ReedSmith

Trust Companies – Formation, Benefit and Operation Checklist

Prepared for TACT by Reed Smith

1. Trust Company, Corporate Trustee and Trust Corporation Under English law any company that conducts a trusteeship may be called a **trust company**. Bodies with particular characteristics may be properly defined as **trust corporations**. This Checklist uses **trust company** to describe both kinds. **Trust corporation** is used only for those so qualifying; **corporate trustee** for the rest.

Sections 3-8 contain a description of the advantages and operational characteristics of a **trust corporation**. Section 10 explains how to form a **trust corporation**.

Section 13 onwards outlines some of the regulatory and legislative duties that may apply to any **trust company**.

2. Historical Background – Protecting Beneficiaries To understand this topic one needs to appreciate the development of legal policy thinking over the last century or so. The late 1800s saw the exposure of a number of frauds by individual, sole, Trustees. This led Parliament to try to encourage a situation under which all trusts had to have at least two trustees – and also that the public could have the assurance of appointing a reputable, government-backed, trustee. The Public Trustee was set up to fulfil this latter role. However it was felt, in the interests of variety and competition, that large institutional businesses such as banks and insurers should be permitted to have an equivalent legal status – that of **trust corporation**. For this, historical, reason the legislation as to what defines a **trust corporation** is to be found in the Public Trustee Rules 1912[1] (as regularly amended since).

3. Historical Background – Protecting Third Parties As well as trying to protect beneficiaries by ensuring that there were normally at least two individual trustees or a **trust corporation** to any trusteeship, Parliament had another balancing act to perform. While it wished to safeguard the rights of beneficiaries in a trust, it also wanted to relieve any purchaser of trust assets – or similar third party – from having to make a minutely detailed examination of the beneficial interests affecting any asset it wished to purchase.

4. Over-reaching For this reason the concept of "over-reaching" was introduced. A purchaser dealing with a properly constituted trust would be safeguarded against having to investigate beneficial interests, deal with beneficiaries or have any duties as to the application of the purchase money paid. For this reason the beneficial interests were said to be "behind the curtain".

5. Retirement and legal "discharge" A further safeguard to encouraging a situation under which every trust had at least two individual trustees or a **trust corporation** were provisions as to how a trustee wishing to retire could obtain an effective "discharge" from his trusteeship. Without a "discharge" the trustee might cease to have any title or powers over the trust assets but nevertheless was answerable to the beneficiaries without limit of time thereafter – a very strong disincentive to an exiting trustee leaving beneficiaries unprotected. To obtain his legal "discharge" there had to be at least two individual on-going trustees or a **trust corporation** to carry on the trusteeship.

6. Trust borrowing It could happen that, through the death of a trustee, say, a trust at any point of time had a single trustee. If that trust was of land and the trustee wished to borrow money on mortgage, the lender would always wish to ensure there were at least two trustees taking out the loan, or a **trust corporation**, since, without this safeguard, the lender would be legally required to see that the money was being raised and applied properly for the beneficiaries.

7. Other roles A **trust corporation** may be a custodian trustee and may be needed to allow a trust to compromise claims. It can be appointed to receive "notices" of beneficiaries' dealing with their interest and may be needed in certain "settled land" roles.

8. Executorships Since **trust corporations** were to be empowered, alone, to conduct trusteeships, it was only consistent that they should be entitled to be executors of Wills. In this respect they have an operational advantage over **corporate trustees** whom Parliament clearly wished to discourage in this field.

9. Corporate Trustees **Corporate trustees** did not and do not meet the aspirations above. A **corporate trustee** cannot effectually single-handedly replace a retiring individual trustee unless there will be two trustees to carry

on the trusteeship. Its presence as seller cannot "over reach" the beneficial interests – hence any buyer of property would be most unwise to proceed without the position being rectified.

Having a sole **corporate trustee** give a mortgage over landed property to secure a loan creates unnecessary dangers for the lender.

While a testator may appoint a **corporate trustee** to be Executor of his Will, court procedure rules "de-prioritise" the **corporate trustee** in favour of any individuals.

10. Forming a Trust Corporation The legal route is confusing. To qualify as a **trust corporation** the body needs to be entitled to act as a custodian trustee. For historical reasons the definition of who is entitled to so act is contained in Rule 30 Public Trustee Rules 1912. This Rule has been updated regularly since, most recently as of 1st April 2013.

The main route to qualify has four components:

- The corporation must be "constituted under the law of the United Kingdom or any part …" or under an EU Member State's.
- Is "empowered by its constitution to undertake trust business" in England and Wales.
- Has one or more places of business in the UK.
- Is registered under the Companies Act 1948 (amongst others) and has an issued capital of not less than £250,000 of which not less than £100,000 has been paid up in cash (or EU State equivalent).

There was a change to UK company legislation in 2006 to align with European practice and the English law doctrine of *ultra vires* (a company may not operate beyond its explicit powers) was abolished. For this reason the current practice is that a company formed after 2006 does not explicitly state the objects for which it has been formed in its "Memorandum and Articles". Hence any such company formed after 2006 is likely to be seen as "empowered by its constitution to undertake trust business". However those forming a new entity with the intention that it should unchallengeably be seen as a **trust corporation** would be wise to include explicit wording to this effect in the formation documents.

Companies formed before 2006 would need, in the writer's opinion, to have explicit powers in their constitution. This is despite a relieving provision that year.[2]

11. Advantages of a company as trustee Apart from the clear legal advantages arising from possessing **trust corporation** status (Sections 3-8) a corporate trustee has an unlimited life. Private trusts may be hamstrung when an individual trustee dies or loses mental capacity. In the latter case, even though there is legal machinery to replace the trustee, a Court Order may still be needed to transfer the trust assets.

Thus a company is particularly suitable for trusteeship of an asset which may not be realised for many years to come (such as a settled life insurance or accident policy).

With trusts of any size or complexity, even a simple change in the constitution of individual trustees may entail transfer difficulties with existing contracts and suppliers. Where the trust is engaging in financial operations of any complexity, any change of individual trustee may involve the complete substitution and "novation" of a large number of detailed contracts.

12. Trustee and director trustee liability An advantage of a company as trustee is said to be that a director of a trustee company is less exposed to any risk of personal liability on the ground of a breach of trust compared to an individual trustee. Full analysis is outside the scope of this checklist and the law is in any event not fully settled.[3] However directors of a **trust company** are unquestionably "safer" in this area than individuals taking on a trusteeship.

Occasions when an innocent lapse or event may, under strict Victorian principles, constitute a "breach of trust", thus rendering a trustee personally liable, are recognised to be, on occasions, unduly harsh. For this reason the Courts have power to relieve a trustee from personal liability if he has "acted honestly and reasonably and ought fairly to be excused".[4]

Case law suggests that the hurdle for receiving this relief is rather higher for a professional, remunerated, trustee, than for an unpaid lay trustee. So a **trust company** has less chance of availing itself of this protection.

13. Regulatory aspects The fact of being a **corporate trustee** or a **trust corporation** is not certified by any authority (and, indeed, many companies may possess the status of **trust corporation** without knowing). Nor is there any "regulator" of either body. For this reason some quite substantial **trust corporations** have no "regulator" at all. It is though necessary to analyse **activities** and needs in a number of fields to see what regulatory aspects may, in practice, come to bear on the entity's activities.

14. Financial services UK financial service legislation requires bodies conducting specified "activities" to have FCA authorisation for their activities unless excluded or exempted.

Possible "activities" are given in the table:

Activity	RAO Ref:[5]	Remarks
Managing (investments)	37	Should not catch trustee managing its own trusts' investments
Advising (on investments)	53	Disapplied for some trustee activities
Arranging (deals in investments)	25 at et seq	Disapplied for some trustee activities
Market making/ underwriting	14	Disapplied for some trustee activities
Dealing as agent	21	
Safeguarding and administering (i.e. active custody of investments)	40	Only applies if the investments belong to another hence does not catch a trustee's own custody duties
Administration and performance of insurance contract	39A	Exemption for trustee advising on insurance or advising co-trustee or beneficiary if it does not hold itself out as providing the service and is not separately remunerated (Art. 66(3A) and (7)RAO)

Detailed guidance is outside the scope of this checklist.

15. Insurance Mediation Directive If trusteeship activities in insurance do not need FCA authorisation, the trustee may nevertheless need to be on the FCA "register" through some other route.

16. Registration for money laundering A company that is a trustee may be a defined "Trust or Company Service Provider" for the purposes of money laundering control and may need to register. Membership of any of the 23 or so professional or trade bodies exercising supervisory functions may suffice as "registration". If a body is not "registered" through this means, it must register with HMRC.[6] Money laundering duties require the need to ID the "customer" and to identify the "beneficial owner" of the trust (generally, one with at least a 25% interest). Pension schemes and their trustees are, though, outside these requirements.[7]

ReedSmith

17. Subsidiary of professional firm Where the **trust company** is a subsidiary or affiliate of a professional firm, the profession concerned may have rules as to the recognition and conduct of such a company.

18. TACT Code TACT, The Association of Corporate Trustees, is the body representing sizeable professional **trust corporations** and **corporate trustees**. Its members are obliged, as a condition of membership, to observe the TACT Code for the assurance of "best practice" in trusteeship.

Disclaimer: TACT, Reed Smith and Keith Wallace disclaim all legal liability. This is no substitute for individual legal advice.

---

1. Public Trustee Rules 1912 (1912 No 348) – see Rule 30, most recently updated 1st April 2013
2. Section 39 Companies Act 2006 "The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution". This is not seen as the same as being expressly empowered to undertake Trust business.
3. Beneficiaries seeking to raise a claim for breach of trust against the director of a trustee company have what is termed a "dog leg" claim. Salient cases are *Gregson v HAE Trustees Limited, Alhamrani v Alhamrani, HR & Others v JAPT & Others, Young & Others v Murphy & Another* (Supreme Court of Victoria).
4. Section 61 Trustee Act 1925
5. Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 SI 2001/544
6. Money Laundering Regulations 2007 and HMRC guidance such as MLR9.
7. Regulation 13(7)