depending on the nature and extent of the trust fund.

The trustees should also meet regarding major decisions such as the sale or purchase of a major asset. These decisions must be recorded in resolutions in the trustee minute book. Where meetings are held and resolutions approved over the phone, minutes from the meeting should be circulated and signed off by all the trustees as a record of the resolutions agreed on.

3.2 **Additional Options:** The following additional options should also be considered:

(a) section 49 of the Act provides that the trustees, or the person holding the power to appoint trustees, may appoint an advisory trustee (the settlor may be an appropriate candidate, if not already one of the trustees) — under section 49 subsection 3of the Act, the trustees can obtain and rely on the advisory trustee's advice on any matter relating to the trust, without being liable for doing so; or

(b) section 50 of the Act provides that a custodian trustee can be appointed in the same manner as a new trustee could be appointed – this role may be the most appropriate role for an independent professional trustee, if the trust deed allows any person to be so appointed (ie, the appointment is not limited to a corporation as it is under section 50 of the Act).

4. SUMMARY

The more complicated and varied the assets that are held in trust, the greater is the time required for administration of the trust.

For example, a trust with only one asset, such as a mortgage-free family home and all outgoings paid by the family members, would require very little administration and may not have to complete an annual tax return.

On the other hand, a trust with a substantial variety of assets, including income-producing investments, would require a lot of administration, not just in terms of the completion of an annual tax return, but also as regards the review of investment strategies and the on-going up-keep and administration of the assets themselves.