

Supplementary Regulatory Impact Statement: A New Trusts Act—Commercial and Financial Trusts

Agency Disclosure Statement

This supplementary Regulatory Impact Statement (RIS) has been prepared by the Ministry of Justice.

The RIS describes the impacts of applying the Law Commission’s recommendations about family trusts to commercial and financial trusts. The Ministry considers the RIS supports two conclusions:

- Most of the Law Commission’s recommendations should apply to commercial and financial trusts, including core trust principles.
- Out of the Law Commission’s 51 recommendations, there are seven sets that should not apply to commercial and financial trusts and that the status quo should continue to govern the arrangements in those situations.

The Ministry has based the assessment in this RIS on the intention that the trust law reforms should not impede the use of trusts in capital markets. The Ministry’s views were informed by a targeted group of participants from the finance sector and feedback from submitters on the exposure draft of the Trusts Bill. The Ministry sought independent advice from external experts on commercial and trust law, and capital markets.

It is not known how many commercial and financial trusts currently exist. In addition, many of the impacts are intangible, for example, the costs of changing established practices. Due to the commercially sensitive nature of commercial and financial trusts, the Ministry has no data on costs that may be incurred by these trusts. Two case studies are provided to illustrate potential impacts.

The conclusion of the Ministry is that changing the status quo with respect to commercial and financial trust transactions is unnecessary, and may disrupt current practice and impose compliance costs with no correlating benefit.

Adam Dubas
Manager, Civil Law and Human Rights Policy

July 2017

1. Executive summary

1. A RIS was prepared by the Ministry of Justice in April 2016 that analysed the Law Commission’s recommendations to reform New Zealand trust law (*Regulatory Impact Statement: A New Trusts Act*). In particular, that RIS identified the broad impacts and benefits of the Law Commission’s recommendations for a predominant trust form in New Zealand—family trusts of low complexity that hold the family home as its main asset.
2. That RIS also indicated:
 - 2.1. the Ministry was aware that some of the Law Commission’s recommendations, designed to support family trusts, may not be suited to the way capital market trusts are formed and operated; and
 - 2.2. the Ministry intended to continue to work with the industry to test whether some or all of the Law Commission’s recommendations could work for capital market trusts.
3. Accordingly, the Law Commission’s recommendations were not analysed in that RIS in so far as they applied to commercial and financial trusts.
4. This supplementary RIS assesses the impact of changing the status quo for commercial and financial trusts by applying the Law Commission’s recommendations that are designed to modify and clarify the law for family trusts.
5. The RIS finds that most of the Law Commission’s recommendations should also apply to commercial and financial trusts including the core principles of trust law. However, parties who are experienced in commercial and financial matters are capable of negotiating and agreeing contracts between them. Out of the Law Commission’s 51 recommendations, there are seven sets of recommendations that should not apply to commercial and financial trusts (discussed further below).
6. The RIS finds that for the family trust situations these recommendations are intended to apply to, the status quo best meets the needs of commercial and financial trusts. Additional protections, such as some of those the Law Commission recommends, that would apply only because the contracts also create trust arrangements, are not necessary.
7. Applying the seven classes of the Law Commission’s recommendations to commercial and financial trust transactions is unnecessary, and may disrupt current practice and impose compliance costs with no correlating benefit.
8. Due to the wide variation of commercial and financial trusts and the often intangible impacts, representative examples of impacts are set out in two case studies.

2. Status quo and problem definition

9. A commercial and financial trust is based on a contract, the primary legal mechanism by which businesses interact with each other.
10. The parties negotiating commercial and financial arrangements that result in trusts are all experienced in commercial and financial matters. There is no power imbalance in negotiations. While the terms of the contract are subject to general contract and commercial law, parties have few restraints in the contracts they negotiate.
11. The use of trusts to implement commercial and financial transactions is widespread. The terms of the trust are subject to the provisions of the Trustee Act 1956 and the common law. This provides both legal certainty and flexibility. This combination means the trust structure can accommodate complex transactions and the specific requirements of different parties, including how to best operate the trust. Over time, commercial and financial trusts have developed rules within the current laws, which are recognised and accepted in commercial

practice. The trust structures are compatible internationally with similar frameworks for commercial and financial purposes.

12. The contractual relationship regulates the basic rights and liabilities of the parties. The trust relationship is not intended to alter the purpose the contract was intended to meet.

2.1 What are commercial and financial trusts?

13. Commercial and financial trusts:
 - 13.1. are mechanisms to implement commercial and financial transactions. They are not family trusts, will trusts, or other forms of trust designed to benefit individuals who are not parties to the transaction;
 - 13.2. have terms that are negotiated and consensual; and
 - 13.3. have parties that are experienced in creating and operating trusts in a professional capacity or as part of being 'in-trade'.
14. Core principles of trust law still apply to commercial and financial trusts. The core principles of trust law are:
 - 14.1. the settlor by words or actions identifies the beneficiaries, or permitted purpose; identifies the trust property; and indicates an intention to create a trust;
 - 14.2. the fundamental duties of trustees, without which there is no trust, must apply;
 - 14.3. liability for dishonesty or wilful misconduct cannot be excluded by the terms of the trust.
15. The terms of commercial and financial trusts vary widely, as they are tailored to meet the requirements of the parties in the transaction. For example, it is creditors or investors and not beneficiaries that are the main focus. The structures aim to provide confidence to creditors and investors through ensuring a proper allocation of risk between lenders, the borrower and the trustee. These trusts generally are established to meet the investment requirements rather than arising out of the transfer of property by way of gift. In some trust schemes, the creditor or investor is fused with the beneficiary. In others, there is a separate beneficiary whose entitlement is largely residual.
16. Examples of commercial and financial trusts¹ include:
 - 16.1. custodial arrangements for securities;
 - 16.2. management of diverse asset portfolios;
 - 16.3. inter-creditor priority agreements;
 - 16.4. debt factoring agreements;
 - 16.5. holding funds in escrow pending completion of transactions; and
 - 16.6. ensuring funds are applied for a designated purpose (*Quistclose* trusts).
17. Trustee corporations providing corporate trustee services are involved in up to NZ\$263.5 billion worth of trusts used to raise capital in the finance industry in New Zealand.² Similar

¹ These trusts are not those regulated by the Financial Markets Conduct Act 2013 or the Financial Advisers Act 2008. Trusts regulated by those Acts are not part of the analysis of this RIS.

² This includes trusts regulated by the Financial Markets Conduct Act 2013 or the Financial Advisers Act 2008. Source: The Trustee Corporations Association of New Zealand Inc Census 2013-2015—'corporate trusts' category: <http://www.tca.org.nz/assets/pdfs/2015-TCA-Census-Final.pdf>

data is not collected for commercial trusts as they cover a much wider range of parties and sectors and there is no central point of data collection.

2.2 Impact of applying the Law Commission’s recommendations

18. The Law Commission’s recommendations were designed to amend the status quo for a predominant trust form in New Zealand—family trusts of low complexity that hold the family home as its main asset. The recommendations address the following issues with current trust law for settlors, trustees and beneficiaries of family trusts:
 - 18.1. the Trustee Act 1956 contains inaccessible or inapplicable administrative procedures;
 - 18.2. many of the current Trustee Act’s provisions are convoluted and out of date; and
 - 18.3. the law on trusts, although relevant to many people, is inaccessible.
19. The identified issues are not problems for commercial and financial trusts. The parties to these trusts are well informed, and well placed to consider whether certain matters should be included or excluded. Applying all of the Law Commission’s recommendations is unnecessary, and may disrupt current practice and impose compliance costs with no correlating benefit.
20. Applying recommendations that are not designed for commercial and financial trusts could make trustees reluctant to exercise discretions or other rights provided for under the trust deed for fear of incurring liability, or they may not be prepared to be trustees in the face of uncertainty. The trust structure may be discarded and replaced with other contractual arrangements or removed from New Zealand and set up in other jurisdictions. This may result in less optimal outcomes for the transactions.

3. Objectives

21. The objective of the Law Commission’s recommendations is set out in *Regulatory Impact Statement: A New Trusts Act*, and is to have accessible, understandable, useful and fair trust law that reduces administrative difficulties and costs, and is generally aligned with internationally accepted principles.³
22. These objectives are also suitable for assessment of the Law Commission’s recommendations for commercial and financial trusts.

3.1 Criteria to assess the recommendations

23. The criteria used in *Regulatory Impact Statement: A New Trusts Act* for assessing the Law Commission’s recommendations for private and family trusts is also suitable to assess the recommendation for commercial and financial trusts:
 - 23.1. **Easy to access and understand:** The Law Commission’s recommendation is necessary to apply to assist/protect the parties. The recommendation makes it easy for settlors to understand what they are doing when establishing a trust. It makes trustees’ obligations clear so trustees can administer trusts well. It outlines beneficiaries’ rights in relation to trusts so they can enforce them.
 - 23.2. **Reflects trust practice now and allows for future developments:** The Law Commission’s recommendation reflects and supports the current certainty of the operation of commercial and financial trusts and allows flexibility for practices to change over time.

³ These objectives align with those of the Law Commission in its report: *Review of the law of trusts: preferred approach*, IP31, p 7.

- 23.3. **Fair and principled, encourages confidence in the use of trusts:** The law Commission's recommendation does not impede the use of trusts in capital markets. It creates trust law that is equitable by balancing the interests of those involved with trusts. It encourages people to deal with trusts with confidence, including overseas settlors. It provides principles for the basis of court intervention in trusts.
- 23.4. **Uses simple, cost-effective, efficient processes:** The benefits of the Law Commission's recommendation outweigh the costs. The recommendation provides simple, cost-effective and efficient ways to administer trusts and resolve problems and disputes related to trusts.

4 Options and impact analysis

24. We do not consider that applying the Law Commission's recommendations to commercial and financial trusts without further consideration is an option. We have identified two other options:

4.1 Do not apply the recommendations to commercial and financial trusts

25. The first option would be that the Law Commission's recommendations did not apply to commercial and financial trusts. This would mean that the status quo would continue ie, the Trustee Act 1956 and common law (as it would now develop for these trusts) would apply.
26. However, this option would mean there would be a different set of rules and procedures for a particular sub-set of trusts. This would undermine uniformity and certainty about which laws apply.
27. There would also be practical difficulties of retaining (some or all) of the Trustee Act 1956 while at the same time having a new Trusts Act containing the Law Commission's recommendations as they apply to family trusts. This option has not been further considered.

4.2 Apply the recommendations unless they do not meet the criteria

28. This option assumes that the Law Commission's recommendations will apply to commercial and financial trusts.
29. Two analyses were undertaken:
- 29.1. Table 1 sets out all the Law Commission's recommendations and identifies, for commercial and financial trusts:
- 29.1.1. those that should apply; and
- 29.1.2. those that do not appear necessary or could disrupt current practice or impose compliance costs.
- 29.2. Table 2 analyses, against the criteria, the Law Commission's recommendations identified in Table 1 as needing further assessment before determining whether they should apply or not.
30. Table 1 below sets out the first analysis. The colour key for the respective rows is:
- 30.1. Green: Law Commission's recommendations that should apply to commercial and financial trusts. These are not analysed further. The analysis as set out in *Regulatory Impact Statement: A New Trusts Act* applies. The recommendation does not change the status quo because it is one or more of the following:
- 30.1.1. core trust law that must apply if commercial and financial trusts wish to access the benefits of trust law;

- 30.1.2. there do not appear to be negative impacts requiring further assessment if they were to apply to commercial and financial trusts;
- 30.1.3. default administrative provisions that commercial and financial parties are able to contract out of if they so wish;
- 30.1.4. not relevant to the circumstances of commercial and financial trusts and will not apply in any case.
- 30.2. Yellow: recommendations further analysed in Table 2. The line in Table 2 where the further analysis is set out is identified.
- 30.3. Orange: a recommendation where parts of the overall recommendation will apply (green) and parts are further analysed.
- 30.4. Purple: recommendations regarding relationship property and trusts that have not been analysed. See *Regulatory Impact Statement: A New Trusts Act* at page 49.

Table 1: the Law Commission’s recommendations as applied to commercial and financial trusts

	Subject matter of the Law Commission’s Recommendation	Category	Line in Table 2 where further analysis is set out
1	Characteristics and creation of a trust	Apply	
2	Mandatory trustee duties	Apply	
3	Other trustee duties	Analyse part	
3A	Default duties	Apply	
3B	Paid advisers	Further analyse	Line 1
4	Trustee exemption and indemnity clauses	Analyse part	
4A	Trustee exemption and indemnity	Apply	
4B	Court power to relief of a trustee from personal liability in certain circumstances	Apply	
4C	Duty of paid adviser	Further analyse	Line 1
4D	Prohibition on exempting or indemnifying ‘gross negligence’	Further analyse	Line 2
5	Retention of information by trustees	Further analyse	Line 3
6	Provision of information to beneficiaries	Further analyse	Line 4
7	Administrative powers	Apply	
8	Powers of maintenance and advancement	Apply	
9	Age of majority	Apply	
10	Appointment of agents	Further analyse	Line 5
11	Appointment of nominees and custodians	Further analyse	Line 5
12	Power to appoint delegates	Further analyse	Line 5
13	Standard of care	Apply	
14	Investment powers and duties	Apply	
15	Distinction between income and capital	Apply	
16	Apportionment of receipts and outgoings	Apply	
17	Investment managers	Further analyse	Line 5
18	Acceptance and rejection of trusteeship	Apply	
19	Who may be appointed as a trustee?	Apply	
20	Mandatory and discretionary grounds for removal of a trustee	Apply	
21	Who may remove and appoint trustees, retirement and replacement of trustees	Apply	

22	Appointment of replacement when trustee dies while in office	Apply	
23	Retirement and replacement of trustee	Apply	
24	Exercise of power to remove and appoint trustees	Apply	
25	Numbers of trustees	Apply	
26	Transfer of trust property	Apply	
27	Custodian trustees	Further analyse	Line 5
28	Advisory trustees	Further analyse	Line 5
29	Revocations and variation by beneficiaries	Further analyse	Line 6
30	Revocation and variation by the court	Apply	
31	Extension of trustees' powers by the court	Apply	
32	Reviewing the acts and omissions of trustees	Apply	
33	Other powers of the court – power to give directions	Apply	
34	Payment of a commission to a trustee	Apply	
35	Beneficiary indemnity for breach of trust	Apply	
36	Barring claims and future claims	Apply	
37	Payments to the Crown	Apply	
38	Distribution of shares of missing beneficiaries	Apply	
39	Protection against creditors by means of advertising	Apply	
40	High Court and District Court jurisdiction	Apply	
41	Family Court jurisdiction	Apply	
42	Alternative Dispute Resolution	Apply	
43	The Public Trust (exercise of role and ability to charge fees)	Further analyse	Line 5
44	The Public Trust (applications for the accounts of trust property to be audited)	Apply	
45	Standing of the Official Assignee to challenge a trust	Apply	
46	Appointment of receiver for trusts	Apply	
47	Trustee's right to indemnity	Further analyse	Line 7
48	Creditors dealing with trustees	Apply	
49	Perpetuities	Apply	
50	Relationship property - Property (Relationships) Act 1976	N/A	
51	Relationship property - Family Proceedings Act 1980	N/A	

31. Table 2 below sets out the second analysis and describes whether the application of the Law Commission's recommendation to commercial and financial trusts will meet the criteria as compared to the status quo.
32. The analysis shows that none of the Law Commission's recommendations in Table 2 are necessary to protect one or more of the parties to a commercial or financial trust.
33. In addition, there were no positive findings that the recommendations either reflected current trust practice or encouraged confidence in the use of commercial and financial trusts.
34. Finally, all identified recommendations created costs. These costs are further described in case studies in Part 5 below.

Table 2: Further analysis of recommendations identified Table 1

Option: Application of recommendation		Criteria for assessment				Preferred Approach
		Easy to access and understand: The recommendation is necessary to assist/protect the parties	Reflects trust practice now and allows for future developments: The recommendation supports the current operation of commercial and financial trusts	Fair and principled, encourages confidence in the use of trusts: the recommendation does not impede the use of trusts in capital markets	Uses simple, cost-effective, efficient processes: the benefits of the recommendation outweigh the costs	
1	<p>Recommendation 3B and 4C: Paid Advisers <i>The Law Commission's recommendation (as modified by Ministry)</i> Linked to R3 (other trustee duties): Paid advisors are required to disclose to settlor any exclusions or modifications of the default trustee duties in the trust deed. <i>The Law Commission's recommendation R4(1)(c):</i> Paid advisors are required to ensure settlor is aware of meaning and effect of liability exclusion or indemnity clause.</p>	<p>Characteristics of commercial and financial trusts do not give rise to policy considerations intended to be addressed by the reform ie, that the settlor of a family trust would not otherwise know the impact of particular trust terms.</p>	<p>New requirement. No disclosure obligation at common law. In a business contract, it is up to the parties themselves to ensure understanding of the terms of the contract, even where it creates a fiduciary relationship.</p>	<p>Parties are experienced and well informed. This adds an unnecessary obligation to the process of negotiating commercial and financial transactions.</p>	<p>Recommendation will impose unnecessary requirements, and create costs.</p>	<p>The provision is unnecessary where parties are experienced and well informed, it does not reflect current practice and creates costs. The provision should not apply to commercial and financial trusts.</p>
2	<p>Recommendation 4D: gross negligence <i>The Law Commission's recommendation (as modified by Ministry)</i> Prohibition on exempting or indemnifying a trustee for gross negligence.</p>	<p>Not necessary where parties have the expertise to negotiate the allocation of risk between them.</p>	<p>New requirement. Addition to current common law prohibitions for wilful misconduct or dishonesty.</p>	<p>Introduces uncertainty. The meaning of 'gross negligence' is not clear in current law and would not be clear until a court has reviewed the issue.</p>	<p>Recommendation will impose unnecessary requirements, and create costs.</p>	<p>The most negative impact would be the uncertainty created therefore impeding the use of trusts in capital markets. The provision should not apply to commercial and financial trusts.</p>

Option: Application of recommendation		Criteria for assessment				Preferred Approach
		Easy to access and understand: The recommendation is necessary to assist/protect the parties	Reflects trust practice now and allows for future developments: The recommendation supports the current operation of commercial and financial trusts	Fair and principled, encourages confidence in the use of trusts: the recommendation does not impede the use of trusts in capital markets	Uses simple, cost-effective, efficient processes: the benefits of the recommendation outweigh the costs	
3	<p>Recommendation 5: Documents to be kept by trustees</p> <p><u>The Law Commission's recommendation</u></p> <p>Set out a non-exhaustive list of documents a trustee is required to retain, so far as is reasonable.</p>	<p>Not necessary for experienced parties. Characteristics of commercial and financial trusts do not give rise to policy considerations intended to be addressed ie, trustees of a family trust need guidance on what documents are to be kept.</p>	<p>The duty to retain important trust documents can be implied from the common law. The extent of the duty is varied depending on the particular circumstances of the trust.</p>	<p>Trustees, as part of usual commercial practice will be retaining documents required to meet the requirements of the transaction. This will not necessarily need to be all of the documents set out in the recommendation.</p>	<p>Some cost impact especially where requirements would be very difficult, if not impossible, for a trustee to comply with eg a list of assets for an investment scheme may change hourly in response to offshore market fluctuations.</p>	<p>The documents that are kept will not always reflect the list in the recommendation and it is not necessary that they do. The provision should not apply to commercial and financial trusts.</p>

Option: Application of recommendation		Criteria for assessment				Preferred Approach
		Easy to access and understand: The recommendation is necessary to assist/protect the parties	Reflects trust practice now and allows for future developments: The recommendation supports the current operation of commercial and financial trusts	Fair and principled, encourages confidence in the use of trusts: the recommendation does not impede the use of trusts in capital markets	Uses simple, cost-effective, efficient processes: the benefits of the recommendation outweigh the costs	
4	<p>Recommendation 6: Giving information to beneficiaries</p> <p><u>The Law Commission's recommendation (as modified by Ministry)</u></p> <p>Trustee must notify beneficiaries of certain information. This information must be provided to beneficiaries on request unless trustee considers it reasonable that information is not provided (after taking into account a range of factors).</p>	<p>Not necessary for experienced parties. Characteristics of commercial and financial trusts do not give rise to policy considerations intended to be addressed ie, trustees of a family trust need guidance on information to be provided and how to decide whether or not to provide it.</p>	<p>Current law sets out no presumption in favour or against disclosure, requires exercise of discretion of trustee. Trustees will be exercising their discretion according to the needs of the transaction and as agreed in the contract. Beneficiaries of these transactions do not require this information.</p>	<p>Extent of the duty can currently be varied depending on the particular circumstances of the trust. The presumption will be changed and new obligations will be imposed.</p>	<p>Cost impact as the new requirements means that either beneficiaries must receive the prescribed information or explicit consideration must be undertaken by trustees in each instance if information were to be withheld. This would be especially difficult where there are hundreds or thousands of beneficiaries.</p>	<p>The purpose of information provision is to enable the trust to be enforced. This is unnecessary for commercial and financial trusts where contractual remedies apply. The provision should not apply to commercial and financial trusts.</p>

Option: Application of recommendation		Criteria for assessment				Preferred Approach
		Easy to access and understand: The recommendation is necessary to assist/protect the parties	Reflects trust practice now and allows for future developments: The recommendation supports the current operation of commercial and financial trusts	Fair and principled, encourages confidence in the use of trusts: the recommendation does not impede the use of trusts in capital markets	Uses simple, cost-effective, efficient processes: the benefits of the recommendation outweigh the costs	
5	<p>Recommendations 10, 11, 12, 17, 27, 28 and 43: Appointment of agents, custodians, nominees and delegates including investment managers and custodial trustees, advisory trustees and the Public Trust.</p> <p><u>The Law Commission's recommendation</u></p> <p>Update the Trustee Act 1956 and set out circumstances where functions and powers can be assigned, with requirements about the continued role of the trustee.</p>	<p>Not necessary for experienced parties. Characteristics of commercial and financial trusts do not give rise to policy considerations intended to be addressed ie, trustees of a family trust need guidance as to what functions can be delegated and what cannot.</p>	<p>There is flexibility to contract and delegate functions that are negotiated depending on the particular circumstances of the trust.</p>	<p>Delegation is an important part in the operation of many trusts eg to maintain a presence in off-shore market time zones. There is a need to retain flexibility to respond to any situation.</p>	<p>Requirements are narrower than current practice and will create costs.</p>	<p>The recommendations are intended to protect beneficiaries by restricting delegation. This is not required where parties are experienced and well-informed. The provision should not apply to commercial and financial trusts.</p>

Option: Application of recommendation		Criteria for assessment				Preferred Approach
		Easy to access and understand: The recommendation is necessary to assist/protect the parties	Reflects trust practice now and allows for future developments: The recommendation supports the current operation of commercial and financial trusts	Fair and principled, encourages confidence in the use of trusts: the recommendation does not impede the use of trusts in capital markets	Uses simple, cost-effective, efficient processes: the benefits of the recommendation outweigh the costs	
6	<p><i>R29: revocation and variation by unanimous consent of beneficiaries</i></p> <p><u><i>The Law Commission's recommendation (as modified by Ministry)</i></u></p> <p>Set out the two common law rights of beneficiaries relating to the distribution of trust property, and the transfer of a fixed share in trust property, as above.</p> <p>Clarify that beneficiaries may also act together with trustees to confer new powers upon trustees or deviate from, or vary, the terms of the trust, and also resettle a trust.</p> <p>In addition to these rights, allow for beneficiaries and trustees to agree to reduce or remove trustee powers.</p>	<p>Not necessary for experienced parties. Characteristics of commercial and financial trusts do not give rise to policy considerations intended to be addressed ie, beneficiaries of family trusts need guidance on the extent of their powers.</p>	<p>Reflects common law but the extent of the duty can currently be varied depending on the particular circumstances of the trust.</p> <p>The statutory powers for beneficiaries will be inconsistent with how many commercial and financial trusts work. Parties have negotiated variation and wind-up mechanisms.</p>	<p>Will introduce uncertainty. The provision is either unnecessary, because the beneficiary has already been a party to negotiating the contract and accepted the terms, or it will be inappropriate for beneficiaries to have this level of control and influence over the transaction.</p>	<p>Recommendation will impose unnecessary requirements, and create costs.</p>	<p>The role of beneficiaries does not need to be set out for experienced and well-informed parties. The provision should not apply to commercial and financial trusts.</p>

Option: Application of recommendation		Criteria for assessment				Preferred Approach
		Easy to access and understand: The recommendation is necessary to assist/protect the parties	Reflects trust practice now and allows for future developments: The recommendation supports the current operation of commercial and financial trusts	Fair and principled, encourages confidence in the use of trusts: the recommendation does not impede the use of trusts in capital markets	Uses simple, cost-effective, efficient processes: the benefits of the recommendation outweigh the costs	
7	<p><i>R47: trustees' right to indemnity</i></p> <p><u><i>The Law Commission's recommendation</i></u></p> <p>Modernising the Trustee Act 1956 to set out principles relating to the liability of trustees and their right of indemnity.</p>	Not necessary for experienced parties where payment schedules are negotiated based on the requirements of the transaction.	<p>Reflects common law but the extent of the duty can currently be varied depending on the particular circumstances of the trust.</p> <p>Inconsistent with many commercial and financial trusts that set out the order in which trust property is applied to meet expenses and liabilities.</p>	For many commercial and financial trusts, a particular payment order is required for certainty and may be expected by rating agencies in order to meet the requirements of a high credit rating.	Recommendation will impose unnecessary requirements, and create costs.	The provision is unnecessary, does not reflect current practice, may impede the use of trusts in capital markets and creates costs. The provision should not apply to commercial and financial trusts.

5 Case studies on impacts of identified recommendations

35. The premise underlying the analysis in this RIS is that applying the Law Commission's recommendations in Table 2 to commercial and financial trusts as if they were family trusts, is unnecessary and may disrupt current practice and impose compliance costs with no correlating benefit. The status quo best meets the needs of commercial and financial trusts for the situations where the seven sets of the Law Commission recommendations set out in Table 2 might apply.
36. Submitters on the exposure draft of the Trusts Bill were concerned about potential disruption to established practices, in particular, the existing flexibility of parties to reach their own agreement within the status quo. Submitters stated that unintended consequences would include increasing commercial friction and the cost of entering into commercial transactions, increasing the costs of capital and preventing innovation, and impacting on credit ratings for issuers and structures. This would affect the development and efficient operation of financial markets if the use of trusts became too difficult and alternative vehicles needed to be found.
37. Table 2 analyses general impacts of applying the Law Commission's recommendations to commercial and financial trusts. Due to the wide variation of these trusts, illustrative examples of impacts are set out in two case studies: a smaller business transaction (a debt factoring arrangement) and a wholesale commercial transaction that would usually be very large (a securitisation trust).

5.1 Case Study 1: Debt factoring arrangement

38. A debt factoring arrangement involves the sale of present and future book debts of a trading company to a factoring company. Debt factoring is widely used to provide a source of finance, to offer protection against bad debt and/or for sales ledger administration. The terms of factoring transactions differ extensively. Common features include:
 - the trading company receives cash up front in exchange for rights to cash collected from its receivables;
 - legal title to the receivables might or might not be transferred (more often not – in which case the trust is created);
 - the rights transferred are often subject to restrictions or guarantees;
 - the factoring company may have recourse back to the trading company. These rights can be up to a set limit, or to the full extent of non-performance;
 - the factoring company might administer the sales ledger, undertake credit control, send invoices and statements and undertake other servicing activities;
 - the debtors might pay the factoring company directly, pay into a designated bank account over which the factoring company has some control or pay the trading company;
 - the arrangement is often "rolling" ie, all new invoices raised are factored until the arrangement is discontinued; and
 - the factoring company charges interest and fees.
39. A trust would be used to provide the factoring company with security. The trading company becomes the trustee of the debts due by its debtors, and the factoring company is the beneficiary. Otherwise the factoring company is exposed to the risk that the trading company

will become insolvent and payments made by debtors will instead go to the liquidator, receiver or administrator of the trading company.

40. The following impacts could arise if the Law Commission’s recommendations are applied:

The Law Commission’s recommendation	Impacts for a debt factoring arrangement
<p>Recommendation 3B, 4C Disclosure requirements for paid advisors:</p> <ul style="list-style-type: none"> • requiring a paid adviser to ensure a settlor is aware of the meaning and effect of any modification or exclusion of default duties; • requiring a paid adviser to alert a settlor to liability exclusion or indemnity clauses. 	<p>Not relevant.</p> <p>The settlor (the trading company) is a party to the terms of the trust deed. The trading company (as settlor) will be aware of the impact of its own instructions and agreements on the commercial arrangements it seeks to give effect to.</p>
<p>Recommendation 4D Limiting liability for and indemnity of gross negligence of a trustee.</p>	<p>Not necessary.</p> <p>The new term introduces uncertainty into the contractual arrangements. Risk is otherwise allocated as negotiated between parties and as suited to the arrangements.</p>
<p>Recommendation 5 and 6 Obligations and presumptions relating to keeping trust information and providing information to beneficiaries.</p>	<p>Additional requirements impose costs for no benefit.</p> <p>The two parties have agreed what information is necessary to be kept and passed on according to established business practice.</p>
<p>Recommendations 10, 11, 12, 17, 27, 28 and 43 Rules relating to trustees’ appointment of agents, custodians, nominees and delegates including investment managers and custodial trustees, advisory trustees and the Public Trust.</p>	<p>Not necessary.</p> <p>Parties are able to make informed decisions and agree what is appropriate to suit the commercial arrangement.</p>
<p>Recommendation 29 Beneficiaries acting unanimously:</p> <ul style="list-style-type: none"> • requiring trustees to terminate the trust and distribute trust property; • empowering beneficiaries to take certain actions such as varying the terms of the trust. 	<p>Not necessary.</p> <p>The beneficiary is the factoring company. The parties have agreed informed decisions about how the arrangement is varied or terminated.</p>
<p>Recommendation 47 The application of certain trustees’ indemnities.</p>	<p>Not necessary.</p> <p>The fee arrangements and cost allocation has been negotiated.</p>

5.2 Case Study 2: Securitisation trust

41. Securitisation is a structured financial arrangement characterised by:
- a special purpose vehicle (SPV), is established to raise funds by issuing debt securities (typically bonds) to investors. The bonds are often rated by credit rating agencies;
 - the proceeds of the issued securities are used by the SPV to purchase receivables eg, principal and interest payments owed on residential mortgages;
 - the receivables are generated and/or owned by an established business entity eg, a bank.
 - the obligations of the SPV are limited to and secured by the pool of receivables;
 - amounts paid in respect of the receivables are received by the SPV, fund payment obligations and the costs of the SPV.
42. A securitisation trust is created when the bank sets up a trust in favour of the SPV as the beneficiary. The bank is the settlor and trustee of the trust assets (the receivables). The securities are legally distinct and, therefore, protected from the bankruptcy of the bank.
43. Securitisation trusts are arrangements made between wholesale parties ie, not consumers. Securitisation arrangements have substantial benefits as an alternative means of raising money for lower cost. An industry source estimates securitisation trusts that it was involved with totalled over NZ\$28 billion in assets as at June 2015.
44. The following impacts could arise if the Law Commission’s recommendations are applied:

The Law Commission’s recommendation	Impacts for a securitisation trust
<p>Recommendation 3B, 4C Disclosure requirements for paid advisors:</p> <ul style="list-style-type: none"> • requiring a paid adviser to ensure a settlor is aware of the meaning and effect of any modification or exclusion of default duties; • requiring a paid adviser to alert a settlor to liability exclusion or indemnity clauses. 	<p>Not relevant.</p> <p>The settlor will often be a bank that does not require the protection the provision is designed for. Settlor either instructs the paid adviser or has only a nominal interest in the construction and operation of the trust fund.</p>
<p>Recommendation 4D Limiting liability for, and indemnity of, gross negligence of a trustee.</p>	<p>Not necessary.</p> <p>Securitisation arrangements need to be certain. Introducing a term that is not defined and requires a methodology or ruling to determine how to distinguish it from ordinary negligence will create uncertainty.</p>
<p>Recommendation 5 and 6 Obligations and presumptions relating to keeping trust information and providing information to beneficiaries.</p>	<p>Not necessary.</p> <p>Adds little value for investors, who will have already received the information they need as part of the investment information disclosure process.</p> <p>Adds to the costs and administration of establishing any securitisation arrangement that will be passed on to debtors ie, mortgagees.</p>

<p>Recommendations 10, 11, 12, 17, 27, 28 and 43</p> <p>Rules relating to the appointment of agents, custodians, nominees and delegates, including investment managers and custodial trustees, advisory trustees and the Public Trust.</p>	<p>More restrictive rules are not necessary and will remove the flexibility required to meet the intent of the arrangement.</p>
<p>Recommendation 29</p> <p>Beneficiaries acting unanimously:</p> <ul style="list-style-type: none"> • requiring trustees to terminate the trust and distribute trust property; • empowering beneficiaries to take certain actions such as varying the terms of the trust. 	<p>Not necessary.</p> <p>Investors as beneficiaries with this control or influence would undermine the commercial arrangement and create uncertainty. This will lower the credit rating for the bonds or make it impossible to get a credit rating.</p>
<p>Recommendation 47</p> <p>The application of certain trustees' indemnities.</p>	<p>Not necessary.</p> <p>The application will undermine the 'waterfall' of payments that have been negotiated and the certainty of which are used by credit agencies to rate the bonds. May interfere with payout arrangements or winding up arrangements.</p>

6 Consultation

45. In April 2016, Cabinet agreed to the majority of the Law Commission's recommendations [EGI-16-MIN-0068 refers]. However, Cabinet noted that finance industry representatives had raised concerns about some of the trust reform proposals and agreed that the Ministry should work with the finance industry members to consider these concerns.
46. The Ministry subsequently held two meetings with a sample of finance industry participants. The industry's key concerns were with the proposed trust definition, restrictions on exemption and indemnity clauses, and mandatory trustee duties. They were also concerned about aspects of other proposals, including those which imposed disclosure or other compliance obligations that they considered were not relevant to the context in which wholesale finance trusts operate.
47. An approach for defining a "wholesale investment trust" was developed and recommendations relating to paid advisers and beneficiaries acting unanimously were identified as not appropriate to apply to wholesale investment trusts. One Law Commission recommendation relating to indemnity of trustees was modified so that it only partly applied.
48. The approach was tested in the exposure draft of the Trusts Bill which was released on 10 November 2016 for six weeks.
49. Eight submissions were received on the exposure draft of the Trusts Bill from the finance industry about the treatment of wholesale investment trusts and on commercial and financial trusts in general. Four were from national law firms, two from industry organisations and two from the banking sector.
50. All eight submitters thought that all the trust structures used to facilitate commercial and financial transactions were not fully recognised in the exposure draft of the Trusts Bill. Some submitters thought trusts for these purposes should be excluded entirely from the application of the Law Commission's recommendations. Others suggested that a wide range of other Law Commission recommendations should not apply.

51. The Ministry sought independent advice from external experts on commercial and trust law and capital markets. The Ministry concluded that there was merit in considering whether a wider group of commercial and financial trusts should be excluded from a greater number of the Law Commission’s recommendations.

7 Conclusions and recommendations

52. The Ministry has come to two conclusions:
 - 52.1. most of the Law Commission’s recommendations should apply to commercial and financial trusts, including core trust principles;
 - 52.2. that out of the Law Commission’s 51 recommendations, there are seven sets that should not apply to commercial and financial trusts.
53. The seven sets of recommendations set out in Table 2 should not apply because commercial and financial trusts have purposes and features that are different to the type of trust the Law Commission contemplated when designing its recommendations. The application of these recommendations would modify the status quo for commercial and financial trusts by imposing unnecessary requirements, and may disrupt current practice and impose compliance costs.
54. The Ministry considers that exclusion of these recommendations strikes a reasonable balance between the preferred approach of many submitters in the finance industry for full exclusion and the intentions of the Law Commission’s recommendations. The preferred approach:
 - 54.1. requires compliance with core trust law;
 - 54.2. reflects, and permits the continuation of, current commercial and financial trust practice;
 - 54.3. supports efficient capital markets by minimising uncertainty and avoiding compliance costs;
 - 54.4. restricts exclusions only to matters where it is appropriate to allow commercial and financial parties to maintain an ability to structure their transactions and specify how a trust will operate; and
 - 54.5. presents no identifiable harm. None of the objectives identified in the Law Commission’s report, and which a new Trusts Act is intended to achieve for family trusts, would be undermined by the proposed exclusions in the context of commercial and financial trusts.

8 Implementation plan

55. The provisions will be given effect to by a Schedule to a new Trusts Act, once it is enacted. This segregates the exclusions so that the parties to the commercial and financial trusts will be able to easily refer to them. A separate schedule supports the fundamental purpose of the new Trusts Act to ensure the law is accessible and understandable to settlers, trustees and beneficiaries of family trusts.
56. An appropriate definition will be needed of a ‘commercial and financial trust’. Firstly, parties to these trusts require certainty. Secondly, family trust trustees should not be able to consider that they are excluded from the specified provisions and therefore not fulfil provisions that are relevant to their trust. The definition should also not, for example, exclude family trusts that have a significant commercial purpose. Such family trusts often have beneficiaries who have not had any input into the terms of the trust, and who require the full range of protections contemplated by a new Trusts Act.

9 Monitoring, evaluation and review

57. The Ministry will administer a new Trusts Act and will continue to monitor case law in this area. The Ministry also expects that the commercial and financial sector will continue to raise any issues with the Ministry directly, as happens currently.