NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Ministry of Justice

on the

Exposure Draft of the Trusts Bill

24 January 2017

NEW ZEALAND BANKERS ASSOCIATION
Level 15, 80 The Terrace, PO Box 3043, Wellington 6140, New Zealand
TELEPHONE +64 4 802 3358 FACSIMILE +64 4 473 1698 EMAIL nzba@nzba.org.nz WEB www.nzba.org.nz

About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

2. The following sixteen registered banks in New Zealand are members of NZBA:

- ANZ Bank New Zealand Limited
- ASB Bank Limited
- Bank of China (NZ) Limited
- Bank of New Zealand
- Bank of Tokyo-Mitsubishi, UFJ
- Citibank, N.A.
- The Co-operative Bank Limited
- Heartland Bank Limited
- The Hongkong and Shanghai Banking Corporation Limited
- Industrial and Commercial Bank of China (New Zealand) Limited
- JPMorgan Chase Bank, N.A.
- Kiwibank Limited
- Rabobank New Zealand Limited
- SBS Bank
- TSB Bank Limited
- Westpac New Zealand Limited.

Background

3. NZBA welcomes the opportunity to provide feedback to the Ministry of Justice (**MoJ**) on the Exposure Draft of the Trusts Bill (**Bill**), and commends the work that has gone into developing it.

4. If you would like to discuss any aspect of the submission further, please contact:

Antony Buick-Constable
Policy Director & Legal Counsel
04 802 3351 / 021 255 4043
antony.buick-constable@nzba.org.nz

Key submissions

Timeframe for submissions

5. NZBA submits that the timeframe provided to submit on the Bill is very tight, given the significance of the reform. It is important that sufficient time is given to consider the effects and implications of the Bill, as it could have significant and unintended consequences for a wide range of trusts.

Focus of Bill and implications for commercial trusts

6. NZBA has concerns that the Bill does not fully recognise trust structures which are not family trusts, such as trust structures used to facilitate important commercial and financing transactions (for example, securitisation trusts, superannuation funds, retail investment trusts). NZBA wishes to ensure that such trust structures, which facilitate legitimate and important commercial transactions, are not compromised as a result of the proposed reform.

7. While Schedule 2, which provides an exemption for "wholesale investment trusts", is a welcome inclusion in the Bill, NZBA submits it requires further refinement and consideration, in particular to broaden its application.

8. NZBA submits that commercial trusts, which are self-governing under contract or subject to other legislative and regulative requirements, should be excluded from the ambit of the Bill or otherwise exempted from certain provisions of the Bill. Certain provisions of the Bill are helpful to some wholesale investment trusts (for example the winding up provisions will assist superannuation schemes) but these may be better placed in other legislation (e.g. the Financial Markets Conduct Act 2013 (**FMCA**) in the case of superannuation schemes). Careful consideration should be given to which clauses are dis-applied. NZBA and its members would be happy to work with MoJ alongside a working group representing affected industries, advisors and regulatory stakeholders to investigate these issues in more detail if that would assist.

Importance of contractual freedom for commercial trusts and retrospectivity

9. Banks use a large number of commercial trusts which will be affected by the Bill. In some instances the Bill places obligations on trustees which might be inconsistent with the contractual terms agreed between the parties. Unlike the vast majority of trust arrangements (by number) the parties to commercial trusts (such as those outlined at paragraph 6 above) are sophisticated and well advised. Accordingly, NZBA submits that it is inappropriate for the Bill to override the freedom of these commercial counterparties to agree, in the documents establishing and governing their trusts, how their arrangements should operate.

10. While this is perhaps a less significant issue for trust structures established after the Bill comes into force (as they will be able to express an intention that specific provisions of the Bill should not apply to them), existing structures will need to carefully examine their current arrangements to ensure that they do not need to be modified to either take account of the Bill once enacted or specifically dis-apply various parts of it. This will be a costly and time consuming exercise and in the case of some older structures may be a practical impossibility. This also risks the Bill overturning the commercial arrangements reached between the parties to those affected trust arrangements.

11. For this reason NZBA submits that the default position for commercial trusts should be that the contractual arrangements prevail, and the Bill should be forward looking rather than retrospective, applying only so far as expressly included in the trust deed.

12. Should this submission not be accepted, the Bill will in our view require all existing trust deeds to be reviewed and, where possible, amended to the extent that the default provisions set out in the Bill are not appropriate for the relevant trust. With an estimated 300,000 – 500,000 trusts in New Zealand, this will be a costly and time consuming exercise and the costs may be ultimately borne by trust beneficiaries. Furthermore, existing trust deeds may not be able to be amended due to their limited variation powers.

Public education campaign

13. NZBA submits that changes of this magnitude require an extensive public education campaign. It is not currently clear whether this will be done and if so by whom. For example, Officials should not assume that lawyers will explain implications of the reform such as retrospectivity to their clients, as lawyer-client relationships which existed when certain trusts were established may have ceased long ago.

14. NZBA considers that the potential ramifications of the Bill, and the level of due diligence and education required, should not be underestimated.

Interaction with the Financial Markets Conduct Act

15. The Discussion Paper acknowledges there may be interface issues between the Bill and the FMCA. MoJ assures it will work to ensure that both Acts operate together in a way that minimises compliance costs for trusts governed by both pieces of legislation. NZBA supports this assurance, and would appreciate the opportunity to be consulted on the proposed details of how the Acts will operate together, once they become available. Concerns could arise for other similarly affected legislation, such as the KiwiSaver Act 2006 and Part 5 of the Reserve Bank of New Zealand Act 1989 relating to covered bonds.

Common Law

16. One of the purposes of the Bill is to make a trustee's obligations clearer and to restate common law principles, with the rules of equity being available to add detail and meaning. NZBA submits that it is not clear that the obligations do reflect common law requirements and more work is required to ensure that the common law meaning is not lost. NZBA requests that MoJ clarify the process undertaken to translate the common law into the Bill. If the intention is not codification, then NZBA submits the legislation should make this clear.

Commencement date and transitional rules

17. The Bill will have major implications for bank processes, policies and documentation, even if it is only applied to new trusts. Banks will need time to implement these changes and, where necessary, to communicate them to customers. A reasonable transitional period should be included for all trusts, in conjunction with the public education campaign discussed above.

Support for other submissions

18. NZBA and its members generally support the submission on the Bill made by Russell McVeagh, and particularly the submission made by Chapman Tripp, and acknowledge the technical expertise of both firms in this area.

Comments on specific sections of the Bill

Definition of express trust

19. NZBA submits that the definition of "express trust" in clause 4 of the Bill is likely to extend to many kinds of 'wholesale trust' including trusts that are established to govern offers of debt securities or managed investment schemes under the FMCA (**FMC investment trusts**), though these trusts will not have the benefit of the Schedule 2 exemption. NZBA submits that the policy reasons for exempting wholesale investment trusts from certain provisions of the Bill (via Schedule 2) are equally applicable to FMC investment trusts. There is existing law that governs the role of trustees (or supervisors) and the content of trust deeds for these FMC investment trusts, namely the FMCA and the Financial Markets Supervisors Act 2011 (**FMSA**). These Acts have been specifically designed to apply to FMC investment trusts and NZBA submits those Acts should prevail to the extent there is any inconsistency between them and the provisions of the Bill.

20. NZBA submits that it would be helpful for the Bill to clarify its territorial scope (i.e. the application of the Bill to trusts not governed by New Zealand law).

21. Furthermore, NZBA questions whether any consideration has been given to how the definition of an "express trust" fits with definitions under tax law. Differences in definitions could give rise to unintended consequences, including expending unnecessary cost and resources in resolving interpretation issues.

Maximum duration of trust

22. NZBA notes that the maximum duration will be 125 years, rather than 150 years as proposed by the Law Commission. NZBA does not understand why this duration has been reduced. If this change has been made deliberately, the reasons for this should be articulated.

Mandatory duties

23. Clause 20 of the Bill requires the trustee to hold or deal with trust property, and otherwise act, for the benefit of beneficiaries or to further the permitted purpose of the trust. NZBA submits that the definition of "permitted purpose" in clause 4 is too narrow as a "permitted purpose" may not be specified in the terms of existing trust deeds. NZBA submits that this definition should be extended to include a purpose which is implicit in the terms of the trust. Alternatively, the word "permitted" could be deleted, instead simply referring to purpose (including an implicit purpose).

24. Additionally, some commercial trusts (such as security trusts) may permit the trustees to act in the interests of a percentage of beneficiaries (for example, on the

instructions of the majority). It is not clear whether clause 20 would permit the trustee to act for the benefit of some beneficiaries, but not others. NZBA submits that contractual/trust deed terms should prevail in these circumstances.

Default duties

25. While the Bill permits a trustee to contract out of the default trustee duties, the ability to do so in relation to existing trusts will be subject to the trust deed's amendment clause. For example, it is common for commercial trust deeds to only permit amendments with the consent of all creditors, or amendments required to comply with law, or that would not have a prejudicial effect on the beneficiaries of the trust. This would mean that trustees may not be permitted to elect to contract out of the default duties under the terms of the relevant deed.

26. Because of the potential impact on existing trusts (i.e. the level of due diligence required and potential restrictions on amendments), NZBA submits that the Bill should be forward looking rather than retrospective, applying only so far as expressly included in the trust deed.

27. Should this proposal not be adopted, NZBA submits:

    a. a reasonable transition period should apply, given the level of due diligence required for existing trust deeds and the need to make 'mum and dad' trustees aware of their new obligations. NZBA notes that Schedule 1 does not include a transitional period for the default duties and NZBA suggests consulting with the New Zealand Law Society to ascertain an appropriate transition period;

    b. the default duties should be limited to those trusts established for "natural love and affection" whose trustees need assistance to understand their duties. The default duties are not necessarily appropriate for trusts such as managed investment schemes or commercial trusts which have corporate trustees and clear obligations set out in the trust deed. MoJ could have regard to Inland Revenue definitions of different trust types when drafting such a limitation;

    c. the Bill should clarify that it is not necessary to expressly contract out of the default provisions and that this can be inferred by way of contrary intention. For example, clause 29 requires the trustee to act impartially in relation to beneficiaries, but the trust deed may allow the trustee to act on instructions of some beneficiaries. NZBA submits this implicit modification should be sufficient.

28. In NZBA's view, the omission of section 81 of the current Trustee Act 1956 from the Bill is problematic, given the default duty to act unanimously. Trust deeds would need to expressly modify the default duty to allow the operation of accounts by individual trustees. NZBA submits a modern equivalent of section 81 should be included in the Bill.

29. NZBA also questions how the duty not to exercise any power directly or indirectly for the trustee's own benefit (clause 24) will work in practice for some trusts. For example, for retailers who hold customer funds on trust until the provision of goods or services, this duty may cause issues as to when or how the retailer can access those funds for the operation of its business.

30. The inclusion of the mandatory and default duties also places banks at a greater risk of becoming "constructive trustees" in a wider range of circumstances.

31. NZBA has the following drafting comments on the default duties:

    a. clause 24 should be amended to exclude the situation where a trustee is also a beneficiary; and

    b. in clauses 22 and 23 "and" should be amended to "or", which is consistent with the reference in clause 116 to clause 23.

Exemption and indemnity clauses

32. In clause 79, the creditor's right to claim through a trustee's indemnity is dependent on the requirements set out in clauses 79(1)(a)-(d) being met. We support inclusion of clause 79, however it is unclear what is meant by the requirement of clause 79(1)(c) that 'that the trust property has received a benefit' and, in any event, it may be difficult to meet or will not be applicable for some trusts if, for example, it effectively means an increase in the trust assets or their aggregate value. For example, where a trust guarantees the obligations of a borrower to the bank, it is not possible for a bank to ascertain definitively whether the trust property has received a benefit and this may in fact not be the case. Further, in a commercial context, such as a securitisation arrangement, a trustee and creditor may contract for no or minimal benefit to trust property and, in fact, the trust assets will diminish over the lifetime of the trust as distributions to the creditors and other counterparties are made in accordance with the contractual obligations of the trustee. We question the extent to which clause 79 reflects the current law and we consider the scope of clause 79(1) is not broad enough to protect the interests of creditors. In addition, clause 79 should be extended to allow the creditor to claim through a trustee's indemnity where clause 36(3) applies.

33. NZBA expresses particular support for the Chapman Tripp submission that the Bill should make it clear that a creditor's right of set off and enforcement of that right is not affected or undermined by clause 79.

34. NZBA also submits that, with respect to commercial trusts, the Bill should include requirements to the effect that the trustee cannot limit their liability in a contract with a third party in a way that is inconsistent with the restrictions in clauses 33 and 34. This will help to limit the number of existing contracts that need to be amended to reflect these new requirements, which would otherwise be a time consuming and costly exercise.

Trustee's obligation to keep trust information

35. NZBA questions whether the requirement to hold trust information will be practical for all express trusts. For example, many informal trusts will not have trust terms or other documents, such as documents of appointment of trustees. The provisions assume trusts are formally created with a trust deed documenting how the trust is to be operated.

Trustee's obligations to give trust information

36. Clause 4 of Schedule 1 appears to extend the application of this clause to existing trusts. The requirement to make available basic trust information to beneficiaries of existing trusts is likely to be a costly and time consuming obligation, and may be of little benefit if a number of beneficiaries know this information anyway. In addition, it is a new obligation which existing mum and dad trustees may not be made aware of. Therefore, NZBA submits clauses 43(3)(a), (b) and (d) should only apply to new trusts. We also note that it is not clear what "make available" means.

37. The "giving information to beneficiaries" requirements will also give rise to unnecessary compliance costs for certain types of trusts, which we think should be excluded from these requirements. For example:

    a. security trust and securitisation arrangements and wholesale trusts generally, where contractual terms have been negotiated and agreed between sophisticated parties suitable for the particular commercial arrangement and specific purpose of that arrangement. In such cases it is vital that the contractual arrangements should prevail;

    b. regulated offers by trusts under the FMCA, which has extensive disclosure and reporting for beneficiaries;

    c. offers by trusts which are covered by Schedule 1 of the FMCA, where disclosure under the FMCA is not necessary for policy reasons; and

    d. custody arrangements, where regular reporting is provided to beneficiaries under the Financial Advisers (Custodians of FMCA Financial Products) Regulations 2014 (**FAA Regulations**).

38. For managed investment schemes, the manager of the trust has the primary relationship with the beneficiary and is responsible for administering the fund, while the trustee has a supervisory role. Given the role of the manager, it is not appropriate for these sections to apply to the trustee.

39. In addition, to limit the potential effect of these provisions on third parties, the Bill should expressly state that any party dealing with a trust does not owe a duty to provide trust information to a beneficiary.

40. As a drafting comment, the references to "giving" in clause 45(2) should be extended to refer to "or making available".

Trustee powers

41. The inclusion of the statement that a trustee has all the powers of an absolute owner of the property is positive, however NZBA would prefer the Bill to include the broader statement that the trustee has the powers of a natural person. To provide greater clarity, the legislation should also expressly state that a trustee has the right to borrow, give security, guarantee, and enter into derivatives and other hedging arrangements as part of the investment activities of a trust in order to protect the underlying trust property.

42. In addition, clause 50 should be extended to cover the provision of security over trust property.

Appointment of agents/nominees

43. Clauses 64(2) and 64(5)(c) appear to limit the ability of the trustee to delegate functions to a manager in the context of a trust where a manager may partially or substantially determine the application of certain contractually agreed and prescribed powers and instructs the trustee (for example securitisation trusts where trustee discretionary powers may be limited and narrow in scope). Again, in this situation NZBA submits it is important that the negotiated contractual terms should prevail.

44. Clause 64(2)(a) could be interpreted to limit the ability of a trustee to appoint a delegate to operate the bank account for a trust on its behalf. As mentioned above, section 81 of the Trustee Act 1956 has been omitted from the Bill and addresses this point. If clause 64 does allow an agent to be appointed for the operation of bank accounts, then there is a tension between clause 64 and the duty to act unanimously. It is also unclear how a trustee is to monitor the operation of an agent's powers when operating a bank account without that trustee being a signatory on the account (compared to clause 65). These clauses should be extended to clarify their practical application. For example, does a trustee need to be involved in the operation of an account, applications for lending etc.?

45. From our members' perspective, these sections increase the risk of a bank becoming a constructive trustee, given the agent's responsibility to act in accordance with the trust.

Powers of attorney

46. NZBA's comments on section 66 are as follows:

a. Clause 9 of Schedule 1 does not explain how clause 66 applies for existing powers of attorney. NZBA submits this should be amended to clarify that the clause only applies to new powers of attorney, as the ability to alter or replace powers of attorney is restricted. In most cases, enduring powers of attorney are used, which require replacement by way of deed and legal advice, and the relevant costs will be unfairly borne by trustees or beneficiaries.

b. There are many issues with applying this clause from a practical perspective. For example:

i. these sections will be difficult for third parties (such as banks) to apply from a practical perspective.

ii. it will not be possible for the delegating trustee to extend the delegation under clause 66(3)(c) if clause 66(2) applies (for example if the delegating trustee is mentally incapacitated);

iii. it is not clear how temporary mental incapacity can be assessed (for example, will a doctor ever provide a medical certificate confirming mental capacity is only temporary);

iv. “temporary inability to be contacted” is very vague and its application needs to be clarified (for example, does this mean that a power of attorney will apply if the grantor does not return a phone call);

v. “mum and dad trustees” and third parties may not be aware of the 12 month limit, particularly if the power of attorney is silent on this point;

vi. this section does not cover trustees who are permanently incapacitated and who may need to exercise powers and functions during the period prior to them being replaced; and

vii. 12 months is a very short time period and will require powers of attorney to be re-executed constantly.

c. Clause 66(4) should be expanded to allow a sole co-trustee to sign documents on behalf of the other trustee under power of attorney.

d. Sections 31(2) and 31(6) of the Trustee Act 1956 should be included in the Bill to clarify the effect of the delegation.

e. In clause 67(3), the words “(or, if the sole trustee is incapable, the trustee’s delegate)” should be moved directly after “if the trustee”.

Special trust advisers

47. It is not clear what a “special trust adviser” is. The scope of the application of this part of the Bill should be clarified.

Other powers and rights of trustee

48. NZBA’s comments on this part of the Bill include:

a. Clause 73(6)(b) refers to the rights of a mortgagee. NZBA submits this is too narrow and should be extended to refer to secured creditors.

b. NZBA acknowledges the benefit of clause 75 for family trusts. However, this section does not work in the context of commercial trusts. For example, if a security trustee is distributing the proceeds of the sale of secured assets, the distribution is made in accordance with the terms of the trust deed or other contractually agreed documentation and there should be no need to notify other potential creditors and other claimants. This is also an issue for securitisation arrangements. For these arrangements it is vital the specific negotiated contractual arrangements prevail otherwise the integrity of these arrangements is undermined.

c. Clause 77 should be extended to include other beneficiaries (such as companies) rather than being restricted solely to natural persons.

Appointment and discharge of trustees

49. NZBA welcomes the clarification of who can remove trustees although we note that this will typically be dis-applied in the context of commercial trusts where the contractual terms will cover this aspect.

50. As a technical point, clause 86(2) should refer to disqualification while a trustee, not just on appointment. This seems to be intended by later sections, but the drafting could be improved to make this more explicit.

51. Clause 90(1) is not clear as to what exercising a power of removal or appointment "for a proper purpose" means and NZBA is concerned that this may give rise to issues and query its relevance in the context of security trusts, securitisations, wholesale trusts, and managed investment schemes.

52. From a retail banking perspective, there is likely to be an increase in disputes where a trustee is removed under clause 90, as a trustee could argue that the person removing them has not acted in good faith or for a proper purpose. We note that only a beneficiary can challenge the removal of a trustee, so an aggrieved trustee cannot seek redress.

53. Clause 94(1)(c) needs to address how a trustee can be discharged if there is no person authorised under paragraph (a) (or that person is unavailable or unwilling to act) and the minimum number of trustees will not remain.

54. The vesting of trust property sections are a welcome inclusion, however these sections should be extended to cover the vesting of obligations under lending and security documents. We also question how clause 102(2) fits with the consent and notice requirements in the Property Law Act 2007, particularly where land is transferred subject to an existing mortgage.

Revocation and variation of trusts

55. NZBA notes that these sections only refer to beneficiaries who are natural persons, rather than entities, and is not sure if this is intentional.

56. We also note that it is unlikely that clauses 108 and 109 would apply in the context of a trust deed which allows these actions to be taken with the consent of the majority of beneficiaries, or a special resolution of beneficiaries adversely affected by the action (for example a security trust or managed investment scheme).

57. Clause 110(c) requires the transfer to not be detrimental to the interests of other beneficiaries, however a trust deed may expressly permit a transfer that is detrimental. NZBA queries the relevance of clause 110(d) to wholesale investment trusts.

Audit of condition and accounts of trust property

58. NZBA submits clauses 142-146 need to be considered in the context of other legislation. For example, they are not necessary for trusts covered by the FMCA,

which already places audit obligations on managers of managed investment schemes and custodians. Clause 142(2) goes some way to address this issue, but an exclusion for such trusts would be clearer. Also, the 12 month period in clause 142(2) is too short, given that the period of time between balance dates can be up to 15 months.

Definition of wholesale investment trusts

59. The proposed definition of "wholesale investment trusts" is too narrow as it only applies where the trust:

    a. is established by or for an investment business, a government agency or a large entity; and

    b. relates to the offer or holding of FMCA financial products.

60. Managed investment structures, public debt offerings, securitisations, covered bond arrangements, retail investment trusts and structured finance arrangements are commonly structured as or involve trust arrangements. In addition, security arrangements for large wholesale or syndicated loans often involve the use of a security trustee who holds the secured assets on trust.

61. Many of the issues applying to securitisations, covered bond structures, structured finance arrangements, retail investment trusts and security trustee arrangements apply equally to managed investment structures and public debt offerings. For this reason, NZBA submits that any relief ultimately provided to wholesale investment trusts should also apply to commercial trusts more broadly – including those which are offered to the public. Please also see our comments at paragraph 19 above regarding FMC investment trusts and their governance by the FMCA and FMSA.

62. Furthermore, the beneficiary requirements are not wide enough in terms of securitisation arrangements where there may be an income charity beneficiary which is the typical beneficiary who receives any residual capital at the end of the transaction.

63. NZBA submits that, in respect of trusts which fall under our proposed expanded definition of wholesale investment trusts, Schedule 2 should be expanded to exclude the following provisions (in addition to those raised in the submissions of Russell McVeagh and Chapman Tripp), given the sophistication of the participants involved and the terms of the trust being agreed between the parties. The application of these sections to wholesale investment trusts appears to be increasing compliance costs for little benefit where negotiated contractual outcomes are typically reached in any event:

    a. subpart 3 of Part 3 (trustee's obligations to keep and give trust information);

    b. clauses 142-146 (audit of condition and accounts of trust property).

64. NZBA submits that clause 3 of Schedule 2 should be expanded to include clauses 33 and 71(1)(c). Furthermore, the drafting of clause 3 appears to limit the exclusion to situations where the trustee acted or omitted to act on the lawful instructions of another person, in which case it is questionable whether the trustee would be grossly negligent. A trustee of a custodial trust or other wholesale investment trust should be able to limit its liability for any gross negligence, given its limited duties and the low level of remuneration. This also applies to other custodial trusts, such as retail custodial trusts (i.e. where financial products are held in custody for retail investors and the custodian is required to act in accordance with instructions). NZBA submits clause 3 of Schedule 2 should be extended to apply to all custodial trusts. NZBA also notes and endorses the comments made by Russell McVeagh and Chapman Tripp regarding the use of the term “gross negligence”.