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An Evolutionary Tale

When I arrived in the Cayman Islands just over thirty years ago this December one of the books I brought with me from London was the fourth edition of The Modern Law of Trusts by David Parker and Anthony Mellows. In their Preface the authors said that it was important for readers to be aware that the law of trusts was constantly, and rapidly, developing. I can see from reading the current ninth edition that this turned out to be an understatement; the statutes, it seems, cannot keep pace with the case-law. The fourth edition contained 415 pages whereas the latest edition has 979 pages.

This demanding section of the law has antecedents that go back even before time immemorial, that date determined in the Middle Ages as the limit of legal memory (which was, in fact, 3rd September, 1189, when the reign of King Richard in England began). And although Rome gave us the concept of wills, the nature of the trust (as understood under English law) was alien to the Romans, although there is clear evidence that even in the Roman law of contract, in force during Cicero's time, there existed a form of pact by which a transferee of property would promise to fulfil an obligation after transfer – even if, perhaps, the obligation would create only a potential in personam (personal) claim rather than one enforceable against the world (in rem).

In England the trust's predecessor, the use, began to feature in law in the second half of the 14th century. Even then, one of the objectives of the use was to avoid taxes, much to the chagrin of the Crown. It was eventually replaced by the trust in the early part of the 17th century, which, as we all know, made the matter of taxes even more vexatious, not just to the Crown but in more recent times to those cash-strapped members of the Organisation for Economic Co-operation and Development who have found their treasuries empty following the last two years of global economic crisis.

If trust law is in continuous development, it is perhaps comforting, then, to find that whilst English trust law might be in a constant state of flux, the principles which apply to the management of trusts are not and despite the passage of time, the fundamentals remain unchanged. Traditionally, trusts were often testamentary (stemming from the terms of a will) and lawyers acted as trustees; although the law allowed laymen to act as trustees, it was often advantageous to have a trustee with legal training – especially where administration was complex. The centuries-old role of the lawyer, however, was eventually supplemented by the advent of financial institutions acting as trustees; in some cases banks either created trust departments (like the one I audited in London as part of a bank inspection team or the one I was in charge of in the Cayman Islands) or they incorporated subsidiaries as

trust companies (such as the one I was a branch manager of in southern Africa). (In addition to pure trust work, as well as other related services, it is not unusual for institutions to act as executors also.) As trust business became big business independent trust companies (like the one I am Managing Director of in Panama) – and which were completely detached from the bankers – began to appear; often quite a few of these trust companies were formed by law firms themselves.

Once the management of trusts developed into a profession in its own right, it became clear that formal training in the field was necessary for non-lawyers. The Chartered Institute of Bankers in England (established near the end of the nineteenth century) introduced a Trustee Diploma which provided students with a knowledge, inter alia, of executor and trustee law, administration and accounting. The Institute of Bankers in South Africa (established in 1904 and of which I am a fellow) also introduced a Trustee Diploma which trust officers such as I myself studied for. Although Roman Dutch law prevailed in South Africa, the principles of the trust law of England arrived along with Lord Kitchener and his troops at the beginning of the 20th century; unlike the British soldiers, however, the influence of English trust law remained. It is perhaps a unique example of a foreign law blending with the legal code of another country (although not without some difficulties which remain to this day).

Cows and Competence

Trust officers worldwide now have their own society based in the United Kingdom called the Society of Trust and Estate Practitioners (I became one of its members in 1992) and which now plays a leading role in training professionals, particularly in the UK. Even so, neither a Trustee diploma from a banking institute nor STEP can substitute for a law degree; it is not meant to, but it provides, inter alia, a sound knowledge of the law of trusts. This concentration of specialised knowledge in a particular field of law – combined with continuous practical application every day –can make many trust companies, including banks with trust departments, repositories of a wealth of expertise which is not usually to be found in such crystallised form elsewhere. In fully respecting the importance of lawyers (particularly their knowledge of laws) one must remember that a skilled craftsmen can produce a fine pair of leather shoes without needing to have an intimate knowledge of cows from whence the leather came. Readers of the September issue of this newsletter may recall how the Greek artist, Apelles, recognised this.

The management of a trust should be viewed from several critical aspects, embracing the general terms of the trust, the specific trust powers (and who can exercise them) and the trustee's administrative powers. Equally important are considerations covering the possible revocation and amendment of the terms of the trust, as well as the trustee's relationship with income beneficiaries versus ultimate capital beneficiaries. Following on from this, the trustee needs to ensure that he avoids conflicts of interest, that he has a right to be indemnified, when appropriate, against liabilities and all the while being careful to avoid breaches of trust claims. (Pages, rather than paragraphs, could be devoted to each of these issues.)

So trust companies wishing to be successful for the long haul have to be concerned with the quality of the administration behind the trusts they manage. Management may take the view that if complicated legal problems do arise, they can always rely on a local law firm to bail them out. However, this hand-holding can be deceptive – particularly where either the lawyer is detached from the overall specifics of the trust or he is brought in too late (and at the same time assuming that he has specialised in trust law, rather than other areas of law). It is a sad fact, however, that whilst a trustee can obtain indemnification from following the guidance of the courts it does not follow that the courts will automatically indemnify the trustee (especially professionals engaged in the business of trust management) whose actions are based on legal advice received. Even the courts have

recognised the distinction between lawyers who specialise in trust law and those who do not.

Like banking itself, trust business began to eventually gravitate towards the emerging offshore financial centres. And yet despite the prevalence of offshore trust companies today, usually it is not until the average person uses one that he begins to understand just what it is trust companies do: everyone understands the relationship between a trust and a lawyer, but a trust company? This corporate tag often mystifies and the blank looks which I wrote about in this newsletter in June, 2005, (Volume 8, Number 2) still appear on the faces of many people today. So for the benefit of more recent readers who are not professionally connected with trust work in any way, it is worth going back over, as well as repeating, some salient issues which will be just as relevant in the second decade of this century we are entering as they have been in the first one.

Journey's End

Both as a practitioner and a former bank and trust company regulator I have encountered businessmen anxious to acquire either an offshore bank or trust company licence. In many cases the motives have had more to do with egos than enterprise; as if such a licence was a badge of success to be worn with entrepreneurial pride. As we have seen, banking in particular can prove to be a precarious profession and although the capital requirements for an offshore trust company are not too difficult to meet, if getting a trust company licence is perceived to be a consolation prize, it is one which may offer little consolation to the holder because the responsibilities it brings can be more onerous, in many respects, than those of the trust company's cousin, the bank. Civil suits in particular – as opposed to criminal suits – are the real danger.

There are similarities between banks and trust companies in that both manage assets. But a trust company, unlike a bank, isolates its trust activity from its balance sheet; in the case of a bank, its audited accounts incorporate customers' deposits and loans, because these have an intrinsic link with a bank's financial health. The depositor, in a way, is the bank's partner and if it fails, the depositor can lose his money. Where a bank does happen to engage in trust work, the auditors recognise that the trust assets under management cannot be pooled with the bank's own assets; this firewall means that the bank's fate is detached from the assets of its trust clients – unless, of course, the bank, in its role as trustee, has become a depositor in its own institution.

Importantly, just because the applicant for a trust company licence is a bank or large corporation, such as an insurance firm, this is not sufficient reason to short-circuit essential elements of the licensing process. The same attention given to a bank's capital by Regulators should be paid to the ability of the applicant to provide an adequate level of expertise in trustee law, accounting and administration. If the level of expertise is inadequate, then this could be akin to a bank's capital reserves being insufficient. It follows, therefore, that a corporate trustee's real strength, like that of a law or accounting or other professional firm, lies in the reservoir of skills which it has at its disposal.

As in the case of small family businesses (Germany comes to mind) it does not always follow, as I have frequently said, that size bears any correlation with competence. Ask the legions of disgruntled customers of some banks with an international reach not dissimilar to that of Coca-Cola but whose general service record is abysmal. Clearly, second tier, but well-established, trust companies which have been in business for many years with a continuity due to minimal senior staff changes have their attractions: transient trust officers abound these days, especially in large banks and trust companies, and getting acquainted (as well as comfortable) with their replacements is the bane of many a client's life.

Unlike airlines, sensible trust companies don't categorise clients by creating the equivalent of coach, business and first-class passengers. Whether a client's assets are, say, six-figure (coach), seven-figure (business) or eight-figure (first class) all should enjoy the same level of comfort and be served champagne;

but like sensible airlines they too should ensure that the pilot who is at the controls is experienced with a proven track record.

The many directions in which the subject of trust management could go at this point and the number of words required would exceed this newsletter's maximum word count so let me just end by telling my readers what I am sure a large number of them already know: that the source of knowledge is reached by many pathways and no matter which path you take as long as you reach your journey's end, that is all that counts; although the Chinese emphasise the importance of the journey rather than the destination, trust work demands the opposite. Bankers in the last two years who made mistakes on Wall Street (should Manhattan be renamed Follywood as the East coast centre of make believe?) often did so from greed; trustees, however, don't need to be greedy to land themselves in trouble far more quickly than any banker: being honest but lacking the necessary skills will do that.

Reading Parker and Mellows on trust law keeps the feet of trust professionals such as myself on the ground and is a reminder that there is always more to learn. Smug trustees, on the other hand, are dangerous and they should heed the words of Johann Wolfgang von Goethe, Germany's 16th-century natural philosopher: "There is nothing more frightening than ignorance in action".

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Engaging an offshore representative is an important decision and we advise all persons to seek appropriate legal and tax advice from professionals licensed to render such advice before making offshore commitments.

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