UPDATE
TRUSTS

Perspectives on the disclosure of information to beneficiaries of family trusts

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In this article, we present two perspectives on an important issue for trustees and families: the legal view from Henry Brandts-Giesen, partner at Kensington Swan, and a humanistic view from David Werdiger, experienced family adviser and international bestselling author on family business and wealth.

The legal view – Henry

Private wealth is typically structured, governed and administered in New Zealand in a rather unusual way. In other countries, family trusts are typically utilised judiciously by the wealthy and for the vulnerable. In New Zealand family trusts are ubiquitous and it is common for people of quite modest means to hold assets in a trust. Sometimes a family may have several trusts, each of which holds a single asset or only a few assets. Trusts became a default setting for a previous generation of advisers and, furthermore, it became the norm in New Zealand for trusts to be governed by the very same people who set them up and benefit from them. This is unusual in a global context.

This traditional approach to trusts in New Zealand is now causing issues. Tens of thousands of trusts in New Zealand have been set up by baby boomers over the past few decades. Many of these trusts are now pregnant with substantial wealth which the next generation of the family are, or will be, keen to access.

Coupled with this is the fact that the interests of the now adult children of baby boomers are not always aligned. A new generation of beneficiaries are increasingly well advised and scrutinising the decisions of the trustees and finding defects in governance and administration. This is leading to legal challenges and, increasingly, decisions being invalidated and trustees being found personally liable.

Historically, a beneficiary challenging a trustee's decisions faced practical difficulties in obtaining the necessary evidence. This is partly because record keeping by trustees is often inadequate, but it is also because beneficiaries are often denied access to information about the trust.

A beneficiary's rights to information

In the New Zealand case *Erceg v Erceg* [2017] NZSC 28, the scope of a beneficiary's rights to information was at issue. The Court of Appeal ([2016] NZCA 7) recognised that trustees have discretion in the disclosure of information. This discretion must be exercised in accordance with fiduciary duties, and be balanced against the interest beneficiaries have in the proper administration of a trust and ensuring that the settlor's wishes are met.

The current position is that beneficiaries are likely to have a right to 'core' trust documents such as the trust deed and general information on assets and liabilities. However, documents which contain commercially sensitive or personal information about others may be withheld or redacted.

This position is likely to change in the near future with changes proposed by the Trusts Bill which is making its way (albeit gradually) through Parliament.

Trustees' obligations to keep trust information

Pursuant to clause 41 of the Trusts Bill, each trustee must keep a copy of documents which constitute the trust (eg, the trust deed and any supplemental documents) together with the following documents:

- Records of the trust property that identify the assets, liabilities, income, and expenses of the trust and that are appropriate to the value and complexity of the trust property.
- Records of trustee decisions.
- Written contracts entered into by the trustees.
- Accounting records and financial statements of the trust.
- Documents appointing and

removing trustees (including court orders).
- Letters or memoranda of wishes from the settlor.
- Any other documents necessary for the administration of the trust.

Trustees' obligations to give trust information to beneficiaries

These record keeping obligations are uncontroversial and, in all likelihood, simply a manifestation of more general duties already contained in New Zealand trusts law, but often not fulfilled in practice. However, the Trusts Bill goes further to impose a positive obligation to disclose basic trust information to beneficiaries. This is arguably the most contentious part of the Trusts Bill.

Disclosure of information to beneficiaries is a very important matter. If beneficiaries are not able to obtain information about a trust and their rights, it is difficult for them to hold a trustee accountable. On the other hand, if a beneficiary is armed with information and documentation then it becomes more likely. A consequence of a legal challenge could be that the integrity of the trust (or related transactions) is compromised and the custody of the property held could become vulnerable to creditors, former spouses/partners and other claimants.

As a matter of public policy greater accountability of trustees should, in the ordinary course, be a good thing but there may be unintended and adverse consequences. There are often very good reasons to withhold financial information from beneficiaries. These may include the need to keep private certain commercially sensitive information about a family business or to save beneficiaries (eg, spendthrifts or addicts) from themselves.

The prevailing view amongst commentators

There is a view among certain commentators that the Trusts Bill needs to be reconsidered and balanced against the practicality of identifying and providing information to beneficiaries. For example, as currently drafted, there is a requirement for trustees to provide basic trust information to "every beneficiary or representative of a beneficiary" unless the trustee reasonably considers otherwise.

A better approach may be to restrict the notification requirement to a defined class of 'qualifying beneficiaries'. These could be defined as the 'settlors during their lifetimes and thereafter their children during their lifetimes' or something to that effect. Alternatively, a new sub-clause could be included to exclude any person with no more than a remote possibility of receiving a direct benefit from the trust. This approach might be more sensible as it focuses on the trustees providing information to beneficiaries who have a real interest in receiving the information and holding the trustees to account.

Having made such a suggestion, it is acknowledged that the legal commentary in relation to this issue is mostly one-sided and there is a legitimate counter-argument that increased disclosure may actually avoid and resolve rather than fuel disputes within families. This argument is not a legal or technical one. Instead it derives from the science of human behaviour.

The humanistic view – David

From years of experience in business negotiating contracts and agreements with customers, suppliers, and for other business relationships, the authors have learned that once the negotiation process is complete and the documents are signed, they are often placed in a filing cabinet never to be looked at again. If they are ever retrieved and inspected, it could be the first

sign that something is amiss in the business relationship.

For legal documents relating to estate planning, this same principle applies, but even more so. Business relationships can be relatively transient – they are governed by legal agreements for as long as they exist, and in most cases, the parties are free to go their separate ways when the agreement terminates. They are rarely built on a fiduciary foundation, but rather predicated on commercial principles. This contrasts with family relationships and the structures used to hold family wealth. These are (or ought to be) designed to endure for decades and are often inherently fiduciary in nature.

Another complicating factor is that, unlike the parties to a commercial agreement, beneficiaries to a trust may be both specified or unspecified, and in the latter case may constitute a large group of people who may not be aware of each other or even that they are all beneficiaries. In many cases, there could be a whole cohort of beneficiaries who are not yet born.

When beneficiaries resort to their rights under law to discover details of the assets in trust that they may one day inherit, it ought to be an immediate red flag of deeper issues within the family. So while the disclosure provisions in the Trusts Bill may well strike fear in the hearts of trustees and settlors, in addition to seeking legal advice as to their obligations under the letter of the law, they ought to seek counsel as to how to avoid the risk of the matter ever "going legal" in the first place.

Practical steps for trustees to consider when dealing with disclosure issues

In light of the current and expected legal position once the Trusts Bill is enacted some advisors and trustees may need to prepare for a change of approach.

The following are three suggestions for consideration:

(1) The best way to deal with questions beneficiaries might have about trust assets is to be proactive: instead of waiting for children to ask, have structured (and sometimes facilitated) discussions about the family assets, and what the future holds. Maintaining open information flow about these issues helps avoid beneficiaries making assumptions, which are usually wrong, and can lead to further fractures about unstated matters. Being proactive allows you to control what information is shared and over what period of time, and in general to deal with the situation "on the front foot."

(2) When establishing a legal structure for holding an asset, settlors usually think about themselves and their wishes as to the disposition of said assets to their beneficiaries. However, there are two parties to consider: the giver and the recipient. Accordingly, they should also give some considerations to how the beneficiaries may feel about their role as recipients of the family wealth. Managing expectations is critical.

(3) Trust structures are designed to hold assets and provide for easy transition of their ownership between generations. That means that ownership will change from one person (or group of people) to another. While the current trustees may think of themselves as 'owners' (particularly if they have created the wealth), another way to think of them when transition in mind as using the framework of a "custodian". The term custodian implies two things: a temporary responsibility for the assets, and also a sense of duty to the custodians who came before (if there are any), and those who will follow. When thinking about family assets that frame of mind can help bring other issues into context.

The best legal documentation is that which ends up sitting in the drawer gathering dust because it is never disputed. To achieve that requires more than just a legal approach to how assets transition from one generation to the next. To that end there is a valid counter-argument to the prevailing view amongst commentators and more disclosure of information to beneficiaries as contemplated by the Trusts Bill is a good thing, particularly in light of the way trusts are traditionally set up and governed in New Zealand.

Conclusion – Henry & David

Perspective is everything. Two ways to look at a problem results in two different responses and approaches. On their own, neither approach is complete. Rather, both approaches help better inform decisions that have both legal and relationship ramifications (and most decisions in a family wealth context do have both).

The principle of perspective applies equally to family trusts – we need to consider the perspective of both the trustees and beneficiaries when establishing these structures and ensuring that they serve their intended purpose. ■

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