Cyprus International Trusts: The Augustinian Synthesis

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The failure of Lehman Brothers and the ensuing banking crisis make 2008 a year many in finance would prefer to forget. For trustees the world over, there must be some concern about the quality and the basis of some of the specialist advice they receive from financial advisors. Nevertheless, it is apparent from the 'prudent man of business rule' that trustees may not take for granted the specialist advice they receive but must scrutinise it rigorously for gaps and inconsistencies.

In light of the recent turmoil, this article examines the Cypriot trustee's duty of care when exercising the investment powers of the Cyprus International Trust (CIT) and considers practical ways of responding to its provisions. It does so having specifically in mind the express family trust holding quoted securities, although the themes proposed may possess a wider trust application.

Investment Powers

Cyprus has expressly adopted English common law and equity within the framework of its written constitution. The Cyprus International Trusts Law (Law 69/1992) is the leading trust law for Cypriot professional trustees offering trusts to international clients. It was enacted in 1992 and remains to this day one of the few innovations of Cyprus' international legal canon. It intentionally retains and builds on CAP193, Cyprus' equivalent of the English Trustees Act 1925.

Law 69/1992[1] specifically refers to the trustee's power of investment in §8 to wit (the author's underlining):

'§8/1. Subject to the provisions of the instrument creating an international trust, a trustee may at any time invest the whole or any part of the trust funds in any kind of investment:

a) wherever the investment is situated[2]; and
b) whether or not funds have already been invested.

§8/2. The trustee may vary the investment or retain it in its original state, as long as he exercises the diligence and the prudence which a reasonable person would be expected to exercise when he makes investments.'

In addition, the Central Bank of Cyprus' explanatory note of the law has this to say about §8:

'The existing rules of Cyprus law in relation to trust investments are rather restrictive. The new law includes wider powers which are essentially similar to the "prudent man" rules found in similar legislation of other jurisdictions.'

Historical Context: Lord Nottingham & Lindlay L.J.

There are two main themes of §8.

Firstly, the trust instrument is of paramount importance. The 'father of modern equity', Lord Nottingham (1675-1681) said 'conscience' was the motivation of equity. One leading example of this can be found in its *ad personam* character, which stresses the importance of following the settlor's intent.

Secondly, at the tail end of the Victorian era, there emerged as a full force in equity the 'prudent man of business rule'. Initially, in 1883 there was the 'businessman of ordinary prudence[3]' but a couple of years later Lindlay L.J. used the principles of equitable remedy to finesse the rule to the circumstances of the claimant[4] so that the trustee's duty became:

'not to take such care as a prudent man would take if he only had himself to consider, but rather to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally obliged to provide.'

On the whole, at least where *inter vivos* trusts are concerned, the settlor's wishes ought to be a given. But the relevant meaning of either of these two Victorian terms in today's world is not quite as clear cut.

Defining the meaning of diligence and prudence of the reasonable person is not the only problem facing the Cypriot trustee here. Evidently, there is plenty of scope for disagreement under §8 between Nottingham's *ad personam* and the appropriate diligence and prudence owed to the beneficial interests.

We surely need to find a way of understanding the standard of care that Law 69/1992 §8 expects from trustees and need a system of appropriate navigation when §8 is in conflict with itself.

Equity in Conflict: St. Augustine's Synthesis

St Augustine of Hippo (354-430) an early 5th century theologian came up against a similar challenge during the early days of the Christian church. Struggling to accommodate his two books; the Books of Scripture and Nature within the framework of his 'Unity of Truth' he proposed a profound synthesis of Greek philosophical thought and Christian belief. Belief based on scripture (faith) has primacy but is inseparable from nature (reason). Neither can be slighted as they build on and co-operate with one another possessing the quality of mutual correction.

St Augustine's synthesis could be likened to the trustee's duality of conscience when balancing the equity of *ad personam* and of 'prudent man' or even some other conflict of equity such as balancing the interests between a life tenant and a remainderman. One may say that St. Augustine's religious primacy has become the trust instrument. His

scientific reason has become the equitable concept of the prudent man. Just as faith without reason tends to myth and superstition, slavishly following the trust instrument or the settlor's wishes tends to 'shamming' or a breach of trust.

The Augustinian system counsels the trustee as follows:

1. The wishes of the settlor contained in the trust instrument are of the greatest importance; and
2. These wishes, though dominant, are always attended upon by the *ancilla*[5] of an appropriate level of diligence and prudence or some other equitable doctrine.

Accordingly, it is the trustee's goal to demonstrably bring such a synthesis into being.

Diligence and Prudence

Law 69/1992 implies that in exchange for a general power of investment, trustees of CITs now have a statutory duty of care when exercising investment powers. The Central Bank of Cyprus explains that the standard is 'essentially similar to the 'prudent man' rules found in similar legislation of other jurisdictions'.

Unfortunately, this similar legislation is far from homogenous, partly as a result of an understandable attempt of some jurisdictions to make their trusts more marketable. Guernsey and Jersey, for instance, have raised the bar demanding reasonable performance in the form of preserving and enhancing the trust fund's value[6]. Turks and Caicos Islands followed the Channels Islands imposing a statutory duty to invest as a 'prudent person ….. [to]……preserve and enhance'[7]. The BVI on the other hand has a lower statutory duty of care demanding 'the diligence and prudence that a reasonable person would be expected to exercise in making an investment as if it were his own money'[8]. There is certainly a striking similarity between the BVI's wording and Law 69/1992`s §8.2. Yet the only clear thing is that within the British Commonwealth there seem to be different ways of dealing with the question.

Lewin on Trusts certainly thinks that England's statutory duty of care today is of the 'morally obliged to provide' kind suggesting that English trust law stresses capital preservation over capital enhancement[9]. But they are quick to point out that today's reasonably prudent investor could choose a balanced and well spaced selection of equities and bonds. This is quite a marked difference from the expectations of Victorian times when the trustee's choice tended to be restricted to government bonds and mortgages.

The Importance of Purpose and Circumstance

After a time, the meaning of diligence and prudence does seem to turn on the purpose for which a trust is established, together with the trust's present circumstances. The shifting sands of equitable remedy imply that no one size fits all. Whether it is a trust to retain the shares of a family business, to provide pension benefits or a 'business unit trust', equity, while never lenient, will always judge the requisite diligence and prudence in context.

It is also important to remember the settlor's right under English law to place the trustee indefinitely outside of the 'prudent man' conventions. The right to grant powers to trustees to choose speculative, hazardous or wasting investments, without diversification, and with full exoneration for the trustees except *in extremis,* was recently reaffirmed in the English courts[10]. The modern trust instrument containing such wide investment powers may hang by an equitable thread but in most cases these popular configurations are established and wound up before the second wave of beneficiaries have even heard of them. Nevertheless, they are no less subject to the jurisdiction of equity for it and, accordingly, trustees should remain alert to the ongoing requirement to balance their wide investment powers with the appropriate level of diligence and prudence.

In sum, Law 69/1992 §8 underpins the settlor's right to direct his trustees to choose any kind of investment. However, trustees must never lose sight when exercising investment powers of their parallel, yet subordinate, obligation to act prudently and diligently in the eyes of the beneficiaries. In addition, the CIT's standard of care being unclear suggests that professional trustees would do well to be clear in their instruments about investment priorities.

Best Practice

Turning finally to best practice. From the moment of creation of a CIT it is important to bring real substance to the trusts contained in the trust instrument. This list is not exhaustive but the Cypriot trustee should certainly address the following key points:

1. The settlor's good and clear title to the trust property should be substantiated;
2. The settlor must have a basic understanding of trust law, understand the trust's terms and in some cases have received independent legal advice in his mother tongue;
3. The beneficial interests, actual or contingent, must be clearly established; and
4. Where investment powers allow for speculative investments, the potential consequences must be brought to the settlor's attention in writing or in a prospectus in order to prove that he understands them.

In addition, at the trustees' annual review, they would consider the following questions *inter alia:*

1. Are the trust's investments deployed in a suitable and appropriate manner for the trust as a whole?
2. Are the trust's investments stable, liquid, diversified and placed with a high grade financial institution, and being those chosen of a reasonable person acting with diligence and prudence who is morally obliged to provide for others or would some greater degree of risk taking be reasonable given the terms of the trust instrument?
3. Does the trust's size or complexity require the trustee to find expert financial advice? and
4. When should the trustee inform the second wave of beneficiaries, if any, of their right to receive trust accounts and documents?

Conclusion

Being a professional trustee does not get any easier, nor is it likely to in the future. The author's hope and contention is that the espousal of Nottingham's *ad personam* and Augustine's *ancilla* will assist Cypriot trustees in bringing an equitable synthesis to the trusts they administer. Furthermore, the Augustinian system, along with the suggested best practice reduce to an acceptable level the risks of breach of trust and inadvertent 'shamming' raising the professional standards of Cyprus in the process.

END NOTES:

1. *The Central Bank of Cyprus has published an English translation, together with explanatory notes*
2. *The single exception appears to be immovable property situated in Cyprus-Law 69/92 §2*
3. *Speight v Gaunt (1883) 9 App Cas 1*
4. *Learoyd v Whiteley (1886) 33 ChD 347*
5. *Being Latin for auxiliary or handmaiden*
6. *Trusts (Jersey) Law 1984 & Trusts (Guernsey) Law 1989*
7. *Trusts Ord. 1990*
8. *Trusts (Amendment Act) 1993*
9. *Lewin on Trusts (Eighteenth Edition) 35-64 & 35-65*
10. *Armitage v Nurse (1998) Ch241*

ACKNOWLEDGEMENTS

The author expresses his sincere thanks to the following publications:

- *Jordans Journal*
- *Donovan Walters QC 'The Trust: Continual Evolution of a Centuries-old Idea'*
- *The Teaching Company*
- *Science and Religion by Prof. Lawrence M*