

The role of trust protectors – food for thought

Article by Stephen Abletshauser

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What is a protector and is it a useful role?

The role of protectors is still a grey area in many senses. Are they quasi-trustees or are they just a safety valve? What kind of powers do they have? What is the tax treatment of trusts with onshore protectors? Can they be removed and if so, how? Who should be a protector? Can protectors be liable for their actions? Here we will briefly examine these and other questions with the conclusion that protectors should have limited powers only, in part due to taxation risks and in part to fetter their control of trusts. Certainly, we believe that protectors should never be a settlor, beneficiary and protector of a trust¹ however they are an indispensable part of modern trusts in an ever-changing, challenging world (see Bayern Legal's articles on Sham trusts: <https://bayernlegal.com/considering-sham-trusts-trust-basics-and-trust-alternatives/>).

A protector should, in our view, primarily inform and nurture beneficiaries as a quasi-settlor. Concurrently, protectors should also guard trusts from themselves, for example, from rogue trustees, overcharging or underperforming investment managers, frivolous beneficiaries, changes in trust laws, trust jurisdiction instability and increase in taxation.

Finally, as food for thought, we set out several factors and perspectives on the protectorship role which settlors and their advisers must consider when setting up a trust, to help the trust succeed for its duration. We also explain the basic situation for protectors as regards legal standing, liability, reporting issues, and the usually fiduciary nature of their powers.

So, what is a protector?

The protector of a trust is not a trustee; a protector is someone who has some control over how trustees exercise their powers. Protectors are supposed to ensure trustees are managing trusts and their assets in accordance with their mandate and considering all relevant factors.

The protector is usually appointed by the settlor, and a protector's powers – be they negative (e.g. power to block all trustees' decisions or only decisions to make distributions to beneficiaries or to make trust investments), or positive (e.g. the exercise of a power to make fundamental changes to the trust, such as adding or removing beneficiaries or trustees), are stipulated in the trust document.

Case law has sought to define protectors thus. In *Steele v Paz* [1993-95] MLR 426 (Isle of Man), a protector was described as "a person... with power to scrutinise and veto proposed decisions of the trustee...to ensure that the settlor's wishes would be given proper consideration without jeopardising his fiscal objectives. Such a person would not be a (professional) trustee and... would be independent of the settlor, who could not, therefore, be said to have retained any control over the trust funds."

There is however no statutory definition of the term 'Protector' in the laws of Barbados, New Zealand, the British Virgin Islands, Cayman, Jersey or Guernsey. The same position has sometimes been described as an 'adviser', 'appointed person', 'appointor', 'supervisor' or 'guardian'. Nevertheless, 'protector' is the most common title. Whichever term is chosen, the protector will be named in the trust document. Often this is by reference to a particular individual or company (for example, 'Mrs X or 'Protector 1 Limited'). However, it is also possible to define the office by reference to a position that may be held by different people (for example, 'the person appointed under clause X' of the trust document).

There is no legal requirement to appoint a protector when creating a trust, and indeed many trusts do not have protectors. We feel it is highly advisable to have a protector. It is usually a decision of the settlor alone. Where the trust document does provide for a protector, however, the purpose of the role is to vet and oversee the trust and its workings.

What if a trust needs a protector and does not have one already?

In *Re the Circle Trust, HSBC International Trustee Ltd v Wong and Others* (2006) 9 ITELR 676, the Grand Court of Cayman Islands considered whether beneficiaries had the power to appoint a protector, where no protector had been appointed under the trust deed. It was held that a protector (unlike a trustee) is not a creature of equity. A protector's existence and powers were held to be based on the written trust instruments (or legislation) alone, and so the position of protector is a 'pure construction' of the trust deed. Critically, it was further decided that the sui juris beneficiaries had the power to appoint a protector, and that the protector could exercise his fiduciary power only for the benefits of the beneficiaries.

For a time of dire need

There may be personal reasons for appointing a protector (e.g. close connection with a family business which is specialised and entwined in various ways with the trust), or as a safeguard. (There are, sadly, many unscrupulous trustees and trust investment advisers, and who make decisions to make secret profits rather than to benefit the trust, its aims, and beneficiaries). Leaving aside mistrust, a trust can be affected by taxes evolving globally, and a sound jurisdiction (or trust company) now may not be so in 10- or 20-years' time. Having a protector to hand when trouble erupts in a certain country – consider Hong Kong at the time of writing, on 29th May 2020 – who can allow the trust to move jurisdiction, is more than ever desirable.

Bear in mind also that so called 'flee clauses', which allow trusts to automatically 'flee' a certain jurisdiction upon the occurrence of certain events, are by no means as robust as you might like them. If they do not work in practice the entire trust's assets could be swallowed up in a coup, war, or revolution. 'Fleeing' trusts are prone furthermore to legal attack or rejection from the jurisdiction of exit and proposed entry, respectively, especially if the trusts carry financial or political importance.

Who should be a protector?

The choice of who to appoint as protector is wide. However, as you may have surmised, a professional person with deep knowledge of trusts and taxes, who has the best wishes of the beneficiaries and settlor at heart, is

ideal. The settlor can, technically, be a protector. However, if so, the settlor should never also be a beneficiary, in our view, lest the trust might be deemed a sham: the trust assets in such cases could be deemed not to have been disposed of genuinely. Beneficiaries can be protectors, although this may lead to conflict and conflict of interest with other beneficiaries (or might even be fatal to the trust²). A trusted professional friend or relative often undertakes the office. In some cases, the settlor might prefer to appoint a professional protector, like Bayern Legal, which would perhaps be more likely to act impartially in the event of a family dispute, whether among the beneficiaries or between the trustees and a beneficiary. The only likely practical restriction is that the protector would not normally also be a trustee, as this would defeat the purpose of having a separate role, but there is no legal restriction on this.

Powers

Protectors are generally treated by courts as fiduciaries and so owe a duty of care to the beneficiaries. Whenever the protector's involvement is required, he must consider what course of action is in the beneficiaries' best interest, and the courts can remove any protector who is not in line! This is an action which carries a psychological and financial burden and is therefore best avoided – see *Alhamrani v Russa Management* (2010) (Jersey), *Re the Circle Trust* (2006) (Cayman), *op. cit.*, *In the Matter of the representation of C, D, E and F*, *In the Matter of the A and B Trusts* and *In the Matter of Articles 51 and 53 of the Trusts* (Jersey) Law 1984 (as amended). Remember, protectors are considered under the CRS to be settlors of a trust (see Reporting Issues below). Whether a power is fiduciary or personal will depend on the proper interpretation of the relevant trust document – see *Re Bird Charitable Trust and Bird Purpose Trust and Bird Purpose Trust Basel Trust Corporation* (Channel Islands) Ltd v *Ghirlandina Anstalt and others* (2008) (Jersey).

What is the difference?

Where a protector has a fiduciary power, she must actively consider whether to exercise it. If the protector does exercise a fiduciary power, she must exercise it in good faith and should consider the interests of the beneficiaries. The protector must not profit from the exercise of a fiduciary power.

Personal powers can be limited or unlimited. An unlimited personal power is unrestricted, and the protector can exercise the power for her or his own benefit or purpose or any purpose. Clearly, many settlors and beneficiaries would like to prevent protectors from having unlimited personal powers. Limited personal powers are more like fiduciary powers, however. They can only be used to benefit specified persons, and they must be exercised in good faith i.e. for the trust beneficiaries. However, where there is a personal power, there is no duty to consider whether to exercise these powers and the protector will not usually be required to consider the interests of the beneficiaries as a whole! To ensure the powers will be considered as fiduciary, planning before settlement of any trust is key.

Can courts regulate protectors as we understand they have wide powers?

Where a protector is found to hold fiduciary powers, a court may exercise its inherent jurisdiction to:

- appoint a protector if there is a vacancy which cannot be filled by the mechanisms of the trust – see *Re the Circle Trust* (*op cit.*).

- remove a protector – see In the Matter of the A and B Trust op cit or declare an appointment of protector invalid – see In the Representation of Jasmine Trustees Limited (2015) (Jersey)
 - set aside the exercise of a power where the power has not been properly exercised.
- This potential for regulation of protectors should reassure settlors and beneficiaries alike.

What legal standing?

Although the courts have not yet fully identified when a protector can bring legal proceedings, it is accepted that he has standing to do so in any matter relating to the exercise of his powers under the trust or in any matter where his powers are relevant.

Wide powers are the rule rather than exception

Examples of positive powers include the appointment or removal of trustees, advising the trustee to act in a certain way, adding or removing beneficiaries and transferring the trust to a different jurisdiction.

Negative powers typically involve requiring the protector's consent before the trustee can do something – for example, transfer assets to beneficiaries, make decisions relating to any substantial trust investment or amend the class of beneficiaries or the terms of the trust generally. In some cases, trustees are merely bound just to keep the protector informed of any such material actions or changes. The codified potential powers permitted under BVI law³ are extensive, to say the least.

Protectors' roles in court cases have been construed as requiring protectors to ensure the trustees have due regard to the settlor's wishes, not to ensure that the settlor's wishes are always carried out. This ties in also with their CRS and reporting classification. That said, as life and circumstances evolve after the passing of a settlor, trustees are and must be flexible, having regard to changes in relevant circumstances. This was underlined by the Jersey case of the Matter of the A Trust [2012] JRC 169a.

Protector's liability

The extent to which a protector is potentially liable for any loss which arises to the trust or the beneficiaries due to the exercise of his powers is not settled in cases yet. Any trust which includes provision for a protector should deal with the liability of the protector. It is common for the protector's liability for his actions to be limited or excluded in the trust document. Whether or not a clause excluding liability is valid will be determined by the courts of the jurisdiction of the trust. A clause excluding the protector's liability for negligent breaches of duty may be held to be valid, whereas a clause purporting to exclude liability for fraudulent, dishonest or reckless breaches of duty may be held to be invalid, as you might expect.

Protector's remuneration

A protector will usually have a right to be reimbursed for any expenses he properly incurs in carrying out his duties to the extent that such duties are fiduciary. However, he will not have a right to be paid for any services he provides to the trust unless the trust document (or any applicable statutory provision) expressly provides for such remuneration, so protectors beware!

Reporting issues

Information on a protector of a trust, including personal information (such as the protector's name, address, jurisdiction of tax residence and tax identification number), and financial information in relation to the trust may have to be reported to the revenue authority of the jurisdiction in which the trust or trustee(s) is resident (or in which the trust holds financial assets) under new financial account reporting obligations imposed by US FATCA, UK FATCA and the Common Reporting Standard.

This classification groups protectors with settlors, which tallies with the role courts deem protectors to have, namely as someone advancing the settlor's wishes and interests in the trust. Of course, not every protector would like her or his name bandied about the world under the CRS – out of principle, not least due to some of the mega privacy breaches we actually know about. For example, in Bulgaria, sensitive personal and financial information of 70% of the population was compromised by a hack!⁴

Food for thought

There is much to consider when drafting a robust trust deed, and the position of a protector should be taken extremely seriously. The ill-advised can find their families embroiled in open dispute with protectors for many, costly years.

Issues to consider when including a protector might include the following:

1. Who may be appointed as a protector? Can there be more than one protector?
2. Must a protector have active, working professional knowledge of international tax and private client law?
3. What is the tax situation of the protector and might her tax residence compromise the structure's tax position negatively? Note that Canadian or Australian courts might view protectors as trustees for tax purposes.
4. Where provision is made for there to be more than one protector, consider:
 - a. whether the co-protectors must exercise their powers jointly, or may exercise them jointly and severally,
 - b. how decisions are to be made, eg unanimously or by majority (here considering also the tax position), and
 - c. how any deadlock may be resolved?
5. Who is to have power to appoint successor protectors?
6. Can the protector appoint his own successor and, if so, how? Surely this could lead to disaster?
7. How can a protector retire?
8. In what circumstances will a protector automatically cease to be the protector?
9. Who can remove the protector and how?
10. What happens on the death or bankruptcy of a protector?
11. What happens if the protector loses mental capacity?
12. What happens if the protector's independence is compromised financially by certain actors within the trust matrix – this could be tricky to prove?
13. What powers is the protector to have? Yes, this is not the only consideration!
14. Does the protector hold powers as a fiduciary or personally? How we exclude the possibility of personal powers which can be biased?

15. How are the protector's powers to be exercised and what formalities must be complied with for the exercise of a power to be valid?
16. Can the protector delegate his powers and under what circumstances?
17. Should there be an exoneration clause?
18. When should exoneration not be limited?
19. Is there a de minimis level to be agreed where protectors can benefit from the trust?
20. In what circumstances should the protector be remunerated even if she is only acting as a friend?

How we can help?

Protectors have an invaluable role in any trust. Beneficiaries are often in the dark about their rights and protectors should facilitate in helping bridge that gap. Bayern Legal has many years' experience in offshore trusts and can provide a regulated, experienced but impartial protector to families and their trusts. In cases where there are potentially errant protectors, Bayern Legal can help evaluate and seek amendments to a trust structure to ensure it is being managed properly.

The legal framework in which trusts (would you settle a trust in Hong Kong right now?), investments (will Covid-19 result in a deflationary cycle for assets of any hue?) and beneficiaries (who move abroad and marry internationally so much more) exist is changing rapidly, so modern-day trusts need skilled protectors to help trusts adapt as required. Protectors provide a much-needed lever to guide trusts through the many uncertainties now and in the future.

Protectors also exist to give beneficiaries confidence that their trust is being administered correctly and that beneficiaries are being listened to, not least when the settlor who understood the trust may have since passed on. Settlers should know that their protector will maintain that confidence and ensure the beneficiaries are benefitted properly by the trust and its aims.

End Notes:

1. *Indeed, being a protector and settlor was well examined in the New Zealand case of Clayton v Clayton (2013) – see the sham Topic trust article by the author for further analysis*

2. *Mezhprom Bank v Pugachev [2017] EWHC 2426 (Ch)*

3. *The powers of a protector as set out in s86(2)(a) of the Trustee Ordinance 1993 (as amended in 2003) (BVI) may include:*

- *appointing, removing and replacing trustees if the protector is dissatisfied with their performance;*
- *vetoing trustee decisions;*
- *including and excluding beneficiaries from the trust;*
- *withholding consent from specified actions of trustees either conditionally or unconditionally;*
- *advising the trustees and giving directions; and*
- *modifying the trust as time goes on, if the list of beneficiaries can be passed on for generations.*

Crucial powers may include:

- *changing the situs of the trust;*
- *changing the forum of administration of the trust and the governing law of trust;*
- *terminating the trust under certain defined conditions;*

- *amending the trust for any valid purpose, such as to respond to changes in tax law; and*
 - *altering the beneficial interests in the trust, such as to add or remove beneficiaries.*
4. <https://www.reuters.com/article/us-bulgaria-cybersecurity-idUSKCN1UB0MA>

Bayern Legal Limited is a law firm registered in England and Wales regulated by the Solicitors Regulation Authority.

Contact: Stephen Abletshauer
Registered office: 23 Berkeley Square, London W1J 6HE, United Kingdom
Phone: +44 (0) 207 788 7631
Email: stephen@bayernlegal.com
Website: www.bayernlegal.com

