Wrangling with wasting assets – A new challenge for Cayman Trustees

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As the global financial services industry continues to grapple with the consequences of the turmoil faced around the world over the past twelve months, further unexpected challenges continue to present themselves to those in fiduciary roles such as trustees. One example of such challenges is a rise in the number of wasting assets that a professional trustee might now find it holds as part of its administrative mandate. These wasting assets (for simplicity, any asset which is going down in value or is likely to go down in value of time) can be problematic and require careful handling, with reference to the trustee's own powers and duties, to manage the associated risks.

A good example of circumstances in which a trustee can, somewhat unexpectedly, find itself with a portfolio that includes wasting assets, can be seen in a recent announcement by UBS Bank. The bank's decision to charge a negative interest rate of 0.75% on all client accounts with more than CHF 250,000[1] has no doubt left many trustees holding such accounts scrambling to ensure that they are able to manage this new liability effectively for their clients. Similar announcements from other lending institutions can be anticipated.

Dealing with Wasting Assets

Broadly speaking, and subject to the terms of the relevant trust deed, trustees have wide powers of investment to be exercised with due skill and care. A prudent trustee will therefore typically invest in and hold assets which it expects to maintain or increase in value over time. However, what should the same trustee do when the assets it holds become wasting assets due to external events such as a market downturn or the advent of negative interest rates?

The answer to this question is that it will depend on a number of factors that the trustee should consider carefully. Those factors will include the size of the 'wasting asset' relative to the rest of the trust fund and the rate at which it is decreasing in value – a small piece of property which has dropped in value due to a temporary fluctuation in the housing market may not be of any long term concern, for example. The views of the beneficiaries of the trust may also be important depending on their knowledge of the trust and its assets and may need to be canvassed: a sophisticated family with diverse assets and numerous accounts with a variety of institutions may not be concerned by the introduction of a negative interest rate that affects only small portions of their pockets of wealth. Also relevant is what steps (if any) the trustee could take to satisfactorily address the problem and how quickly those steps could be implemented. For example, the problem is much more manageable if the wasting asset in question is cash in a bank account with a negative interest rate as the balance incurring penalty interest could simply be moved. Using the UBS Bank scenario, the trustee could simply ensure that any balance over and above the CHF250, 000 at UBS is moved to a different bank to ensure no negative interest is paid.

1 – https://www.reuters.com/article/ubs-group-rates-idUSL8N2JN0TI

However, the problem is much more challenging when the asset is of a very high value and illiquid, like a hotel building, which may not be easily sold and where any sale may crystallize a significant loss. Further challenges – and new layers of liability – can arise when assets are held through holding companies rather than the trustee directly, both when the trustee provides directors and when the directors are independent.

Modern Solutions

More modern trust deeds can hold the solution. Over recent years, specialist drafters have anticipated increased market turmoil and newer trust deeds often expressly allow for a trustee to hold wasting assets, either to increase flexibility in allowing a diverse portfolio to be created or because the settlor wants a particular asset that is likely to go down in value (a superyacht for example) to be held in trust. Such a provision would read something like "*the trustees may acquire and retain wasting assets and assets which yield little or no income, for investment or any other purpose*". Liability for losses connected to the trustee holding wasting assets is obviously far more limited in such circumstances, and including a wasting assets provision as a standard term in all new trusts is likely a prudent step to take. Including a power to give directions as to investments which held by someone other than the trustee is also worth considering as a means of mitigating risk and addressing the problems identified above.

Where a trust deed does not contain an express wasting assets provision (as will likely be the case with most older trust deeds), trustees will need to carefully monitor any trust assets and portfolios which may become problematic or exposed to market developments triggering a decline in value or even penalties. Faced with a scenario where trust assets are materially decreasing in value, the trustee will need to act quickly to minimize any loss in value and to avoid a potential fire sale event. Acting quickly to consider the consequences of market turmoil, and limiting the damage on this front will also help to manage the trustee's own exposure for claims of breach of trust or duty. This is particularly important where the exoneration provisions in the relevant trust deed are narrowly drawn and the protections offered are relatively scant. In more serious circumstances, where significant loss is imminent and likely unavoidable, it may be necessary to bring an urgent application to court for directions to bless the sale of the wasting asset or to approve of the trustee taking some other action to appropriately deal with it.

Conclusion

The consequences of recent global events, including the imposition of negative interest rates, have led to many new challenges for trustees. Some of these are obvious, but others - including the likelihood of trust assets transforming into wasting assets - may not have previously been on the radar and can present themselves with little warning and significant consequences. Trustees should therefore ensure they are actively monitoring trust assets and that they are proactive when issues arise, both to protect the trust and to limit their own exposure to liability. Sound management, clear communication with clients and advisors, and a commitment to implementing practical resolutions will offer important protections and at least some level of stability in an otherwise turbulent environment.

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