Role of the protector – from a Guernsey perspective

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Introduction

Settlors may wish to establish a trust for any number of reasons, including asset protection, estate planning, tax mitigation or to circumvent forced heirship regimes. It may be that trusts are not recognised in the settlor's home jurisdiction and consequently he is advised to set up a trust in an unfamiliar geographical territory and to transfer the ownership of his property to relatively remote trustees with whom he has no prior relationship.

A settlor may be reluctant to make an irrevocable gift of his (often very substantial) assets to trustees who are unknown to him, especially where those trustees have broad discretionary powers and are free to ignore completely any request made by the settlor by way of letter of wishes or otherwise.

To allay his concerns, a settlor may wish to incorporate comprehensive and prescriptive terms within the trust instrument or he may wish to reserve to himself certain powers. However, either option is not without its disadvantages or risks; a rigidly drawn trust instrument would lack adaptability should unforeseen circumstances arise and the reservation of extensive powers may imperil the integrity of the trust or give rise to adverse fiscal exposure.

Protectors – a solution?

For decades, wary settlors have sought to quell their concerns by appointing someone with whom they have an established relationship as the protector.

Protectors are power-holders of varying degrees who often (but not exclusively) feature in trusts where the governing law and residence of the trustees differ from the place of residence of the settlor and the beneficiaries. Although there is a risk that the conferment of wide-ranging powers on a protector may render him a quasi-trustee, with consequent fiscal exposure, such risk may be managed by choosing a protector who is resident in a tax neutral jurisdiction.

The protector and his role

The term '*protector*' is not defined in the Trusts (Guernsey) Law, 2007 (the '**Trusts Law**') but such an office-holder would clearly fall within the definition of '*trust official*', which means '*a person having a function or holding an office in respect of the trust other than a settlor, trustee, enforcer or beneficiary*'.

The role of a protector will be determined by the powers conferred upon him by the settlor pursuant to the terms of the trust instrument. The scope of the powers bestowed will depend on the extent to which the settlor wishes to curtail the powers of the trustees – the settlor may want the trustees' powers to be subject to oversight, control or direction. Ultimately, the settlor may even wish the protector to have the power to remove the trustees and/or appoint new or additional trustees.

A protector's rights or powers can take many forms and the nature of the powers may be categorised as positive powers, negative powers or dispositive powers.

Examples of positive powers might include the power of appointment and removal of trustees or the power to direct the trustees as to investment of the assets of the trust. A protector may also

be given direct administrative powers to enable the trust property to be managed.

Negative powers, or veto powers, traditionally involve the trustees' powers being made subject to the consent of the protector. If the protector's consent is not obtained, the purported exercise by the trustees will be invalid and generally it will not be possible for the exercise to be ratified *nunc pro tunc,* i.e. retroactively. The right to give or withhold consent may be held by the protector in a personal or a fiduciary capacity.

Dispositive powers would empower the protector to affect beneficial rights and interests in the trust property. A typical dispositive power would be the power of appointment of trust assets. Other dispositive powers would include the power of addition or removal of beneficiaries or the amendment of the terms of the trust instrument. Although it is unlikely for a protector to be given direct dispositive powers, it is common for the trustees to require the consent of the protector before they may exercise their dispositive powers.

Irrespective of the nature of powers granted to a protector, it should be borne in mind that a protector's loyalty is owed to the beneficiaries of the trust and his function is not simply to make sure that the settlor's wishes are fulfilled.

This point was addressed directly by the Royal Court of Jersey *In the matter of the A Trust*[1] (which concerned an application to remove the protector from office) where the court identified that the protector had a '*misconceived view of himself as the living guardian and enforcer of the settlor's wishes*'. The court went on to stress that '*It can be no part of the function of a protector with limited powers of the kind conferred … by the trust instruments to ensure that a settlor's wishes are carried out any more than it is open to a settlor himself to insist on them being carried out. A trustee's duty as regards a letter of wishes is no more than to have due regard to such matters without any obligation to follow them. And a protector's duty can, correspondingly, be no higher than to do his best to see that trustees have due regard to the settlor's wishes (in whatever form they may have been imparted): from the moment of his acceptance of the office of protector his paramount duty is to the beneficiaries of the trust.*'

A protector cannot refuse his consent in order to frustrate something the trustees wish to do to benefit the beneficiaries simply because the proposed course of action is inconsistent with the wishes of the settlor.

Powers in which capacity?

It is also necessary to consider whether the protector holds his or her powers in a fiduciary capacity, in which case those powers are *fiduciary powers*; or whether he holds them in a non-fiduciary capacity, in which case those powers are *personal powers.*

In the case of a fully fiduciary power, the holder '*must independently consciously consider from time to time whether or not to exercise it and he must exercise it responsibly according to the purpose for which it was conferred on him and not perversely to any expectation of the settlor, e.g. by exercising it capriciously or arbitrarily or in bad faith.*'[2]

Insofar as personal powers are concerned, these may be further characterised as:

- *unlimited personal powers*, in which case the protector may exercise his powers entirely for his own benefit and for any purpose without (in theory) being subject to the supervision or oversight of the court;

[1] [2012] JRC 169A

[2] Underhill and Hayton, Law of Trusts and Trustees, Eighteenth Edition, 1.77

- *limited personal powers*, in which the protector may exercise his powers in good faith for the benefit of a specified class of objects; or
- *partly fiduciary personal powers* in which case the holder may be under a fiduciary duty to consider exercising the power but where the actual decision whether or not to exercise it is an unchallengeable personal power. A protector of a limited power or a partly fiduciary personal power must exercise the power in good faith and for the purpose for which it was conferred; if such a power is exercised in a way that is superficially within the scope of the power but is done for an unauthorised purpose it may be challenged as being a fraud on a power.

Determining which type of power one is dealing with is not always straightforward.

Although the starting point for distinguishing between personal and fiduciary powers may be to ascertain in whose interest the power may be exercised, the ultimate classification of those powers would depend on the specific circumstances of each case, the terms of the trust, the purposes for which have been conferred and the context in which they have been provided.

The distinction between fiduciary powers and personal powers is of import for a number of reasons.

The purported exercise of a fiduciary power in the protector's personal interest or in fraud on the power would be void.

A protector is permitted to release personal powers but he may not release fiduciary powers unless specifically authorised by the trust instrument.

In terms of a protector's right to indemnities, if the terms of the trust do not specifically make provision for his indemnification the distinction as to whether his powers are personal or fiduciary may be of critical concern. This point was addressed by the Royal Court of Guernsey in the case of *In the matter of the K Trust*[3], which dealt with an application for the removal of a protector and a cross application by the protector for a blessing of the court to sanction her voluntary retirement.

The applicants' argument for the protector's removal echoed the reasoning established *In the matter of the A Trust* in that the poor relations between the protector and the beneficiaries was stated to be hampering the proper execution of the trust. The court heard that following the settlor's death the trust had been operated in a way that had led to the protector almost becoming a de facto trustee. The fact that the protector appeared to scrutinise every action of the trustee struck the court as being the root of the problems which had led to the application.

The protector had extensive powers which were not specified as being either fiduciary or personal. The terms of the K Trust did not make any provision for the protector's remuneration or indemnification. The protector considered that in her absence it was possible that action may be taken that would expose the beneficiaries (and former beneficiaries) to a possible tax liability. Whilst willing to step down she was concerned that to do so may expose her to personal liability. Therefore the protector sought a determination that she would be entitled to be indemnified in the event of her retirement.

Matters were complicated by an apparent inconsistency in the Trusts Law. Section 15 sets out that '*the reservation, grant or exercise of a power or interest…does not… (a) constitute the holder of the power or interest a trustee; [or] (b) subject to the terms of the trust, impose any fiduciary duty on the holder…*'. Consequently, where the trust instrument provides for such

[3] (2015), unreported,31/15 Royal Court of Guernsey

powers but is silent as to whether or not the powers are held in a fiduciary capacity, they will not be fiduciary.

However, in seeming contrast, section 32 of the Trusts Law sets out that '*… (2) The terms of the trust may require a trustee to consult or obtain the consent of another person before exercising any function. (3) A person shall not, by virtue of being so consulted or giving or refusing such consent (a) be deemed to be a trustee, or (b) if the terms of the trust so provide, be under any fiduciary duty to the beneficiaries or the settlor.*' Consequently, it seems that negative powers are held in a fiduciary capacity unless otherwise specified in the trust instrument.

In the matter of the K Trust, the Court acknowledged the apparent contradiction in the two sections but concluded that it did not need to provide a ruling on how they should be interpreted as the trust had been established prior to the enactment of the Trusts Law. The court went on to conclude that as certain of the powers of the protector had the hallmarks of being fiduciary in nature, they should be regarded as such. This point was critical in terms of the protector's right of indemnification and the court accepted the general principle that a holder of fiduciary powers has an implied right of indemnification against costs and expenses. However, the court went on to say that the protector was not entitled to a 'blanket indemnity' which would effectively render her unaccountable for any act or omission and would leave the trustees and beneficiaries without remedy should they wish to challenge her conduct. The issue of the nature of the protector's powers, her indemnification and removal could all have been addressed quickly and cost effectively if the trust instrument had contained appropriate terms.

In other jurisdictions the courts have concluded that they had power to remove a protector from office where that protector was a fiduciary. The Royal Court of Guernsey, however, concluded that it was not necessary to find that a protector is a fiduciary in order to have the jurisdiction to remove them from office; it was sufficient for the protector to be a 'trust official' and for it to be in the interests of the beneficiaries for them to be removed.

Conclusion

Ultimately, when drafting trust instruments which include the appointment of a protector (or provisions to appoint a protector at a later date), a trust practitioner should understand clearly the settlor's objectives in order to incorporate suitable powers, the practical workability of which should be considered on a clause by clause basis. Moreover, the protector should be entitled to the information he needs in order to perform his function.

It should be made clear whether the powers conferred upon the protector are intended to be personal or fiduciary and, if personal, whether they may be exercised purely in his own interests.

In choosing a protector, the settlor should be advised to select a person who is not only suitable for the role but who is also not in a position of conflict or potential conflict.

Lastly, consideration should be given to incorporating a mechanism for the removal (and subsequent replacement) of a protector in circumstances where the protector is mentally incapacitated or is adversely affecting the administration of the trust. This has the potential to avoid lengthy and costly legal advice and possibly a court application.