TRUSTEE COMPANIES' INTERNAL TRADING RELATIONSHIPS

Report of the Property Law and
Equity Reform Committee

Presented to the Minister of Justice
30 September 1982

PROPERTY LAW AND EQUITY REFORM COMMITTEE
REPORT ON
TRUSTEE COMPANIES' INTERNAL TRADING RELATIONSHIPS

To: The Minister of Justice

Reference

1. On 21 March 1980, through the Secretary for Justice, you requested the Committee to advise you on a proposal by the Trustee Companies that "they be entitled to benefit in their individiual capacity from business transactions and the receipt of commissions gained in the normal course of business". The purpose of this proposal is to allow trustee companies who conduct any particular business, e.g. as insurer, land agent and the like, to act in this capacity for the trusts of which they are trustees. It not infrequently happens that trustee companies will be associated directly, or through their subsidiary or shareholder companies, with other businesses, and the testator or settlor who established the trust would probably expect that these services would be used by the company in its capacity as trustee. There can be occasions when it is inconvenient and unrealistic to expect the trustee to go elsewhere to obtain services it could provide itself. The question the Committee has been asked to consider is whether these circumstances justify a departure from the general rule that a trustee cannot profit from the administration of his own trust.

Assessment of the Proposal

2. The general rule is that a trustee cannot undertake remunerative work on behalf of his trust without express authorisation in the trust instrument, or the express agreement of all the beneficiaries. The salutary consequence of this rule is that a trustee who breaks it cannot claim remuneration and is accountable to the trust for any profits he might have made by so acting. This is a long-standing and strictly maintained equitable rule, which is vitally necessary where a trustee is in sole charge of the trust's affairs, there often being little opportunity for close scrutiny of his actions, and the Committee cannot see sufficient grounds for departing from the rule in the present case. Still less does there seem any basis for such a departure in the case of trustee companies only, while all other trustees would be affected by the former rule; any reform would need to be more general in character, and could have ramifications to which the Committee is not prepared to assent. While the Committee accepts that the proposal has been put forward by the trustee companies in good faith in what they believe to be the best interests of the trusts they administer, the proposal is not one which fits in with the larger canvas of trustee law, and the principle that a trustee should not only act fairly, but be seen by the beneficiaries to act fairly and solely in the trust's interests.

Existing Position for Remuneration

3. The Trustee Companies Amendment Act 1979 provided, by the new section 18(2) that trustee companies may charge and receive remuneration of $100 or 5% of the total capital and income of the estate whichever was the greater and, by section 18(3), in addition to such remuneration,

> "... a reasonable fee or other remuneration for work done or services rendered by it in respect of any of the following matters that arise in the course of administration or management of an estate or trust ..."

and then are listed five specific matters and, as a sixth,

(f) Any other matter of an unusual or special nature".

Subsection 18(4) provides that any fee or other remuneration charged pursuant to subsection (3) is to be clearly identified in the estate accounts. It is the Committee's opinion that the provisions of the 1979 Amendment Act are quite sufficient to ensure that trustee companies are properly remunerated for their services (the additional charge for any additional services must be reasonable) and that the beneficiaries are properly informed of the additional charge so made (so that they may have it reviewed by the High Court if they wish).

4. The difference between these provisions, and what is proposed, is that they require full disclosure of all charges made by the trustee. The trustee companies' proposed clause would have read:

> "A trustee company shall not by reason of its fiduciary position whether pursuant to this act or otherwise be in any way precluded from making contracts or entering into transactions in the ordinary course of business, or undertaking any insurance financial or agency services, including investing or borrowing funds, with itself or its holding company or any of its subsidiaries or any subsidiary of its holding company or with any associated company and a trustee company shall not be accountable to any estate or trust for any profit arising from such contracts transactions or services provided however that this subsection shall not be deemed to empower a trustee company to do anything in addition to what it could otherwise do if the contract, transaction or service had been with any person or company other than the trustee company holding company, holding company subsidiary or associated company".

This could have the effect of allowing the trustee company to make undisclosed profits (e.g. by buying property from the trust and selling it on to third parties) which would not appear in the trust accounts. Nor would the size of the profit be limited in any way, or be confined to "reasonable" remuneration.

Existing Special Statutory Provisions

5. In their submission attention was drawn by the Trustee Companies Association to the provisions in section 11 of the New Zealand Insurance Company Trust Act 1916 and section 10 of the Pyne Gould Guinness (Limited) Trust Act 1934. The Trustee Companies Association submitted that these provisions have the same effect as a charging clause in the instrument creating the trust and that, in consequence, the respective companies are entitled, under existing law, to retain the profits of such use of trust assets.

6. The Committee accepts this submission so far as it goes but the Committee does not accept the implied assertion that these provisions negate, in the cases of these two companies, the equitable rule that a trustee must not profit from the trusteeship except so far as expressly authorised nor the implied assertion that the present proposal by the Trustee Companies Association for the suggested further amendment to the Trustee Companies Act 1967 would merely place all trustee companies on the same footing.

(a) Section 11 of the New Zealand Insurance Company Trust Act 1961 is, from the Trustee Companies Association's point of view, the stronger of the two provisions quoted. It provides (in part):

> ... and the company shall be entitled to transact the insurance business in connection with any estate it may for the time being be administering and receive in respect thereof all premiums properly chargeable therefor, in the same manner as it would have been entitled to do if it had not been a trustee of such estate.

It is important to note that this provision is merely a power ("shall be entitled to ...") and, being a fiduciary power must be exercised, not for the benefit of the company but for the benefit of the trust and the beneficiaries therein. Thus the Committee believes that the company is obliged to consider in each case whether there is sufficient justification for the exercise of this fiduciary power. It seems doubtful whether the decision can be made routinely, or in cases where there is no advantage to be gained for the trust if it is exercised in the trustee company's own favour.

(b) Section 10 of the Pyne Gould Guinness (Limited) Trust Act 1934 contains a proviso allowing the company to act as agent to sell lease or dispose of any property belonging to any estate committed to its charge and charging for its services in accordance with the usual scale.

... in all cases where it is expressly authorised so to do by the will, deed or other instrument creating or evidencing the trust, or ... charging and accepting

payment of any commission, remuneration, expressly directed by the will, deed, settlement or other document creating or evidencing any such trust.

This statutory provision is expressly applicable only in those cases where the trust instrument expressly authorises the company as trustee to undertake the particular activity and to charge for doing so.

These provisions are much more restricted than the powers proposed by the trustee companies, and do not establish any precedent for such legislation.

"In the Ordinary Course of Business"

7. The proposed provision contains a limitation (in one category of dealing) to transactions entered into "in the ordinary course of business", and the Committee considered the possibility that this restriction, if generally imposed, might prove a satisfactory safeguard. One of the difficulties with such a limitation is that, under the existing law, any such dealing with one's own beneficiary by definition cannot be an "ordinary" dealing. Presumably what is meant is that the dealing would be an ordinary one if entered into between strangers. It is unclear what safeguards, if any, are introduced by such a limitation. Nor would the Committee wish Parliament to encourage the notion that there can be any "ordinary course" about a trustee dealing with his own trust.

8. It may be that more satisfactory limitations can be imposed in respect of individual types of business or transaction; but the trustee companies are already free to have provision made for this in each individual trust instrument, where the testator or settlor can himself (under the guidance of an independent adviser) fix the limits of the business he wishes the trustee to do. The Committee would not suggest that it is in any way improper for trustee companies to seek and act upon such provisions, as long as their effect is brought home to the person creating the trust. But there is little advantage in legislation which would of necessity have to be generally drafted, and it could do considerable harm if it were seen as setting a precedent, and giving statutory force to a general power to deal with one's trust.

9. The Committee nevertheless recognises that the trustee companies, and others who are similarly placed, have a difficult problem when such questions arise. Clearly, the testator or settlor who has been associated with a particular company will expect that company to continue to perform the services - whether they be for insurance, farm management, supervision of investments - to mention but a few of the wide variety of activities they might be involved in - that the company has hitherto performed for him. At the same time, the relationship between the company and the trust must inevitably be a different one; particularly after the

settlor dies, there will be a greater need for the company's services and less opportunity for supervision of its actions by other members of the family. Nor is it unknown for children of a testator or settlor to have less faith in the trustee company than their parent would have reposed in it. It could be suggested that it is not altogether satisfactory that the relationships between the trustee company and beneficiaries should be governed entirely by arrangements made between the settlor and the trustee. A system of permission and corresponding safeguards which has been approved by the legislature could well carry moral force, and assist in the amicable resolution of complaints about the administration of the trust. Such a system would also put into legal effect what no doubt has become regular practice through provisions in trust instruments.

10. There seem to the Committee, however, to be two basic and insuperable objections to any such scheme. The first is the element of disclosure at two points in the process: (a) when the testator is drawing up the trust instrument; and (b) when the trustee is accounting to the beneficiary for the administration of trust funds. It seems important to the Committee that the settlor in such cases should give some thought, when he sets up his trust, to the possible conflicts of interest which may arise through his trustee's administration of the trust. Any statutory provision such as that proposed would relieve the settlor and his adviser of that difficult but necessary task. So too, when the trustee accounts to the beneficiaries, it will be practically impossible to say what is the profit element of the transaction to the trustee.

11. The second, more fundamental objection is the question of conflict of interest. Will the trust be better off because of the trustee's decision to choose its own, or its subsidiary's, services as opposed to those of outside organisations? After it has embarked on serving the trust, how frequently should the quality of the trustee's services be reviewed, and what criteria should be used in deciding to continue with them? When difficulties arise with the services given - e.g. the compromise of an insurance claim, or the negligence of a servant of the trustee which requires to be redressed - what decision is to be made? These are questions which require independent consideration; if the trustee is left to its own choice, it will be very easy to find compelling reasons, in the interest of the trust, for following the line of least resistance as the trustee deals with itself in the capacity as the operator of a business. It would indeed be possible to provide safeguards against this, for example: (a) an independent expert's assessment of available options; (b) full disclosure to the beneficiaries of all amounts paid to the trustee in its business capacity, with details of each transaction; (c) arbitration or independent assessment in the event of any dispute. However, it seems likely that in most ordinary business situations, the

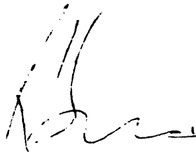
cost of complying with such safeguards (which would presumably be passed on to the trust) would make that option uncompetitive anyway, and thus defeat the object of the exercise. "The truth of the matter seems to be that, when a testator or settlor authorises a trustee company to act in this way, he is giving it powers which in practice beneficiaries and the courts will find difficult to supervise in situations of conflict of interest. The choice is one which should be made by the testator, not by statute."

Circumvention of the Existing Law

12. One point made to the Committee was that under the present law, there is some incentive for the introduction of commercial devices which have a similar effect and would not be disclosed to the beneficiary. The Committee has no knowledge whether such devices are used, and would not wish to attribute their use to the institutions which would be benefited by the proposed legislation; though certainly the point is germane to a more general reform of trustee law. From the Committee's point of view, however, it would be a matter of regret if the law were to be driven to an unsound principle because of persistent disobedience to the law. It would be preferable to strengthen the beneficiaries' hands in discovering and remedying such abuse.

Conclusion

The Committee is therefore unable to support the Trustee Companies' proposals.



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