

CUSTODIAN TRUSTEESHIP
A brief review of Section 19F of the
International Trusts Act(the “ITA”)

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The Cook Islands enacted certain changes to its trust legislation in November 1996, concerning custodian and managing trustee structures. These amendments were designed to simplify the use of custodian trusteeships in the offshore forum. The split of trustee functions by custodian trusteeship, prima facie, makes it an ideal vehicle for offshore/domestic trust arrangements. It may also be an appropriate trust structure for use under foreign/domestic US tax reporting rules.

Introduction

This article focuses on the amendments to the ITA concerning Custodian trusteeships. The Cook Islands legislators sought to consolidate and modernise existing laws, whilst affording statutory protection and granting certain rights to those trustees appointed under such provisions, without abrogating the fundamental characteristics and concepts of trust law.

The custodial provisions largely follow the equivalent provisions in the English and New Zealand statutes with some important modifications to allow its use in the offshore trust arena.

Cook Islands Application

To English practitioners, the most radical change, is that any person or corporation can under Cook Islands law be a custodian trustee. This is not new to New Zealand, as adopted in the Cook Islands, although it is a significant departure from English law where only the Public Trustee or other approved institution is permitted to be a custodian trustee.

It is important to appreciate that the custodial provisions only apply to a custodian trustee expressly appointed pursuant to section 19F. It is only custodian trustees appointed under these provisions that are entitled to the statutory protections and rights conferred by the above sections. A trustee that merely assumes the role of a custodian, and leaves management of the trust to co-trustees, will remain exposed to the duties and standards of an ordinary trustee in the absence of specific enabling statutory provisions¹.

1 But see Ford & Lee, Principles of the law of Trusts, 2nd Ed., pg 344.

Managing Trustee powers

It was previously uncertain as to the extent to which a managing trustee could take control of trust property. A managing trustee, realistically, at least should be permitted access to trust property to allow it to carry out its administrative and managerial functions such as the paying of trust expenses, management of businesses etc.

Section 19F(2) clarifies previous uncertainty as to the extent of a managing trustee's powers in relation to the control of trust property. This is done by expressly recognising that the vesting of trust property (in the custodian) is without prejudice to the managing trustee's control of that property. Section 19(5) further permits that assets may be held by, or under the control of, the managing trustee to facilitate the managing trustee's management and administration of trust assets. This provides considerably more flexibility and scope to the practical operation of the trust, and gives the managing trustee the ability to operate certain bank accounts and hold other positions of control over trust property.

Notwithstanding this flexibility, a custodian is still under an obligation to ensure the managing trustees are observing the terms of the trust. It is still incumbent on the custodian to assess the operation and actions of the managing trustees in carrying out the management of the trust.

Delegation Powers of a Custodian

Subsection 19F(5) further changes the existing law in another way, in allowing a custodian trustee to assume full powers of delegation. This provides an alternative way to pass control to managing trustee's and also facilitate the holding and administration of trust assets in multiple jurisdictions.

However, it should be appreciated the ITA is merely permissive in this regard, to allow either trustee to discharge their duties in good faith and for the proper purpose of which the custodial arrangement was set up. It would be unwise, for example for a managing trustee to attempt to assume a full custodian type role in disregard of the custodian trustee's functions. The managing trustee's dealings of trust property must be limited to the functions conferred by section 19F(5) ie. they are limited to the extent necessary to facilitate the managing trustee's management and administration of the trust. If the managing trustee's control over property is not seen as been necessary to achieve this aim, it is likely to draw an adverse reaction from the court if it is ever contested.

An example of that considered a suitable exercise of these powers would be the management of an expense account by the managing trustees to allow them to pay the costs and expenses of the trust. On a similar vein, a trading account for an active business managed by the managing trustees should be permitted, at least in terms of the managing trustee being a signatory to that account. The legislator's intention is to allow for custodians to only delegate such of their

functions as are justifiable in the ordinary course of business given the respective functions of each trustee.

Removal Provisions

The main changes to existing law are seen in subsections 19F(7)-(9).

Subsection 19F(7) essentially reiterates the existing common law position², and clarifies the ability of a custodian trustee to assume full trustee responsibilities where permitted by the trust instrument. It is important that a custodian trusteeship be properly terminated where it is desired for the custodian trustee to become the managing trustee³.

Subsection (9) is unique in allowing a custodian, upon the removal of the managing trustees to assume all the powers and obligations of the managing trustees if permitted to do so by the trust instrument. Previously there was some uncertainty about the ability of a custodian to assume these powers in the absence of court direction or appointment, and the effect of such an appointment. This aspect is clarified by subsection (7)(b) which provides in this situation that the custodian trustee shall be treated as an ordinary trustee.

Conclusion

The extent to which the amendments will encourage the use of custodian trustees in the future remains to be seen. Certainly the splitting of custodial and management functions accords with the practice of offshore trusts. More recently, the changes to the US tax rules governing foreign trusts mean that the split in administration allows a custodian trust to comply with US tax requirements, while retaining the offshore advantages of the trust.

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² *Forster v Williams Deacon's Bank Ltd*

³ Re Squire's Settlement (1946) 115 L.J. Ch. 90.