Speech by

Mr L. SPRINGBORG

MEMBER FOR WARWICK

Hansard 25 November 1999

TRUSTS (INVESTMENTS) AMENDMENT BILL

Mr SPRINGBORG (Warwick—NPA) (Deputy Leader of the Opposition) (9.16 p.m.): The Opposition supports this Bill, which in all material aspects mirrors the Trusts (Investments) Amendment Bill 1998, which was introduced into this Chamber by the member for Indooroopilly on 8 June last year.

There are two aspects to this Bill. First, there is the move away from a statutory or legal list of trustee investments to the adoption of the prudent person rule. Second, there are other consequent changes designed to provide guidance to trustees and protection for beneficiaries, not just as a result of the adoption of the prudent person test but generally for most trusts.

This is a very important legislative initiative and, fortunately, it is one that not only will attract bipartisan support in this Parliament but also has obtained support in all the other legislative Chambers of each State and Territory around Australia. In fact, we are the very last Parliament in Australia to debate the change to the prudent person test. Victoria, South Australia and the Northern Territory passed similar legislation in 1995. New South Wales and Western Australia followed in 1997. Tasmania adopted the model in 1998 and, finally, the ACT did likewise in May this year.

It is important, for reasons I will outline shortly, that we achieve, as far as is appropriate, some measure of national uniformity in this area. Trust activities do not stop at State boundaries and, although that is never a reason for sovereign jurisdictions to abrogate their legislative responsibilities, it is nevertheless an important consideration that should be considered by parliamentarians.

Until recently, each Australian State and Territory had general trustee legislation which prescribed a legal or statutory list of investments which were authorised for trustees to invest in. Of course, it has always been the case that trustees were only limited to the authorised investments where the trust instrument which conferred on them their authority failed to confer any general or specific investment powers.

Where a trust instrument gave a trustee powers of investment, then the trustee was, and remains, subject to that instrument. As a result, for many years lawyers and accountants who drafted trust documents, both in Queensland and elsewhere, gave to trustees very wide powers of investment. They certainly gave trustees much wider powers than those contained in either the Queensland Trusts Act or those in any of the other trust legislation enforced in Australia. That was not the case for most of the small trusts and it is those small trusts which are administered largely by non-professional trustees that the Trusts Act was aimed at giving some guidance to and protection against imprudent investment decisions.

Before turning to the Bill and the reasons behind the Australiawide push for a prudent person test, it is worth while recording in Hansard some background to this issue. Originally, trusts and the duties of trustees were developed to meet the needs of administering large estates in the rural part of Britain in the 18th century. Accepting the role of a trustee was not a matter to be taken lightly. In an English case in 1747, the then Lord Chancellor said that a trust was an office "if faithfully discharged, attended with no small degree of trouble and anxiety". He also said, "It is an act of great kindness in anyone to accept it."

Having regard to the numerous and onerous duties now placed on trustees, it is clear that the wheel has now moved full circle and the same sentiments could just as easily apply to any person taking on the duty of a trustee in 1999. This Bill makes it abundantly clear that a trustee owes a very high standard of care to beneficiaries. This is a matter which any person should bear in mind before taking on such an office.

The problems besetting trustees of a few hundred years ago centred on looking after large rural estates, with beneficiaries who usually had the right to live in country houses, and collecting rents from tenant farmers. The main beneficiaries were successive elder sons who lived on the trust property as tenants for life. On top of that, trustees usually had to look after the investments of widows, daughters and younger sons. Under the law, they were given the right to live in small houses, endowment on marriage or were shipped off to the army or the church and had their reasonable expenses paid.

In all of this, as can be appreciated, very little attention was given to actually reinvesting money. Country estates generally produced their own income; they were self-sustaining entities and it was the role of the trustee to make sure that they continued in that way. The courts, in fact, held that when the trust deed was silent, a prudent trustee was only permitted to acquire 3% consolidated annuities called "consols" issued by the Bank of England. The judges even refused trustees the right to invest in mortgages of land.

It was not until the passage, in 1859, of the Law of Property Amendment Act that the Legislature intervened and gave trustees a little more latitude. The statute empowered trustees to invest in ordinary stock of the Bank of England, the East India Company and land mortgages. This, then, was the first of the authorised trustee investment statutes and, as the century progressed, other laws were passed which added new categories of authorised investments. By this incremental approach, the statutory list of authorised trustees' investments came about.

The legal list approach was adopted in Australia, New Zealand, Canada and parts of the United States. Around the same time as the English courts were preventing trustees from investing in anything other than 3% "consols", some American courts were striking out in a very different direction. It has always been the case that a trustee is bound by the terms of the trust deed, including the powers of the investment. English courts of equity measured the action of trustees against the care that would be exercised by a prudent person.

In the United States, this general principle was extended and applied in assessing the investment decisions of trustees. Instead of trying to draw up a statutory list of investments which were considered to be safe, some American courts simply considered that, if an investment was one that a reasonably prudent person might make, the trustee should not be able to be in breach of trust if a loss resulted from it.

In 1830, this rule was expressed by one American court as follows—

> "All that can be required of a trustee to invest, is, that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of capital to be invested."

The prudent person approach has, over the years, been adopted by most American States and is used in the Federal Employment Retirement Income Security Act to describe the standard of care to be met by pension fund trustees.

It was recommended by the Uniform Law Conference of Canada as early as 1970, and has since been adopted by New Brunswick, Manitoba, Nova Scotia and the two Canadian Territories. It was enacted by the New Zealand Parliament in 1988. There have been moves even in England away from the statutory list approach.

As the Attorney-General pointed out in his speech, the statutory list approach has a number of drawbacks. Firstly, the list of authorised investments was not uniform between the various States and Territories. The lack of uniformity would have caused, from time to time, problems for trustees. The lack of uniformity, however, also highlighted an inherent problem, with the State picking which investments were authorised and which were not. What is an appropriate and safe investment differs from time to time, and in reality it is hard to say that one sort of investment security is either appropriate for all trusts or is inappropriate for all trusts. In short, the statutory list approach can be inflexible and lead to inappropriate investment decisions.

On top of that, as I have mentioned, authorised investments were always intended to apply only when the trust instrument was silent on the question of what sort of securities a trustee could apply trust money towards. Larger institutional trusts were never constrained in the same manner that smaller, non-professional trusts have been. It is important to appreciate what a critical role trustees play in our economy.

When researching this Bill, I read an article in the March 1996 Australian Law Journal by Lord Nicholls entitled Trustees and their Broader Community. The article was based on a speech that the author had given to the superannuation conference of the Australian Law Society. He made the following observations—

> "As industry and business have flourished, the securities of trading companies have increasingly provided the means by which individuals may share in the growing wealth of a nation. Trustees who hold funds, large or small, if they are to do their best for their beneficiaries, need to be able to invest in these securities, both nationally and internationally. By and large trustees have been given the necessary freedom for this purpose.
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> Freedom brings choice, and choice brings risks, dangers, problems. In one sense trustees' problems may be said to have been self-induced. They are a result of the successful administration of most trust funds. The trust mechanism has proved a useful means for administering funds providing pensions for former employees of companies and their families, ranging from the tiniest firms to the most massive organisations. As living standards have risen in the developed countries, the funds have grown hugely. So trustees of the very large funds now find themselves holding substantial blocks of shares in many major trading enterprises ... Taken together, pension (superannuation) funds and insurance companies and other large institutions own one half or more of the shares of all listed companies in the United Kingdom, the United States and Japan. In Australia the figure is somewhat less. This means that taken together, the institutions are in a position to control much of the industry of these countries. They are now the long-term owners of industry."

Lord Nicholls also highlighted the way in which the administration of modern trusts differs markedly from trusts of just five or six decades ago—

> "They are open-ended, with a continuing flow of cash. And they have ceased to be predominantly concerned with the private financial concerns of one family. Now the number of beneficiaries interested in one fund may be legion. Often a single set of trustees administers a pension fund for tens of thousands of people, each of whom has his own needs and aspirations."

Looked at from this perspective, having a non-uniform and largely out of date list of authorised investments in the Trusts Act is not only unrealistic and an impediment to the good administration of many smaller trust estates but also contrary to the wellbeing of the wider community.

The larger institutional trusts have, for many years, invested in securities of a much more diverse nature than those prescribed under the Trusts Act. Large professional trusts have extensive investment provisions, so there is no need to default back to the authorised investments. Peter McDermott in an article in the October 1996 issue of the Australian Law Journal said—

> "A professionally drafted trust deed would, of course, confer upon a trustee wider powers of investment than conferred under the trustee legislation; and, for that reason, the legislation is considered to be irrelevant in professional circles."

Nevertheless, there are many smaller trusts which rely upon the Act, and it is that class of trustees who require some legislative assistance and special attention. In the past, the well-meaning view was that the most effective means of ensuring that these smaller trustees did not make inappropriate investment decisions was to prescribe a statutory list of investments. Many non-professional trustees may well have got the impression that if they invested in any of the securities specified in the statutory list, then that would be a safe investment and they would have met the duty of care reposed in them.

Yet when we look at the type of securities set out in section 21 of the Trusts Act, we would be struck by the fact that some of the so-called authorised investments are far from secure and, in some circumstances, could be highly speculative. For example, it is currently quite proper for a trustee to purchase land in fee simple not just in Queensland but in any other Australian State or Territory. Having regard to fluctuations in land prices, it is patently obvious that this listed investment is only as safe as the prudence and expertise exercised by the trustee when purchasing such a security.

However, the crunch came with the collapse of a number of financial institutions at the end of the last decade, all of which were authorised investments in the relevant States. The collapse of Rothwells in Western Australia in 1988, the Pyramid Permanent Building Society in Victoria, as well as the disintegration of the State Banks of Victoria and South Australia—all of which were on the relevant State's list of authorised investments— highlighted the drawbacks of a statutory list approach. The collapse of the Pyramid Building Society led not only to national reform of non-bank financial institutions but also a thorough investigation of authorised investments. This Bill is the result of that investigation, and just as the NBFI reforms deserved and received unanimous support around Australia, so, too, does this reform package.

I turn now to the terms of the Bill. The first point is that the Bill defines the term "authorised investments" to include not only those investments allowed under the Trusts Act but, in addition, investments authorised under the trust deed as well as investments specifically authorised under another Act or the general law. It is always important to ensure that the settlor of a trust can specify in the trust instrument what discretion is to be given to a trustee. Only in exceptional circumstances where public policy considerations come into play should the Legislature intrude into proper commercial arrangements. By allowing settlors to set the parameters of a trust deed so far as investments are concerned, the Bill is in keeping with the common law and reflects commercial reality.

The Bill inserts a new Part 3 in the Trusts Act. Although, as I have said, professional trust deeds have been drafted in a way to give trustees greater investment latitude than that allowed under the statutory list, nevertheless the other provisions of the Act are of importance to almost all trusts. Proposed section 21 provides that a trustee, unless forbidden by the trust deed, may invest trust funds in any form of investment. This seemingly open-ended discretion is then limited by the remaining provisions contained in Part 3. Nevertheless, section 21 makes it clear that there will no longer be a legal list of investments prescribed by the Act, and that a trustee in the future will have greater freedom to invest, on the one hand, and yet greater responsibility imposed on the other.

Proposed section 22 sets out the general duties of trustees in relation to investment powers. This section draws a distinction between professional and non-professional trustees. So far as professional trustees are concerned, Lord Nicholls made the following observation—

> "... the ordinary prudent person. His standards are the minimum standards expected of trustees. If the trustee is a person professing particular expertise in the management of trusts, and he has been appointed for that reason, his conduct will be judged by the standards he professes. A professional person, a trust corporation, an insurance company, held out as an expert, will be expected to display the degree of skill and care and diligence such an expert would have."

The same approach is reflected in the Bill, with professional trustees being required to—

> "... exercise the care, diligence and skill a prudent person engaged in that profession, business or employment would exercise in managing the affairs of other persons."

Non-professional trustees are required to exercise—

> "... the care, diligence and skill a prudent person of business would exercise in managing the affairs of other persons."

It is important to note that a non-professional trustee is still required to exercise the skill of a prudent person of business not just towards that person's own property but towards the management of other persons' property.

I read with interest the legislation note on this Bill prepared by Karen Sampford of the Parliamentary Library. It is an excellent document—and full credit to her. In it, she quotes a famous 1886 English case where this principle is expressed as follows-

> "The duty of the trustee is not to take such care only as a prudent man would take if he had only himself to consider; the duty rather is 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 bound to provide."

Proposed section 22 also imposes on a trustee the obligation to review the performance of trust investments at least once a year. This obligation is very important, and I would suggest to the Minister that, in preparing any information about the Bill for the commercial community, this provision be highlighted. It is an obligation that is reasonable, but it is one which ensures that a trustee cannot afford to simply sit on his or her hands; a much more proactive approach to supervising trust investments is required.

Just as a trustee will be liable if he or she negligently invests trust funds in hazardous securities, so, too, will a trustee be liable if he or she fails to invest funds in a way which will produce a just return to the beneficiaries of the trust. In this context, the obligation imposed by the Bill to review the investment portfolio annually is a very important one and needs to be made clear to the commercial community.

I am less happy with the attempt made in proposed section 24 to codify the matters which a trustee must have regard to in exercising a power of investment. Anyone reading this section will see a multitude of considerations that may have to be taken into consideration. When reading them, they all seem worthy and sensible.

Mr Santoro interjected.

Mr SPRINGBORG: I pick up on the point made by my honourable colleague and friend the member for Clayfield who, when he speaks on this legislation a little later, will be following up on other issues on which I have not commented. I commend him for the interest that he has been showing in the legislation relevant to the Department of Justice and Attorney-General.

If anything can be learned from the history of the legal list approach to trustee investment it is that, apart from overarching principles of equity and prudence, it is unwise for the Legislature to attempt to presume to know what is in the best interests of trust estates. The range and nature of trust estates and the various considerations that have to be taken into consideration are enormous.

Although an attempt at codification of considerations of the nature illustrated by section 24 may appear to be worth while and helpful, it could prove to be counterproductive. To illustrate what I am saying, I refer to the first edition of the leading Australian legal text on the Law of Trusts, written by Ford and Lee, and which makes the following observation—

> "The way in which the trustee will perform his duty of care will depend upon the terms of the trust, the nature of the property settled upon trust and the powers conferred upon him by the trust investment and by law. For instance in the case of a strict trust for successive beneficiaries it will be the duty of the trustee to maintain an even hand between the beneficiaries entitled to the capital and those entitled to the income. The duty will oblige him to invest the trust fund in securities which will preserve its capital value for the benefit of the capital beneficiaries and produce income for the income beneficiaries. On the other hand if the trustee is not required to maintain separate capital and income accounts, for instance if the trust is a discretionary trust as to both income and capital, it may well be proper for the trustee to pursue capital appreciation rather than income production or vice versa. If the trust fund is small in size the trustee may well be within the duty of care imposed upon him in investing within a range of trustee securities permitted by statute, even although that range may be narrow and not necessarily investment wise. This is because the high cost of seeking the permission of the court to enlarge his investment powers, followed by the relatively high administrative costs of forming and maintaining a sophisticated investment portfolio, might well outweigh the small loss which a virtually cost free investment in the financially unattractive but statutorily authorised portfolio might entail. But if the trust fund is substantial the trustee's duty may well be to set up an appropriately sophisticated investment portfolio ... Such a portfolio might seek a reasonable spread of securities."

The clear implication is trustees have to take on board many considerations and it is impossible to generalise, having regard to the varied nature of trustee estates, investment conditions and the obligations imposed by trust deeds. For any Parliament to try to codify matters that trustees should take into account is, therefore, a very big ask.

In this context, I would like to touch on two matters. The first is the obligation imposed by subsection (1)(b) for trustees to have regard to the desirability of diversifying trust investments. I just hope that out of our very, very developed debate tonight, a lot more people in this Parliament are going to be a lot more knowledgeable, if not a lot wiser. This is an attempt to duplicate a provision that is found in the English Trustee Investments Act 1961. The Act requires not just that a trustee in exercising investment powers must have regard to the suitability of the investments but also have regard to—

> "The need for diversification of investments of the trust, in so far as it is appropriate to the circumstances of the trust."

Although I recognise that both the English provision and this Bill do not mandate diversification, they imply that it is a good thing. Yet there are many cases where diversification is not prudent, especially in the case of small trusts. This point was made clear by Ford and Lee in the extract that I have just quoted. In volatile economic circumstances, trustees with comparatively few investment skills would not be advised to invest funds in other than safe environments, even if they received a lesser rate of return. Likewise, paying large overheads to various persons for the benefit of investing relatively small sums of trust moneys simply does not make much sense.

Of course, for larger trusts, diversification is not an option but a necessity of life, and I will turn next to that matter. However, the point that I want to make is that there is no one set of rules that suits all cases and rests for all time, except the most basic and commonsense. It is no accident that other law reform bodies elsewhere have looked at the question of drafting mandatory or optional matters that trustees must or can take into account and have drawn attention to the types of problems that I have just outlined.

In the context of national legislation, the Minister does not have much scope for deviating from the accepted model. I appreciate that. Nevertheless, I raise for the Minister's attention the question of whether proposed section 24 in its entirety should be kept under review and whether his department officers can assure that this issue is kept under review.

The second matter is that, although diversification may not be appropriate for some smaller trusts, it is absolutely essential for most large trust vehicles and, more than that, consideration needs to be given to the consistency of trustee investment legislation with modern portfolio theory. In that context, I draw the attention of the House to the following comments from the English case of Nestle v. National Westminster Bank—

"Modern trustees acting within their investment powers are entitled to be judged by the standards of current portfolio theory which emphasises the risk level of the entire portfolio rather than the risk attaching to each investment taken into isolation."

In recent times, some of the earlier formulations of the prudent investor rule have been criticised as not reflecting current portfolio theory or standards, particularly the need to apply the prudent standard on a portfolio-wide basis in terms of the reasonableness of the trustee's overall investment strategy. The issue has been dealt with specifically in the United States by the Uniform Prudent Investor Act, which was approved in 1994 by the US National Conference of Commissioners on Uniform State Laws. The relevant provision in this Bill states—

"(a) a trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.

(b) a trustee's investment and management decisions respecting individual assets must be evaluated not in isolation but in the context of the trust portfolio as a whole and as part of an overall investment strategy having risk and return objectives reasonably suited to that trust."

My concern with setting lists of matters that the trustee must take into account is that it could lead to the stifling of proper investment decisions by trustees. It is certainly not desirable to draft legislation that could lead to legitimate investment vehicles and strategies being taken away from the trustee's arsenal. I think that if we were to largely deregulate the range of investments that trustees may utilise, they should not be precluded from having the tools needed to properly, prudently and legitimately diversify their trust portfolios and thereby minimise the risk across-the-board to beneficiaries. Once again, I ask the Attorney-General, in conjunction with his interstate colleagues, to keep this matter under review.

The next issue that I wish to comment on is proposed section 26, which enables trustees to use the Reserve Bank information and transfer system. According to the Legislation Note 1 that I referred to previously, only Victoria and Western Australia appear to have specific provisions to ensure that trustees can utilise this system. I would appreciate if the Attorney-General could outline in his reply why this is an issue that is not uniform and indicate the implications of this provision. It is not an issue of the Opposition not supporting this clause; rather, it is finding out the background to why some jurisdictions are proceeding with it and some are not, and the implications of specifically allowing it for trustees.

Proposed section 30B is also very important. It sets out matters that a court may take into account in proceedings against a trustee for a breach of trust in relation to investment decisions. One of those factors is—

"Whether the trust investments have been made under an investment strategy formulated in accordance with the duty of a trustee under this part."

In the article that I referred to earlier, Peter McDermott states—

"It is therefore in the interests of a trustee to adopt an investment strategy."

I agree entirely with Mr McDermott. It is essential that the Department of Justice disseminate widely to the commercial community the key importance of developing clearly and explicitly such a strategy.

Obviously, in a number of other areas this Bill attempts to prevent trustees from simply sitting on their hands and not taking a very active role in managing trust assets. In that regard, I have already mentioned the annual obligation to review the performance of trust investments. Nevertheless, the fact that the Bill for the first time specifically requires the court to have regard to whether there is such an investment strategy in place when determining the amount of damages that may be awarded against trustees is an important development that needs to be taken on board by the commercial community at the first opportunity.

Before concluding, the only other matter that I want to briefly comment on is the retention of proposed section 28, which enables the trustee to purchase a dwelling house as a residence for a beneficiary. This is currently provided for in section 22 of the Trusts Act. I am pleased that this section is retained in the Bill. Cases have held that a power to invest trust property in the purchase of real estate does not include a power to purchase the dwelling house for the occupation of beneficiaries. This, of course, led to problems and injustices, and was remedied in Queensland in 1973. It has likewise been attended to in the relevant legislation of Western Australia and South Australia.

This Bill is the last instalment of reform measures that came about from the collapse of various financial institutions in Victoria, South Australia and Western Australia a decade ago. Those events have resulted in national non-bank financial institution legislation and the adoption of the prudent person investment rules in all other Australian jurisdictions. National uniformity is not a matter that is necessarily good. Uniform bad laws or uniform poor administration benefits nobody and, in fact, accentuates problems.

The history of Queensland's administration of non-bank financial institutions was commendable, especially under successive Registrar of Commercial Acts. However, I welcome this Bill and I think that national uniformity in the area of generic guidelines for trustees is not just desirable but is critical for our nation's economic development. Although this aspect of the NBFI reforms has not received all that much publicity, it is possibly the most far-reaching and important aspect.

The Bill in no way diminishes the responsibility that trustees owe to beneficiaries. In fact, it significantly increases the standard of care. It reflects the proactive and professional approach that modern trustees are expected to adopt. However, it also recognises that trustees must have the investment flexibility to fulfil their duty to beneficiaries and, in so doing, ensure that all trustees will be able to obtain the best return from their trusts. Nevertheless, the test of prudence is one that looks not at performance but at conduct. As one writer has put it, "prudence is demonstrated by the process through which risk is managed". It cannot be said too often that the message that the Department of Justice should be imparting is that under this Bill the courts will be looking at the investment process adopted by trustees, the nature of investment strategies and tactics, the extent to which trustees are watching their investments, the rate of returns, market volatility and a host of other matters.

I welcome the Minister's commitment not to proclaim the Bill immediately so that trustees will have enough time to become acquainted with their new duties. As I said earlier, I hope that the Department of Justice plays some role in bringing the benefits and obligations of this Bill to the attention of the commercial community. I commend the Bill to the House.