



Compliance

interpretation bulletin

Conformité

bulletin d'interprétation

TO: CHIEF FINANCIAL OFFICERS - IDA AUDIT
JURISDICTION FIRMS
PANEL AUDITORS

February 10, 1992
C-35

CUSTOMER ACCOUNTS "IN TRUST"

The purpose of this interpretation bulletin is to outline the general common law principles applicable to trust accounts held by members. Members are advised that pursuant to the civil laws of the Province of Quebec, trust law may differ and should seek legal advice accordingly. This bulletin was prepared with the assistance of Borden & Elliot, IDA legal counsel.

1. "In trust" What is a trust?

An account that is designated as being "in trust" suggests a legal trust relationship. In order to determine the rights, duties and practices of a Member carrying a trust account it is necessary to understand the basic principles applying to trusts.

The legal relationship which is described as a trust covers a wide range of specific relationships in practice but the following textbook definition contains the primary and common characteristics:

"[A trust is] an equitable obligation binding a person (who is called the trustee) to deal with the property over which he has control (which is called the trust property), for the benefit of the persons (who are called beneficiaries...) of whom he himself may be one, and any one of whom may enforce the obligation." (Waters, Law of Trusts in Canada)

The essential element is one person, group or entity holding property or rights over property for the benefit of another person.

2. What are the Different types of Trusts?

There are many different kinds of trusts which are used for a great variety of purposes. From the point of view of a securities dealer, it is often important to determine what kind of trust the customer has because the requirements of the dealer with respect to the trust may vary according to its kind. The following is a list of the common kinds of trust:

- (a) Intervivos Trust: An intervivos trust is a trust which takes effect during the lifetime of the settlor (the person who establishes the trust). Such a trust is often called a living trust.
- (b) Testamentary Trust: A testamentary trust takes effect only after the death of the

settlor. The trust provisions are usually contained within a will or, if there is no will, letters of administration granted pursuant to a statute or by a public authority such as a surrogate court depending on the provincial jurisdiction.

- (c) Express Trust: An express trust is created when the settlor clearly and specifically declares that certain property is to be held in trust. A declaration is usually in a written trust document.
- (d) Trust Arising by Implied Intent: An implied trust is one that arises because the non-express actions or language (written or verbal) of the settlor are construed in such a way that it is concluded that the settlor intended that a trust relationship arise.
- (e) Bare and Simple Trust: A bare and simple trust arises when the trustee holds property without any further duty to perform particular obligations except to transfer the property to or to the order of the beneficiary on demand.
- (f) Special Trust: A special trust, by contrast to a bare or simple trust, is a trust in which the trustee has active duties to perform or the beneficiaries are unable to demand the trust property. Bare trusts or special trusts would not be expected to be established very often by customers of Members.
- (g) Statutory Trust: Some trusts arise because a statute either says they arise or require that a trust be established. For instance, statutes require that certain pension funds be held in trust, that funds held by certain financial intermediaries (i.e., insurance brokers) and registered retirement savings plans and other plans be held in the form of a trust.

Other statutes may require that politicians or government officials establish trusts to hold their property, control of which would be vested in arms' length trustees. There are many other examples of trusts of this kind and if a Member has dealings with such a trust, it is prudent that the specific terms of the legislation be reviewed.

3. **What are the essential elements required to create a trust?**

It is not uncommon for persons to describe their legal relationship as that of a trust or trustee-beneficiary when in fact no trust actually exists. There are three essential elements of such a relationship for a trust to be recognized. **First, the intention to create a trust must be ascertained. Second, the trust property must be clearly identified and residing with the trustee. Third, the trust's objects (i.e., the beneficiaries) are clear and either ascertained or ascertainable.**

Without the existence of these three fundamental aspects of the trust, a court will not enforce the relationship as a trust. For example, a customer may wish to open an account designated to be "in trust", but until some specific property is identified as being trust property and is held by the customer or the account, there would be no trust.

4. **What are the powers and duties of trustees?**

As indicated above, a trust is a relationship recognized at law in which a trustee has certain duties and obligations. Three basic duties of a trustee are:

- (a) to not delegate the trustee's duties or office to other persons, although a trustee is permitted within limits to employ agents;
- (b) to act in a fiduciary capacity vis-a-vis the beneficiaries;

- (c) to act honestly and with that level of skill and prudence which would be expected of a reasonable man administering his own affairs.

5. **What is the relationship between the member, the trustee, and the beneficiaries?**

When a customer opens an account "in trust" with a Member, it is important for the Member to understand who the customer is and how the Member is entitled to deal with the customer. A trustee which deals with a third party such as a Member acts in the trustee's personal capacity. In other words, in the usual dealings by Members with their customers, such as agreements to purchase and sell securities, the Member and the trustee in its personal capacity are the parties to the contract. The Member is obliged to look to the trustee for satisfaction of the obligations to buy, sell, deliver, maintain margin, provide information and so on.

The trustee is not the agent of the beneficiaries of the trust; a trustee is regarded as dealing as a principal with the Member. There is no legal relationship between the Member and the beneficiaries which would enable the Member to have recourse against the beneficiaries to satisfy any liabilities arising in connection with the accounts.

If a trust account (and therefore a trustee) has an obligation to the Member to pay, for instance, the purchase price for securities ordered, the Member has recourse against the trustee personally and not the beneficiaries or the trust property. However, as between the trustee and the trust property, the trustee would be entitled to look to the trust property to satisfy the obligation to pay the purchase price to the Member, provided the transaction is otherwise authorized in accordance with the terms of trust.

If a trustee has properly put trust property in the hands of the Member (such as free credit balances or securities held by the Member) the Member would normally be entitled to its common law and regulatory remedies of applying that property in satisfaction of the outstanding obligations of the account. **The reason for this conclusion is that the trustee is empowered to commit the trust property to the terms of any customer account agreement and the general terms and customs of trading securities.**

6. **Can a trust account guarantee another account?**

The trustee cannot treat the assets of a trust as his or her own, even though they are gratuitously settled on or are to be distributed to the beneficiaries. Nor can it be assumed that the assets held in the trust are readily available to meet obligations in the trustee's personal accounts with Member or any other person.

7. **What industry rules apply in dealing with trust accounts?**

Of most importance is the know-your-client and suitability rules contained in IDA Regulation 1300.1 which has counterparts in provincial securities legislation and the rules of the other self-regulatory organizations. Although the general principle of trust law identified above is that a third party such as a Member dealing with a trust need only look to the trustees, the requirements of Regulation 1300.1 impose responsibility on the Member to understand the general terms and purpose of the trust.

In complying with the know-your-client and suitability rules, the Member is obliged to make the necessary enquiries to understand the nature of the trust, the beneficiaries, the authority of the trustee and the identity of the persons who are authorized to act on behalf of the trust.

8. What are the potential legal liabilities of the Member?

Members of the Association should be aware of breaches of industry rules and regulations forming a basis for civil actions by customers against Members. Although not all violations of industry rules themselves will give rise to a common law cause of action, very often the same facts which constitute the rule violation will support a common law action. These same concerns exist in the case of trusts. There may be an unarticulated but real concern that a court would expect a high standard of behaviour from a Member dealing with a trust account on the basis that the true owners of the trust property (the beneficiaries) are relatively helpless in dealing with the account.

In some instances, an agent of a trust may become directly liable to the beneficiaries if the agent knowingly participates in or assists in a breach of a trust. The general rule is that the Member is the agent of the trust in carrying out securities trading and is not liable to the trust or its beneficiary if it acts within the scope of its agency. However, an agent, such as a Member, may become personally liable to the beneficiaries of the trust on the basis that the Member is a constructive trustee in dealing with trust property. This liability may arise where the Member is holding or dealing with the customer's trust property and knows or should reasonably know that dealing with the property constitutes a breach of the trust. In addition, if the Member assists or participates in the trustee's own wrongful act, the Member may be personally liable to the trust and the beneficiaries for the loss or damages arising from the breach.

Courts do not readily impose this kind of liability on agents such as securities dealers or banks for the reason, among others, that such agents cannot reasonably be expected to monitor closely all of the day-to-day dealings of the account of the trust. However, Members would have to be able to show that they have acted reasonably in the circumstances and have established prudent and orderly procedures for dealing with trust accounts.

9. In dealing with trust accounts, what key factors must the Member be aware of?

(a) Terms of Trust

It is essential that the terms of the trust be ascertained. If there is a declaration of trust, a will or other written instrument, a copy and all subsequent amendments should be obtained. If the instruction is merely that the account is to be "in trust", the Member should obtain from the trustees particulars as to the nature of the trust, its terms and investment objectives, the trustee's powers, the beneficiaries, restrictions on operation of the trust, and so on.

(b) Trustee's Agents

The authority of the trustees and any agents authorized to act on behalf of the trust should be determined. If, for instance, it is necessary that two trustees sign contracts, cheques or any other instrument, the record of the Member should reflect this fact and be checked before any written instruction or instrument is accepted from the trust. Similarly, if the trustee is a corporation, the Member should determine who has signing authority and check to ensure proper authority has been given when receiving instructions. Full identification and personal information on each of the trustees should be obtained as in any individual customer.

(c) Know Your Client

The new account or know-your-client form should be completed and kept up to date with particular care in the case of a trust in order that the beneficiaries of the trust are known and the investment objectives of the trust understood by the dealer.

(d) Communication with Customer

A Member is entitled to take instructions from the trustees as to how and to whom customer communications should be sent. Normally, a Member can deal directly with the trustee but care should be taken if authorization is required from other persons. A warning that this might be the case would be if copies are required to be sent to other persons such as beneficiaries.

Louis P. Piergeti, Director of Compliance

PLEASE DISTRIBUTE TO ALL INTERESTED PARTIES IN YOUR FIRM