MyFiduciary
Governance & Investment Support

The Trusts Bill, the Duty of Disclosure and Investment Governance: What Trustees Need to Know

Executive Summary

This paper discusses from an investment governance perspective the new Trusts Bill and its clarification of trustees' disclosure obligations. The paper aims to help trustees who oversee trusts with investments better understand their disclosure obligations. We also discuss how improving investment governance practices can mitigate the reputational and liability risks that arise from disclosing trust information. Along with general trustees we consider the position of trustees providing trustee services through their professional (legal or accounting) practices. Such firms stand to benefit from independent expert resources that address key investment governance responsibilities, such as investment provider due diligence.

Introduction

In 2009, the Law Commission began a comprehensive review of New Zealand's trust law. This paper was written in reference to the Trusts Bill 2017 (the Bill), as reported from the Justice Committee. The Bill was initially introduced to Parliament for consideration in October 2017. At the time of writing, the Justice Select Committee had issued its final report on the Bill, on the 31st of October 2018. The Committee's recommendation was that the Bill should pass with some minor amendments. The Bill is currently on its second reading where the House will debate the Justice Committee report and vote on the proposed changes. As such, please note the Bill and the conclusions we draw from it may be subject to change during its third reading and final passage through Parliament.

The Law Commission found that while trusts are extremely common in New Zealand (it estimated there are between 300,000 and 500,000), the law of trusts is neither well understood nor easily accessible for many trustees and beneficiaries. It stated:[1]

"The growth in the number of trusts has inevitably led to trust law issues coming before the courts more frequently and necessitated more people grappling with trust law. With family trusts in particular becoming more common, more non-experts are playing roles within trusts and should be aware of their rights and obligations."

Trust law is found mostly in case law, but also in legislation. The key statute is the Trustee Act 1956, which the Commission has described as containing "some of the most lengthy and technical provisions on our statute book" and being "increasingly irrelevant to modern day legal practice"[2]. Consequently, the Law Commission has recommended that the Trustee Act 1956 be repealed and replaced with a new Trusts Act that modernises and clarifies the law of trusts, setting out several fundamental trust principles (such as the duties of trustees) that are currently found predominantly in case law.

The new Trust Bill aims to clarify trustee's duties and information obligations. One important provision is that it hopes to make it clear to trustees that they have an obligation "to have regard to

[1] Law Commission *Review of Trust Law in New Zealand: Introductory Issues Paper* (NZLC IP19, 2010) at [4.41].
[2] At [4.46] and [4.37].

the context and objectives to the trust when performing both their mandatory duties and their default duties"[3]. The intent of the Bill is to make sure that trustee's duties directly relate to the terms, context and objectives of a particular trust[4]. For trustees who oversee investments in a trust, this means a core requirement is to know standards, laws and trust provisions.

Disclosure of trust information to beneficiaries is one area of law that will be clarified in the new Trusts Act[5]. A trustee's duty is to be accountable to beneficiaries and manage a trust in accordance with the terms of the trust and trustee duties. However, trustees must balance these principles with other considerations when deciding whether to disclose trust information to beneficiaries[6]. Many trustees are unaware of what their obligations are when faced with this situation. Issues in this area were under the spotlight in the New Zealand courts, culminating in the Supreme Court's judgment in *Erceg v Erceg*,[7] which clarified the approach trustees should take in deciding how to respond to a beneficiary's request for trust information. The Bill in its current form incorporates many of the elements of this case.

The Bill's approach to disclosure will pave the way for increased awareness of beneficiaries of their right to be informed and hold trustees to account. This is in-line with the transparency and accountability focus of the new Financial Advisers Amendment Act (2019), which regulates advice provided to retail investors, and increasing transparency in larger scale 'wholesale' investment entities, such as KiwiSaver providers and New Zealand Community Trusts. An implication is that the new Trusts Act will only increase the reputational and liability risks trustees face if they do not properly apply prudent investment governance practices and oversight.

What is Investment Governance?

Investment governance is a specialised discipline focusing on the legal duties of care and loyalty (fiduciary obligations) owed by **investment fiduciaries**.

Investment fiduciaries are usually people who either give investment advice or oversee the assets of another party and who stand in a special relationship of trust, confidence and legal responsibility. In this paper, we focus on those investment fiduciaries in governance roles, **Investment Stewards**. Investment Stewards are often trustees who oversee the investment of money or assets for the benefit of other people or charitable purposes.

Investment governance seeks to define what investment fiduciaries should do and the systems and processes they should have in place in order to fulfil their fiduciary obligations relating to investments to the greatest possible extent. It involves working to a defined, objective fiduciary standard and conducting assessments of investment governance practices in order to outwardly demonstrate the adopted processes are consistently and effectively applied. Good investment governance helps ensures trustees follow sound decision-making processes when devising an investment strategy and selecting and monitoring investments and investment service providers.

Fi360 Pacific provides education and training in investment governance best practices with reference to an objective fiduciary standard devised by Fi360 in the United States and MyFiduciary, a sister

[3] Trust Bill, as reported by Justice Committee. Justice Report Commentary, at [5].
[4] Clause 19(A).
[5] Clause 45-51.
[6] Clause 48.
[7] *Erceg v Erceg* [2017] NZSC 28.

company to Fi360 Pacific. Fi360 Pacific assists organisations and boards with the implementation of investment governance practices.

The Trusts Bill on Disclosure of Trust Information to Beneficiaries

General legal principles

The Bill significantly improves the accessibility of the legal principles that should guide trustees when managing disclosure of trust information to beneficiaries. As noted by the Justice Committee, the Bill seeks to incorporate the most fundamental principles of common law as well as strike a balance between prescription and flexibility[8].

The Bill attempts to balance the general principles from case law that have now been affirmed by the Supreme Court in *Erceg v Erceg*. A beneficiary has a right to have the trust properly managed and hold trustees to account, which is a key foundation of trusts, and the right to seek disclosure of trust information from trustees is ancillary to this[9] . However, it is also important that trustees are free to act autonomously in the exercise of their discretions under the terms of the trust and, therefore, are usually permitted to keep the reasons for their decisions confidential[10]. Further, whether and what information should be disclosed will depend on the obligation the beneficiary is seeking to enforce and other considerations, such as confidentiality[11]. In deciding whether to disclose trust information, trustees must identify the course of action that is most consistent with proper administration of the trust and the interests of all beneficiaries, not just the beneficiary requesting disclosure[12].

What does the Trusts Bill actually say about disclosure of trust information?

The Bill proposes a general obligation for trustees to make enough information available that is "reasonably necessary" for the beneficiaries to enable the trust to be enforced[13]. The Bill also establishes two presumptions in favour of disclosure of information to beneficiaries, with which trustees may decide not to comply only if certain factors weigh against disclosure.

The first presumption is that a "trustee must notify basic trust information" to beneficiaries[14]. This means that trustees will need to provide basic trust information to beneficiaries and will need to consider whether to make this information available at regular intervals. In the Bill **Basic trust information** is defined to include[15]:

- the fact that that person is a beneficiary of the trust;
- the name and contact details of the trustees;
- any appointment, removal and retirement of a trustee; and

[8] Trusts Bill, as reported by Justice Committee, at [1].
[9] *Erceg v Erceg* [2017] NZSC 28, at [49].
[10] Clause 36.
[11] Clause 47(2)(b) and Clause 49(b).
[12] At [53].
[13] Clause 45 a(ii).
[14] Clause 47.
[15] Clause 47(3).

- finally, the fact that the beneficiary has a right to request a copy of the terms of the trust or trust information. In principle this could include documents such as the Trust's investment policy, due diligence files, and financial reporting on the trust. See below for further discussion on what the information could entail.

The second presumption is that when a beneficiary requests trust information, trustees must give them that information within a reasonable period of time following the request[16].

Trustees can only decide against making information available despite the above presumptions after considering certain factors, bearing in mind their general obligation to disclose enough trust information to enough beneficiaries to enable the trust to be enforced[17]. The factors that trustees must consider are[18]:

- the nature of the interests in the trust held by the beneficiary making the request and other beneficiaries, including the likelihood of the beneficiary receiving trust property in the future;
- whether the information is subject to personal or commercial confidentiality;
- the expectations of the settlor at the time of settlement of the trust as to disclosure of information to beneficiaries;
- the age and circumstances of the beneficiary making the request and of the other beneficiaries;
- the effect of disclosing the information on trustees, other beneficiaries and any third parties;
- in the case of family trusts, the effect of disclosing the information on relationships;
- in a trust that has a large number of beneficiaries or unascertainable beneficiaries, the practicality of giving information to all beneficiaries or all members of a class of beneficiaries;
- the practicality of imposing restrictions and other safeguards on the use of the information (for example, by way of an undertaking or restricting who may inspect the documents);
- the practicality of disclosing some or all of the information in redacted form; and
- the nature and context of a beneficiary's request for information.

Therefore, the Bill leaves room for trustees to withhold information where it would be damaging to disclose it, as was the case in *Erceg v Erceg*[19]. Also, where a beneficiary seeks a variety of documents, each document or class of documents may need to be evaluated separately based on different considerations[20]. However, the Bill's presumptions in favour of disclosure and the requirement that trustees inform beneficiaries of their right to request trust information will likely result in beneficiaries becoming more aware of their rights and more interested in how trusts are managed. This increases the reputational and liability risks facing trustees, especially those trustees

[16] Clause 48.
[17] Clause 49.
[18] Clause 49.
[19] In that case, the plaintiff sought a wide variety of documents and the trustees declined to disclose any of them to the plaintiff. The Supreme Court upheld this decision for several reasons, including, for example, the beneficiary's remote interest in the relevant trusts (he was not a named beneficiary of either trust, but one of a class of primary, secondary or final beneficiaries), commercial confidentiality of some documents sought and the potential for the plaintiff to harass other beneficiaries if their identity was disclosed.
[20] *Erceg v Erceg* [2017] NZSC 28, at [56].

who have not followed good investment governance practices such as putting in place an Investment Policy Statement (IPS) and ensuring sound due diligence and monitoring processes are followed.

What Do the Trustee's Duties in the Trusts Bill Mean from an Investment Governance Perspective?

As mentioned above, the Trusts Bill sets out the duties of trustees. Trustees' duties are divided into those duties that cannot be excluded or modified by the terms of the trust (mandatory duties) and those duties that can be modified or excluded by the terms of the trust provided such modification or exclusion is not inconsistent with any of the mandatory duties.

The focus of investment governance as a discipline is to help entities put practices and processes in place to ensure trustees fulfil their duties in respect of a trust's investments to the greatest extent possible. Therefore, good investment governance practices both increase the likelihood of improved investment outcomes and lessen potential reputational and liability risks.

While good investment governance practices can help trustees fulfil many of their duties, it can help with the following duties in particular:

- the **duty to know the terms of trust**: A trustee must know the terms of the trust[21] (mandatory duty);
- duty to **act honestly and in good faith**[22] (mandatory duty);
- the general **duty of care**: when exercising any power or performing any function in relation to a trust (other than the exercise of a discretion to distribute trust property), trustees must exercise the care and skill that is reasonable in the circumstances (default duty);[23]
- the **duty to invest prudently**: when exercising any power of investment of trust property, trustees must exercise the care and skill that a prudent person of business would exercise in managing the affairs of others (default duty);[24] and
- the duty to **avoid conflict of interest**: trustees must avoid a conflict between the interests of the trustee and the interests of the beneficiary (default duty)[25].

Remember that the definition of "trust information" for the purposes of the disclosure provisions in the Bill is "any information regarding the terms of the trust, the administration of the trust or the trust property … that is *reasonably necessary for the beneficiary to have to enable the trust to be enforced*…"[26]. Therefore, much of the information trustees hold regarding investments could potentially be subject to a beneficiary's request for information if these documents could assist in enforcing the trust, that is, ensuring that trustees are managing the trust in accordance with the trust deed and their duties. Relevant documentation could include, for example:

[21] Trusts Bill, Clause 22.
[22] Clause 24.
[23] Trusts Bill, Clause 27.
[24] See cl 28.
[25] See cl 32.
[26] Clause 45(a).

- the Investment Policy Statement (IPS) or any other investment policy document (e.g. SIPO) of the trust;

- documents that evidence monitoring of investments and investment service providers; and

- documents evidencing the efforts trustees went to carry out due diligence on providers before engaging them. This is particularly important as the bar is rising as to what constitutes acceptable due diligence[27]. Also, in today's world of information overload, it has never been easier for beneficiaries to do their own research into providers and make their own judgments against which to measure trustees' decisions.

Of course, disclosure will be subject to the procedure for deciding against giving information set out in the Bill[28] and trustees will be entitled to keep the reasons for their decisions confidential[29]. Regardless, the simple fact that the Bill proposes a presumption that trustees must inform beneficiaries of their right to request trust information could alert beneficiaries and open trustees up to more disclosure requests.

Putting sound investment governance in place will help trustees demonstrate that they are fulfilling their duties. For example, having a trustee-owned, governance-orientated IPS can help trustees demonstrate they follow processes designed to ensure fulfilment of their duties. An IPS should include the roles of all parties involved in the investment process. It should also set out due diligence procedures for trustees' selection of investment service providers that help avoid actual or perceived conflicts between the interests of trustees (personal or business) and the interests of the beneficiaries. An IPS should also set out monitoring procedures to help trustees exercise the necessary care and skill when making decisions about investments, their performance and costs. An IPS should also demonstrate that trustees have considered an appropriate responsible investing strategy if that is required by the terms of the trust.

What Can Trustees who are Investment Stewards do to Prepare for the Trusts Act?

Many busy trustees, especially professional trustees, have relied on the simple yardsticks of brand, apparent costs and client satisfaction for investment provider selection or referrals. However, these measures are not suitable from a fiduciary perspective and this will likely be highlighted under the new trusts regime. A good place to start in preparing for the new Trusts Act and any increases in disclosure of trust information is for trustees to consider systemising the approach to investment governance responsibility. A key ingredient of doing so is adopting processes that are aligned against a defined investment governance standard, such as that developed by Fi360. This is equally applicable to all trustees, including professionals offering independent trustee services to clients.

Special Considerations for Professionals Acting as Trustees

The Trusts Bill includes the common law principle that, for the purposes of the general duty of care and the duty to invest prudently, the standard of care and skill expected of trustees with particular skills and experience and professional trustees will be higher than the standard expected of other trustees. The Bill proposes that performance of these duties will be assessed with regard to:

[27] refer to article *Trustees – now's the time to recalibrate your provider radar,* June 2016 available at www.fi360.co.nz for further explanation
[28] See cl 50.
[29] See cl 45.

- any special knowledge or experience of a trustee;[30] and
- if a person is acting as trustee in the course of their business or profession, any special knowledge or experience that is reasonable to expect of a person acting in the course of that kind of business or profession.[31]

This will affect the many lawyers and accountants and other professionals who act as independent trustees for clients, companies that provide professional trustee services and those with special legal, investment or financial knowledge who volunteer their time and skills as trustees of charitable, Māori and other trusts.

Since the release of the Law Commission's recommendations on trusts and the subsequent consultation draft of the Trusts Bill, we have observed anecdotal evidence that some professional trustees, especially lawyers and accountants, are considering whether to continue to offer independent trustee services as part of their business offering. This seems to be especially so in the context of trusts with investments since making decisions about investments can be time-consuming for trustees and require specialised understanding. This is understandable since such professionals feel they can only offer trustee services if they have the time and resources to fulfil their obligations properly and can add genuine value to their clients. They must also be able to justify the financial and temporal cost of providing trustee services, which are additional to their core legal or accounting service offering. They must also stay out of trouble and manage their risk so that trustee services are not offered at the potential expense of losing their right to offer their core professional services.

However, it would be a great loss to the trusts infrastructure in New Zealand if professional firms and individuals were to stop offering independent trustee services. Instead, we would encourage these professionals to lead by example under the new trusts regime. We recognise that there are practical constraints in doing so, including lack of time and specific investment skills and difficulties recovering the costs to the firm of the required effort. Arguably, what is required to help firms in this area is an independent information resource that addresses core investment governance responsibilities and that professional trustees can share with their clients and co-trustees.

Conclusion

The new Trusts Act will significantly improve the clarity and accessibility of New Zealand's trust law for both trustees and beneficiaries. The proposed provisions regarding disclosure of trust information to beneficiaries will likely alert beneficiaries to their rights and interests, resulting in increased transparency and increased risk for trustees. Trustees who oversee investments in capital markets must take care to ensure they are fulfilling their duties, especially the duty to invest prudently. Employing best investment governance practices and following an objective investment governance standard can be of great assistance in achieving this.

[30] Clauses 27(b) and 28(a).
[31] Clauses 27(b) and 28(b).

About MyFiduciary's Investment Governance Support Services

Good investment governance can prevent trustees from potentially breeching their fiduciary obligations of care. For example, we would argue it is not a good governance practice for trustees to get in the weeds of investment management (e.g. choosing or approving individual security or fund selections); instead this is a task that is best delegated to investment professionals (such as advisers or asset consultants). In turn selecting such providers needs a proper evidentiary basis.

MyFiduciary offers support services to trustees and professional firms who either offer independent trustee services to clients, or wish to offer guidance on good investment governance and valid provider referrals. Our support services include:

- Investment governance training: We provide Fiduciary Education courses and in-house workshops, as well as on-line training that meet various CE requirements.
- Investment governance assessments: We provide confidential assessments for Trustees as well as assessments that garner the internationally recognised Centre of Fiduciary Excellence (CEFEX) accreditation.
- Provider due diligence: We provide structured due diligence reports on providers (Advisers, Fund Managers and Custodians).
- Fiduciary consulting: We assist investment entities develop investment policies and strategies, review providers, and manage assets. Including economic commentary, asset allocation, model portfolios, approved product lists investment due diligence, and monitoring, and reporting.

For more information, visit our websites at www.MyFiduciary.com and www.fi360.co.nz