Volume 34 Number 4 2021 Pages 189–264

ARTICLES

Trusts of Cryptoassets
Kelvin F K Low

The 'Prudence' Test for Trustees in Pension Scheme Investment: Just a Shorthand for 'Take Care'
David Pollard

Charity Law's Transition from 'Poverty' to 'Financial Hardship'
David Wilde and Imogen Moore

BOOK REVIEW

INDEX TO VOLUME 34

Trust Law International

Bloomsbury Professional

Trust Law International

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Contents

191
ARTICLES

191
Trusts of Cryptoassets
Kelvin F K Low

215
The 'Prudence' Test for Trustees in Pension Scheme Investment: Just a Shorthand for 'Take Care'
David Pollard

249
Charity Law's Transition from 'Poverty' to 'Financial Hardship'
David Wilde and Imogen Moore

260
BOOK REVIEW

263
INDEX TO VOLUME 34

Trusts of Cryptoassets

Kelvin F K Low⋆

The birth of bitcoin in the Great Recession of 2008 appealed to cypherpunks and libertarians distrustful of government. Together with copycat altcoins, the volatility of cryptoassets has drawn interest from investors and speculators who did not share in these ideals, including trustees, raising four questions. First, can cryptoassets be the subject-matter of trusts? Secondly, if so, how may the rules relating to validity be applied to cryptoassets? Thirdly, is such an investment permitted under the terms and/or governing law of a particular trust? Finally, what must trustees be aware of in deciding whether to invest in this new asset class?

The rise of cryptomania

Amidst the Great Recession of 2008, when trust in governments was at its nadir, an idea was borne of a person(s) known only as Satoshi Nakamoto.[1] If centralised authorities could not be trusted, could the trust necessary to facilitate transactions between strangers be secured instead by an algorithm? The consensus algorithm that lay at the heart of the bitcoin blockchain, so-called because it engenders consensus on the state of a distributed ledger, leveraged game theory to compel strangers to cooperate in the absence of trust. It employed a 'proof-of-work' algorithm, whereby users that engage in updating the ledger, called 'miners', are required to solve a computationally difficult puzzle in order to win the right to add a new block of transactions to the blockchain. By adding transactions in blocks and linking individual blocks through cryptography, falsifications of the ledger can be easily detected. The high energy and computational cost involved in 'mining', in conjunction with an algorithmic rule to 'mine' on the longest chain, ensures the integrity of the blockchain in most situations. Initially the preserve of cypherpunks,[2] the Great Recession provided fertile ground for bitcoin to flourish – particularly among libertarians – once wider access could be provided to non-technophiles, provided by the launch of cryptoasset exchanges in 2010, most famously Mt Gox. Instead of 'mining' bitcoins, exchanges provided access to as much bitcoins as a cryptomaniac could desire so long as they could afford them. Combined with the increasing use case of bitcoins for illicit transactions on the dark web,[3] owing to its pseudonymous[4] nature, demand exploded. This led to bitcoin prices rising, which in turn drew other 'investors' to bitcoin in a manner not unlike a Ponzi scheme, whereby growth feeds further growth, leading to the inflation of

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1 A O'Hagan, 'The Satoshi Affair', *London Review of Books*, available at www.lrb.co.uk/the-paper/v38/n13/andrew-o-hagan/the-satoshi-affair [accessed 8 December 2020].

2 Cryptography enthusiasts advocating the use of cryptography for social and political change. See further L Swartz, 'What was Bitcoin, what will it be? The technoeconomic imaginaries of a new money technology' (2018) 32 Cultural Studies 623, 625–626.

3 Particularly on the online black market known as the 'Silk Road' set up by Ross Ulbricht.

4 Pseudonymity is not anonymity. Cf A Greenberg, 'Prosecutors Trace $13.4m in Bitcoins from the Silk Road to Ulbricht's Laptop', *Wired* (29 January 2015), available at www.wired.com/2015/01/prosecutors-trace-13-4-million-bitcoins-silk-road-ulbrichts-laptop/ [accessed 8 December 2020].

'the mother and father of all bubbles'.[5] Since its collapse from an all-time high price of almost US$20,000 per bitcoin in 2017, the price of bitcoin has struggled until recently to overcome the US$10,000 barrier.[6] Its remarkable volatility has attracted both traders, who value volatility over any other attribute, and investors starved of returns in a low to no and in some cases even negative interest rate environment.

Some among these circling investors hungry for returns are trustees, which raises a range of questions for the role that cryptoassets may play in relation to 'the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence'.[7] First, can cryptoassets even be the subject-matter of a trust? Secondly, if so, how would traditional trust law rules, such as the rules on certainty of intent and subject-matter, apply to cryptoassets? Thirdly, can trustees of pre-existing trusts invest in cryptoassets? Finally, assuming it is permitted, what are the considerations trustees should bear in mind in deciding whether to invest? This article considers these issues.

Cryptoassets as trust property

Can cryptoassets be held on trust?

The question of whether cryptoassets can be held on trust appears initially to translate to the question of whether cryptoassets are property, an approach adopted by the UK Jurisdiction Taskforce's 'Legal Statement on Cryptoassets and Smart Contracts'.[8] The Legal Statement was intended to clarify the status of cryptoassets, which adoption some perceived to have been hindered by legal uncertainty.[9] This is very much arguable since legal developments have always lagged technological innovation. Provided the innovation met some unserved need, legal uncertainty usually provided little hindrance to adoption. Nevertheless, it is arguable that cryptoassets are different in that legal uncertainty is more inimical where property rather than contract is involved. The latter tends to be inclusionary, as evidenced by the general rule that no particular form is required for a legally binding contract.[10] The former, on the other hand tends to be exclusionary, as evidenced by the *numerus clausus* principle.[11]

Even in the absence of authority, scholars were unanimously of the view that cryptoassets were property,[12] for different reasons. The most common approach, adopted by the Taskforce,

5 N Roubini, Testimony to the US Senate Committee on Banking, Housing, and Urban Affairs on 'Exploring the Cryptocurrency and Blockchain Ecosystem' at www.govinfo.gov/content/pkg/CHRG-115shrg34525/html/CHRG-115shrg34525.htm [accessed 8 December 2020].

6 O Godbole, 'First Mover: Bitcoin at Last Passes $10K, but Why Has It Struggled While Gold Shone?', *Coindesk*, available at www.coindesk.com/first-mover-bitcoin-at-last-passes-10k-but-why-has-it-struggled-while-gold-shone [accessed 8 December 2020].

7 F W Maitland, 'The Unincorporate Body', in H A L Fisher (Ed), *The Collected Papers of Frederic William Maitland*, Vol III (Cambridge University Press, 1911), pp 271–2.

8 UK Jurisdiction Taskforce, 'Legal Statement on Cryptoassets and Smart Contracts', available at https://35z8e83m1ih83drye280o9d1-wpengine.netdna-ssl.com/wp-content/uploads/2019/11/6.6056_JO_Cryptocurrencies_Statement_FINAL_WEB_111119-1.pdf [accessed 8 December 2020].

9 Sir Geoffrey Vos, 'Cryptoassets as property: how can English law boost the confidence of would-be parties to smart legal contracts?', available at www.judiciary.uk/wp-content/uploads/2019/05/Sir-Geoffrey-Vos-Chancellor-of-the-High-Court-speech-on-cryptoassets.pdf [accessed 8 December 2020].

10 E Peel, *Treitel: The Law of Contract*, 14th Edn (Sweet & Maxwell, 2015), p 206.

11 B Rudden, 'Economic Theory v Property Law: The *Numerus Clausus* Problem' in J Bell and J Eekelaar (Eds), *Oxford Essays in Jurisprudence, Third Series* (Oxford University Press, 1987), p 239.

12 K F K Low and E Teo, 'Bitcoins and Other Cryptocurrencies as Property?' (2017) 9 Law, Innovation & Technology 235; D Fox, 'Cryptocurrencies in the Common Law of Property' in D Fox and S Green (Eds), *Cryptocurrencies in Public and Private Law* (Oxford University Press, 2019), p 139.

to divining proprietary status was to search for so-called indicia of property,[13] which inevitably leads to Lord Wilberforce's famous definition of property in *National Provincial Bank v Ainsworth*:[14]

> 'Before a right or an interest can be admitted into the category of property, or of a right affecting property, it must be definable, identifiable by third parties, capable in its nature of assumption by third parties, and have some degree of permanence or stability.'

The Taskforce concluded that 'cryptoassets possess all the characteristics of property set out in the authorities.'[15] So too did the Singapore International Commercial Court (SICC) in *B2C2 Ltd v Quoine Pte Ltd*,[16] which reached the same conclusion independently of the Taskforce, as well as the English High Court in *AA v Persons Unknown*,[17] and the New Zealand High Court (NZHC) in *Ruscoe v Cryptopia Ltd (in liq)*,[18] both of which cited the Legal Statement. Although the SICC's conclusion was not confirmed on appeal,[19] neither was it reversed, as the Singapore Court of Appeal (SGCA) simply reversed a finding of fact, rendering the issue moot.

The resort to *Ainsworth* is highly problematic. First, the scathing criticism that the test is 'riddled with circularity'[20] remains unanswered, likely because they are unanswerable. As the Grays explain:[21]

> 'If naively we ask which entitlements are 'proprietary', we are told that they are those rights which are assignable to and enforceable against third parties. When we then ask which rights these may be, we are told that they comprise, of course, the entitlements which are traditionally identified as 'proprietary'. It is radical and obscurantist nonsense to formulate a test of proprietary quality in this way.'

It seems unlikely that the courts are unaware of these criticisms, yet they are repeatedly ignored and *Ainsworth* is frequently cited as if its test is uncontroversial.

Secondly, in addition to the vice of circularity, the requirement of 'some degree of permanence or stability' is both vague and incompatible with the common law. It arguably imports antithetical Roman civil law concepts of permanence in ownership[22] to the common law. It bears remembering that the largest estate known to the common law, the freehold fee simple, was time limited in its original feudal conception. Although freehold fee simple estates are today conceived of as lasting in perpetuity,[23] this is the result of the Statute of Wills 1540[24] and Tenures Abolition Act 1660[25] authorising the devise of all land as well as

13 Taskforce, Legal Statement, at [49]–[58].

14 [1965] 1 AC 1175, 1248.

15 Taskforce, Legal Statement, at [57].

16 [2019] SGHC(I) 3; [2019] 4 SLR 17.

17 [2019] EWHC 3556 (Comm). See also *Vorotyntseva v Money-4 Ltd, t/a Nebeus.com* [2018] EWHC 2598 (Ch); *Liam David Robertson v Persons Unknown* (unreported 15 July 2019).

18 [2020] NZHC 728, at [75], [102]–[121].

19 *Quoine Pte Ltd v B2C2 Ltd* [2020] SGCA(I) 2.

20 K Gray and S F Gray, *Elements of Land Law*, 5th Edn (Oxford University Press, 2009), p 97.

21 Ibid.

22 Cf W W Buckland and A D McNair, *Roman Law and Common Law, A Comparison in Outline* (Cambridge University Press, 1936), p 70.

23 Most obviously in the curious Singapore 'estate in perpetuity': see H W Tang and K F K Low, *Tan Sook Yee's Principles of Singapore Land Law*, 4th Edn (LexisNexis, 2019), pp 44–45.

24 Which permitted the devise of socage land and most land held by knight service.

25 Which converted all land held by knight service to socage.

provisions for their passing upon intestacy via the Intestacy Rules under the Administration of Estates Act 1925. Prior to these developments, freehold fee simple land would escheat to the immediate lord when a tenant died without heirs.[26] Freehold estates can thus be regarded as distinct from leasehold estates, after the latter came to be reified in the 15th century,[27] by the manner in which time is measured. Freehold estates are measured in time by human lives – the tenant's and his heirs' – which are uncertain in duration. Leasehold estates must be certain in duration[28] and so are measured by days, weeks, months, and years, though in theory it is difficult to see what beyond commercial practicality stands in the way of a lease for hours, minutes, or seconds. The requirement also sits particularly uneasily with the common law concept of a tenancy at will.[29] The addition of 'some degree' merely heaps ambiguity upon alienness. How much permanence is required? If the nature of a licence is that it is merely permissive, why should a longer duration cause it to acquire a different, more robust nature?[30] Conversely, if a lease is in the nature of an exclusive right, why should a shorter duration denature it to mere permissiveness?

Finally, the *Ainsworth* test is simply misguided as a test in the context of determining what property may be the subject matter of trusts.[31] *Ainsworth* was concerned with the possible *in rem* character of the 'deserted wife's equity' so that 'property' here means *in rem* right. The test is in effect devised to dress up, in the invisible threads of obfuscatory circularity, the process of segregation of *in rem* wheat from *in personam* chaff. But property in the common law is a messy concept.[32] Unlike some civilian systems, which ruthlessly segregate 'property' in the *in rem* sense of the word from 'property' in the wider asset sense through the use of different vocabulary,[33] common lawyers muddle along with a single ambiguous word, often shifting between meanings carelessly.[34] If the *Ainsworth* test is determinative of whether a right may be the subject-matter of a trust, then *in personam* contractual rights would not be capable of being held on trust, contrary to authority.[35] It would render nonsensical Lord Shaw's oft-cited exhortation in *Lord Strathcona Steamship Co Ltd v Dominion Coal Co Ltd*[36] that:

> 'The scope of the trusts recognised in equity is unlimited. There can be a trust of a chattel or of a chose[37] in action, or of a right or obligation under an ordinary legal contract, just as much as a trust of land.'

26 Even if the Crown is the ultimate beneficiary via bona vacantia in an intestacy, there are important distinctions in consequences between escheat and bona vacantia.

27 R Megarry and H W R Wade, *The Law of Real Property*, 5th Edn (Sweet & Maxwell, 1984), pp 1156–1157.

28 *Lace v Chantler* [1944] KB 368; *Prudential Assurance Co Ltd v London Residuary Body* [1992] 2 AC 386; *Mexfield Housing Co-operative Ltd v Berrisford* [2012] 1 AC 955.

29 S Bridge, E Cooke, and M Dixon, *Megarry & Wade: The Law of Real Property*, 9th Edn (Sweet & Maxwell, 2019), 741–742.

30 Cf Gray and Gray, *Elements of Land Law*, pp 1304–1305.

31 K F K Low, '*Quoines* in *Cryptopia*: When (If Ever) Are Cryptoasset Exchanges Trustees?' [2020] Conv 70; J Lau, 'That New Chestnut – The Proprietary Status of Bitcoins' [2020] LMCLQ 378.

32 B McFarlane and S Douglas, 'Property, Analogy, and Variety' (2020) 40 OJLS (forthcoming).

33 Cf K F K Low and Y C Wu, 'The Characterization of Cryptocurrencies in East Asia' in Fox and Green (Eds), *Cryptocurrencies in Public and Private Law*, p 199.

34 Cf P W Lee, 'Inducing Breach of Contract, Conversion and Contract as Property' (2009) 29 OJLS 511. Contra S Douglas, Liability for Wrongful Interferences with Chattels (Oxford University Press, 2011), 18; A Goymour, 'Conversion of Contractual Rights' [2011] LMCLQ 67.

35 *Paul v Constance* [1977] 1 WLR 527.

36 [1926] AC 108, 124.

37 In this article, unless within a quote, the modern English 'thing' is preferred over the French 'chose'.

The requirement of transferability would also invalidate both *Don King Productions Inc v Warren (No 1)*[38] and *Swift v Dairywise Farms Ltd (No 1)*,[39] both of which held that non-transferable property could nevertheless be held on trust.

Although *Ainsworth* regards property synonymously with rights *erga omnes*, such a view of property is both too narrow and ahistorical for common law systems. The original thing in action that the common law recognised as a form of personal property was none other than the *in personam* contractual right. Property turns not on exigibility[40] but on exclusivity,[41] 'the word "property" reflects its semantically correct root by identifying the condition of a particular resource as being "proper" to a particular person'.[42] Where a resource is tangible, exclusivity can only be secured by rights *erga omnes* since anything short of that would not secure exclusive control of the *res* in question. But even here, the genius of equity cheated strict adherence to logic. The institution of the trust permitted indirect rights to be infinitely replicable safe as against equity's darling, in effect fashioning a simulacrum of property in the *in rem* sense through the ingredient of *in personam* obligation.[43] Where the resource is intangible, any reference to rights *erga omnes* breaks down. Intangible property are ideational and abstract. Right and *res* are inseparable. Exclusivity is thus secured by means other than widespread exigibility, although certain abstractions may require *erga omnes* effect. Thus, in common law systems, we see rights of varying exigibility all classified as things in action from purely personal rights (contractual things in action) to rights enforceable against a limited but varying and fluctuating class (company shares) to rights *erga omnes* (many intellectual property rights).

In each instance, exclusivity is secured in precisely the same fashion, whether the right is *erga omnes* or *in personam*. Suppose A is the holder of a patent for a widget. Suppose then that B pretends to be A and 'licenses' the patent to C, who proceeds to manufacture the widget. The 'licence' is no defence to an action for patent infringement brought by A against C because property law provides that only A is able to release C from his duty not to infringe the patent. This pattern is exactly the same where the subject-matter of the property is *in personam*. Suppose A has been assigned a debt owing by D. Suppose then that B pretends to be A and convinces D to 'pay' him. Absent any contrary contractual provision, the 'payment' by D to B would not absolve him of his duty to pay A because property law provides that only A may release him from his duty to make payment. Classification as property tells us nothing about the content of the right[44] (eg not to copy, not to manufacture, to make payment) nor its exigibility (eg against the contracting counterparty, against all members, against everyone in England and Wales). It merely tells us who among various competing parties may legitimately control those rights. The *erga omnes* effect of patents is necessary not because it is property but because it is conceived in terms of an exclusive right to manufacture, import, sell, etc.

38 [2000] Ch 291. But see A Tettenborn, 'Trusts of Unassignable Agreements' [1998] LMCLQ 498; A Tettenborn, 'Trusts and Unassignable Agreements Again' [1999] LMCLQ 353.

39 [2000] 1 WLR 1177.

40 Cf P Birks, 'Before We Begin: Five Keys to Land Law' in S Bright and J Dewar (Eds), *Land Law: Themes and Perspectives* (Oxford University Press, 1998), pp 457, 473.

41 Cf K Gray, 'Property in Thin Air' (1991) 50 CLJ 252.

42 K Gray and S F Gray, 'The Idea of Property in Land' in Bright and Dewar (Eds), *Land Law: Themes and Perspectives*, pp 15, 15–16.

43 S F C Milsom, *Historical Foundations of the Common Law*, 2nd Edn (Oxford University Press, 1981), p 6.

44 Cf C Rotherham, 'Property and Justice' in M H Kramer (Ed), *Rights, Wrongs and Responsibilities* (Basingstoke 2001) 148.

How then are courts to determine whether some new resource is capable of being property? In truth, judicial recognition of new forms of property has slowed if not ceased for decades if not centuries. Most modern innovations in terms of property, such as shares and intellectual property, are creatures of statute. One man's right necessarily impinges upon another's liberty. This is the basis of the aphorism, 'Your liberty to swing your fist ends just where my nose begins.' The conceptual certainty of this tension is also demonstrated by Hohfeld's fundamental legal conceptions.[45] Granting a claim right/privilege/power/immunity to one man necessarily imposes its cognate correlate upon another/others. Where the right is exclusive and the resource precious, the exercise becomes a highly political affair,[46] increasingly unsuited to unelected judges in modern democracies. It is a rare for modern courts to recognise a novel form of property right.[47] How is it then that the reification of cryptoassets is so uncontroversial? First, it accords with the practices of users of cryptoassets, corresponding to Humean conceptions of property.[48] But more importantly, properly conceptualised as a narrow right to have the unspent transaction output (UTXO) of a cryptoasset locked to a holder's public address on a blockchain,[49] it is difficult to conceive how such a right would interfere with any legitimate liberty of any stranger. The only instance where a legitimate concern could arise would be if an innocent stranger purchased some cryptoasset in good faith in circumstances when the transfer is impugned but this is precisely the sort of balancing exercise that property law's priority rules are well adapted to deal with.

There were also concerns as to whether cryptoassets could fit within the common law's traditional two-fold classification of personal property, as set out by Fry LJ in *Colonial Bank v Whinney*:[50] 'All personal things are either in possession or in action. The law knows no tertium quid between the two.' The poor fit supposedly led the Taskforce to endorse the recognition of an intangible tertium quid. Although this issue is really a 'red-herring',[51] the argument bears airing:[52]

> 'A cryptoasset is not a thing in possession because it not tangible and so cannot be possessed. […]
>
> 'Whether a cryptoasset is a thing in action is more debatable. The term is generally used to mean a right of property that can be enforced by court litigation, or action, such as a debt or contractual right. A cryptoasset would not normally be a thing in action on that definition.'

Assuming that the Taskforce endorses this narrow definition will colour one's reading of its conclusion 'that the fact that a cryptoasset might not be a thing in action on the narrower definition of that term does not in itself mean that it cannot be treated as property.'[53] Thus Bryan J reasoned in *AA v Persons Unknown*,[54] '[t]hey are not choses in action because they do

45 W.N. Hohfeld, 'Fundamental Legal Conceptions as Applied in Legal Reasoning' (1917) 26 Yale LJ 710.
46 Cf B McFarlane, *The Structure of Property Law* (Oxford University Press, 2008), pp 4–5.
47 *Regency Villas Title Ltd v Diamond Resorts (Europe) Ltd* [2019] AC 553. Cf *Hunter v Canary Wharf Ltd* [1997] AC 655.
48 Cf J Waldron, 'To Bestow Stability upon Possession' in J Penner and H E Smith (Eds), *Philosophical Foundations of Property Law* (Oxford University Press, 2013), p 1.
49 Cf Low and Teo, 'Bitcoins as Property?', 252–254.
50 (1885) 30 Ch D 261, 285.
51 *Ruscoe v Cryptopia* [2020] NZHC 728, at [123].
52 Taskforce, Legal Statement, [67]-[68].
53 *Ibid* at [84].
54 [2019] EWHC 3556 (Comm), at [55].

not embody any right capable of being enforced by action.' By assuming that the Taskforce endorsed the 'narrower definition', Bryan J reasoned from their conclusion that 'it is fallacious to proceed on the basis that the English law of property recognises no forms of property other than choses in possession and choses in action.'[55]

Bryan J's decision arguably reads too much into the Taskforce's conclusion, which means exactly what it states, 'that the fact that a cryptoasset *might* not be a thing in action *on the narrower definition* of that term does not in itself mean that it cannot be treated as property.'[56] [Emphasis added.] It does not endorse the narrower definition of thing in action nor does it conclude that cryptoassets are hence intangible tertium quid. In their discussion of *Colonial Bank v Whinney*, the Taskforce explicitly noted that Fry LJ 'attributed a *very broad meaning* to things in action.'[57] [Emphasis added.] In its examination of the reasoning of the House of Lords in the same case, they further surmised:[58]

> 'Thus, to the extent that the House of Lords agreed with Fry LJ on the classification issue, that seems to have been on the basis that the class of things in action could be *extended* to all intangible property (i.e. it was a residual class of all things not in possession) rather than on the basis that the class of intangible property should be *restricted* to rights that could be claimed or enforced by action.' [Emphasis in original.]

A more accurate reading of the Taskforce's Legal Statement should therefore be that cryptoassets are preferably regarded as things in action but if this is not possible for some reason, they may still be accommodated as a form of intangible tertium quid. The former view was preferred in *Cryptopia*,[59] Gendall J explaining:[60]

> 'Fry LJ in his judgment did not seem to be taking a narrow view of what of what can be classified as property, but rather he was simply wanting to push all examples of property into one of two categories. There is nothing, as I see it, in Fry LJ's dictum that would lead a court to conclude that cryptocurrencies are not property. The most that could be said is that cryptocoins might have to be classified as choses in action.'

Save perhaps for patents in England, which are statutorily excluded[61] as things in action for reasons that are obscure,[62] it is not entirely clear what purpose is served by adopting the narrower definition of things in action. As Bridge et al observed:[63]

> '[S]uch a view of things in action both overemphasises the necessity of a right of action and underestimates the panoply of remedies available to a modern court. As to the former, the right of action serves the purpose of securing performance and in the vast majority of cases, things in action, even in the limited sense, are enjoyed in their performance rather

55 *Ibid* at [58].
56 Taskforce, Legal Statement, [84].
57 *Ibid* at [75].
58 *Ibid* at [76].
59 [2020] NZHC 728, at [75], [102]-[121].
60 Ibid at [124].
61 Patents Act 1977, s 30.
62 M Bridge et al, *The Law of Personal Property*, 2nd Edn (Sweet & Maxwell, 2017), pp 175–176.
63 Ibid at 175.

> than by way of action. … As to the latter, the availability of declaratory and quai timet injunctive relief also severely blunts the force of criticisms that no rights of action exist prior to infringement.'

The irony of permitting legal *actions*, with accompanying remedies, in respect of intangible property that have been specifically rejected as things in *action* seems to have eluded the English court, which also overlooked an endnote in the Legal Statement observing that '[t]he existence of a remedy is an essential condition for the existence of a thing in action'.[64]

There are few cases in which a tertium quid has been asserted in the common law. The most well-known instance is the Privy Council decision of *Attorney-General of Hong Kong v Daniel Chan Nai-Keung*,[65] which held that export quotas for textiles fell within the Hong Kong Theft Ordinance as property was defined therein as including 'things in action and other intangible property'. A single sentence summed up both reasoning and conclusion. 'Their Lordships have no hesitation in concluding that export quotas in Hong Kong although not "things in action" are a form of "other intangible property."'[66] No reasons are offered as to why export quotas are not things in action, nor is *Colonial Bank v Whinney* cited. This lackadaisical attitude, not uncommon in sometimes pithy Privy Council decisions, suggests that it is best regarded as decided per incuriam. Another case that appears to promote the tertium quid was the case of *Armstrong DLW GmbH v Winnington Networks Ltd*,[67] another decision of the High Court. Although often cited for the proposition that carbon credits are a tertium quid, as the Taskforce did in its *Legal Statement*,[68] Stephen Morris QC actually concluded that a carbon credit was '*not a chose in action in the narrow sense*, as it cannot be claimed or enforced by action. However to the extent that the concept encompasses wider matters of property, then it could be so described.'[69] [Emphasis added.] As against these weak expressions of support for the tertium quid, the Court of Appeal has rejected the tertium quid in *Allgemeine Versicherungs-Gesellschaft Helvetia v Administrator of German Property*[70] and *Your Response v Datateam Business Media*.[71] The grant of remedies by the courts necessarily entails the recognition of legal rights between (at least) the litigants and it is not obvious why such rights are less properly regarded as things in action than contractual debts, rights between shareholders, or intellectual property rights (less patents). It is true that the task of delimiting and defining the precise rights involved is contentious – it has already been proposed that rights to cryptoassets is best conceptualised as a narrow right *erga omnes* to have the unspent transaction output (UTXO) of a cryptoasset locked to a holder's public address on a blockchain – but this is preferable to the tempting alternative 'to first determine if an intangible asset meets the criteria of property and then adapt the rules of tangible property to it'.[72] Such rule adaptation typically entails the application of a metaphorical version of the tort of conversion as a means of preventing interference with property but 'the metaphor is broken since conversion primarily protects against physical interferences with a tangible *res* and such interferences are, by definition, impossible in relation

64 Taskforce, Legal Statement, 41, endnote 34.
65 [1987] 1 WLR 1339.
66 *Ibid* at 1342.
67 [2013] Ch 156, noted in K F K Low and J Lin, 'Carbon Credits as EU Like It: Property, Immunity, TragiCO_2medy?' (2015) 27 J Environmental Law 377.
68 Taskforce, Legal Statement, [82].
69 *Ibid* at [61].
70 [1931] 1 KB 672, 704.
71 [2014] EWCA Civ 281, [2015] QB 41.
72 Low, '*Quoines* in *Cryptopia*', 80.

to that which is intangible.'[73] Such reasoning amounts to little more than allowing the tail to wag the dog.

Certainty of intention

The question of whether a trust structure is intended is ultimately one of fact and one of the key issues that cloud the nature of the legal relationship between a cryptoasset exchange and its customers. Most investors in cryptoassets purchase their holdings of cryptoassets through an exchange rather than 'mine' them using the relevant computer hardware. Unfortunately, many cryptoasset exchange agreements are poorly drafted and contain contradictory indications as to whether a trustee-beneficiary or debtor-creditor relationship is intended.[74] Clearly drafted cryptoasset exchange agreements, such as that which featured in *Cryptopia*, are uncommon. Fortunately, a body of case law is beginning to build up that will provide better guidance to future courts faced with this thorny question. In Singapore, both the SICC and SGCA were the first Commonwealth courts to consider the question in *Quoine*, which decisions helped the NZHC in *Cryptopia* to formulate helpful guidelines for future courts.

The *Quoine* cases concerned seven trades of bitcoin and ether, the latter being an upstart cryptoasset that briefly eclipsed Bitcoin for attention[75] owing to its so-called 'smart contract' functionality.[76] The trades were purportedly between three customers of Quoine Pte Ltd (Quoine) the defendant cryptoasset exchange operator: (i) B2C2 Ltd (B2C2), the plaintiff, on the one part; and (ii) Pulsar Trading Capital (Pulsar) and (iii) Yu Tomita (Tomita) as counterparties to B2C2. Pulsar and Tomita engaged in margin trading facilitated by Quoine, who also operated its exchange as a 'market-maker', actively placing buy and sell orders on its system and engaged in futures trading, which necessarily entailed trading in cryptoassets it did not own. Like Quoine, its customers were also market makers rather than passive investors. In the trades, B2C2 sold ether and bought bitcoin whereas Pulsar and Tomita sold bitcoin and bought ether. A mistake in Quoine's software led B2C2's own algorithmic trading software offer to sell ether at 10 and 9.99 bitcoins per ether, which were filled by Quoine's malfunctioning software to complete the margin calls on Pulsar and Tomita. These trades overvalued ether by a measure of approximately 250 times its then market value. Following the trades, approximately 3092.5 bitcoins were credited by Quoine to and 309.25 ether were debited from B2C2's account with it. When Quoine became aware of these trades the following morning, they were immediately reversed, which triggered the dispute between B2C2 and Quoine. Although the case focused primarily on contractual liability,[77] our interest is limited to the question of whether the 3092.5 bitcoins credited to B2C2 was intended by Quoine to be held on trust for B2C2.

At first instance, the SICC concluded that Quoine had held the 3092.5 bitcoins credited to B2C2 on trust and was liable for breach of trust when it debited the same thereafter. On appeal, the SGCA reversed the finding of an intention to create a trust, ostensibly for two reasons. First, because there was no actual segregation of cryptoassets by Quoine on the facts.[78]

73 *Ibid*.

74 Cf Low and Teo, 'Bitcoins as Property?', 264–267.

75 'Etherised: Bitcoin's resurgence may be short-lived', *The Economist*, available at https://www.economist.com/finance-and-economics/2016/06/02/etherised [accessed 8 December 2020].

76 Cf K F K Low and E Mik, 'Pause the Blockchain Legal Revolution' (2020) 69 ICLQ 135, 165–174.

77 Noted in K F K Low and E Mik, 'Lost in Transmission: Unilateral Mistakes in Automated Contracts' (2020) 136 LQR (forthcoming).

78 *Quoine v B2C2* [2020] SGCA(I) 2, at [146].

Secondly, because part of clause 9 of the Risk Disclosure Document indicated that Quoine did not take client safety measures such as depositing clients' assets with a trust bank.[79] Both reasons are unconvincing but before addressing them, it is necessary to understand how cryptoassets are 'held'. This requires clear understanding of three different concepts:

(1) cryptoasset public addresses;
(2) cryptoasset 'wallets'; and
(3) notional cryptoasset exchange accounts.

A holder of cryptoassets possesses a public address and a private key. The public address is often regarded as serving a similar function to a bank account number, which is necessary in order to receive cryptoassets. Like a bank account, it is possible to have as many public addresses as one can be bothered to create. In order to transfer cryptoassets out of the address, however, one needs both the address and its matching private key. Although sometimes considered the equivalent of a password, the private key is mathematically linked to the public address by cryptography so that it is not possible to change the private key, unlike a conventional password. One creates this mathematically matched pair of data strings by first choosing a private key, which is ideally randomly generated. This randomly generated private key is then fed to an algorithm to generate a mathematically linked public address. The public address is intended to be freely shared whereas the private key kept secret and the latter is regularly described metaphorically as a digital signature. As both data strings are often a random jumble of characters, it is impractical to commit them to memory alone so a means of storing them securely is often necessary.

This is where cryptoasset wallets features. Such wallets are often divided into five main types. They are:

(1) paper wallets;
(2) hardware wallets;
(3) desktop wallets;
(4) mobile wallets; and
(5) online wallets.

Although it is sometimes said that cryptoassets are stored in such 'wallets', in truth, they merely 'store' the private-public key pair. Paper wallets are simply pieces of paper on which the private-public key pair are printed, often in the form of QR codes for convenience. As they are permanently offline, they cannot be hacked but cryptoassets can be 'stolen' if a stranger manages to glean the information contained therein, as apparently happened to the CEO of a financial services company who left his account information in his car while having it valet parked.[80] Hardware wallets are devices, typically thumb drives, that store the same information, but with some form of added security, including PIN, password, and/or biometric. Similarly to paper wallets, they are mostly offline, reducing the risks of hacking. Some of them also come with so-called recovery seeds, which are a list of words in a particular order that can be used to recover data lost through either loss or damage of the device. Although generally regarded

79 Ibid at [148].
80 L Coleman, 'Researcher Has Bitcoin Stolen Off His Back in a Public Experiment', *Crypto Coins News*, available at www.cryptocoinsnews.com/researcher-bitcoin-stolen-off-back-public-experiment/ [accessed 8 December 2020].

as the most secure of all 'wallets', they are alas expensive. Moreover, although recovery seeds may help with recovery of cryptoassets if a hardware wallet is lost/damaged, they risk the loss of cryptoassets if compromised. Desktop wallets are software installed on desktop PCs or laptops which provide some measure of security beyond simply storing the private-public key pair in an unencrypted file on the same device. Obviously, any compromise in the device, whether through hacking or otherwise, could result in a loss of cryptoassets. Mobile wallets are similar to desktop wallets except that the device is a mobile phone. Online wallets are a service provided by a service provider in the cloud, providing advantages similar to those offered by cloud computing more generally – access to the same service from multiple devices and multiple locations. However, just as it is true that cloud computing does not actually happen in a cloud but in actual terrestrial servers, so too any private-public key pair 'stored' in an online wallet will actually be stored in a server (or multiple servers).

Wallets are also generally categorised into hot or cold varieties. Hot wallets are wallets connected to the Internet whereas cold wallets are not. Hot wallets are generally regarded as riskier than cold wallets as they can be hacked. Whilst some wallets will be almost permanently hot (online wallets) and others permanently cold (paper wallets), most can be connected to and disconnected from the Internet as necessary.[81] Most cryptoasset exchanges would, as a cautionary measure, store most of the cryptoassets that it holds in cold wallets and only keeping sufficient cryptoassets in hot wallets to meet customer demands.[82] As these 'wallets' store private-public keys rather than cryptoassets per se, the same data strings can be stored in multiple wallets since information is nonrivalrous. Indeed, it is generally advisable to do so. This also means that cryptoasset wallets must be irrelevant for the purposes of cryptoasset segregation. Unlike their metaphorical physical cousin, it is possible to 'store' private-public key pair A together with private-public key pair B in one wallet whereas another wallet could 'store' private-public key pair A together with private-public key pair C. Cryptoasset 'wallets' therefore matter less to segregation than public addresses, which can obviously be used to segregate cryptoassets since property in cryptoassets is best conceived in terms of exclusive rights to the UTXO associated with a particular public address.[83] UTXO belonging to different persons can end up being mixed in the same public address for any number of reasons ranging from mistake to fraud and it is theoretically possible to apply common law systems' tracing rules to resolve any resulting disputes.[84] Like 'wallets', notional accounts should also be regarded as irrelevant for purposes of segregation since they are purely notional and may not be actually backed by any underlying cryptoasset at all.[85]

The absence of actual segregation in *Quoine* related to absence of segregation by either public address or wallet. The latter should be irrelevant, the former at best equivocal. It is important to establish why there was no actual segregation. Was it because the parties agreed that segregation was unnecessary or was it because Quoine promised to segregate but failed to do so? Even if the parties agreed that segregation was unnecessary, this does not preclude a trust. It merely suggests (without mandating[86]) a debtor-creditor rather than a trustee-beneficiary

81 *Ruscoe v Cryptopia* [2020] NZHC 728, at [22](f).

82 *Ibid* at [22](c), observing that Cryptopia held 75 per cent of its cryptoassets in cold wallets and 25 per cent in hot wallets.

83 Low and Teo, 'Bitcoins as Property?', 252–254.

84 R Anderson, I Shumailov, and M Ahmed, 'Making Bitcoin Legal' in Vashek Matyáš et al (Eds), *Security Protocols XXVI. Security Protocols 2018. Lecture Notes in Computer Science, vol 11286* (Springer, 2018), p 243.

85 See text accompanying nn 98–100.

86 See text accompanying nn 104–107.

relationship. Perhaps more importantly, the absence of segregation is also consistent with an agreement to segregate followed by failure to do so, which would actually support a claim for breach of trust. Clause 9 of the Risk Disclosure Document in full clause appears to suggest the opposite conclusion:[87]

> '*The Company may receive deposits of money or virtual currency from customers, but the assets deposited by customers will be managed separately from the Company's assets.* The Company does not, however, take client fund safety measures such as depositing them in an account with a trust bank, etc. regarding these assets, so if the Company goes bankrupt, the Company will not be able to return customer assets, and customers may suffer losses.' [Emphasis added.]

By citing only the unitalicised part of the clause, a wrong impression is created. The italicised (and omitted) part of the clause clearly envisages a segregation of assets. Moreover, surely the absence of the use of a trust bank merely precludes a sub-trust (whereby the trust bank holds on trust for the exchange which holds on sub-trust for its clients) rather than a trust per se?

Cryptopia concerned the hacking of the eponymous cryptoasset exchange. Although the scale of the hack, where cryptoassets valued at NZ$30m was 'stolen', paled in comparison to the worst hacks of all time,[88] it sufficed to force Cryptopia into liquidation. *Cryptopia* was essentially an application by its liquidators for directions on the legal status of the remaining cryptoassets held by Cryptopia: were the 'unhacked' cryptoassets held on trust for its accountholders? Leaving these aside, Cryptopia's available assets for distribution in the liquidation was a mere NZ$5.4m. This contrasted with the estimated value of all creditors' claims at NZ$12.7m. The liquidators had no personal interest in whatever outcome was reached by the court so that the tussle was effectively one between the creditors of Cryptopia and its accountholders. Unlike Quoine, Cryptopia did not engage in market making or futures trading, nor did its customers. Naturally, the documentation of the exchange played an important role in the NZHC's conclusion that a trust was intended but clarity in cryptoasset exchange customer documentation is not always present and *Cryptopia*, by highlighting the significance market making and futures trading, provides some useful guidelines for future courts that may be faced with more muddled drafting. Futures trading, involving as it does non-existent cryptoassets, is particularly telling.

Although not highlighted by Gendall J, it appears that Cryptopia did not segregate its own beneficially owned cryptoassets from those that it held for its customers, nor did it segregate the cryptoassets of different customers, except by way of its own notional, and hence irrelevant, accounts. Despite Cryptopia having a 'beneficial interest in its own personal cryptocurrency as an accountholder',[89] this did not deter Gendall J from concluding that a trust was intended. This conclusion is consistent with the law since segregation is merely indicative of and not necessary to demonstrate the requisite intent.[90] It is also trite law that a trustee can have a beneficial interest in trust assets.[91] It is suggested that, as a matter of policy, a clear preference

87 The full clause can be found in Annex 2 of the SICC judgment, *B2C2 v Quoine* [2019] 4 SLR 17, 104.

88 See text accompanying nn 159–160.

89 *Ruscoe v Cryptopia* [2020] NZHC 728, [165](d)(iii).

90 *R v Clowes (No 2)* [1994] 2 All ER 316, 325. Cf *South Australia Insurance Co v Randell* (1869) LR 3 PC 101; *Henry v Hammond* [1913] 2 KB 515, 521.

91 The only prohibition is against a trustee holding the equitable interest for himself exclusively: *Re Selous* [1901] 1 Ch 921, 922. See also *Re Cook* [1948] Ch 212.

for a presumption of a trustee-beneficiary relationship for cryptoasset exchanges is desirable since the absence of interest payments, a hallmark of debt,[92] in practically all such agreements is highly suggestive.

Certainty of subject-matter

But for an elementary error made by the SICC in *Quoine*,[93] which elided the question of whether property can be held on trust with the quite separate question of certainty of subject-matter, it would not have been necessary to emphasise their distinctness. Needless to say, the SICC cannot be correct. The leading cases on certainty of subject matter, *Re London Wine Co (Shippers) Ltd*,[94] *Hunter v Moss*,[95] and *Re Goldcorp Exchange Ltd (in receivership)*,[96] concerned wine, shares, and gold bullion respectively. All of those 'property' were indubitably capable of being held on trust. Yet they gave rise to fierce debates over whether there was sufficient certainty of subject matter on the facts of those cases. Conversely, arguably the most controversial case on the susceptibility of 'property' to trust holding is that of *Swift v Dairywise Farms Ltd*,[97] which held that EU milk quota could be held on trust separately from the 'holding' it was attached to even though the Regulations that give rise to the quotas prohibited their transfer independently, raised no question of certainty of subject matter at all.

There was almost certainly no trust in *Quoine* in favour of B2C2 of the disputed 3092.5 bitcoins Quoine had mistakenly credited to it. First, as the bitcoins represented one half of a trade between B2C2 on the one part and Pulsar and Tomita on the other, it seems obvious that any trust intended by Quoine should be impressed upon bitcoins beneficially owned by Pulsar and Tomita rather than bitcoins it personally beneficially owned. In this respect, there was one insurmountable hurdle: 'the available [bitcoin] balances in Pulsar's and Tomita's accounts were insufficient to meet B2C2's orders'.[98] A trust cannot be impressed upon non-existent property.[99] Even the question of a trust in respect of the bitcoins *actually* beneficially owned by Pulsar/Tomita is also clouded by the issue of priority between competing claims. Presumably, these were held by Quoine on behalf of Pulsar/Tomita under the same terms as with B2C2. If these terms would give rise to a trust, then Pulsar/Tomita would have pre-existing equitable interests in these BTC. Since the transaction was concluded only on account of the software malfunction, it seems doubtful that Quoine would be, vis-à-vis Pulsar/Tomita, authorised to transfer their equitable interests to B2C2. If so, any declaration of trust by Quoine in favour of B2C2 over assets it already holds on trust for Pulsar/Tomita must be subject to the equitable maxim *qui prior est tempore, potior est jure*[100] so that B2C2's equitable title to the bitcoins that actually exists must rank behind that of Pulsar/Tomita.

Provided the necessary cryptoassets exist, it is likely that a declaration of trust of part of a holding locked to a single public address will be treated in the same way as a declaration of

92 Cf *Ex parte Plitt* (1889) 60 LT 397.
93 *B2C2 v Quoine* [2019] 4 SLR 17, at [142].
94 [1986] PCC 121.
95 [1994] 1 WLR 452.
96 [1995] 1 AC 74.
97 [2000] 1 WLR 1177.
98 *B2C2 v Quoine* [2019] 4 SLR 17, at [75].
99 *Holroyd v Marshall* (1862) 10 HL Cas 191, 220.
100 Where the equities are equal, the first in time prevails.

trust of part of a single holding of shares.[101] Like shares,[102] fungibility of cryptoassets may be effectively irrelevant if the entire 'issue' of cryptoassets, eg all 21 million bitcoins, are regarded as a single asset. Alternatively, if each unit of bitcoin, the smallest being a satoshi, which is equivalent to 100 millionth of a bitcoin, is regarded as a separate asset, they should be regarded as fungible if, like bitcoin and ether, they were intended to serve as an alternative form of money.[103] Naturally, segregation will put matters beyond doubt but provided the requisite intent is clear, segregation is unnecessary, as *Cryptopia* suggests. Segregation is unlikely so far as cryptoasset exchanges are concerned because segregation by separate public addresses would make trading in cryptoassets unnecessarily cumbersome and expensive. The sale to or purchase from a customer of cryptoassets would require a transfer on the relevant blockchain from one public address to another. This is impractical for two reasons. First, it is costly. Whilst bitcoin was heralded in the early days for its ability to facilitate cross-border fund transfers at a low cost, this was a function of the high levels of newly 'mined' bitcoins awarded by the system to 'miners' for 'mining' new blocks of transactions. As mining rewards have fallen, transfer fees have increased and many proposed transactions have not been selected by miners, giving rise to tens of thousands of unconfirmed transactions in the mempool.[104] At one point, these exceeded 200,000 transactions.[105] Secondly, cryptoasset transfers on the blockchain are slow. As most cryptoassets rely on a 'proof-of-work' consensus algorithm, new transactions are added in blocks only in set intervals when the 'proof-of-work' puzzle is solved by a 'miner'. Although blocks so added supposedly acquired 'immutability' as a result, 'blockchain immutability is not an absolute concept but rather more 60 blocks/shades of grey.'[106] A transaction gets increasingly immutable as more blocks are added to the blockchain so that on initial addition, a transaction contained in a brand-new block is surprisingly susceptible to erasure. For bitcoin, the general advice to wait for six blocks of confirmation before treating a transaction as final. Given that a new block is only added roughly every ten minutes, this is almost a full hour. Any cryptoasset exchange that adopts a business model which segregates its own cryptoassets from those of its customers will find itself uncompetitive vis-à-vis its peers in terms of both cost and speed.

Investing in cryptoassets

Are cryptoassets an authorised investment?

Although it is clear that cryptoassets may be held on trust, it is an entirely different question altogether whether traditional private trusts can/ought to invest in cryptoassets as part of their investment strategy. Two questions arise. First, are the trustees of a particular trust even authorised to invest in cryptoassets? Secondly, if so, should they do so? The former is dependent on the terms of the trust and its governing law. The latter requires an understanding of the peculiar risks involved in holding cryptoassets as well as how they work.

It is convenient to first dismiss the objection to investment in cryptoassets on the basis that they generate no income. Although the traditional meaning of 'invest' is 'to apply money

101 *Hunter v Moss* [1994] 1 WLR 452; *Re Harvard Securities Ltd* [1997] 2 BCLC 369; *Re CA Pacific Finance Ltd* [2000] 1 BCLC 494; *White v Shortall* [2006] NSWSC 1379.

102 R Goode, 'Are Intangible Assets Fungible?' [2003] LMCLQ 379.

103 T Cutts and D Goldstone QC, 'Bitcoin Ownership and its Impact on Fungibility', *Coindesk*, available at www.coindesk.com/bitcoin-ownership-impact-fungibility/ [accessed 4 January 2021].

104 A contraction of memory pool, which has been likened to a waiting area for unconfirmed transactions.

105 I Kaminska, 'The Currency of the Future has a Settlement Problem', *Financial Times*, available at https://ftalphaville.ft.com/2017/05/17/2188961/the-currency-of-the-future-has-a-settlement-problem/ [accessed 8 December 2020].

106 Low and Mik, 'Pause the Blockchain Legal Revolution', 144.

in the purchase of some property from which interest or profit is expected and which property is purchased in order to be held for the sake of the income which it will yield',[107] a more modern perspective of investment regards the 'acquisition of property for the sake of income *or capital profit*, or a combination of both, can count as an "investment"'.[108] [Emphasis added.] Accordingly, even the absence of express authorisation of non-income producing property should not prevent trustees from investing in most cryptoassets provided it otherwise falls within the scope of an investment power.[109] Thus, a recently leaked slide from Goldman Sachs with the header 'Cryptoccurencies Including Bitcoin Are Not an Asset Class',[110] which noted that cryptoassets '[d]o not generate cash flow like bonds', nor do they 'generate any earnings through exposure to global economic growth', is irrelevant for the purposes of this threshold question. For the purposes of trust law, most cryptoassets *are* an asset class in that they can be held on trust provided the terms of an investment power are sufficiently wide. The only exception to this analysis may well be stablecoins.

There are broadly four types of stablecoins:[111]

(1) fiat-collateralised stablecoins;
(2) crypto-collateralised stablecoins;
(3) commodity-collateralised stablecoins; and
(4) non-collateralised stablecoins, also known as algorithmic stablecoins.

As their name suggests, stablecoins are cryptoassets designed with price stabilisation in mind. The most well-known and significant (by market capitalisation) of stablecoins is Tether, a cryptoasset supposedly backed by US dollar deposits and hence an exemplar of fiat-collateralised stablecoins. Tether is an extremely controversial stablecoin in that the true extent of its reserves has been doubted and it is believed to be used to manipulate bitcoin prices.[112] But on the assumption that it truly is fully backed by fiat currency, then it would not amount to an investment unless the US dollar happens to be a foreign currency for a particular trust. However, even in such a situation, it would be difficult to justify an investment in Tether, except perhaps as a means of then using it to invest in non-stablecoin cryptoassets, since a traditional investment in US dollars, whether through the purchase of bonds or a bank deposit, would at least earn interest payments, however low those may be. Crypto-collateralised stablecoins operate on similar principles to those backed by fiat currencies except that the collateral used is another cryptoasset rather than fiat currency. Accordingly, they are an even poorer 'investment'. Not only is there no capital appreciation potential, as they are pegged to traditional fiat currencies, there is arguably a risk of depreciation. As the collateral for such stablecoins are other volatile cryptoassets, it is said that 'this type of stablecoin is often "overcollateralized."'[113] Often, unfortunately, is not the same as always, and sharp

107 *Re Wragg* [1919] 2 Ch 58, 65.

108 L Tucker et al, *Lewin on Trusts*, 20th Edn (Sweet & Maxwell, 2020) at [35-18].

109 *Marson v Morton* [1986] 1 WLR 1343, 1350; *Harries v Church Commissioners for England* [1992] 1 WLR 1241, 1246; *Cook (Inspector of Taxes) v Medway Housing Society Ltd* [1997] STC 90, 98.

110 Goldman Sachs Client Call, 27 May 2020, Slide No. 30, available at https://resources.goldman.com/content/dam/pwm/direct-links/isg-calls/client_call_materials_27May20.pdf?sa=n&rd=n [accessed 8 December 2020].

111 M Mita et al, 'What is Stablecoin? A Survey on Its Mechanism and Potential as Decentalized Payment Systems' *2019 8th International Congress on Advanced Applied Informatics (IIAI-AAI)*, (Toyama, Japan, 2019), 60.

112 J M Griffin and A Shams, 'Is Bitcoin Really Untethered?' (2020) 75 The Journal of Finance 1913.

113 A R Zhang et al, 'The Regulation Paradox of Initial Coin Offerings: A Case Study Approach' (2019) 2 Frontiers in Blockchain 2, 8.

drops in the prices of the underlying cryptoasset collaterals may leave them under-collaterised. Commodity-collateralised stablecoins are rare. As their name suggests, they are backed neither by fiat currency nor cryptoassets but commodities. The most infamous example of a commodity-collateralised stablecoin is the petro, issued by a Venezuelan government facing crippling sanctions and a plummeting currency. It has been described as 'the most obviously horrible investment ever … The petro is about creating something useless – that's why only foreigners can buy them, but only Venezuelans can spend them'.[114] Unlike fiat-collateralised or crypto-collateralised stablecoin, the price of petro is supposed to be equivalent to the price of a single barrel of oil, which thus offers at least the potential for capital appreciation making it technically an investment. However, for obvious reasons, trustees wishing to seek exposure to any underlying commodity can simply purchase that commodity. Instead of using another asset to stabilise its price, non-collateralised or algorithmic stablecoins do so through algorithms, either in their protocol or applications layers, adjusting supply to ensure long term price stability. One of the most successful stablecoin proposals in terms of fundraising is Basis, which raised US$133m through private placement for their project.[115] It envisaged ensuring price stability of its Basis token, which is be pegged to a fiat currency, through the issue of two other types of tokens:

(1) bond tokens; and
(2) share tokens.

Bond tokens are auctioned off whenever it is necessary to reduce the supply of actual Basis tokens at the cost of less than one Basis token for future redemption of one Basis token. Share tokens are issued at the outset upon the genesis of the blockchain. Share tokens are not pegged to anything but entitle shareholders to newly created Basis tokens on a pro rata basis when new tokens are issued to meet increasing demand. Accordingly, the actual base tokens in such an algorithmic stablecoin would probably not amount to an investment for present purposes. Bond tokens and share tokens, on the other hand, would. Despite funding success, the Basis project is now defunct,[116] and it has been suggested that its price stability algorithm, dubbed the seignorage share model,[117] is fundamentally flawed:[118]

> '… incentives to buy bonds are based on a circular dependency: people will buy the bonds if they think Basis will climb up, but Basis will only climb up if people buy the bonds. This assumption will inevitably break in free markets.'

It is thus not clear that algorithmic stablecoins will be able to ensure price stability in the face of sharp market sell-offs. An academic paper recently concluded that 'despite the potential

114 M O'Brien, 'Venezuela's cryptocurrency is one of the worst investments ever', *Washington Post*, available at www.washingtonpost.com/news/wonk/wp/2018/03/05/venezuelas-cryptocurrency-is-one-of-the-worst-investments-ever/ [accessed 8 December 2020].

115 N Al-Naji, J Chen, and L Diao, 'Basis: A Price-Stable Cryptocurrency with an Algorithmic Central Bank', available at www.basis.io/basis_whitepaper_en.pdf [accessed 8 December 2020].

116 N Al-Naji, 'Letter to the Basis Community' at www.basis.io/ [accessed 8 December 2020].

117 R Sams, 'A Note on Cryptocurrency Stabilisation: Seigniorage Shares', available at https://blog.bitmex.com/wp-content/uploads/2018/06/A-Note-on-Cryptocurrency-Stabilisation-Seigniorage-Shares.pdf [accessed 8 December 2020].

118 Q Wang, *Twitter* at https://twitter.com/QWQiao/status/998213027097989120 [accessed 8 December 2020].

utility of non-collateralized stablecoin, we still do not have a method to maintain its purchasing power.'[119]

In most Commonwealth jurisdictions, apart from stablecoins, cryptoassets will be an authorised investment owing to statutory expansions of trustees' investment powers to an unlimited class of assets, moving away from the old statutory list of authorised trustee investments,[120] unless the statutory power is either excluded or restricted. In some common law jurisdictions, such as Hong Kong, which retains the statutory list of authorised trustee investments,[121] whether or not cryptoassets are an authorised investment class will turn instead on the express powers of investment within the trust deed (if any). A general power of investment should suffice but more limited powers of investment may not. Thus, a power to invest in such securities as the trustees thought fit[122] is arguably not sufficiently wide to permit investment in cryptoassets given the controversies over whether they are securities or not. Given that investment clauses are to be construed strictly,[123] statements such as those by regulators expressing the view that some cryptoasset offerings are securities offerings[124] may not be persuasive as courts may take the view that the definition of securities for regulatory purposes may be wider than that for trustee investment purposes. This is because a wider regulatory definition would better protect the public from initial coin offering scams, whereas a narrower definition may be preferable from a trustee investment perspective since cryptoassets do not resemble traditional securities. They do not generate income like ordinary securities, carry completely different risks in ownership, and exhibit price volatility on an altogether different scale.

Understanding the risks

Even on the assumption that cryptoassets are an authorised investment under the terms of a particular trust, the question remains as to whether the trustees ought to invest in cryptoassets. This requires trustees to be familiar with the risks and consequences that investments in cryptoassets entail. These may be broadly classified into four categories:

(1) hacks and scams;
(2) insurance;
(3) volatility; and
(4) ethics and environmental considerations.

119 Mita et al, 'What is Stablecoin?', 66.

120 New Zealand (Trustee Amendment Act 1988, No 119); the Northern Territory (Trustee Amendment (No 2) Act No 60 of 1995); South Australia (Trustee (Investment Powers) Act 1995); Victoria (Trustee and Trustee Companies (Amendment) Act 1995 (No 104/1995)); New South Wales (Trustee Amendment (Discretionary Investments) Act No 102 of 1997); Queensland (Trustee (Investments) Amendment Act No 69 of 1999); Tasmania (Trustee Amendment (Investment Powers) Act 1997); Western Australia (Trustees Amendment Act 1997); Australian Capital Territory (Trustee Amendment Act No 28 of 1999); England and Wales (Trustee Act 2000); Singapore (Trustees Act (Cap 337, 2005 Rev Ed)).

121 See Sch 2 to the Trustee Ordinance (Cap 29).

122 Cf *Re Smith* [1896] 1 Ch 71; *Re McEachern's Settlement Trusts* [1939] Ch 858.

123 *Re Maryon-Wilson's Estate* [1912] 1 Ch 55; *Re Harari's Settlement Trusts* [1949] WN 79.

124 See, eg US SEC Chairman Jay Clayton, 'Statement on Cryptocurrencies and Initial Coin Offerings' at www.sec.gov/news/public-statement/statement-clayton-2017-12-11 [accessed 8 December 2020].

Hacks and scams

It has been suggested that the first duty of trustees is to acquire control over trust property.[125] Once under their control, trustees are under a duty to ensure their safe custody. Despite cryptoassets being marketed as 'secure', supposedly as a result of their reliance upon the vaunted blockchain, cryptoassets are actually remarkably insecure. Much is often made of the indisputable, mathematical link between the private keys and public addresses that holders use to receive and transfer cryptoassets, but little is said of the absence of a similar link between a private key and its user.[126] After all, the blockchain consensus protocol cannot differentiate between an end user using his private key and his dog doing the same.[127] Accordingly, cryptoasset holders are only as secure as they are able to secure their private keys. Blockchains provide '*zero* protection [to end users] from … hacking, which is not only possible but commonplace'.[128] Individuals can be targeted[129] just as easily as cryptocurrency exchanges.[130] The threat extends beyond cyber-intrusion. Mere sight of paper wallets can lead to loss.[131] Other forms of cold wallets, including thumb drives unconnected to the Internet, are like all tangible property susceptible to theft. Physical threats of violence have also been used to divest a cryptomaniac of their cryptoassets.[132]

Lest it appear that trustees need only concern themselves with securing trust cryptoassets from dishonest interlopers, the challenge is complicated by the risk of loss of the private key, highlighted by the curious case of QuadrigaCX. Although revealed to be a case of fraud,[133] the original headlines highlighted the risks of maintaining only a single copy of the private key. After the sudden death in India of Gerald Cotten, the co-founder and CEO of QuadrigaCX, then Canada's largest cryptoasset exchange, QuadrigaCX announced that it had lost access to the cryptoassets it held for its customers because 'Cotten was the only person with the cryptographic keys to access $137 million of cryptocurrencies kept in "cold" storage to mitigate the risk of hacks.'[134] This has since been revealed to be merely an excuse to hide the fact that QuadrigaCX was essentially run as a Ponzi scheme[135] but though the cautionary tale proved false, the lesson of the parable is very real. Other cautionary tales exist of the great lengths that cryptoasset holders had to go through to recover their 'lost'

125 *Wyman v Paterson* [1900] AC 271, 288.

126 C Ellison and B Schneier, 'Ten Risks of PKI: What You're Not Being Told about Public Key Infrastructure' (2000) 16 Computer Security Journal 1, 2.

127 Cf P Steiner, 'On the Internet, nobody knows you're a dog' (cartoon caption), *The New Yorker*, 5 July 1993. See also S Mason and T S Reiniger, '"Trust" between Machines? Establishing Identity between Humans and Software Code, or Whether You Know It Is a Dog, and If So, Which Dog?' (2015) 21 CTLR 135.

128 K F K Low and E Teo, 'Legal Risks of Owning Cryptocurrencies' in in David Lee Kuo Chuen and Robert Deng (Eds), *Handbook of Blockchain, Digital Finance, and Inclusion, Vol 1: Cryptocurrency, FinTech, InsurTech, and Regulation* (Academic Press, 2017), pp 225, 236.

129 N Popper, 'Identity Thieves Hijack Cellphone Accounts to Go After Virtual Currency', *The New York Times*, available at www.nytimes.com/2017/08/21/business/dealbook/phone-hack-bitcoin-virtual-currency.html [accessed 8 December 2020].

130 Most hacks have targeted Asian cryptocurrency exchanges because of higher rates of adoption of cryptocurrency in Asia: see Low and Wu, 'Characterisation of Cryptocurrencies in East Asia'.

131 Coleman, 'Researcher Has Bitcoin Stolen off His Back'.

132 N Popper, 'Bitcoin Thieves Threaten Real Violence for Virtual Currencies', *The New York Times*, available at www.nytimes.com/2018/02/18/technology/virtual-currency-extortion.html [accessed 8 December 2020].

133 Ontario Securities Commission, 'QuadrigaCX: A Review by Staff of the Ontario Securities Commission' (14 April 2020).

134 G Barber, 'A Crypto Exchange CEO Dies – With the Only Key to $137 Million', *Wired*, available at www.wired.com/story/crypto-exchange-ceo-dies-holding-only-key/ [accessed 8 December 2020].

135 Ontario Securities Commission, 'QuadrigaCX', 3.

cryptoassets when they lost access to sole copies of their private keys.[136] For every triumphant story of recovery, innumerable tales of woe go unreported.[137] In 2018, a digital forensics firm estimated that at least 2.3m bitcoins are lost and a further 1.5m are likely to be lost.[138] As 4m out of the theoretically total of 21m bitcoins had not yet been 'mined', this represented more than 22 per cent of bitcoins then in existence. Trustees who invest in cryptoassets must thus maintain a delicate balance between guarding against inadvertent loss of their private keys and securing the same against prying third parties. The former dictates that multiple copies be kept as the loss of the only copy of a private key is disastrous whereas the latter implores against multiplicity since each additional copy is an additional point of failure.

Trustees confident in their ability to sail between the Scylla of fraud and the Charybdis of loss must still contend with risks at the network level. 'Proof-of-work' blockchains are only secure so long as a majority of users by network hash rate (ie total computing processing power) are honest. They are thus susceptible to what is called the 51 per cent attack, in which a person (or persons) who control(s) 51 per cent of the network hash rate could rewrite earlier blocks and effectively invalidate previously valid transactions.[139] The 51 per cent attack has since transitioned from theoretical possibility to worrisome reality for a handful of smaller blockchain networks,[140] so trustees must avoid investing in cryptoassets with small networks. Any bugs in the blockchain code may also spell disaster. On 20 September 2018,[141] it was revealed that the bitcoin code contained a bug which would have allowed malicious miners to artificially inflate bitcoin's theoretically finite supply,[142] defeating one of its raison d'êtres.

Where a cryptoasset's blockchain includes so-called 'smart contract' functionality, these carry additional security concerns. 'Smart contracts', properly analysed, are no more than 'self-executing ledger-modification instructions, for example "if X occurs, send Y amount of tokens from account A to account B."'[143] They are code used to automate a particular change of state within the relevant blockchain ledger. There is nothing fundamentally wrong with automation or with code but marrying that supreme human frailty – mistake – with blockchain immutability is a recipe for disaster, as demonstrated by the DAO ('Decentralized Autonomous Organisation') disaster. The DAO was a peculiar fund designed to allow all investors to vote upon investment decisions. Crowdfunded in April 2016, it managed to raise more than US$168m worth of ether. Unfortunately, owing to a bug in the code of its

136 M Frauenfelder, '"I Forgot My PIN": An Epic Tale of Losing $30,000 in Bitcoin', *Wired*, available at www.wired.com/story/i-forgot-my-pin-an-epic-tale-of-losing-dollar30000-in-bitcoin/ [accessed 8 December 2020]; Z Hines, 'My $200,000 Bitcoin Odyssey', *Engadget* at www.engadget.com/2017-12-05-how-not-to-store-your-bitcoins.html [accessed 8 December 2020].

137 L Matsakis, 'How WIRED Lost $100,000 in Bitcoin', *Wired*, available at www.wired.com/story/wired-lost-bitcoin/ [accessed 8 December 2020].

138 'Bitcoin's $30 billion sell-off', available at https://blog.chainalysis.com/reports/money-supply [accessed 8 December 2020].

139 Jimi S, 'Blockchain explained: how a 51% attack works (double spend attack)', available at https://blog.goodaudience.com/what-is-a-51-attack-or-double-spend-attack-aa108db63474 [accessed 8 December 2020].

140 A Hertig, 'Blockchain's Once-Feared 51% Attack Is Now Becoming Regular', available at www.coindesk.com/blockchains-feared-51-attack-now-becoming-regular/ [accessed 8 December 2020]; J I Wong, 'Every cryptocurrency's nightmare scenario is happening to Bitcoin Gold', *Quartz*, available at https://qz.com/1287701/bitcoin-golds-51-attack-is-every-cryptocurrencys-nightmare-scenario/ [accessed 8 December 2020].

141 See CVE-2018-17144 Full Disclosure at https://bitcoincore.org/en/2018/09/20/notice/ [accessed 8 December 2020].

142 Fixed at 21 million bitcoins. Note that there is no cap for ether.

143 Low and Mik, 'Pause the Blockchain Legal Revolution', 165.

smart contract, hackers managed to siphon off some US$50m worth of the invested ether. The incident exposed the risks of smart contracts, particularly among novice coders attracted to the crypto-community's libertarian ideals, who fail to appreciate the exactitude that coding demands:[144]

> 'The process of coding is highly exacting as it entails formulating precise instructions that describe how to complete a particular task while anticipating all possible variations in conditions that might affect its operation. In coding, there is no officious bystander to add lines of code that go without saying or reinterpret code that must have gone awry. Coding has been likened to "writing War and Peace – but with no typos."'

According to a leading text, '[i]ndustry average experience is about 1–25 errors per 1000 lines of code for delivered software.'[145] For ethereum 'smart contracts', the industry average was 100 bugs per 1000 lines of code in 2016.[146] Many of the investors in the DAO who lost their ether were able to 'recover' them as the hack affected so many investors that a majority of users of ethereum supported rolling back the ethereum blockchain to its pre-hack state,[147] a decision so controversial that caused a fork in the blockchain when a small core of users refused to do so.[148] Should trustees face a similar loss, there can be no assurance that a majority of users of the relevant cryptoasset would support a wholesale reversal of that cryptoasset's blockchain so as to allow them to recover their lost cryptoasset. This is particularly as such reversal would also entail reversal of perfectly legitimate transfers since transactions cannot be individually reversed but only in blocks at a time.

The view is also increasingly shared that many cryptoasset launches in the form of initial coin offerings (ICOs) are inadequately regulated[149] so that even if none of the above risks eventuate, the cryptoasset itself is either simply a scam or a poorly thought out venture.

Insurance

Although there is some authority suggesting that trustees are under no duty to insure trust property,[150] this view has been doubted by no less than the Law Commission.[151] The authority has been castigated as 'unsatisfactory',[152] the cases cited in support[153] going no further than to

144 *Ibid* at 173.

145 S McConnell, *Code Complete*, 2nd Edn (Microsoft Press, 2004), p 521.

146 P Vessenes, 'Ethereum Contracts Are Going To Be Candy For Hackers', available at https://vessenes.com/ethereum-contracts-are-going-to-be-candy-for-hackers/ [accessed 8 December 2020].

147 J I Wong and I Kar, 'Everything You Need to Know about the Ethereum "Hard Fork"', *Quartz*, available at http://qz.com/730004/everything-you-need-to-know-about-the-ethereum-hard-fork/. [accessed 8 December 2020].

148 A van Wirdum, 'Rejecting Today's Hard Fork, the Ethereum Classic Project Continues on the Original Chain: Here's Why', *Bitcoin Magazine* available at https://bitcoinmagazine.com/articles/rejecting-today-s-hard-fork-the-ethereum-classic-project-continues-on-the-original-chain-here-s-why-1469038808 [accessed 8 December 2020].

149 A Gurrea-Martínez and N Remolina, 'The Law and Finance of Initial Coin Offerings' in C Brummer (ed), *Cryptoassets: Legal, Regulatory, and Monetary Perspectives* (Oxford University Press, 2019), p 117, C Brummer, T I Kiviat and J Massari, 'What Should Be Disclosed in an Initial Coin Offering?' in C Brummer (ed), *Cryptoassets: Legal, Regulatory, and Monetary Perspectives* (Oxford University Press, 2019) 157. Cf K Yeung, 'Regulation by Blockchain: the Emerging Battle for Supremacy between the Code *of* Law and Code *as* Law' (2019) 82 MLR 207, 210.

150 *Re McEachern* (1911) 103 LT 900, 902.

151 Law Commission and Scottish Law Commission, *Trustees' Powers and Duties* (LC 260; SLC 172).

152 *Lewin on Trusts*, at [34-74].

153 *Bailey v Gould* (1840) 4 Y & C Ex 221; *Fry v Fry* (1859) 27 Beav 144.

state that the absence of insurance in particular circumstances did not entail breaches of duty. The absence of insurance may be excusable in certain situations because it is impracticable because the costs implications are enormous, such as where the trust estate comprises paintings, works of art, antique furniture or other chattels of substantial value. In such cases, 'it would go too far to say that trustees must sell some of the chattels in order to fund the insurance of the rest.'[154] However, it is obvious from the context that this relaxation of the duty to insure relates to the trust estate in its original form, not new investments made by trustees out of trust funds, for which the availability of insurance must surely be an important consideration in deciding if it is an appropriate investment.

In this respect, the necessity of insurance is even more important because of the risks previously considered.[155] Already generally regarded as necessary for most trust assets, the case for insurance of cryptoassets must surely be a fortiori. Unfortunately, insurance coverage for cryptoassets is scarce. Although Aon, was recently reported to have insured a major cryptoasset exchange, Coinbase, to the tune of US$255m,[156] there are many hurdles to insuring cryptoassets which have deterred many other insurers from doing so. Cryptoasset exchange hacks have not abated despite the industry being subject to regulation.[157] After suffering the most infamous cryptoasset exchange hack in 2014 with the Mt Gox hack,[158] in which US$460m worth of bitcoins were stolen, the Japanese Financial Services Agency began to regulate the industry. However, in spite of the regulation, another Japanese exchange, Coincheck, was hacked in 2018 and US$500m worth of XEM tokens were stolen, bestowing Japan with the dubious honour of having hosted the two worst cryptoasset exchange hacks of all time.[159] It is not obvious that more regulation will resolve this risk. Hacking presents challenges to law enforcement that have proven remarkably resilient as it usually crosses national boundaries. 'Existing mechanisms for international police cooperation are expensive and slow – designed to catch the occasional fugitive murderer, but not for dealing with millions of frauds at a cost of a few hundred dollars each.'[160] The pseudonymous nature of cryptoassets exacerbate the challenges to law enforcement agencies, as does their transaction modality. Although transferees are advised to wait for multiple blocks before treating a transaction as finalised, it is effectively beyond the control of the transferor from the moment the transaction is added to the blockchain. Any subsequent reversal of the transaction is a matter of chance rather than choice, making hacks of cryptoassets less readily reversible than hacks of bank money.[161] The extreme volatility of cryptoasset prices also makes it challenging to set appropriate premiums. Set too low and the insurer may suffer losses. Set too high and no one will purchase insurance. Although '[c]ertain insurers are willing to deploy capital and create bespoke insurance solutions for digital asset companies, many

154 *Lewin on Trusts*, at [34-75].

155 See text accompanying nn 121–144

156 P Martin, 'On insurance and cryptocurrency', available at https://blog.coinbase.com/on-insurance-and-cryptocurrency-d6db86ba40bd [accessed 8 December 2020].

157 For a list of cryptoasset exchange hacks, see 'A Comprehensive List of Cryptocurrency Exchange Hacks', available at https://selfkey.org/list-of-cryptocurrency-exchange-hacks/ [accessed 8 December 2020].

158 R McMillan, 'The Inside Story of Mt Gox, Bitcoin's $460 Million Disaster', *Wired*, available at www.wired.com/2014/03/bitcoin-exchange/ [accessed 8 December 2020].

159 L Lewis and R Harding, '"Crypto crazy" Japanese mystified by virtual heist', *Financial Times*, available at www.ft.com/content/7010982c-0800-11e8-9650-9c0ad2d7c5b5 [accessed 8 December 2020].

160 T Moore, R Clayton and R Anderson, 'The Economics of Online Crime' (2009) 23 Journal of Economic Perspectives 3, 16.

161 Low and Teo, 'Legal Risks of Owning Cryptocurrencies'.

remain conservative given the evolving nature of the underlying blockchain technology,' it is thus not surprising that 'a number of the larger, established insurers have taken a hard line and do not participate in the crypto sector at all.'[162] Thus far, the few insurance products that exist appear to be available only to large entities within the crypto-community such as cryptoasset exchanges and the adequacy of coverage is concerning. Coinbase's coverage with Aon only extends to its hot wallets, not its cold wallets, which whilst less susceptible to hacks, is not impervious to loss. Furthermore, it is important to note that Coinbase boasts of responsibility for the custody of more than US$20 billion of cryptoassets.[163] A US$255m coverage, it turns out, amounts to a little more than 1.2 per cent of total assets under management.

Volatility

The extreme volatility of cryptoassets is both an attraction (when prices rise) and a concern (when prices collapse). Between October 2009, when the now defunct New Liberty Standard exchange priced bitcoins at US$1 for 1,309.03 bitcoins in October 2009 to its first heady peak of US$1,216 per bitcoin on 28 November 2013, the price for bitcoins grew at an astonishing 160 million per cent in four years. By the time it reached its all-time peak of US$19,783.06 per bitcoin in December 2017,[164] this marked a further 1,600 per cent growth. If the gains are eye-watering, the losses can be equally tear-inducing. When Mt Gox announced on 7 February 2014 that it was halting withdrawals because of 'technical issues', and before admitting to being hacked, the price of bitcoin nosedived by more than 20 per cent in less than a single day, from US$831 on a Thursday evening to US$658 the following morning.[165] By 14 January 2015, after the Chinese Government prohibited banks from using bitcoin the previous month, the price would fall to US$179.13,[166] or more than 85 per cent from its peak of US$1,216 just a little over a year ago. From its peak in 2017, bitcoin would lose a third of its value in a single day the following month.[167] Falling to US$3,293.31 by December 2018, or more than 83 per cent from its peak in just over a year. The famed investor Warren Buffett has christened bitcoin as 'rat poison squared',[168] explaining in an interview:[169]

> 'Cryptocurrencies basically have no value and they don't produce anything. … It can't do anything. And what you hope is that somebody else comes along and pays you more money for it later on. But then that person's got the problem. But in terms of value, uh, zero.'

162 J Shawdagor, 'Crypto Insurance a Promising Sector Despite Caution of Major Players', available at https://cointelegraph.com/news/crypto-insurance-a-promising-sector-despite-caution-of-major-players [accessed 8 December 2020].

163 S McIngvale, 'Coinbase Custody is Officially Open For Business', available at https://blog.coinbase.com/coinbase-custody-is-officially-open-for-business-182c297d65d9 [accessed 8 December 2020].

164 D Z Morris, 'Bitcoin Hits a New Record High, But Stops Short of $20,000' *Fortune*, available at https://fortune.com/2017/12/17/bitcoin-record-high-short-of-20000/ [accessed 8 December 2020].

165 M Rhodan, 'Bitcoin Value Nosedives as Exchange Stops Withdrawals', *Time*, available at https://time.com/5439/bitcoin-mt-gox-price-nosedives/ [accessed 8 December 2020].

166 J Southurst, 'Bitcoin Price Continues to Fall, Breaking Through $200 Barrier', available at www.coindesk.com/bitcoin-price-continues-fall-breaks-200-mark. [accessed 8 December 2020].

167 D Shane, 'Bitcoin lost a third of its value in 24 hours', *CNN*, available at https://money.cnn.com/2017/12/22/investing/bitcoin-plunges-below-14k/index.html [accessed 8 December 2020].

168 K Burgess (28 May 2018), 'The Jabberwocky World of Bitcoin', *Financial Times*, available at www.ft.com/content/167cbec4-5f73-11e8-ad91-e01af256df68 [accessed 8 December 2020].

169 Interview with *CNBC Squawk Box*, available at www.youtube.com/watch?v=JvEas_zZ4fM. [accessed 8 December 2020].

Cryptoasset volatility[170] resembles atrial fibrillation in an electrocardiogram, marked as it is by irregular irregularity. Although their volatility has been defended on the basis of their comparatively low volume of trade,[171] trustees are understandably concerned with 'raw' volatility rather than volume-normalised volatility. The low volume of trades[172] also arguably makes cryptoassets more susceptible to price manipulation,[173] of which evidence is rife.[174] Given these circumstances, only a foolhardy trustee would invest without securing the consent of all beneficiaries[175] since investments 'which are attended with hazard'[176] are to be avoided. It would be difficult to justify even a modest holding of cryptoassets in a large portfolio[177] without such consent given its speculative nature and concerns over manipulation.

Ethics and the environment

Although the scope for considering ethical concerns remains limited for most private trusts,[178] some trustees, such as pension fund trustees in England,[179] may set out and take into account such concerns in a statement of investment principles. A settlor could also direct trustees of a private trust to take into account ethical considerations. As we transition clearly into the Anthropocene,[180] environmental concerns are increasingly likely to feature in both types of trusts. Such trusts must avoid investing in any cryptoassets that employ 'proof-of-work' consensus algorithms, which is to say most cryptoassets. 'Proof of work' consensus requires enormous amounts of energy[181] to solve the cryptographic puzzle involved in mining so as to ensure that their blockchains are immutable. At the time of writing, according to the *Digiconomist*,[182] a single transaction on the bitcoin blockchain carried the equivalent carbon footprint of 627,716 Visa transactions at 251.09 kg of carbon dioxide and consumed 528.60 kilowatt-hours of electricity, which is the equivalent power consumption of an average US household over 17.86 days. Despite these alarming numbers, the bitcoin blockchain is only capable of processing about 4.6 transactions per second as compared to the average of 1,700 transactions per second on Visa's centralised network.[183] A world that transacted on

170 Cryptoasset volatility is tracked by the Crypto Currencies Index at https://cci30.com/. [accessed 8 December 2020]. See also J C Gerlach, G Demos, and D Sornette, 'Dissection of Bitcoin's multiscale bubble history from January 2012 to February 2018' (2019) 6 Royal Society Open Science 180643.

171 S Sapuric and A Kokkinaki, 'Bitcoin Is Volatile! Isn't that Right?' in W Abramowicz and A Kokkinaki (Eds), *Business Information Systems Workshops. BIS 2014. Lecture Notes in Business Information Processing, vol 183* (Springer, 2014), pp 255, 262–264.

172 Cf D McCrum, 'Bitcoin passes $1,000 but only number that matters is zero', *Financial Times*, available at www.ft.com/content/b5d66ed8-d1b3-11e6-b06b-680c49b4b4c0 [accessed 8 December 2020].

173 Cf R.K. Aggarwal and G. Wu, 'Stock Market Manipulations' (2006) 79 The Journal of Business 1915.

174 Griffin and Shams, 'Is Bitcoin Really Untethered?'; J Kamps and B Kleinberg, 'To the Moon: Defining and Detecting Cryptocurrency Pump-and-Dumps' (2018) 18 Crime Science 7; N Gandal et al, 'Price Manipulation in the Bitcoin Ecosystem' (2018) 95 Journal of Monetary Economics 86.

175 Which would serve as a defence to a claim in breach of trust.

176 *Learoyd v Whiteley* (1887) 12 App Cas 727, 733.

177 Cf Lord Nicholls of Birkenhead, 'Trustees and their Broader Community: Where Duty, Morality and Ethics Converge' (1995) 9 TLI 71, 76.

178 *Cowan v Scargill* [1985] Ch 270.

179 Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378), reg 2(3)(b)(vii).

180 S L Lewis and M A Maslin, 'Defining the Anthropocene' (2015) 519 Nature 171.

181 A de Vries, 'Bitcoin's Growing Energy Problem' (2018) 2 Joule 801; C Stoll, L Klaaßen, and U Gallersdörfer, 'The Carbon Footprint of Bitcoin' (2019) 3 Joule 1647. For the latest information on Bitcoin energy consumption, see https://digiconomist.net/bitcoin-energy-consumption [accessed 8 December 2020].

182 https://digiconomist.net/bitcoin-energy-consumption [accessed 8 December 2020].

183 K Li, 'The Blockchain Scalability Problem & the Race for Visa-Like Transaction Speed', available at https://hackernoon.com/the-blockchain-scalability-problem-the-race-for-visa-like-transaction-speed-5cce48f9d44 [accessed 8 December 2020].

'proof-of-work' blockchains would find that global warming is no longer an urgent problem because it is now a hopeless one.

Conclusion

Although there is much interest in cryptoassets, the conclusions to the four questions posed at the outset of this article may be summarised as follows. First, cryptoassets are capable of being the subject-matter of a trust. Secondly, being preferably regarded as things in action, trust law rules that have developed in relation to such property can be readily applied to trusts of cryptoassets so that despite the absence of segregation, most cryptoasset exchanges should be regarded as trustees of their cryptoasset holdings in relation to their customers. Thirdly, provided a general power of investment exists, most cryptoassets, save for stablecoins, would be an authorised investment for such trustees. Finally, even if cryptoassets are an authorised investment, the vast majority of trustees should avoid investing in them.

Postscript

In mere weeks, between the time this article was accepted for publication and proofing, the price of bitcoin reached new highs on more than one occasion. The precise date when the new records were achieved is a matter of some controversy, with some reporting a new record price on 25 November 2020.[184] However, *Coindesk* suggested that '[t]he current debate over what exactly is the all-time-high price of the leading cryptocurrency shows how a sector that is all about decentralization has difficulty coming up with a common pricing system on which everyone can agree.'[185] *Coindesk* only reported a new record high of US$19,850 on 30 November 2020,[186] a record since overtaken.[187] Consensus as to what exactly the new record high is remains contentious in a fragmented market[188] and bitcoin prices remain highly volatile, with the early (arguably premature) call of new records followed immediately by an almost 10 per cent fall within a day[189] and hacks remain alarmingly frequent.[190]

184 See, eg E Szalay, 'Bitcoin exceeds 2017 peak to hit record high of almost $20,000', *Financial Times*, available at www.ft.com/content/f26baeb0-7218-4a9f-89ce-f19a716ce1b4 [accessed 22 December 2020].

185 L Lewitinn, 'Some Are Calling All-Time Highs for Bitcoin. Here's Why CoinDesk Hasn't Yet', *Coindesk*, available at www.coindesk.com/bitcoin-price-index-all-time-highs [accessed 22 December 2020].

186 Z Voell, 'Bitcoin Price Sets New Record High of $19,850', *Coindesk*, available at www.coindesk.com/bitcoin-price-reaches-record-high [accessed 22 December 2020].

187 K Reynolds and Z Voell, 'Bitcoin Tops $24K, Setting New All-Time High', *Coindesk*, available at www.coindesk.com/bitcoin-briefly-tops-24k-setting-new-all-time-high [accessed 22 December 2020].

188 P Vigna, 'What Is Bitcoin Worth? There Is Little Consensus in Fragmented Market', *Wall Street Journal*, available at www.wsj.com/articles/what-is-bitcoin-worth-there-is-little-consensus-in-fragmented-market-11607871602 [accessed 22 December 2020].

189 J Kelly, 'Bitcoin goes splat', *FT Alphaville*, available at www.ft.com/content/6143b7ee-946e-4f9b-9143-ff4085bb1a4d [accessed 22 December 2020].

190 Coindesk reported at least three new hacks (though not involving bitcoin) within the last month at the time this postscript was written on 22 December 2020.

The 'Prudence' Test for Trustees in Pension Scheme Investment: Just a Shorthand for 'Take Care'

*David Pollard**

> 'Investment powers are an example of equitable principles being supplemented by high-level statutory statements of principle which make the law, if anything, more flexible than it was before. I do not think that we need fear such reformulations. After all most of the general statements of equitable principles which we use today are simply a way of putting the matter which occurred to some Victorian judge in the course of an ex tempore judgment which his successors sought sufficiently felicitous to be worth repeating. There is nothing sacred about such formulations and I do not see why Victorian judges should be regarded as having had some special insight into the mot juste which the Australian Parliament or Professor Goode's committee or even modern judges lack. What matters is not the source of the principle but whether the judges are willing to regard it as a principle rather than try to interpret it as a black–letter rule.'
>
> *Lord Hoffmann (then Hoffmann LJ) in his 1994 paper*
> *'Equity and its role for superannuation pension schemes in the 1990s'*[1]

This article looks at the duty of care for trustees of an occupational pension scheme in relation to in investment. It is common to refer to a duty of 'prudence' or to be 'prudent' or to be a 'prudent person'.

This article looks at the meaning of prudence in this context and whether it helps in defining the trustee's duty of care in relation to investments. Broadly, this article looks at:

- What does prudence mean?
- What does the investment duty of care require?
- Is it the right test for pension schemes and commercial trusts?

Trustee investment duty

This article primarily looks at the role and duties of the trustee[2] of an occupational pension scheme, in particular at the duty of care applying to the trustee in relation to investment matters.

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* Barrister, Wilberforce Chambers, Lincoln's Inn, London. This article is based on a talk given as part of the 2020 series of the Edward Nugee Memorial Lectures given by Wilberforce Chambers on pensions law topics.

1 'Equity and its role for superannuation pension schemes in the 1990s', Ch 5 in M Scott Donald and Lisa Butler Beatty (Eds), *The Evolving role of Trust in Superannuation* (Federation Press, 2017) at p 79.

2 The trustee of an occupational pension scheme is now usually a separate trustee company (rather than individual trustees). The directors of the trustee company are often called 'trustees' but strictly as a legal matter they are not. See further Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at Chs 4 and 5.

As such this article does not deal with the trustee duties in other areas, such as in relation to the exercise of discretions in relation to benefits or in relation to funding – for example the statutory reference to funding on a prudent basis in the scheme specific funding provisions under Pt 3 of the Pensions Act 2004 (PA 2004).[3]

The discussion in this article applies to investment by the trustees of other trusts as well, for example unit trusts and family wealth trusts. However, as discussed below, one of the important factors (contexts) in relation to the scope and ambit of the duty of care is the nature and purpose of the trust. A family wealth trust, for example, has a materially different purpose to a pension scheme.

Other duties in relation to investment

It is clear that a duty of care – or skill and care – applies to the trustee in relation to its investment powers. This is in addition to and should be considered as separate from the other duties and limits on the investment power. The duty of care and skill is separate from those other duties, although the ambit of those other duties will inform the scope and extent of the duty of care and skill.

Those other duties and constraints are not considered in detail in this article, although they form the context in which the courts will consider the ambit of a duty of care (or prudence). Broadly those other duties and limits are:

(a) **Within powers:** Staying within terms of the trust instrument. The trustee should only invest (or hold investments) which are authorised investments, that is within the terms of the investment power for the pension scheme. In practice it is common for pension scheme trust instruments to include a wide express investment power. Such a wide power is also now implied under s 34 of the Pensions Act 1995 (PA 1995).[4] But this statutory power is subject to any limitation in the trust instrument.[5]

Any other requirements in the trust instrument also need to be complied with (for example if a third-party consent is needed, other than, in the case of an occupational pension scheme, that of an employer[6]).

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3 See for example the Occupational Pension Schemes (Scheme Funding) Regulations 2005 (SI 2005/3377) in relation to the methods and assumptions determined by the trustees (usually in agreement with the employer – see PA 2004, s 229) to be used in the calculation of technical provisions:

- at reg 5(4)(a) – 'economic and actuarial assumptions must be chosen <u>prudently</u>, taking account, if applicable, of an appropriate margin for adverse deviation';
- reg 5(4)(b) – 'rates of interest used to discount future payments of benefits must be chosen prudently …'; and
- reg 5(4)(c) – 'the mortality tables used and the demographic assumptions made must be based on <u>prudent</u> principles …'.

This aspect of prudence in relation to funding was discussed by Jonathan Hilliard QC and Leonard Bowman in their talk 'The virtue of prudence and other funding puzzles' given at the Association of Pension Lawyers (APL) annual conference in November 2019.

4 There can still be issues on the meaning of 'investment' as used in the statutory provision or in the trust instrument. Not all assets or contracts may be investments for this purpose. See, eg the discussion of simple loans in *Re Wragg* [1919] 2 Ch 58; *Khoo Tek Keong v Ch'ng Joo Tuan Neoh* [1934] AC 529, PC; *Dominica Social Security Board v Nature Island Investment Co* [2008] UKPC 19 at [21] and *Dalriada Trustees Ltd v Faulds* [2011] EWHC 3391 (Ch), [2012] 2 All ER 734 (Bean J) at [58] to [64].

5 PA 1995, s 34(1): 'subject to … any restriction imposed by the scheme'.

6 PA 1995, s 35(5).

It is clear that a duty of care remains on trustees, even where there is a wide investment power.[7]

(b) **Act for a proper purpose:** Trustees must exercise the investment power consistent with the purposes of the scheme and the purposes of the power.[8] This can give rise to issues in some cases where trustees may be seen to have mixed motives, for example investing based on political or moral considerations, rather than investment purposes based on financial factors.[9]

(c) **Fiduciary duties**: The trustees should not have an unauthorised conflict of interest or duty.[10]

(d) **Statutory duties and constraints**: These include the requirements (mainly under the Pensions Act 1995) for:

  (i) specific requirements under the 2005 Investment Regulations[11] on the exercise of powers of investment including diversification, investment on regulated markets, restrictions on borrowing, etc;
  (ii) trustees to produce and review a statement of investment principles (SIP);[12]
  (iii) trustees to take advice;[13]
  (iv) to consult with the employer;[14]
  (v) restrictions or prohibitions on employer-related investment;[15]
  (vi) the need to appoint a fund manager (and other advisers);[16] and
  (vii) a requirement under the Financial Services and Markets Act 2000 (FSMA), for trustees to be authorised under that Act if they make 'day-to-day' investment decisions

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7 Eg *Nestle v National Westminster Bank Plc* [1993] 1 WLR 1260, [1994] 1 All ER 118 CA per Dillon LJ at 126c. Discussed further below.

8 For a comparatively recent example of a pension trustee decision (not on investment) being set aside for not having a proper purpose, see *British Airways Plc v Airways Pension Scheme Trustee Ltd* [2018] EWCA Civ 1533, [2018] Pens LR 19. See generally on proper purposes, Pollard *Pensions, Contracts and Trusts: Legal Issues on Decision Making* (Bloomsbury Professional, 2020), in particular Chapter 30 on investment.

9 For an example of political issues, see *Martin v City of Edinburgh* 1988 SLT 329, [1989] Pens LR 9 and *R (Palestine Solidarity Campaign Ltd) v Secretary of State for Housing, Communities and Local Government* [2020] UKSC 16, [2020] 1 WLR 1774.

On economic social or governance (ESG) issues, the Law Commission reached the view that pension trustees can take into account non-financial factors if 'they have good reason to think that scheme members share the concern and there is no risk of significant financial detriment to the fund': Law Commission of England and Wales Report 'The Fiduciary Duties of Investment Intermediaries' (2014, Law Com No 350) at 6.57 and 6.101, drawing on *Harries v Church Commissioners* [1992] 1 WLR 1241 at 1247 (Sir Donald Nicholls V-C). This issue is discussed in Philip Bennett 'Must an occupational pension scheme take into account ESG factors, even if there is a risk of financial detriment to the pension fund?' (2019) 32 TLI 239. It (or a variant taken from the statutory guidance under consideration) was also mentioned (seemingly without criticism) by the Supreme Court in *R (Palestine Solidarity Campaign Ltd) v Secretary of State for Housing, Communities and Local Government* [2020] UKSC 16, [2020] 1 WLR 1774.

For a US perspective, see Max Matthew Schanzenbach and Robert H Sitkoff, 'Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee' (2020) 72 Stanford Law Review 381.

10 Eg for pension trustees on conflicts, see *Manning v Drexel Burnham Lambert* [1995] 1 WLR 32 (Lindsay J). See further Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at Ch 6.

11 The Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378) ('Investment Regs 2005'), reg 4.

12 PA 1995, s 35(11). Supplemented by Investment Regs 2005, reg 2(3).

13 Advice on a SIP: in writing and from a person believed to be qualified and to have appropriate knowledge and experience – Investment Regs 2005, reg 2(2)(a). Advice on whether investments are suitable – PA 1995, s 36(3) and (4). The advice usually needs to be from an FSMA-authorised adviser and needs to be given or confirmed in writing – PA 1995, s 36(6) and (7).

14 Investment Regs 2005, reg 2(2)(b). For a case on SIP consultation, see *Pitmans Trustees v The Telecommunications Group* [2004] EWHC 181 (Ch), [2005] OPLR 1.

15 PA 1995, s 40 and Investment Regs 2005, regs 10 to 16. Discussed in Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at Ch 19.

16 PA 1995, s 47. Mode and terms of appointment are dealt with in the Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715, as amended).

(subject to some exceptions).[17] Most pension trustees are not FSMA authorised and so in practice delegate day to day decisions to an authorised fund manager.

This list is likely to be joined by obligations in regulations aiming to secure 'effective governance' in relation to the effects of climate change.[18]

Investment duty of care not a fiduciary duty

Any trustee duty of care in relation to an investment function is not in itself a 'peculiarly' fiduciary duty[19] in the strict and limited categorisation of Millett LJ in *Mothew*.[20] Despite this, where exercised by a fiduciary (eg a trustee) the duty of care is still sometimes called a fiduciary duty[21] and even as a non-fiduciary duty its exercise will be subject to the 'peculiarly' fiduciary duties (eg no unauthorised conflicts etc).[22]

Why is the investment duty of care so important?

In current times there is much economic (and physical) turmoil. This may well place strains on an occupational pension scheme, for example a strain on the strength and ability of the employer to support the scheme – called the employer covenant – and also on the level and performance of the scheme's investments.

For occupational pension schemes the trustee has a duty of care – it needs to manage and monitor the investments and (mainly for defined benefit schemes) employer covenant. Clearly there is an increased risk that interested parties – members (and employers and the PPF[23]) – will review pension fund asset performance in retrospect and consider whether the trustee board should have done better. The current turmoil may result in more legal claims against trustees in relation to the investment performance.

There is also the potential for criminal sanctions or civil penalties against trustees in some circumstances. The Pension Schemes Bill 2020, currently before Parliament, will, if enacted, create new widely-drawn criminal offences (and increased penalties) based on acts or omissions in relation to or affecting an occupational pension scheme. These include offences that could fairly easily extend to investment decisions – for example as 'conduct that

17 Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 (SI 2001/1177, as amended), art 4. The exemptions include the buying or selling of units or rights in certain pooled funds (eg units in collective investment schemes or shares in investment trusts or rights under an insurance policy), provided advice has been received and considered from a relevant adviser (usually FSMA authorised) – art 4(6) and (7).

18 The Pension Schemes Bill 2020, currently before Parliament, will, if enacted, give power to the Secretary of State to make regulations requiring trustees of occupational pension schemes to consider climate change – see new s 41A proposed to be added into PA 1995:

> 'Regulations may impose requirements on the trustees or managers of an occupational pension scheme of a prescribed description with a view to securing that there is effective governance of the scheme with respect to the effects of climate change.'

19 McGhee and Elliott (Eds) *Snell's Equity,* 34th Edn (Sweet & Maxwell, 2019) at 10-042; Law Commission report 'Fiduciary Duties of Investment Intermediaries' (2014, Law Com no 350) at 3.13, citing *Hilton v Barker Booth & Eastwood* [2005] UKHL 8, [2005] 1 WLR 567 at [29].

20 *Bristol and West Building Society v Mothew* [1998] Ch 1, CA per Millett LJ at 17.

21 Eg *Pitt v Holt* [2013] UKSC 26, [2013] 2 AC 108 per Lord Walker at [73] and *Palestine Solidarity Campaign* [2020] UKSC 16 per Lord Carnwath at [44] agreeing with a submission from counsel.

22 This confusion in terminology is discussed in the Law Commission report 'Fiduciary Duties of Investment Intermediaries' (2014, Law Com no 350) at 3.11 to 3.13 and 3.64 (fn127) and Pollard *Pensions, Trusts and Contracts: Legal Issues on Decision Making* (Bloomsbury Professional, 2020) at Ch 62.

23 The board of the Pension Protection Fund, established under PA 2004.

detrimentally affects in a material way the likelihood of scheme benefits being received'.[24] It may be argued to be an offence if a decision was made that resulted in investments being over risky with the result that it risked the likelihood of benefits being received in full. This is discussed further below.

The pension trustee's duty of care in relation to investment is particularly important because:

- the assets of pension schemes can be large – so any claim based on underperformance could involve very large sums; and
- the common exonerations in pension scheme trust instruments (eg that trustees are only liable for a breach of duty if they act fraudulently or knowingly wrongly[25]) are excluded by PA 1995 from applying in relation to investment functions.[26]

What is the investment duty of care for a pension trustee board?

When looking at the legal duty of care and skill on trustees (including pension trustees), commentators (and case law) generally refer to a 'prudent person of business' test, citing two decisions from the 1880s. The first is the 1883 decision in *Speight v Gaunt*:[27]

> 'As a general rule a trustee sufficiently discharges his duty if he takes in managing trust affairs all those precautions which an ordinary prudent man of business would take in managing similar affairs of his own.'

The second is the 1886 decision in *Re Whiteley*[28], in particular the holding by Lindley LJ:

> 'the duty of a 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.'

Implied prudence duty?

These cases are cited by most commentators in relation to trustee investment duties for trusts generally[29] and in the smaller number of commentaries on pension trusts.[30] Prudence is

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24 Proposed new PA 2004, s 58B. The 2020 Bill currently envisages further requirements for an act to be a crime, including: (a) that the person knew (or ought to have known) that the relevant act would have that effect; and (b) that the person has no 'reasonable excuse'.

25 For examples in public documents see Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at 14.11.

26 PA 1995, s 33. Discussed further below.

27 *In re Speight* (1883) 22 ChD 727, CA (Jessel MR, Lindley and Bowen LJJ). Upheld by the House of Lords on appeal: *Speight v Gaunt* (1883) 9 App Cas 1, HL.

28 *In re Whiteley* (1886) 33 ChD 347, CA per Lindley LJ at 355. Upheld by the House of Lords on appeal: *Learoyd v Whiteley* (1887) LR 12 App Cas 727, HL.

29 Eg Tucker, Poidevin and Brightwell (Eds), *Lewin on Trusts,* 20th Edn (Sweet & Maxwell, 2020) at 35-066; Hayton, Matthews and Hilton, *Underhill & Hayton: Law of Trusts and Trustees,* 19th Edn, (LexisNexis, 2017) at [49.57], citing *Cowan v Scargill* [1985] Ch 270 at 289 at 289, which itself cited *In re Whiteley*; Jonathan Hilliard and Emily McKechnie 'Practice Note on Duty of Care for Pension Trustees' (Practical Law); Heydon and Leeming, *Jacob's Law of Trusts in Australia,* 8th Edn, (LexisNexis Butterworths, 2016) at [17-18]; and Guy Newey 'Constraints on the exercise of trustees' powers', Ch 2 in P G Turner (ed) *Equity and Administration* (Cambridge University Press, 2018), at p 49. McGhee and Elliott (Eds) *Snell's Equity,* 34th Edn (Sweet & Maxwell, 2019) mentions the term 'prudence' (eg at [29-003] and [29-007], although in the latter case morphing into 'commercial prudence'), but generally focuses on the reasonableness duty under the Trustee Act 2000.

mentioned in the guidance on investment[31] issued by the Pensions Regulator (TPR) and in its Funding Code of Practice.[32]

Where does a duty of 'prudence' come from?

Chantal Stebbings outlined the history of investment duties in *The Private Trustee in Victorian England*.[33] This discussed the gradual extension of authorised investments (whether by express provision in the trust, or gradually by statute). It also looked at the prudent man of business test applicable to trustees managing investments within the authorised category, commenting that this test (under *Re Whiteley*), 'depended on the economic and investment conditions pertaining at the time'.[34] But later Professor Stebbings noted:[35]

> 'In theory a test founded on the long term conduct of the ordinary prudent man of business, although making long term provision for others was practical, reasonable, realistic and inherently flexible. It had the potential to adapt to current commercial conditions. In practice, however, most people involved in trust administration found that the way it was interpreted by the courts was too demanding, because it was in practice and perception applied in a way far removed from its pragmatic and realistic origins.
>
> […] such risks were anathema to the law, and the test became increasingly distorted by the judges as they failed to keep up with business practices.'[36]

As mentioned above, the 1883 decision in *Speight v Gaunt*[37] and the 1886 decision in *Re Whiteley* are usually taken as the current foundation[38] of any prudence duty for trustees (generally, not just pension trustees) in relation to investment matters.[39]

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30 *Freshfields on Corporate Pensions Law 2015* (Bloomsbury Professional, 2015) at Ch 17; CMS Pensions Team, *Pensions Law Handbook,* 14th Edn, (Bloomsbury Professional, 2019) at 10.22; *Tolleys Pensions Law* (loose-leaf, 2018) at Ch G1 (Clifford Sims); John Quarrell 'The law relating to investments' (1994) APL conference; Law Commission report 'Fiduciary Duties of Investment Intermediaries' (2014, Law Com no 350) at 3.13; Stuart O'Brien 'Trustees Fiduciary duties of investment' (APL Conference, Nov 2018).

31 TPR's recent publication (17 March 2020) 'DB scheme funding and investment: COVID-19 guidance for trustees' does not mention prudence. See https://www.thepensionsregulator.gov.uk/en/covid-19-coronavirus-what-you-need-to-consider/db-scheme-funding-and-investment-covid-19-guidance-for-trustees [accessed 1 December 2020].

32 TPR CoP 3 'Funding Defined Benefits' (July 2014) at [94]:

> '94. As fiduciary stewards of scheme assets, trustees have a duty to invest them prudently in accordance with the scheme's provisions and the legislative framework.'

Citing 'section 36 of the Pensions Act 1995 and regulation 4 of the Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378)'.

33 Chantal Stebbings, *The Private Trustee in Victorian England* (Cambridge University Press, 2002) at Ch 5.

On the history of the duty of care, see also M Scott Donald 'Prudence under pressure' (2010) 4 J Eq 44 at 46 to 48; Joshua Getzler 'Duty of Care', Ch 2 in Peter Birks and Arianna Pretto (Eds), *Breach of Trust* (Hart Publishing, 2002) and Joshua Getzler 'Fiduciary investment in the shadow of a financial crisis: was Lord Eldon right?' (2009) 3 J Eq 219.

On the impact of inflation in the Victorian age, see WA Lee 'Modern Portfolio theory and the Investment of Pension Funds', Ch 10 in P D Finn (Ed), *Equity and Commercial Relationships* (Law Book Co, 1987).

34 Stebbings, n 33 above, at p 155.

35 Stebbings, n 33 above, at p 157.

36 A comment echoed by Edelman J in *ASIC v Drake (No 2)* [2016] FCA 1552, discussed below.

37 (1883) 9 App Cas 1, HL (Earl of Selborne LC, Lord Blackburn, Lord Watson and Lord Fitzgerald) per Lord Blackburn at 19.

38 Prudence or being prudent had clearly been applied in earlier cases, see eg *Blue v Marshall* (1735) 24 ER 1110, (1735) 3 P Wms 381 (Lord Talbot LC) at 383 – 'The defendant seems to have done nothing but what was prudent'; *Harden v Parsons* [1758] 1 Eden 145, (1758) 28 ER 639.

Speight v Gaunt

In 1883 in *Speight v Gaunt* the Court of Appeal held that it was the duty of a trustee to conduct the business of the trust with the same care as *an ordinary prudent person*[40] *of business would extend towards his or her own affairs*: *In re Speight*.[41] Sir George Jessel MR held at p 739:

> 'It seems to me that on general principles a trustee ought to conduct the business of the trust in the same manner that an ordinary prudent man of business would conduct his own, and that beyond that there is no liability or obligation on the trustee. In other words, a trustee is not bound because he is a trustee to conduct business in other than the ordinary and usual way in which similar business is conducted by mankind in transactions of their own. It never could be reasonable to make a trustee adopt further and better precautions than an ordinary prudent man of business would adopt, or to conduct the business in any other way.'

Similarly Bowen LJ at p 762:

> '[…] it is clear that a trustee is only bound to conduct the business of the trust in such a way as an ordinary prudent man of business would conduct his own.'

This was affirmed by the House of Lords on appeal in *Speight v Gaunt*.[42] Lord Blackburn held at p 19:

> '[…] as a general rule a trustee sufficiently discharges his duty if he takes in managing trust affairs all those precautions which an ordinary prudent man of business would take in managing similar affairs of his own. There is one exception to this: a trustee must not choose investments other than those which the terms of his trust permit, though they may be such as an ordinary prudent man of business would select for his own money […]'.

Re Whiteley

However in investment matters, in applying this principle three years later in 1886, Lindley LJ[43] in *In re Whiteley*[44] added a gloss that the duty is to take such care as an ordinary prudent person would take if he or she were minded to make an investment *for the benefit of other people for whom he or she felt morally bound to provide.*

In *ASIC v Drake (No 2)* [2016] FCA 1552, Edelman J refers at [264] to 'numerous earlier applications' of a prudent person test before *Speight*, including in *Oriental Commercial Bank v Savin* (1873) LR 16 Eq 203 at 206 and in the US in *Harvard College v Amory* (1830) 26 Mass 446.

39 See eg *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515 per Brightman J at 531B.

40 The judgments in this era, and for an appreciable time after, tend to refer to a 'reasonable man' or a 'prudent man' etc, but there is, of course, no reason to limit the principle to men.
Robert Megarry commented in *Miscellany at Law* (Stevens, 1955) that it is appropriate 'to attribute to insufficiently skilled advocacy the finding of the Court of Appeal that [the reasonable man] has no feminine counterpart at all', citing (the fictitious) *Fardel v Potts* (1935) Herbert's Uncommon Law 1 at 6 'at Common Law a reasonable woman does not exist'.

41 *In re Speight* (1883) 22 ChD 727, CA (Jessel MR, Lindley and Bowen LJJ).

42 (1883) 9 App Cas 1, HL (Earl of Selborne LC, Lord Blackburn, Lord Watson and Lord Fitzgerald) per Lord Blackburn at 19.

43 Lindley LJ had been the third member of the Court of Appeal in *Speight*.

44 (1886) 33 ChD 347, CA per Lindley LJ at 355.

Thus Lindley LJ at p 355:

> '[…] care must be taken not to lose sight of the fact that the business of the trustee, and the business which the ordinary prudent man is supposed to be conducting for himself, is the business of investing money for the benefit of persons who are to enjoy it at some future time, and not for the sole benefit of the person entitled to the present income. The duty of a 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*[45] *would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide*. That is the kind of business the ordinary prudent man is supposed to be engaged in; and unless this is borne in mind the standard of a trustee's duty will be fixed too low; lower than it has ever yet been fixed, and lower certainly than the House of Lords or this Court endeavoured to fix it in *Speight v Gaunt*.'

This is a clear (and early) recognition that the purpose of the trust (and the investment power) is a factor in moulding the nature of the relevant duty of care.

This was upheld on appeal in *Learoyd v Whiteley*.[46] Lord Watson added, at p 733:

> 'Business men of ordinary prudence may, and frequently do, select investments which are more or less of a speculative character; but it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise to avoid all investments of that class which are attended with hazard.'

But in considering the application of these cases, it is important to keep in mind the usual principles applicable when considering a judgment:

(a) Judgments are not statutes and should not be construed or followed as if they were.[47]
(b) The context of the decisions needs to be considered,[48] in particular that:

    (i) the trusts involved were private wealth trusts, with limited implied authorised investments, and a purpose of protecting capital or balancing life tenants and those entitled in remainder; and

45 Note that the reference here is to the ordinary prudent man – not to the trustee being prudent – see Ruth Goldman 'The Development of the 'prudent man' concept in relation to pension schemes' (2000) 5 Jnl of Pens Management 219 and M Scott Donald 'Prudence under pressure' (2010) 4 J Eq 44 at 46. Presumably the onus is on the person who is the trustee – see eg *Bartlett* on a professional trustee. So in a pension trust, it may be relevant that trustee body is part employer nominated and part member.

46 (1887) 12 App Cas 727, HL.

47 See eg *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378, PC per Lord Nicholls at 386B, *Bridge Trustees Ltd v Houldsworth* [2011] UKSC 42, [2012] 1 All ER 659 per Lord Walker at [59] and *Express Electrical Distributors Limited v Beavis* [2016] EWCA Civ 765 per Sales LJ at [55] and [56]. More colourfully, Munby J in *Beazer Homes Ltd v Stroude* [2005] EWCA Civ 265 at [29] held:

> 'Utterances, even of the demi-gods, are not to be approached as if they were speaking the language of statute.'

48 Lord Steyn in *R v Secretary of State for the Home Dept, ex p Daly* commented in a 'famous phrase' that: 'In law, context is everything.' Lord Nicholls stated (extra judicially) that: '[…] it is always necessary to know the context in which the words were being used' – 'My kingdom for a horse: The meaning of words' (2005) 121 LQR 577 at 579 and 580. Similarly Edelman J in *Rinehart v Hancock Prospecting Pty Ltd* [2019] HCA 13 at [83]: 'No meaningful words, whether in a contract, a statute, a will, a trust, or a conversation, are ever acontextual.'

(ii) *Speight v Gaunt* and *Re Whiteley* are decisions now over 130 years old. The cases were in the Victorian era, a time of limited inflation and less developed financial markets.[49]

Speight and *Whiteley* can both be seen as part of a move at that time (the 1880s) to a greater level of duty of care for trustees than previously.[50] Earlier cases on trustees' duties had indicated that legal review was not possible if trustees acted in 'good faith'.[51] This reference to good faith has continued in some more recent cases,[52] but it may be possible to construe these as using the term 'good faith' in this context as going beyond its core meaning of subjective honesty to include proper purposes and due consideration.[53]

Hoffmann LJ (as he then was) made a telling point on this in his 1994 paper:[54]

> 'Investment powers are an example of equitable principles being supplemented by high-level statutory statements of principle which make the law, if anything, more flexible than it was before. I do not think that we need fear such reformulations.
>
> After all most of the general statements of equitable principles which we use today are simply a way of putting the matter which occurred to some Victorian judge in the course of an ex tempore judgment which his successors sought sufficiently felicitous to be worth repeating.
>
> There is nothing sacred about such formulations and I do not see why Victorian judges should be regarded as having had some special insight into the mot juste which the Australian Parliament or Professor Goode's committee or even modern judges lack. What matters is not the source of the principle but whether the judges are willing to regard it as a principle rather than try to interpret it as a black–letter rule.'

Why prudence?

Why does prudence (or prudent) keep featuring as the duty of care (or part of the duty of care) for trustees in relation to investment?

Part of this may be because the words 'prudence' and 'prudent' sound more informative as legal terminology used for a duty of care. They perhaps seem deeper than just saying 'reasonable'.

There are examples of this in everyday life: Gordon Brown (when Chancellor of the Exchequer) liked to be thought of as 'prudent',[55] and companies are named after prudence –

49 Australian courts are readily prepared to point out the implications of seeking rigidly to follow older cases. See eg the trust cases *Kearns v Hill* (1990) 21 NSWLR 107 per Meagher JA at [111] – 'the conditions which existed in England in 1850 are not necessarily the same as those which existed in New South Wales in 1970' – and *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405 per Kirby P (dissenting) at 413, commenting on *Re Beloved Wilkes Charity* – 'The opinion was expressed 141 years ago in respect of a dispute in rural England about a religious office.'

50 This is not a new point. See Robert Ham QC, 'Trustees' Liability' (1995) 9 TLI 21 at 22: '[…] this is to read too much into the use of the word "prudence" rather than the more familiar "care" in this context. This is just a nineteenth-century formulation of a duty of care.'

51 Eg *Re Beloved Wilkes's Charity* (1851) 3 Mac & G 440, 42 ER 330 (Lord Truro); *Duke of Portland v Topham* (1864) 11 HLC 31; *Gisborne v Gisborne* (1877) 3 App Cas 300, HL.

52 Eg *Re Londonderry's Settlements* [1965] 1 Ch 918, CA; *Whishaw v Stephens; Re Gulbenkian's Settlement Trusts* [1970] AC 508 at 518; *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405 at 427, 428–429.

53 Pollard, *Pensions, Contracts and Trusts: Legal issues on decision making* (Bloomsbury Professional, 2020) at 3.15.

54 Lord Hoffmann (then Hoffmann LJ) in 1994 in 'Equity and its role for superannuation pension schemes in the 1990s' in M Scott Donald and Lisa Butler Beatty (Eds), *The Evolving Role of Trust in Superannuation* (Federation Press, Sydney, 2017) at p 79.

55 See eg William Keegan, *The Prudence of Mr Gordon Brown* (Wiley, 2004).

eg the Prudential Assurance Company. Even one of the main UK financial services regulators is called the 'Prudential Regulation Authority' (PRA).

Looking further at the issue of prudence and the investment duty of care, this article looks at six facets:

(1) What does the legislation say about prudence?
(2) What does 'prudence' mean? – prudence as a shorthand?
(3) What is a better way of describing the duty of care for investment?
(4) Applying out the duty of care: context, time of decision, professionals.
(5) Test for pension trustees?
(6) Legal claims – process/perversity – applying *Braganza*?

(1) What does the legislation say about prudence?

The legislation in England and Wales contains *no* express statutory investment prudence duty on trustees. The main legislation is the Trustee Act 2000 (TA 2000) (for non-pension trusts) and the Pensions Act 1995 (and the Investment Regs 2005) for trusts of occupational pension schemes.

This is unlike the position in other similar trust jurisdictions, for example Jersey, New Zealand and Australia,[56] where the legislation includes an express reference to 'prudence' or 'prudent', in what looks often to be a direct statutory codification of what was said in *Re Whiteley*.[57]

As mentioned above, the funding regulations made under PA 2004 do refer to 'prudent' actuarial assumptions for funding, but this is not in a direct investment context.[58]

Trustee Act 2000, s 1

'1— The duty of care

(1) Whenever the duty under this subsection applies to a trustee, he must exercise such care and skill as is reasonable in the circumstances, having regard in particular—

(a) to any special knowledge or experience that he has or holds himself out as having, and
(b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

(2) In this Act the duty under subsection (1) is called 'the duty of care'.

For England and Wales, the Trustee Act 2000 (TA 2000) codifies many duties on trustees. It includes in s 1 a duty of care on the basis of a reasonableness duty, ie what is 'reasonable in the circumstances'.

This duty under s 1 applies to investment functions, whether under the 2000 Act or otherwise (TA 2000, Sch 1, para 2). But the s 1 duty does *not* apply to investment functions of trustees of an occupational pension scheme (TA 2000, s 36).

56 See eg the discussion of the Queensland Trusts Act 1973, s 22 in *Australian Securities and Investments Commission v Drake (No 2)* [2016] FCA 1552 (Edelman J) at [324].
57 See eg the discussion of the statutory position by Hoffmann LJ in his 1994 paper 'Equity and its role for superannuation pension schemes in the 1990s' (n 1 above) at p 78 as being unlikely to change the 'well-understood equitable principles'.
58 See text to fn 3 above.

The Trustee Act 2000 followed directly from a report of the Law Commission in 1999. In its report, 'Trustees' powers and duties',[59] the Law Commission commented that this duty was intended to be a flexible default standard:

> '[…] the Law Commission considers that, in formulating the new statutory duty, express regard should be had to the particular skills and position of the trustees, and to the circumstances of the trust.'

Pensions Act 1995, ss 33 to 36

In contrast, just five years earlier, when legislating for pension trusts, Parliament decided not to enact a specific investment duty of care on pension trustees.[60] Instead the Pensions Act 1995 (and the underlying regulations, currently the Investment Regs 2005) contain only a very limited express mention of prudence for investment. Investment process is dealt with in PA 1995, ss 33–36 and 40 (and the regulations), but a general duty of care or duty based on prudence in relation to prudence is not expressly set out. There are various exemptions and modifications for small schemes.[61]

PA 1995, s 33 is headed 'Investment powers: duty of care', but it does not set out a duty. Instead it prohibits any exclusion or restriction of a duty of care 'under any rule of law'.

> **'33 Investment powers: duty of care**
>
> (1) Liability for breach of an obligation under any rule of law to take care or exercise skill in the performance of any investment functions, where the function is exercisable—
>
> (a) by a trustee of a trust scheme[62], or
> (b) by a person to whom the function has been delegated under section 34,
>
> cannot be excluded or restricted by any instrument or agreement.'

Section 33(2) goes on to expand the meaning of excluding or restricting in s 33(1).

Section 33 is not an easy section.[63] Establishing a 'rule of law' in relation to care or skill in the exercise of investment functions is not as simple as looking for a statutory provision.

The Pensions Act 1995 and the Investment Regs 2005 (made under PA 1995, s 36(1)) do contain specific obligations in relation to investment. To repeat the outline already given above:

(a) specific requirements under the 2005 Investment Regulations[64] on the exercise of powers of investment including diversification, investment on regulated markets, restrictions on borrowing etc;
(b) trustees to produce and review of a statement of investment principles (SIP);[65]

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59 Law Commission of England and Wales '*Trustees' powers and duties*' (May 1999, Law Com No 260) at 3.24 and 3.25.
60 The Report of the Pension Law Review Committee (Sept 1993, CM 2342), chaired by Professor Roy Goode, had recommended (at 4.9.7) a statutory prudent person provision for investment based on the *Learoyd v Whiteley* and *Bartlett* judgments.
61 See Investment Regs 2005, regs 6 to 9 and 13(12).
62 Defined to mean 'an occupational pension scheme established under a trust' – PA 1995, s124(1). The term 'occupational pension scheme' has the same meaning as in PSA 1993, s1 – PA 1995, s176.
63 See, eg Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at 14.45 and Fenner Moeran QC 'Trustee exoneration & exemption clauses and pension schemes' (2018) Nugee Lecture.
64 The Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005/3378) ('Investment Regs 2005'), reg 4.
65 PA 1995, s 35(11). Supplemented by Investment Regs 2005, reg 2(3).

(c) trustees to take advice;[66]
(d) to consult with the employer;[67]
(e) restrictions or prohibitions on employer-related investment;[68] and
(f) the need to appoint a fund manager (and other advisers).[69]

This list is likely to be joined by obligations in regulations aiming to secure 'effective governance' in relation to the effects of climate change.[70]

Investment Regs 2005, reg 4

Regulation 4 of the Investment Regs 2005 deals with the exercise of investment powers, with specific obligations on pension trustees (and fund managers). Reg 4 contains a fairly detailed list of express constraints and duties on trustees.

IORP

Regulation 4 aims to enact in the UK the obligation derived from EU law,[71] in particular Art 18 of the IORP Directive.[72] The IORP Directive on pensions was originally put in place in 2003. The key provision on investment is in Art 18.[73]

> **'Article 18: Investment rules**
>
> Member States shall require institutions located in their territories to invest in accordance with the 'prudent person' rule and in particular in accordance with the following rules: […]'.

The IORP is potentially important in the context of a prudence duty in that it expressly refers to a 'prudent person' rule. But this is not expressly reflected in UK national legislation:

(1) IORP is a directive, so it is not directly binding on non-governmental entities. But national law should be interpreted so far as possible to comply, for example *Marleasing.*[74]

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66 Advice on a SIP: in writing and from a person believed to be qualified and to have appropriate knowledge and experience – Investment Regs 2005, reg 2(2)(a). Advice on whether investments are suitable – PA 1995, s 36(3) and (4). The advice usually needs to be from an FSMA authorised adviser and needs to be given or confirmed in writing – PA 1995, s 36(6) and (7).

67 Investment Regs 2005, reg 2(2)(b). For a case on SIP consultation, see *Pitmans Trustees v The Telecommunications Group* [2004] EWHC 181 (Ch), [2005] OPLR 1 (Morritt V-C).

68 PA 1995, s 40 and Investment Regs 2005, regs 10 to 16. Discussed in Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at Ch 19.

69 PA 1995, s 47. Mode and terms of appointment are dealt with in the Occupational Pension Schemes (Scheme Administration) Regulations 1996 (SI 1996/1715, as amended).

70 The Pension Schemes Bill 2020, currently before Parliament, will, if enacted, give power to the Secretary of State to make regulations requiring trustees of occupational pension schemes to consider climate change – see new s 41A proposed to be added into PA 1995:

> 'Regulations may impose requirements on the trustees or managers of an occupational pension scheme of a prescribed description with a view to securing that there is effective governance of the scheme with respect to the effects of climate change.'

71 Explanatory Note to the Investment Regs 2005, first paragraph.

72 Its full title is 'Directive on the activities and supervision of institutions for occupational retirement provision' (Directive 2003/41/EC).

73 This is now in IORP 2 (2016/2341/EU), Art 19.

74 *Marleasing SA v La Comercial Internacional de Alimentacion SA* (C-106/89) EU:C:1990:395, [1990] ECR I-4135.

(2) The IORP refers to the 'prudent person' rule. But this is not expressly defined further. There is a similar prudent person rule in the Solvency II Directive (2009/138/EC).[75]

In context it seems at least arguable that the 'prudent person' rule in IORP, Art 18 is limited to compliance with the principles described later in the article (diversification, regulated markets etc).

The Court of Appeal in *Palestine Solidarity*[76] perhaps give limited support to that view when it commented that 'the article places obligations on Member States to require institutions to invest in accordance with the prudent person rule as more particularly set out in Article 18(1)'.

LGPS and prudence?

The Local Government Pension Scheme (LGPS) is a statutory pension scheme for local government employees. This is a public service pension scheme, so the IORP will have direct effect. The LGPS Investment Regulations[77] do not use the word 'prudent' (nor does the Public Service Pensions Act 2013). But the Secretary of State's binding 'Guidance'[78] in 2017 does refer to prudence. It states:

> 'In the context of the local government pension scheme, a prudent approach to investment can be described as a duty to discharge statutory responsibilities with care, skill, prudence and diligence.'

This seems a bit circular: 'a prudent approach' means act with prudence (as well as 'care, skill, […] and diligence')?

Exclusion of prudent person duty in Investment Regs was deliberate

Regulation 4 was clearly designed to enact the requirements under the EU directive, the IORP. But, significantly, no general 'prudent person' investment duty was included in the Investment Regs 2005. This was a deliberate decision by the then government. The government response to consultation[79] on the regulations, in October 2005, expressly confirmed that no 'prudent person' principle would be included (emphasis added):

> 'The term "security, quality, liquidity and profitability of the portfolio as a whole" is taken directly from the Directive, where it is used to give expression to the "prudent person principle". *The requirement for "prudence" is already a central feature of trust law and it is not the Government's intention to place a higher duty of care upon trustees than that which*

75 See Charles H R Morris *The Law of Financial Services Groups* (Oxford University Press, 2019).

76 *R (Palestine Solidarity Campaign Ltd) v Secretary of State for Housing, Communities and Local Government* [2018] EWCA Civ 1284, [2019] 1 WLR 37 per Sir Stephen Richards at [35]. This point was not discussed in the subsequent appeal in Supreme Court in *R (Palestine Solidarity Campaign Ltd) v Secretary of State for Housing, Communities and Local Government* [2020] UKSC 16, [2020] 1 WLR 1774.

77 Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 (SI 2016/946).

78 Ministry of Housing, Communities and Local Government, 'Local government pension scheme: guidance on preparing and maintaining an investment strategy statement' published 15 September 2016 and last updated 12 July 2017. Available at www.gov.uk/government/publications/local-government-pension-scheme-guidance-on-preparing-and-maintaining-an-investment-strategy-statement [accessed 8 December 2020].

79 For the consultation document and government response, see: https://webarchive.nationalarchives.gov.uk/20060214032048/http://www.dwp.gov.uk/consultations/2005/ [accessed 8 December 2020].

already exists. By requiring that investments are made not only "in a manner calculated to" ensure the security, quality, liquidity and profitability of the portfolio as a whole, but also with regard to the scheme's expected liabilities, the regulations will focus on the matters trustees should consider when making investment decisions, rather than judging them against the outcomes of the overall investment strategy.'

What is the effect of a failure to comply with ss 34 to 36 (or the Investment Regs 2005)?

There is the potential for claims before the Pensions Ombudsman for maladministration or breach of law[80] and breach may be grounds for removal as a trustee by the Pensions Regulator.[81] PA 1995 provides[82] for TPR to be able to impose a civil penalty (PA 1995, s 10) for a breach by a trustee of s 35 (SIP) or s 36 (choosing investments). This means it is at least arguable that because there is an express sanction in the statute, then this means that there is no other remedy, including a claim by (say) a member for breach of statutory duty – see for example the decision of the House of Lords in *Scally*[83] (a pensions case, but involving a different statute).

(2) What does 'prudence' mean?

The Oxford English Dictionary[84] (OED) definition of 'prudence' is that it means being sensible, taking care or caution:

> 'Prudence:
>
> 1. The ability to recognize and follow the most suitable or sensible course of action; good sense in practical or financial affairs; discretion, circumspection, caution.
>
> In early use: the wisdom to see what is virtuous, seen as one of the four cardinal virtues.'

Effectively the term 'prudence' or being 'prudent' refers to taking care and weighing up risks. So it seems it is no different to 'reasonable'. Some cases do refer to 'reasonable and prudent',[85] seemingly implying a difference, but this is not expanded on in the judgments.

The Law Commission commented on this in its joint 1999 report on Trustees' Powers and Duties[86] which led to TA 2000:

> '3.24 Every trustee should be required to exercise such care and skill as is reasonable in the circumstances. However, the level of care and skill which is reasonable may increase

80 Eg *Adams* (March 2009).

81 Under PA 1995, s 3. See, eg TPR determinations re Stephen Ward (Nov 2018) and Organic Insurance Limited Pension Scheme (Feb 2020).

82 See PA 1995, ss 35(6) and 36(8), as substituted.

83 *Scally v Southern Health and Social Services Board* [1992] 1 AC 294, HL. But this may be impacted by the provision in PA 1995, s 117 that the legislation in PA 1995, Part 1 and any relevant regulations override the provisions of the scheme to the extent that they conflict. Note also the Trustee knowledge and understanding (TKU) provisions in PA 2004, ss 247 to 249B. These include a requirement for knowledge and understanding of investment matters – ss 247(4)(b)(ii) and 248(5)(b)(ii).

84 The OED does also refer to an alternative meaning, involving vicars: '4. A gathering or group of vicars. Obsolete. rare.' It is not contended that this applies in this context.

85 Eg *Cocks v Chapman* [1896] 2 Ch D 763, CA at 778, Lopes LJ referring to 'reasonable care, prudence and circumspection'. Cited by Brightman J in *Bartlett v Barclays Bank* [1980] Ch 515 at 532A.

86 Law Commission 'Trustees' powers and duties' (May 1999, Law Com No 260) at 3.24.

> if the trustee has special knowledge or skills, (or holds him or herself out as having such knowledge or skills), or if the trustee is acting in the course of a business or profession.'
>
> '[…] the Law Commission considers that, in formulating the new statutory duty, express regard should be had to the particular skills and position of the trustees, and to the circumstances of the trust.'

The later Law Commission report in 2014 on Fiduciary Duties of Financial Intermediaries[87] commented that there had been a move away from using the language of 'prudence':

> '3.72 There has been a move away from this traditional language of "prudence". In 2000, trustees' duties of care were put on a statutory footing in England & Wales through the Trustee Act 2000 (the 2000 Act). This implemented, with minor changes, the recommendations of the Law Commission and Scottish Law Commission in our 1999 Report on Trustees' Powers and Duties. The Act signalled a move towards "reasonableness" as the relevant standard of conduct.'

Prudence does not mean risk free

Prudence or reasonableness must depend on the context of the trusts, its purposes and objects and the purposes and objects of the relevant investment power. In the investment context, this must depend on identifying the risks that the trustee is being cautious or careful about.[88] Part of the duty of care must be to use care, in using reasonable efforts:

- to identify the relevant risks,
- to consider their likelihood and materiality or impact; and
- to consider what can be done to mitigate or deal with those risks and at what cost.

In relation to identifying the relevant risks (and their materiality) it is, of course, clear that trustees cannot be expected to have complete foresight or understanding. This would be to impose (in retrospect) a test of perfect vision. This leads to the famous comment by Donald Rumsfeld in 2002:[89]

> 'there are known knowns; there are things we know we know. We also know there are known unknowns; that is to say we know there are some things we do not know. But there are also unknown unknowns – the ones we don't know we don't know.'

It is clear that not all risk can be avoided or mitigated. It is difficult to envisage a totally risk-free investment, even from a nominal capital perspective:

- bank deposits – risk of bank and compensation scheme (in the UK the financial services compensation scheme or FSCS) collapse;

87 Law Commission of England and Wales 'Fiduciary Duties of Financial Intermediaries' (July 2014, Law Com No 350) at 3.72.

88 See M Scott Donald 'Prudence under pressure' (2010) 4 J Eq 44 at 47 to 53.

89 On 12 February 2002 Donald Rumsfeld, then the US Secretary of Defense, answered a question at a US Department of Defense news briefing about the lack of evidence linking the government of Iraq with the supply of weapons of mass destruction to terrorist groups. This is also discussed in Scott Donald 'Prudence in extremis' (Nugee Lectures 2020).

- Government gilts – risk of political change and/or government default (hopefully a low risk for the UK?)

For example, a concern about risk of a fall in equities might lead a trustee to seek what it perceives as a safer investment in (say) cash deposited at a bank. But this mitigation is not risk free: even if it preserves the nominal value of the amount, it probably does not deal well with inflation and if deposited in another currency leaves a currency exposure. In addition there remains a risk of bank failure (perhaps mitigated by state compensation funds, but even these have a risk of failure).

It also seems clear that a trustee is not expected to have perfect knowledge, for example to forsee (or anticipate the effect of) all risks. It cannot be part of the duty of care for a trustee to spend a large amount on identifying even small risks, or spend a large amount insuring against small risks, if on balance the cost (or time?) is reasonably considered to outweigh the perceived benefits. This is similar to the problems with implying a duty on trustees (or others) to consider <u>all</u> relevant factors, regardless of relevant resources. For example in *Alcoa of Australia v Frost*,[90] Nettle JA in the Victorian Court of Appeal referred to a trustee not being 'required to do the impossible', nor be 'expected to go on endlessly in pursuit of perfect information in order to make a perfect decision.' There must be (although not mentioned greatly by the courts) a balance struck between risk and cost or reward.[91]

The courts have confirmed that the duty of care (or prudence) does not mean in relation to investment that no risks should be taken. In effect the courts apply a judgment rule – how has the trustee balanced risk with potential reward?

In 1979, in *Bartlett v Barclays Bank Trust Co Ltd*,[92] Brightman J (as he then was) confirmed that trustees could take risks:

> 'That does not mean that the trustee is bound to avoid all risk and in effect act as an insurer of the trust fund'

Brightman J cited Bacon V-C in the 1883 case *In re Godfrey*:[93]

> 'No doubt it is the duty of a trustee, in administering the trusts of a will, to deal with property intrusted into his care exactly as any prudent man would deal with his own property. But the words in which the rule is expressed must not be strained beyond their meaning. Prudent businessmen in their dealings incur risk. That may and must happen in almost all human affairs.'

Brightman J continued:

> 'The distinction is between a prudent degree of risk on the one hand, and hazard on the other. Nor must the court be astute to fix liability upon a trustee who has committed no more than an error of judgment, from which no business man, however prudent, can expect to be immune'

90 *Alcoa of Australia Retirement Plan Pty Ltd v Frost* [2012] VSCA 238, 36 VR 618 per Nettle JA at [60]. See Pollard *Pensions, Contracts and Trusts* (fn 8 above) at Ch 49.

91 Similarly, J D Heydon and M J Leeming, *Jacobs' Law of Trusts in Australia*, 8th Edn (LexisNexis, 2016) at 17.19 discussing that any duty to insure can only apply 'at least where the cost of insurance is not prohibitive'.

92 *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515 (Brightman J) at 531F.

93 *In Re Godfrey* (1883) 23 ChD 483 (Bacon V-C) at 493.

Brightman J also cited Lopes LJ in the 1896 case *In re Chapman*:[94]

> 'A trustee who is honest and reasonably competent is not to be held responsible for a mere error in judgment when the question which he has to consider is whether a security of a class authorized, but depreciated in value, should be retained or realized, provided he acts with reasonable care, prudence, and circumspection.'

Not a retrospective test – skill and judgment at the time

At first instance in *Nestle*,[95] Hoffmann J confirmed that the duty of care needs to be considered at the time of the relevant decisions and not in retrospect. He held:

> '[…] in reviewing the conduct of trustees over a period of more than 60 years, one must be careful not to endow the prudent trustee with prophetic vision or expect him to have ignored the received wisdom of his time'.

Later, Hoffmann LJ made a similar point about timing in his Australian paper[96] in 1994:

> '[…] we have an example of the flexibility of equity and its ability to adapt to new conditions. In a case in 1987 called *Re Wellcome Trust* which concerned a huge charitable trust, I committed himself to the proposition that equities were a safer form of investment than gilt-edged. It is perhaps a pity that I made this statement about six weeks before the October Black Monday on the world stock markets'.

Balance risk against return: Harries v Church Comrs (1991)

In 1991 in *Harries v Church Comrs*[97] involved a claim in relation to the investment policy of a large charitable trust. Sir Donald Nicholls V-C held that the guiding principle for the investment power was for it 'to further the purposes of the trust'. It would normally further this purpose if the investments grew as much as possible. But seeking such growth must be balanced with the relevant risks. Nicholls V-C held that for investment property charity trustees should be 'seeking to obtain […] the maximum return, whether by income or capital growth, which is consistent with commercial prudence'.

Nicholls V-C held (at p 304c):

> 'Second, there is property held by trustees for the purpose of generating money, whether from income or capital growth, with which to further the work of the trust. In other words, property held by trustees as an investment. Where property is so held, prima facie the purposes of the trust will be best served by the trustees seeking to obtain therefrom the maximum return, whether by way of income or capital growth, which is consistent with

94 *In Re Chapman, Cocks v Chapman* [1896] 2 Ch D 763, CA per Lopes LJ at 778. Chapman is cited in Chantal Stebbings *The Private Trustee in Victorian England* (fn 33 above) at 156 as one which 'showed an unusual perception by the judiciary of the effect of economic conditions on trustees and their impact on the already difficult task of trustees …'

95 *Nestle v National Westminster Bank Plc* (1988) 29 June, (1996) 10 TLI 113 (Hoffmann J) at 115.

96 'Equity and its role for superannuation pension schemes in the 1990s', Ch 5 in M Scott Donald and Lisa Butler Beatty (Eds), *The Evolving role of Trust in Superannuation* (Federation Press, 2017) at p 77.

97 *Harries (Bishop of Oxford) v Church Commissioners* [1993] 2 All ER 300 (Nicholls V-C).

> commercial prudence. That is the starting point for all charity trustees when considering the exercise of their investment powers. Most charities need money; and the more of it there is available, the more the trustees can seek to accomplish.'

And later (at p 304e) that:

> 'investments should be made solely on the basis of well-established investment criteria, having taken expert advice where appropriate and having due regard to such matters as the need to diversify, the need to balance income against capital growth and the need to balance risk against return'

Context

It is clear that the context (and purpose) of a trust is relevant to how the investment powers are to be exercised and to the relevant duty of care for trustees. The nature of the trust is clearly relevant to the relevant duty and this must be kept in mind when looking at the judicial decisions.

Most of the reported caselaw on investment duties for trusts involves family wealth trusts. Their context is often different from that of a pension trust (or a commercial trust or charity):

- A different balance between capital and income?
- Seeking to preserve capital value?

In an age of inflation, does a duty of care or prudence mean looking at preserving the real value of capital (ie taking into account inflation)?[98]

Drake: Edelman J discusses issues on prudence

In 2016 in Australia in *ASIC v Drake*,[99] Edelman J (who was later promoted to join the High Court of Australia) reviewed the duty of care for a trustee in the light of the prudence wording used in previous cases. He outlined the history of the duty of care in England, citing *Speight v Gaunt* and *Re Whiteley*.

Edelman J convincingly criticised how the duty of care had been dealt with over the year, commenting that as a 'flexible standard' too much had been read into the caution implicit in the use of 'prudence' in *Re Whiteley*.

Edelman J identified two particular difficulties that can arise with a 'prudent person' test:

(1) it has been applied in an inflexible manner and by adding a 'gloss' based on a need for caution – [267]. Whether an investment is 'incautious' will depend on the context and circumstances – the terms of the trust instrument and the purposes of the trust – [271]; and
(2) it does not distinguish between the degrees of skill required by different types of trustee – [272].

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98 See *Nestle* per Hoffmann J at 115; Hoffmann LJ in 1994 article (n 96 above) at 76.
99 *Australian Securities and Investment Commission v Drake (No 2)* [2016] FCA 1552 (Edelman J).

It is useful to set out Edelman J's comments in *ASIC v Drake*[100] in some detail (with emphasis added):

> *'The trustee's equitable duty of care (the "prudent person" test)*
>
> […]
>
> [265] The statement of the test was, and is, intended to be flexible. As Heydon and Leeming observe, the standard "changes with economic conditions and contemporary thinking": Heydon JD and Leeming MJ, Jacobs' Law of Trusts in Australia (8th ed, LexisNexis Butterworths Australia, 2016) 356 [17-18].
>
> [266] However, *there are two difficulties that can arise with the application of the prudent person* test.
>
> [267] The first difficulty is that this flexible test *was often applied in an inflexible manner or by adding glosses such as a need for caution*. Many of the early decisions that considered the test in England, Australia, and the United States placed great importance upon the need for caution in trust investment. For instance, in *Learoyd v Whiteley* (1887) 12 App Cas 727, 733, Lord Watson said:
>
>> "Business men of ordinary prudence may, and frequently do, select investments which are more or less of a speculative character; but it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise to avoid all investments of that class which are attended with hazard."
>
> See also *Re Whiteley* (1886) 33 Ch D 347, 356-357 (Lindley LJ).
>
> [268] This approach was appropriate in an era where the trust was almost invariably used as a concept for preservation of the capital of the settlor, rather than as an investment vehicle. But *this requirement for caution is very difficult to apply as a single, undifferentiated test in the context of the use of trusts in an almost infinite variety of businesses and business purposes*. […]
>
> […]
>
> [271] *The short point is that the refrain in the older cases about caution and avoidance of hazard, if read in isolation, suggests a duty which is abstracted from the terms of the trust instrument and the nature of the trust business. But whether an investment is incautious due to its speculative nature, or impermissibly hazardous, may be affected by the terms of the trust instrument. To give a simple example, a trust established for the purposes of speculation, with terms requiring investment in speculative ventures, requires a different assessment of hazard from a trust which requires investment in government bonds*. As Gummow J said in *Breen v Williams* [1996] HCA 57; (1996) 186 CLR 71, 137, describing the obligations of a trustee under a trust instrument to manage a trust business: "the trustee is required *both to observe the terms of the trust* and, in doing so, to exercise the same care as an ordinary, prudent person of business would exercise *in the conduct of that business* were it his or her own" (emphasis added).

100 *ASIC v Drake (No 2)* [2016] FCA 1552 (Edelman J) at [265] to [273].

[272] *A second difficulty with a single prudent person standard of care is that it does not differentiate between the degrees of skill required by different types of trustee.* As ASIC submitted, a more precise approach is that of Finn J in *Australian Securities Commission v AS Nominees Limited* (517–518):

> "The standard of trustee care and caution of which I have been speaking so far does not differentiate between types of trustee. It is of general application. That standard, moreover, was settled a century ago and during a period when trust corporations were not used for the trading and investment purposes that are the commonplace in this country today. There is, in my view, a substantial question now to be answered as to whether a higher standard is not to be exacted from at least corporate or professional trustees (a) which hold themselves out as having a special or particular knowledge, skill and experience, and (b) which, directly or indirectly, invite reliance upon themselves by members of the public in virtue of the knowledge, etc, they appear so to have."
>
> In *Bartlett v Barclays Trust Co Ltd (No 1)* [1980] Ch 515 at 534 Brightman J was prepared to impose such a higher duty of care on a trust corporation:
>
> > "a professional corporate trustee is liable for breach of trust if loss is caused to the trust fund because it neglects to exercise the special care and skill which it professes to have."
>
> […]
>
> If it were in fact necessary for me so to do (which it is not), I would be prepared to apply to the trustee companies in these proceedings a standard of care higher than that of the ordinary prudent businessperson.

[273] With respect, I agree with these observations.'

Reckless prudence?

Being over cautious, can result in underperformance, compared to a reasonably well understood and considered (and even remunerated) risk? Over caution can be described as 'reckless prudence'. Reckless prudence sounds a bit like an oxymoron.[101] Is recklessness the opposite of prudence (or care)? But the point that this makes is that, for trustees and investment, not taking risks can itself be considered in some circumstances not to be prudent/careful?

There is an early example of such an investment risk in the bible in the new testament in the 'parable of the talents'.[102] The employer asked his two servants to each look after a gold coin during his absence. One servant invested the coin and earned a good return. The other was more cautious and buried the coin in the earth for safekeeping. On the employer's return, both servants returned their coins, but the first also returned a further amount. The employer praised the first servant but castigated the second: 'and cast ye the unprofitable servant into outer darkness: there shall be weeping and gnashing of teeth[103]'.

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101 Being reckless seems to be the opposite of prudence: 'Trustees should not be reckless with trust money.' per Dillon LJ in *Nestle* [1994] 1 All ER 118 at 126c.

102 Matthew 25:24–30.

103 Not currently remedies used by the Courts or the Pensions Ombudsman. Perhaps the closest is TPR's power to prohibit a person from being a trustee (or a director of a trustee company) – PA 1995, s 3.

Michael O'Higgins (then TPR Chair) in a speech[104] in 2012 made a similar point when discussing trustee powers in relation to fixing employer funding contribution levels:

> 'The best support for a DB pension is a properly funded scheme supported by a strong employer. While we believe contributions should be made where they are affordable, we do not want trustees to be 'recklessly prudent' in the valuation assumptions they make and in their negotiations with employers. There will be occasions when the right thing to do for the employer and the scheme will be to invest in the growth of the sponsoring company rather than making higher pension contributions.'

And later in relation to investment:

> 'The idea of reckless prudence I mentioned earlier also applies to investment strategy. Legislation does not require trustees to only invest in gilts. Those schemes with a strong employer underpinning pension promises may be able to afford to take more risk. Trustees should, of course, ensure they are aware of what the risks are; and that the employer can support these in the long term.
>
> I see no reason why schemes with a strong covenant, and trustees that fully understand the risks, should not continue to invest in the UK economy through the many equity or debt investment vehicles available on the market.'

It seems clear that in some circumstances, not taking a greater level of risk can be considered not to be careful or prudent.

Finally on this there is a colourful comment in the Wikipedia entry on 'Prudence'[105] that if a reluctance to take risks is 'unreasonably extended to into overcautiousness, then this can become the 'vice of cowardice':

> 'In modern English, the word has become increasingly synonymous with cautiousness. In this sense, prudence names a reluctance to take risks, which remains a virtue with respect to unnecessary risks, but, when unreasonably extended into over-cautiousness, can become the vice of cowardice.'

Caution – ie no speculation or hazard?

Given that some degree of risk taking is allowed by the duty of care (indeed can be mandated), how have the courts sought to draw the line as to when an investment decision has strayed into being a breach of the duty of care (or imprudent)?

In practice this must be a fact specific test (albeit objective rather than subjective). The context of the trust and the investment will be relevant. The courts have therefore only been able to give relatively high-level tests,[106] referring to a distinction between investment (on the one hand) and 'speculation' or 'hazard' on the other.

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104 Speech at the Professional Pensions Show in October 2012. Text is archived at https://webarchive.nationalarchives.gov.uk/20121030105729/http://www.thepensionsregulator.gov.uk/press/michael-ohiggins-professional-pension-show-2012.aspx [accessed 8 December 2020]. Quoted by Mark Smith at p 27 in his paper 'Lessons learned from the Pensions Regulator' (Nov 2012) at the APL 2012 annual conference.

105 https://en.wikipedia.org/wiki/Prudence [accessed 9 December 2020].

106 See Hoffmann J's comments in *Steel v Wellcome* on a 'high level of abstraction' discussed below (text to fn 116).

In *Learoyd v Whiteley*, Lord Watson considered that investments 'attended with hazard' should be avoided:

> 'it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise to avoid all investments of that class which are attended with hazard.'

Nearly a century later in 1979 in *Bartlett v Barclays Trust*,[107] Brightman J cited Lord Watson and commented:

> 'The distinction is between a prudent degree of risk on the one hand, and hazard on the other.'

In Australia in 1952 in *Fouche v Superannuation Fund Board*,[108] the High Court held that the making of a loan by a pension trust was a breach of trust, 'by reason of its inherent nature', citing *Learoyd v Whiteley*.

Caselaw refers to hazard and speculation, but what is the dividing line between an investment that is prudent or careful and one that is hazardous or speculative?. The courts have found this difficult to define. The risk is that the distinction becomes one which is very subjective, in the eye of the beholder:

- I invest
- You save
- He speculates

Comments outside the legal sphere make this point as well. In particular comments about how buying and holding shares quoted on a stock exchange (presumably an investment) differs from gambling (presumably not).

President Theodore Roosevelt said: 'There is no moral difference between gambling at cards or in lotteries or on the race track and gambling in the stock market.'[109]

The economist JM Keynes in 1936 in his book *The General Theory of Employment, Interest and Money*[110] compared investing on a stock exchange as being similar to a casino:

> 'Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes a by-product of the activities of a casino, the job is likely to be ill-done. The measure of success attained by Wall Street, regarded as an institution of which the proper social purpose is to direct new investment into the most profitable channels in terms of future yield, cannot be claimed as one of the outstanding triumphs of laissez-faire capitalism.'

107 *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515 (Brightman J) at 531H. On hazard, see also *Jones v AMP Perpetual Trustee Co NZ Ltd* [1994] 1 NZLR 690, [1995] Pens LR 53 (Thomas J) and *ASC v AS Nominees Ltd* (1995) 63 FCR 504, [1996] Pens LR 297 (Finn J).

108 *Fouche v The Superannuation Fund Board* [1952] HCA 1, (1952) 88 CLR 609 (Dixon CJ, McTiernan and Fullagar JJ) at [20] (p 637).

109 President Theodore Roosevelt 'Message to Congress on Worker's Compensation', 31 January 1908.

110 Keynes (Cambridge University Press, 1936), p 159.

Pension Schemes Bill and investment risk as a crime?

Taking risks in relation to a defined benefit pension scheme is probably about to become more hazardous in itself. The Pension Schemes Bill 2020, currently before Parliament, will, if enacted in its present form, create a new criminal offence by inserting a new PA 2004, s 58B called 'Offence of conduct risking accrued scheme benefits'.

The main element is that a person[111] does an act 'which detrimentally affects in a material way the likelihood of accrued scheme benefits being received'. It would seem that making investment decisions could, in retrospect, have that effect if the investments do not achieve the return hoped for. Or conversely if the decision is too cautious?

It will be the case that other elements need to be proved for there to be an offence, including that the person knew or ought to have known that the act would have that effect (but this may be relatively easy to show in relation to investment decisions).

The main limiting factor for an offence is the third requirement that 'the person did not have a reasonable excuse for engaging in such conduct'. This is framed as an objective factual test (which is likely to be a decision for a jury[112]). In practice a pension trustee will usually be able to show that it was acting on professional advice in relation to investment, and in which case the risk of prosecution (let alone conviction) may well be reduced.

It remains an intriguing example of potential criminalisation of negligent (rather than intentional or reckless[113]) conduct and may well have a sobering effect on trustees (and others, including advisers).

Proposed new section in PA 2004

> '**58B Offence of conduct risking accrued scheme benefits**
>
> (1) […]
>
> (2) A person commits an offence only if—
>
> (a) the person does an act or engages in a course of conduct that detrimentally affects in a material way the likelihood of accrued scheme benefits being received (whether the benefits are to be received as benefits under the scheme or otherwise),
>
> (b) the person knew or ought to have known that the act or course of conduct would have that effect, and

111 The primary offence is not limited to trustees or employers or persons associated with them. In addition, if a body corporate is guilty of the offence, then if the offence was committed with the consent or connivance of, or was attributable to, any neglect on the part of a director, manager, secretary or similar officer, each of them can also be convicted – PA 2004, s 309(1).

112 *R v G* [2009] UKHL 13.

113 Contrast the (then) government's response to green paper (Feb 2019) 'Government Response to the Consultation on Protecting Defined Benefit Pension Schemes – A Stronger Pensions Regulator', which referred to a crime only in relation to wilful or reckless behaviour:

> 'The Government plans to move forward with proposals for new criminal offences for wilful or reckless behaviour in relation to a pension scheme, and for failure to comply with a CN […].' https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/777758/response-protecting-defined-benefit-pension-schemes.pdf [accessed 9 December 2020]

(c) the person did not have a reasonable excuse for engaging in such conduct.

(3) A reference in this section to an act or a course of conduct includes a failure to act.'

Meaning of prudence or prudent

The terms prudent or prudence in this context each sound like a well-defined concept in terms of a legal test. In fact, they are very high level and ill defined. Their application depends greatly on the particular context. The terms are most useful as a shorthand for 'duty of care' or instead of 'reasonably' or 'cautiously'. Perhaps, as a concept, they are best treated as a 'twitter' shortcut.

There are similar multiple meaning problems with other concepts used in trust law, for example, 'best interests', 'good faith', and 'fiduciary duty' – each much used, but often without further explanation.

(3) Reasonableness is a better way of describing the duty of care for investment?

Trustee Act 2000, s 1

Section 1 of the Trustee Act 2000 (already set out above) codified the common law duty of care for trusts other than occupational pension schemes, based on such care and skill as is 'reasonable in the circumstances'. As noted above, in its report, 'Trustees' powers and duties',[114] the Law Commission preferred this formulation to the use of the term 'prudent' or 'prudence', but felt that ultimately this was just a codification of the common law terminology, with little difference between the terms.

Directors: CA 2006 codifying the common law

Six years later, a similar approach can be seen for directors in the 2006 codification of the law in the Companies Act 2006 (CA 2006) relating to the duty of care owed by directors to their company. The test used in CA 2006, s 174 does not refer to 'prudence' but refers to 'reasonable care, skill and diligence of a 'reasonably diligent person'.

'174 Duty to exercise reasonable care, skill and diligence

(1) A director of a company must exercise reasonable care, skill and diligence.

(2) This means the care, skill and diligence that would be exercised by a reasonably diligent person with—

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company, and

(b) the general knowledge, skill and experience that the director has.'

114 Law Commission of England and Wales 'Trustees' powers and duties' (May 1999, Law Com No 260) at 3.24 and 3.25.

The Law Commission later commented that the use of 'prudence' reflects traditional language. As mentioned above, in its report in 2014 on Fiduciary Duties of Financial Intermediaries[115] it commented:

> '3.72 There has been a move away from this traditional language of "prudence". In 2000, trustees' duties of care were put on a statutory footing in England & Wales through the Trustee Act 2000 (the 2000 Act). This implemented, with minor changes, the recommendations of the Law Commission and Scottish Law Commission in our 1999 Report on Trustees' Powers and Duties. The Act signalled a move towards "reasonableness" as the relevant standard of conduct.'

(4) Applying the duty of care: context, advice, professionals

How then do the courts apply the duty of care (or prudence) in relation to investment? There are not a huge number of reported cases, whether for pension trustees or trustees generally.

In 1987 in *Steel v Wellcome*,[116] a case on judicial approval for a widening of the investment power, Hoffmann J commented that the duty of care was at a 'very high level of abstraction', but that being more specific (either in legislation or court judgments) will run the disadvantage of trying to apply to all trusts and also dealing with the circumstances at the time of the decision. Hoffmann J held:

> 'The general prudence principles in *Bartlett* and *Whiteley* […] "put the matter at a very high level of abstraction and neither the courts nor the legislature have been content to leave it there"
>
> 'It is inherent in such attempts to express an abstract canon of prudence in more concrete terms that they will suffer from two disadvantages. First, that they will necessarily have to be expressed as general rules applicable to all trusts which therefore cannot discriminate easily between individual circumstances […].
>
> Secondly, the rules will represent what was thought to give effect to the prudence principle at the time when they were enacted or formulated by the courts. With changes in economic circumstances they may cease to give effect to that principle and may indeed contradict it. There is therefore always a tension, increasing as time passes, between the prudence principle and the more concrete rules which have been laid down from time to time.'
>
> M Scott Donald has commented to similar effect:[117]
>
> 'The measure of what is "prudent", "reasonable" or "fair" can flex and evolve in accordance with community expectations and technologies in a way that is not possible for a narrower, more precise formulation.'

115 Law Commission of England and Wales 'Fiduciary Duties of Financial Intermediaries' (July 2014, Law Com No 350) at 3.72.

116 *Steel v Wellcome Custodian Trustees Ltd* [1988] 1 WLR 167 (Hoffmann J).

117 'The Pension Trust: Fit for Purpose?' (2019) 82 MLR 800.

An undemanding standard

Prudence has been held to be an 'undemanding standard'. In *Nestle*,[118] Leggatt LJ held:

> '[…] by the undemanding standard of prudence the bank is not shown to have committed any breach of trust resulting in loss.'

Look at standards at the time

The level of expertise required by the duty of care depends on the standards of the time. In *Nestle*,[119] Dillon LJ referred to the need to consider the duty of care by reference to the 'economic and financial conditions of that time' and commented that too much weight should not be placed on court decisions from the previous century. Dillon LJ held:

> 'Mr Nugee QC for the bank rightly stressed the duty of a trustee to act prudently. The best known formulation of this is in the judgment of Lindley LJ in *Re Whiteley*. […]
>
> 'This principle remains applicable however wide, or even unlimited, the scope of the investment clause in a trust instrument may be. Trustees should not be reckless with trust money. But what the prudent man should do at any time depends on the economic and financial conditions of that time – not on what judges of the past, however eminent, have held to be the prudent course in the conditions of 50 or 100 years before. It has seemed to me that Mr Nugee's submissions placed far too much weight on the actual decisions of the courts in the last century, when investment conditions were very different.'

'Extremely flexible standard'

At first instance in *Nestle*,[120] Hoffmann J, after citing Lindley LJ in *Re Whiteley*, referred to the duty of care (prudence) as being an 'extremely flexible standard' and varying with the times. Hoffmann J held[121]:

> 'This is an extremely flexible standard capable of adaptation to current economic conditions and contemporary understanding of markets and investments. For example, investments which were imprudent in the days of the gold standard may be sound and sensible in times of high inflation. 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 in isolation.
>
> […]
>
> But in reviewing the conduct of trustees over a period of more than 60 years, one must be careful not to endow the prudent trustee with prophetic vision or expect him to have ignored the received wisdom of his time.'

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118 *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118, CA per Leggatt LJ at 142g.
119 *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118 CA per Dillon LJ at 125j and 126c.
120 *Nestle v National Westminster Bank Plc* (1988) 29 June (Hoffmann J), later reported in (1996) 10 TLI 113, [2000] WTLR 795.
121 (1996) 10 TLI 113 at 115.

Context: consider all the circumstances

The duty of care in Trustee Act 2000, s 1 makes express reference to the need to consider the relevant context. It refers to what is 'reasonable in the circumstances'.

The Trustee Act 2000 followed directly from a report of the Law Commission in 1999. In its report, 'Trustees' powers and duties',[122] the Law Commission commented that this duty was intended to be a flexible default standard:

> 'the Law Commission considers that, in formulating the new statutory duty, express regard should be had to the particular skills and position of the trustees, and to the circumstances of the trust.'

This clearly means the context of:

- the trust;
- the times; and
- the trustee.

Advice

Part of the duty of care will mean that trustees are usually expected to obtain and consider proper advice, for example on investment matters.[123] But there may be circumstances where the trustees (or one of them) are sufficiently competent in an area that separate advice is not needed – see for example the family trust case *Daniel v Tee*.[124] Taking advice can help in the trustees meeting their duty of care to take proper account of relevant factors[125].

Similarly the statutory process under TA 2000[126] and, for pension trusts, PA 1995 and the Investment Regs 2005 include requirements for separate advice.[127]

In *Cowan v Scargill*,[128] Megarry V-C cited Lindley LJ in *Re Whiteley* that trustees owed a duty to act prudently, and held:

> 'That duty includes the duty to seek advice on matters which the trustee does not understand, such as the making of investments, and on receiving that advice to act with the same degree of prudence.'

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122 Law Commission of England and Wales 'Trustees' powers and duties' (May 1999, Law Com No 260) at 3.24 and 3.25.

123 Eg *Cowan v Scargill* [1985] Ch 270 (Megarry V-C) at 289C: 'the duty to seek advice on matters which the trustee does not understand, such as the making of investments'; *Martin v City of Edinburgh* 1988 SLT 322, [1989] Pens LR 9 (Lord Murray) at 334H; *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118, CA per Dillon LJ at 123j: 'It is inexcusable that the bank took no step at any time to obtain legal advice as to the scope of its power to invest in ordinary shares'; *Harries v Church Comrs* [1993] 2 All ER 300 at 304e: 'having taken expert advice where appropriate'.

124 *Daniel v Tee* [2016] EWHC 1538 (Ch), [2016] 4 WLR 115 (Richard Spearman QC).

125 *Scott v National Trust* [1998] 2 All ER 705 (Robert Walker J) at 717. See Pollard *Pensions, Contracts and Trusts: Legal issues on decision making* (Bloomsbury Professional, 2020) at 42.11 and Ch 47.

126 TA 2000, s 5. Previously, see Trustee Investments Act 1961, s 6(2) and (3).

127 Advice on a SIP: in writing and from a person believed to be qualified and to have appropriate knowledge and experience – Investment Regs 2005, reg 2(2)(a). Advice on whether investments are suitable – PA 1995, s 36(3) and (4).

128 *Cowan v Scargill* [1985] Ch 270 (Megarry V-C) at 289C.

Megarry V-C held that honesty and sincerity are not the same as prudence and reasonableness:

> 'This requirement is not discharged merely by showing that the trustee has acted in good faith and with sincerity. Honesty and sincerity are not the same as prudence and reasonableness. Some of the most sincere people are the most unreasonable; and Mr. Scargill told me that he had met quite a few of them. Accordingly, although a trustee who takes advice on investments is not bound to accept and act on that advice, he is not entitled to reject it merely because he sincerely disagrees with it, unless in addition to being sincere he is acting as an ordinary prudent man would act.'

Portfolio theory/prudent person rule

As noted above, in the 1880s and after, the implied class list of authorised investment was much more restrictive than it is now. In effect, in the 'prudent man of business' test in *Re Whiteley* the courts opted for a very cautious approach looking at each investment on an investment-by-investment basis. However, 130 years later this has changed to a portfolio test, for example the IORP 'prudent person test' as set out in Art 18 of the original IORP and discussed above.

In *Nestle*,[129] Hoffmann J held that

> '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 in isolation.'

The size of the fund being invested is also relevant to the investment duty of care, in particular the use of a portfolio theory.[130]

A similar process applies in the US under American Uniform Prudent Investor Act.[131]

It is noticeable that the reported cases against trustees involving family wealth trust mainly concentrate on the trustee underperforming in their investment role, often because they did not focus more on investment in shares instead of fixed interest or government bonds at times of inflation or significant capital growth. Examples are:

- not having enough equities: *Nestle*,[132] *Re Mulligan;*[133] or
- too many of the wrong sort of equities: *Daniel v Tee*.[134]

129 *Nestle v National Westminster Bank Plc* (1988) 29 June, (1996) 10 TLI 113 (Hoffmann J) at 115. See also Hoffmann LJ in his 1994 paper 'Equity and its role for superannuation pension schemes in the 1990s', (fn 1 above) at p 77. On portfolio theory, see M Scott Donald 'Prudence under pressure' (2010) 4 J Eq 44 at 54 to 56; Paul Ali 'Hedge fund investments and the prudent investor rule' (2003) 17 TLI 74; and Emma Ford 'Trustee investment and modern portfolio theory' (1996) 10 TLI 102.

130 See, eg Lord Nicholls 'Trustees and their broader community: Where Duty Morality and Ethics Converge' (1995) 9 TLI 71 at 76.

131 See, eg John H Langbein 'The Uniform Prudent Investor Act and the Future of Trust Investing' [1996] 81 Iowa L Rev 641 at 646. On the then proposed IORP, Ruth Goldman 'The Development of the "prudent man" concept in relation to pension schemes' (2000) 5 Jnl of Pens Management 219.

132 *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118, CA.

133 *Re Mulligan (Deceased); Hampton v PGG Trust Ltd* [1998] 1 NZLR 481 (Panckhurst J).

134 *Daniel v Tee* [2016] EWHC 1538 (Ch), [2016] 4 WLR 115 (Richard Spearman QC).

Diversification

Considering the impact of diversification is now seen to be part of the duty of care (or prudence). Diversification was mandated as part of the obligations under the Trustee Investments Act 1961 and the later TA 2000 and Investment Regs 2005.[135] However, there is not an absolute duty to diversify – only to consider the merits of diversification. Some pension trusts are in effect not diversified in some respects – for example a trust that is invested mainly with one insurer (or investment trust), even though the underlying economic investments may still be diversified.

Same test as for directors' duties

How do the duties of care on trustees compare with those on directors? This is relevant for two reasons:

(1) to look at the development of the common law duties of care and skill; and
(2) where the trustee is a trust company, to consider the duties of the directors.

Prudence was initially used as the standard for directors as well: see *Overend Gurney*.[136] However, later this reduced to a more subjective 'good faith' standard – *Re City Equitable Fire Insurance*.[137]

Given the entrepreneurial and trade/risk-taking purpose of many (most?) companies, prudence (old style) was seen as too cautious. In more recent times, see, for example, the trio of Australian cases: *Daniel v Anderson*,[138] *ASIC v Drake*,[139] and *ASIC v Cassimatis*.[140] This was reflected in the statutory codification of the duty of care owed by directors in the Companies Act 2006, s 174 (Duty to exercise reasonable care, skill and diligence), set out above

As mentioned above, in *ASIC v Drake*[141] in 2016 Edelman J commented that a test based on prudence was 'difficult to apply as a single test' in modern conditions:

> 'Whether an investment was incautious due to its speculative nature, or impermissibly hazardous, might be affected by the terms of the trust instrument. The requirement to avoid hazardous investments which was appropriate in an era where trusts were almost invariably used for the preservation of capital was difficult to apply as a single test in the context of the use of trusts for an almost infinite variety of businesses and business purposes.'

For trustee companies, it is clear that generally the directors owe the relevant duties to the trustee company, and not direct to the beneficiaries of the trust of which the company is trustee.

A director can be liable in relation to a breach of duty:

- to beneficiaries, if he or she dishonestly assists in a breach of trust by the company; or

135 Trustee Investments Act 1961, s 6(1)(a); TA 2000, s 4(3)(b); Investment Regs 2005, reg 4(7).
136 *The Overend & Gurney Co v Gibb* (1872) LR 5 HL 480 per Lord Hatherley LC at 486-487. Cited in *ASIC v Cassimatis* [2020] FCAFC 52 at [127].
137 *Re City Equitable Fire Insurance Co* [1925] Ch 407 (Romer J). Cited in *ASIC v Cassimatis* [2020] FCAFC 52 at [133].
138 *Daniels v Anderson* (1995) 16 ACSR 607 (NSW CA: Clarke, Sheller and Powell JJA).
139 *ASIC v Drake (No 2)* [2016] FCA 1552 (Edelman J).
140 *Cassimatis v ASIC (No 8)* [2016] FCA 1023, 336 ALR 209 (Edelman J), upheld on appeal [2020] FCAFC 52.
141 *ASIC v Drake (No 2)* [2016] FCA 1552 (Edelman J) at [268].

- to trustee company, if a breach of duty by the director to the company, for example claim by a liquidator (or perhaps by a new trustee) – *HR v JAPT*[142] and *Gregson v HAE.*[143] As to the level of duty, see *Bishopsgate Investment Management*[144] and *ASIC v Cassimatis.*[145]

(5) Test for pension scheme trustees?

Having worked out that referring to a duty of 'prudence' does not give much insight, even for family wealth trusts, where do commercial trusts such as pension schemes fit in?

It would generally be possible for a trust instrument to specify a duty of care for investment matters (rather than an exemption provision, which as discussed above for pension schemes may be over-ridden by PA 1995, s 33) – see the discussion of the difference between exemption and duty framing provisions in *ASIC v Drake.*[146] However, a specific duty of care may well be difficult to frame and seems to be, in the author's experience, unusual.

The caselaw still refers to 'prudence' or 'prudent' – for example *Daniel v Tee*[147] – but most of the reported cases are about private wealth trusts. Some cases are not, for example *Cowan v Scargill*[148] (pension trust) and *Harries v Church Comrs*[149] (charitable trust).

Some caselaw indicates the same duties for pension trusts as for family wealth trusts – see for example *Cowan v Scargill*,[150] where Megarry V-C basically agreed on this point with the plaintiffs, but it does not seem to have been argued on either side that 'prudence' was not a suitable test.

In *Nestle*[151] at first instance, Hoffmann J commented that family trusts have different considerations to unit trusts:

> '[…] the investment considerations in family trusts such as this were different from those in unit trusts. I agree […]'.

Similarly, in *ASIC v Drake*[152] (as already cited above), Edelman J contrasted family trusts with commercial trusts.

In practice it is probably too late to argue that it is inappropriate to refer to a 'prudence duty' for pension trusts, given the decision in *Cowan v Scargill*[153] and the terms of the IORP. However, in context, it seems that prudence just means take reasonable care – taking into account the context of the pension trust.

(6) Legal claims – process/perversity – applying Braganza?

Referring to a duty of care by reference to terms such as 'prudence' and 'prudent', seems to do no more than mean 'careful'. It may historically imply aspects of being 'cautious' as well, but

142 *HR v JAPT* [1997] OPLR 123 (Lindsay J).
143 *Gregson v HAE Trustees Ltd* [2008] EWHC 1006 (Ch), [2008] 2 BCLC 542 (Robert Miles QC). Discussed in Pollard *The Law of Pension Trusts* (Oxford University Press, 2013) at Ch 5.
144 *Bishopsgate Investment Management Ltd v Maxwell (No 2)* [1994] 1 All ER 261, CA.
145 *Cassimatis v ASIC (No 8)* [2016] FCA 1023, 336 ALR 209 (Edelman J), upheld on appeal [2020] FCAFC 52.
146 *ASIC v Drake (No 2)* [2016] FCA 1552 (Edelman J) at [277] to [280], citing Donaldson J in *Kenyon, Sons & Craven Ltd v Baxter Hoare & Co. Ltd* [1971] 1 WLR 519, 522-523.
147 *Daniel v Tee* [2016] EWHC 1538 (Ch), [2016] 4 WLR 115 (Richard Spearman QC).
148 *Cowan v Scargill* [1985] Ch 270 (Megarry V-C).
149 *Harries (Bishop of Oxford) v Church Commissioners* [1993] 2 All ER 300 (Nicholls V-C).
150 *Cowan v Scargill* [1985] Ch 270 (Megarry V-C).
151 *Nestle v National Westminster Bank Plc* (1988) 29 June, (1996) 10 TLI 113 (Hoffmann J) at 116.
152 *ASIC v Drake (No 2)* [2016] FCA 1552 (Edelman J) at [271].
153 *Cowan v Scargill* [1985] Ch 270 (Megarry V-C).

this seems unhelpful. So effectively the duty of care means that the trustee must consider and weigh up the potential risks and rewards.

Assuming the investment is authorised, this looks more like a process test. Did the trustee board:

- follow the statutory process (SIP etc)?
- take reasonable steps to identify the relevant risks and rewards?
- take advice? (statutory requirement)?
- consider the relevant factors set out in legislation (eg liquidity, diversification) or otherwise reasonably considered to be material?

Effectively this involves the trustee acting carefully and weighing up risks, but with an objective outcome element if the ultimate decision was one that no reasonable trustee would have reached (a perversity test).

No reasonable trustee?

In order to bring a claim for a breach of trust it seems clear that often a beneficiary will need to show that the trustee board makes a decision that no reasonable/prudent trustee would make: *Nestle* and *Daniel v Tee*.[154]

The burden of showing that there was not a proper investment rests on the claiming beneficiary: *Shaw v Cates*.[155]

In *Nestle*[156] at first instance Hoffmann J, citing an expert witness, agreed with a description of there being a range of opinions:

> 'The difficulty – perhaps sheer impossibility – of satisfying both [tenant for life and remainderman] is reflected in the fact that there is no such thing as an authentic 'proper balance'; although it will be easy enough to say that a fund is unbalanced in extreme cases there must be a wide band in the middle, so to speak, where there is room for a genuine difference of opinion. An opinion on this subject will reflect the view taken of the present state of the market, the prospects for both fixed-interest stocks and equities in the future and the present and future circumstances of the beneficiaries. Clearly an equation containing so many variables is not going to resolve itself into an inevitable solution.
>
> That is in my judgment the right way to approach the problem.'

In *Nestle*[157] in the Court of Appeal, Staughton LJ held that the claim should be dismissed because beneficiary could not show that the trustee made a decision which 'no prudent trustee would have followed':

> 'However, the misunderstanding of the investment clause and the failure to conduct periodic reviews do not by themselves, whether separately or together, afford Miss Nestle a remedy. They were symptoms of incompetence or idleness – not on the part of National Westminster Bank but of their predecessors; they were not without more breaches of trust.

154 *Daniel v Tee* [2016] EWHC 1538 (Ch), [2016] 4 WLR 115 (Richard Spearman QC).
155 *Shaw v Cates* [1909] 1 Ch 389 (Parker J) at 395.
156 *Nestle v National Westminster Bank Plc* (1988) 29 June, (1996) 10 TLI 113 (Hoffmann J) at 116.
157 *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118, CA per Staughton LJ at 133j.

> Miss Nestle must show that, through one or other or both of those causes, the trustees made decisions which they should not have made or failed to make decisions which they should have made. If that were proved, and if at first sight loss resulted, it would be appropriate to order an inquiry as to the loss suffered by the trust fund.'
>
> 'I am inclined to agree with Professor Briston that there should have been diversification in the 1950s, rather than from 1960 onwards. But I cannot accept that failure to diversify in that decade was a course which no prudent trustee would have followed.'

In 2000 in *Wight v Olswang (No 2)*,[158] Neuberger J equated a claim against a professional trustee as needing to be considered in the same way as a negligence claim – was the decision something that could be reasonably done? Neuberger J held:

> 'whether or not that was something which a trustee, complying with the test laid down by Lord Watson, could reasonably have done'
>
> 'This substantially equates the position of a trustee facing a claim for breach of trust in connection with an investment decision with that of a professional man, such as an accountant or solicitor, facing a claim for professional negligence. In *Saif Ali v Sydney Mitchell & Co* [1980] AC 198 Lord Diplock said this at 218C–D: "Those who hold themselves out as qualified to practise […] professions, although they are not liable for damage caused by what in the event turns out to have been an error of judgment on some matter upon which the opinions of reasonably informed and competent members of the profession might have differed, are nevertheless liable for damage caused by their advice, acts or omissions in the course of their professional work which no member of the profession who was reasonably well-informed and competent would have given or done or omitted to do."'
>
> This was followed in 2016 in *Daniel v Tee*[159] by Richard Spearman QC:
>
> '[163] […] 'such a decision is one which no trustee, complying with the duty to act prudently which is laid down in the authorities, could reasonably have made.'

A Wednesbury/Braganza test

So the investment duty of care (or prudence) looks to be very similar to the well-known two-limb *Wednesbury/Braganza* test:[160]

- process: due consideration of what ought to be considered (relevant factors); and
- outcome: not perverse – 'no reasonable decision maker'.

But with input from a proper purpose test too – aim of investment is to be prudent, not take undue risks?

158 *Wight v Olswang (No 2)* [2000] Lloyd's Rep PN 662 (Neuberger J) at 665. In *Daniel v Tee* [2016] EWHC 1538 (Ch) at [43], Richard Spearman QC pointed out that although the decision of Neuberger J in *Wight v Olswang* was overturned on appeal, the Court of Appeal made no criticism of Neuberger J's 'no reasonable trustee' test.

159 *Daniel v Tee* [2016] EWHC 1538 (Ch), [2016] 4 WLR 115 (Richard Spearman QC).

160 *Associated Picture Houses v Wednesbury* [1948] 1 KB 223, CA and *Braganza v BP Shipping Ltd* [2015] UKSC 17, [2015] 4 All ER 639. See further on this Pollard *Pensions, Trusts and Contracts: Legal Issues on Decision Making* (Bloomsbury Professional, 2020).

The process element is not subjective – it is not enough that the trustee considered that it was acting carefully and considering what it thought were the proper factors. In *Cowan v Scargill*,[161] Megarry V-C commented on this:

> 'This requirement is not discharged merely by showing that the trustee has acted in good faith and with sincerity. Honesty and sincerity are not the same as prudence and reasonableness.'

This has recently been cited by the Supreme Court in *Lehtimäki v Cooper.*[162]

Expert evidence needed for a challenge?

If there is a challenge about a failure to invest properly then the claimant will normally need expert evidence in relation to the alleged failure by the trustee, in particular to establish any loss, by showing what would have been the position had the trustee invested properly[163]. In *Nestle*[164], Leggatt LJ held that expert evidence would be needed to show any loss:

> 'The appellant therefore had to prove that a prudent trustee, knowing of the scope of the bank's investment power and conducting regular reviews, would so have invested the trust funds as to make it worth more than it was worth when the appellant inherited it. That was a matter for expert evidence. In the result, there was evidence which the judge was entitled to accept and did accept that the bank did no less than expected of it up to the death of the testator's widow in 1960.'

Expert evidence may, however, not be needed if the failure is 'glaring and obvious'[165].

Overview on use of 'prudence'

Describing the investment duty of care as involving 'prudence' does not give much (any?) help on the nature of the duty of care. The duty looks the same as the reasonableness test. The duty on trustees is similar to the development of that on company directors.

'Prudence' or 'prudent' gives a mixed message

Use of the term 'prudence' is perhaps fine as a shorthand, but it is necessary to understand this and keep it in mind. A pension trustee needs to consider level of risk and reward in the context of the scheme. This means that it needs to take care. This involves working out the purpose of the investment and the relevant risks (eg inflation, asset return, economic prospects, pandemics etc). The legislation and TPR guidance point toward the need for advice and consultation.

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161 *Cowan v Scargill* [1985] Ch 270 (Megarry V-C) at 289.

162 *Lehtimäki v Cooper* [2020] UKSC 33, [2020] 3 WLR 461 per Lord Briggs at [232].

163 Proof of loss or damage is needed to complete a claim: *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118, *Daniel v Tee* [2016] EWHC 1538 (Ch) and *ASIC v Drake (No 2)* [2016] FCA 1552 (Edelman J) at [302] to [312].

164 *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118, CA per Leggatt LJ at 141h. On experts, see M Scott Donald 'Prudence under pressure' (2010) 4 J Eq 44 at 51.

165 Eg *Sharp v Blank* [2019] EWHC 3096 (Ch) (Norris J) at [632].

In practice a pension trustee following the statutory investment processes is unlikely to be in breach of its duty of care (or prudence). The trustee should

- properly instruct advisers about risk level, etc (usually this will emerge from the SIP);
- consider and monitor advice; and
- document reasons for investment strategy.

There remains a potential breach if the investment decision is perverse (no reasonable trustee) or contrary to statutory process. But for a damages claim, the onus of proof is on the claimant to show a loss has resulted.

Charity Law's Transition from 'Poverty' to 'Financial Hardship'

*David Wilde and Imogen Moore**

Introduction

The relief of poverty has always been a cornerstone of charity law.[1] But the suggestion here is that, legally speaking, this category of charity may – unnoticed – have now been made practically redundant when defining the limits of charitable purposes in the law of England and Wales by a relatively obscure provision in the Charities Act 2011 (CA 2011). By CA 2011, s 3(1)(j), 'the relief of those in need because of … financial hardship …' is now also a charitable purpose.[2] Arguably, this is *wider* than the relief of poverty and therefore renders superfluous in the modern law any reliance on relieving poverty for charitable status. A charity may have good principled or practical reasons for limiting its objects specifically to the relief of poverty: we shall come to those. But the general point suggested with regard to defining the outer limits of charitable purposes appears valid. This depends, however, on the interpretation given to 'the relief of those in need because of … financial hardship …', and on the public benefit test to be applied to it.

Legal definition of charity

By Charities Act 2011, s 2, being a charitable purpose involves satisfying a two-stage test: first, the purpose must be on a list of recognised charitable purposes, set out in CA 2011, s 3; and secondly, it must also be of 'public benefit'. A third requirement for charitable status is being exclusively charitable: by CA 2011, s 1, a charity is an institution established for charitable purposes only.[3]

Prevention or relief of poverty

On the list of recognised charitable purposes in Charities Act 2011, s 3(1), the very first item, in para (a), is 'the prevention or relief of poverty'.

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1 The relief of poverty was mentioned in the first clause of the list of charitable purposes in the Preamble to the Charitable Uses Act 1601 (or 'Statute of Elizabeth'); it was the first of the four principal divisions of charity famously stated by Lord Macnaghten delivering the leading judgment in *Comrs for Special Purposes of the Income Tax v Pemsel* [1891] AC 531 (HL), 583; and it is now first on the list of charitable purposes in the Charities Act 2011 (s 3(1)(a)).

2 Originally enacted as Charities Act 2006, s 2(2)(j). This 'financial hardship' provision is so little considered that the Charity Commission's guidance 'Charitable Purposes' (September 2013) has nothing to say about it.

3 By CA 2011, s 9(3), an 'institution' may be incorporated or not, and includes a trust or undertaking.

'Prevention'

The word prevention was first introduced into the law in Charities Act 2006, s 2(2)(a). The addition of 'prevention' is now the *only respect* in which this charitable purpose, in para (a), is indisputably wider than the different charitable purpose of relieving need from financial hardship, in para (j), which will be the main focus here. However, it is arguably a difference of relatively minor importance.

'Relief'

Relief of poverty means alleviating needs arising from the poverty; it is not the same as benefiting the poor – it is possible to benefit the poor without ameliorating their poverty.[4]

'Poverty'

The most widely cited, and helpful, definition of poverty is that in *Re Coulthurst*.[5] Evershed MR, delivering the leading judgment, said:

> 'It is quite clearly established that poverty does not mean destitution; it is a word of wide and somewhat indefinite import; it may not unfairly be paraphrased for present purposes as meaning persons who have to "go short" in the ordinary acceptation of that term, due regard being had to their status in life, and so forth.'

So, widows and orphans of bank workers could be regarded as in 'poverty'.

Public benefit

The public benefit requirement for relieving poverty is minimal. First, the form of relief must be socially beneficial, not anti-social.[6] Secondly, it must be for the relief of poverty amongst a class of poor people and not be for particular beneficiaries;[7] accordingly, the provision can be for a relatively small group and they can all have a personal nexus – for example, they can all be relatives, or employees: *Dingle v Turner*.[8] So, a trust for those 'in special need' among 50 relatives has been held a charitable relief of poverty,[9] and a trust for 'the poor and needy' among a smaller class of 26 relatives, plus issue born during a 21-year period, has been held a charitable relief of poverty.[10] A possible justification for the minimal numbers that need to be

4 *Joseph Rowntree Memorial Trust Housing Association Ltd v A-G* [1983] Ch 159 (Ch), 171.

5 [1951] Ch 661 (CA), 665–66.

6 *A-G v Charity Commission for England and Wales* [2012] UKUT 420 (TCC), [2012] WTLR 977.

7 It is no objection that the property is distributable at once, rather than held as an endowment with only the income distributed – if the provision is not, in substance, for particular individuals: *Re Scarisbrick* [1951] Ch 622 (CA).

8 [1972] AC 601 (HL). The law has not been changed by the Charities Act: *A-G v Charity Commission for England and Wales* [2012] UKUT 420 (TCC), [2012] WTLR 977, [39] (although that case probably did not correctly state the prior law: see Jonathan Garton, *Public Benefit in Charity Law* (Oxford University Press, 2013), para 5.280). The case added ([76]–[80]) that the same test may apply for the 'prevention' of poverty, where the prevention is very close to relief, because the prevention is of impending poverty, but, where the prevention is staving off distant risks (eg through general financial advice) then benefit to a wider public may be required.

9 *Re Cohen* [1973] 1 WLR 415 (Ch).

10 *Re Segelman* [1996] Ch 171 (Ch).

helped in order to satisfy the public benefit requirement is that any relief of poverty benefits the general public, by reducing the burden on the state – the taxpayer.[11]

Relief of those in need because of financial hardship

The relief of those in need because of financial hardship is now a listed charitable purpose. It forms part of a wider category stated in Charities Act 2011, s 3(1)(j): 'the relief of those in need because of youth, age, ill-health, disability, financial hardship or other disadvantage'.

'Relief'

Relief has essentially the same meaning as in relieving poverty: it means a need arising from their condition ('youth, age, ill-health, disability, financial hardship or other disadvantage') is being remedied.[12]

'Those in need because of financial hardship'

There appear to be no judicial pronouncements explaining 'those in need because of financial hardship';[13] although Andrew Smith J accepted that those in social housing in the Netherlands were in need of accommodation because of financial hardship within the meaning of the provision, in *Credit Suisse International v Stichting Vestia Groep*.[14] This is possibly a first indication that the judges will see financial hardship as wider, and easier to find, than poverty.[15] By contrast, the leading specialist texts appear doubtful as to whether 'those in need because of financial hardship' form a wider category than those in 'poverty'.[16] But it is plain from authority that that a person can be in 'need' even if they are not poor: *Joseph Rowntree Memorial*

11 Alison Dunn 'As "Cold as Charity"?: Poverty, Equity and the Charitable Trust' (2000) 20 LS 222, esp 222 and 233–34. (But for the view that this is an unjustified historical anomaly, see Jonathan Garton, Rebecca Probert and Gerry Bean (Eds), *Moffat's Trusts Law: Text and Materials,* 7th edn (Cambridge University Press, 2020), 930–31.)

12 *Joseph Rowntree Memorial Trust Housing Association Ltd v A-G* [1983] Ch 159 (Ch), 171.

13 Nor do the Parliamentary debates help. The Minister of State, Home Office, Baroness Scotland, said about the list of charitable purposes, originally in Charities Act 2006 (HL Deb 20 January 2005, vol 668, col 885): 'The Government's intention is to clarify and codify the law, rather than to extend it significantly.' But there were extensions, and we are left wondering what 'significantly' meant. According to Lord Browne-Wilkinson, delivering the leading judgment in *Pepper v Hart* [1993] AC 593 (HL), 634 and 640, only 'clear' ministerial statements are admissible as an aid to construction, which this is not. There is no reference to the 'financial hardship' provision specifically. The Minister for the Cabinet Office, Hilary Armstrong, spoke about avoiding statements that might be used in future litigation, saying very *uncharitably* (HC Deb 26 June 2006, vol 448, col 22): 'I have learned already that there are incredible legal issues here, and I do not want to say anything that will lead me into giving lawyers any more money than they are already entitled to.'

14 [2014] EWHC 3103 (Comm), esp [261].

15 Compare the agonising in *Re Niyazi's Will Trusts* [1978] 1 WLR 910 (Ch), where Megarry V-C held a modest testamentary trust to construct a working men's hostel in an area of 1960s Cyprus suffering a housing shortage to be *only just* a charitable relief of poverty, saying (915) 'the case is desperately near the borderline'.

16 Hubert Picarda, *The Law and Practice Relating to Charities,* 4th edn (Bloomsbury Professional, 2010), p 168, sees no extension to the previous law; while William Henderson, Jonathan Fowles and Julian Smith (Eds), *Tudor on Charities,* 10th edn (Sweet & Maxwell 2015), para 2.209, concedes only that there might be a small extension, saying need from financial hardship 'almost completely overlaps with … poverty'. Although, helpfully to the argument made here, the passage does continue, 'However, the scope of "the relief of financial hardship" may be wider than the relief of poverty because although as a matter of charity law "poverty" is a relative term, persons who might not generally be described as poor might suffer from financial hardship from time to time'.

Trust Housing Association Ltd v A-G.[17] And there would have been no point in introducing the financial hardship provision unless there was a meaningful distinction from poverty: the law's presumption is that everything in a statute is independently significant.[18]

There must clearly be *some* difference between need from financial hardship and poverty. It is suggested that there is likely to be an *appreciable* difference; because – at least given the context that poverty is itself already a more extensive category in charity law than the ordinary layperson might think – *this is the natural meaning of the words 'in need because of financial hardship', in their statutory context*. To take a topical example, those solidly in the middle class who have lost their income during the current pandemic, have fearfully consumed their life savings to meet day-to-day expenses, and are now shamefacedly borrowing from relatives or friends to afford the mortgage or school fees, etc, could reasonably be described as in need from financial hardship. And it is easy to recall other situations – investment scandals, pension collapses, etc – where those well outside the range of poverty could sensibly have been described as in need from financial hardship. Helping such people would admittedly be a long way from the popular notion of 'charity': but the legal concept of charity *is* a long way from the popular concept.[19] And why should such financial casualties of the current pandemic be undeserving of charity's concern, given the width of 'charity' in other respects, if helped in a suitably limited and targeted way?[20]

If it is correct that those in need from financial hardship form a wider category that those in poverty, and especially if they form a *significantly* wider category, relying on the relief of poverty for charitable status unnecessarily assumes the burden of proving 'poverty' – unless there is some other difference making the relief of poverty a legally attractive category option to rely on. This raises the question whether the financial hardship category enjoys all the same benefits as the poverty category when it comes to the public benefit test.

Public benefit

We can only claim that the financial hardship purpose has rendered the relief of poverty purpose effectively redundant, when defining the outer limits of charity law, if, in the financial hardship category, the public benefit test can be satisfied as easily as in the poverty category: that is, even when those who may benefit are numerically small and/or have a personal nexus. The better view of the law appears to be that the poverty category enjoys *no advantage* over the financial hardship category: the two are in the same position. But the matter is debatable.

17 [1983] Ch 159 (Ch), 174. So, non-profit provision of age-adapted housing was held charitable as a relief of the needs of the elderly: there selling leases to those able to afford them.

18 Diggory Bailey and Luke Norbury (Eds), *Bennion on Statutory Interpretation,* 7th Edn (LexisNexis 2017), section 21.2, explains (notes omitted): 'There is a presumption that every word in an enactment is to be given meaning … Given the presumption that Parliament does nothing in vain, the court must endeavour to give significance to every word of an enactment. It is presumed that if a word or phrase appears, it was put there for a purpose and must not be disregarded.'

19 Most notoriously in the charitable status of expensive fee-charging schools: *R (Independent Schools Council) v Charity Commission for England and Wales; A-G v Charity Commission for England and Wales* [2011] UKUT 421 (TCC), [2012] Ch 214. See generally Mary Synge, *The 'New' Public Benefit Requirement: Making Sense of Charity Law?* (Bloomsbury 2015), esp 29-32. Countless examples exist of charities primarily benefiting the middle class and even the well-to-do, such as in the arts.

20 For some observations on possible practical application of this view, see David Wilde and Imogen Moore, 'Charitable Relief of Financial Hardship: the Public Benefit Requirement' [2021] PCB 36, esp 41–42.

A sufficiently large section of the public

The most authoritative general statement regarding the sort of numbers that need to benefit for a purpose to be of public benefit is that the benefits must be for the whole public, or a sufficiently large section of it – examples given were the inhabitants of a town or parish – it must not be for a set of private individuals: *Verge v Somerville*.[21] But a sufficiently large section of the public does not have a precise meaning; it markedly varies with the context.[22] In particular, in *Gilmour v Coats*[23] Lord Simonds, delivering the leading judgment, said:

> '[I]t is, I think, conspicuously true of the law of charity that it has been built up not logically but empirically. It would not, therefore, be surprising to find that, while in every category of legal charity some element of public benefit must be present, the court had not adopted the same measure in regard to different categories, but had accepted one standard in regard to those gifts which are alleged to be for the advancement of education and another for those which are alleged to be for the advancement of religion, and it may be yet another in regard to the relief of poverty.'

Looking at cases of what we would today call 'need because of financial hardship', seemingly the most helpful authority regarding minimum numbers treated the dependants of six victims killed in a disaster as a sufficient section of the public: *Cross v Lloyd-Greame*.[24] And amongst other 'need' cases within Charities Act 2011, s 3(1)(j) – beyond need due to financial hardship – a gift to just 10 blind girls and 10 blind boys has been held charitable, as relieving needs of the disabled: *Re Lewis*.[25] No doubt the gift to the blind children benefited more than just the recipients: the wider public also benefited through their care and education, meaning the children would contribute more to society and perhaps cost the taxpayer less. However, a similar case of indirect benefit to society can also be made for relieving need due to financial hardship: that it reduces the range of social ills associated with hardship – suicide and self-harm, domestic abuse and family break-up, mental health and addiction issues, disrupted education of children and supportive social networks, etc. If we save even only 20 or so individuals – and those around them – from such hardship, why is that not of public benefit (in the legal sense)? If this reading of the case law is correct, we are apparently dealing in numbers entirely comparable to the relief of poverty.

21 [1924] AC 496 (PC). Providing for soldiers returning from war was held to benefit a sufficient section of the public.

22 For high judicial recognition of this, see the citations in William Henderson, Jonathan Fowles and Julian Smith (Eds), *Tudor on Charities,* 10th Edn (Sweet & Maxwell, 2015), para 1.144.

23 [1949] AC 426 (HL), 449.

24 (1909) 102 LT 163 (Ch). When the crew of two fishing boats were lost, an appeal was made for 'relief' of their dependants. There is no mention that they were reduced to immediate or imminent poverty – although that might be speculated upon. The appeal raised more than the trustees believed the dependants should receive and the trustees planned application of the surplus to similar future disasters. Despite a concession by counsel for one widow that the fund would place her (164) 'in a position of affluence', Eve J was not persuaded there was a surplus in the charitable fund to be applied cy-près – although he referred the matter for consideration by a judge in chambers. So, it is not clear that the trust was a response to poverty; and it is tolerably clear that the dependants were not restricted to what was necessary to relieve poverty. In today's terms, this appears to be a relief of need from the financial hardship of losing a breadwinner. Peter Luxton, *The Law of Charities* (Oxford University Press, 2001), para 5.03, specifically views the case as, '[o]utside the relief of poverty'.

25 [1955] Ch 104 (Ch). It could be said that *all blind children* was the class to benefit, but with particular individuals to be selected. However, it is arguably disingenuous to talk about a large class when it is clear that the benefits will go to only a few individuals within it: Joseph Jaconelli, 'Adjudicating on Charitable Status – a Reconsideration of the Elements' [2013] Conv 96, 105–6.

The point is not completely clear. Contrast in particular 33 residents of an old people's home held not to be a sufficient section of the public for a relief of need due to age.[26] But this case has been criticised at length and appears to be wrong on the point.[27]

Personal nexus

In *Oppenheim v Tobacco Securities Trust Co Ltd*,[28] the House of Lords decided that as a general rule of charity law, there is only private – not public – benefit if those who can benefit are all defined by a 'personal nexus': that is, they are all linked to one person, or to several people – equally to one company or several companies. Links mentioned were being family members or employees. A trust to educate children of employees of a group of companies was held not charitable: those who could benefit (even though they were numerous) were all linked to the companies. The case recognised that the relief of poverty is an exception to the general personal nexus rule. Would relief of need due to financial hardship also be an exception?

It is important to emphasise that the personal nexus proposition is probably less absolute than is generally thought. It was only indicated in *Oppenheim v Tobacco Securities* to be a *general rule*: it was recognised that there might be *other* exceptions beyond relief of poverty.[29] And it is worth noting that whether the personal nexus rule is correct at all was questioned by high authority (although the criticism may have stemmed from a failure to recognise it was potentially *subject to reasoned exceptions*).[30] In that context, the House of Lords has expressly indicated since, albeit *obiter*, in *Dingle v Turner*,[31] that the personal nexus rule is subject to numerous exceptions: indeed, it is a rule that should only apply where there is a justification for it – as in *Oppenheim v Tobacco Securities*, where an attempt was being made to finance employee perks at the taxpayer's expense, under the guise of charity, for the benefit of the companies.[32] The best rationalisation we have seems to be that of Chesterman: the personal nexus rule negatives charitable status only where a settlor is self-interested; an exception

26 *Re Duffy* [2013] EWHC 2395 (Ch).

27 Mary Synge, 'Charitable Status: not a negligible matter' (2016) 132 LQR 303. (Even on its own terms the case seems wrong. The gift was £250,000. It could therefore presumably have benefited numerous future residents as well. But this point was not considered. This was possibly because the home had closed down by the date of the hearing. However, this fact should not have been relevant to consideration of possible cy-près application of the gift to other similar charities. Note also, *Re Gillingham Bus Disaster Fund* [1958] Ch 300 (Ch) (affd [1959] Ch 62 (CA)), 305, where it was believed around 30 disaster victims were not a sufficient section of the public, but without argument or decision on the point. Again, the reasoning looks suspect even on its own terms: it appears the families of the victims were not considered, as they probably ought to have been.)

28 [1951] AC 297 (HL).

29 *Ibid*, 307–8, Lord Simonds, delivering the leading judgment. An example given was government employees, all linked to the same employer: such a case, it was said, would be dealt with 'on its merits' – recognising that a trust for all the employees in an industry, with various employers, can be of public benefit; so it might be anomalous if, by chance, it was a nationalised industry, all with a single employer.

30 In particular, Lord MacDermott, dissenting in the *Oppenheim v Tobacco Securities* case itself, 317–18; Lord Denning MR in *IRC v Educational Grants Association Ltd* [1967] Ch 993 (CA), 1009; and Lord Cross, writing extrajudicially – Geoffrey Cross, 'Some Recent Developments in the Law of Charity' (1956) 72 LQR 187, 190.

31 [1972] AC 601 (HL), 623-25, Lord Cross – now acting judicially – delivering the leading judgment.

32 The personal nexus rule had previously been side-stepped on occasion, where it appeared to make no sense. In *Re White's Will Trusts* [1951] 1 All ER 528 (Ch), providing a rest home for working nurses was held charitable as an advancement of the efficiency of their hospital. A potential 'personal nexus' problem, arising from the nurses all having the same employer, was avoided by interpreting the trust as being, not to benefit the nurses, but to benefit the hospital instead.

from the general rule can be made where they are altruistic.[33] (Watkin provides a counter-argument: the terms of an instrument should decide charitable status, not the motives of the settlor.[34] In other words, the altruism test would produce a strange result – exactly the same instrument would be charitable, or not, depending on who declared it. But the law does have to confront such issues: for example, exactly the same instrument might be a valid trust or a sham depending on the intentions behind it – and at least there would be a trigger to investigation here, mention of a personal nexus, whereas a trust of practically any sort could turn out to be a sham.) On this altruism test, it is hard to envisage that relieving need due to financial hardship, even for those with a personal nexus – for example employees – should violate the personal nexus rule any more than relief of poverty does.

Indeed, there may be direct authority that need cases, such as need from financial hardship, *are* an exception to the personal nexus rule. The very foundation of the 'poor employees' line of cases – showing that relieving poverty amongst employees is outside the personal nexus rule – *Re Gosling*[35] seems not to have been a poverty case at all, but a needs case. A trust 'for the purpose of pensioning off the old and worn-out clerks of the firm of Goslings and Sharpe' was held to be for a sufficient section of the public and charitable, despite those able to benefit all sharing a common employer. Byrne J is reported to have said that the trust came within relief of the aged and the impotent;[36] what we would call today the relief of those in need because of age or ill-health.[37] He added[38] that he thought 'poor clerks of the firm and those unable to properly provide for themselves and their families are intended to be benefited'. This appears to envisage the relief of poverty, but also an extension beyond that, to what we would call today the relief of those in need because of financial hardship arising from their age and ill-health. Overall, it looks like the judge was not treating the trust as restricted to the relief of poverty – and indeed this seems correct, given the terms of the trust. One of our finest jurists, Atiyah, interpreted *Re Gosling* as not being a poverty case.[39] And in *Dingle v Turner*,[40] Lord Cross, delivering the leading judgment, said of Byrne J's decision that a personal nexus was no obstacle to the trust in *Re Gosling* being charitable, 'It is to be observed that he does not confine what he says there to trusts for the relief of poverty as opposed to other forms of charitable trust'.

Accordingly, it seems that the Charity Commission is probably wrong to suggest that a personal nexus among those to benefit necessarily means a relief of need (rather than poverty) does not satisfy the public benefit test.[41]

33 Michael Chesterman, *Charities, Trusts and Social Welfare* (Weidenfeld and Nicolson, 1979), pp 317–19. (See also A L Goodhart, '*Oppenheim v Tobacco Securities*' (1951) 67 LQR 164 (note).)

34 Thomas Glyn Watkin, 'Charity: the Purport of "Purpose"' [1978] Conv 277, 281–83.

35 (1900) 48 WR 300 (Ch).

36 At the time of *Re Gosling*, courts tended to determine charitable status by reference to the charitable purposes listed in the Preamble to the Charitable Uses Act 1601 (or 'Statute of Elizabeth' – later repealed by Charities Act 1960, s 38(1)). The list began (put into modern English), 'The relief of aged, impotent and poor people …'. The words 'aged', 'impotent', and 'poor' were treated disjunctively: each was seen as an independent charitable purpose.

37 (1900) 48 WR 300 (Ch), 301.

38 *Ibid*.

39 PS Atiyah, 'Public Benefit in Charities' (1958) 21 MLR 138, 144–45.

40 [1972] AC 601 (HL), 618.

41 Charity Commission, *Public Benefit: analysis of the law relating to public benefit* (September 2013), para 71, citing *Re Hobourn Aero Components Ltd's Air Raid Distress Fund* [1946] Ch 194 (CA). That case was, in fact, decided applying the distinct rule that mutual benefit or self-help funds do not (usually) satisfy the public benefit test: the observations about personal nexus were obiter, and made at a time when the personal nexus rule was less understood.

Mutual benefit or self-help funds

The limited situation of mutual benefit or self-help funds may possibly involve a minor distinction between poverty and need from financial hardship when it comes to public benefit. *Re Hobourn Aero Components Ltd's Air Raid Distress Fund*[42] appears to decide that such funds can only be of public benefit, and so charitable, if they relieve poverty. The decision on its facts would certainly appear to exclude from charitable status relieving other forms of need.[43] But, overall, the case law is in fact rather unclear about whether the *Hobourn* case's approach is correct.[44]

A modernisation argument for the same public benefit test to be applied to both 'poverty' and 'financial hardship'

Beyond a strict legal argument based on the authorities, a wider modernising argument can also be made aimed at persuading the Charity Commission – and more importantly the courts, who have the final say – to treat the newly-listed financial hardship category as generously as the traditional poverty category has been treated when applying the public benefit test. Historically, poverty has received special treatment, reflecting the practical wisdom of the judges. In particular, businesses, and those associated with them, have been allowed and in turn encouraged to 'look after their own', with appropriately targeted support for individuals among their workers, through charity, with the fiscal benefits this brings. If encouragement of such virtuous humanity and commendable social responsibility is to be preserved in charity law today, arguably we ought to update. In contemporary times, it is increasingly unattractive for anyone in business to establish a fund for the relief of 'poverty' amongst employees – thereby opening the business up to the accusation that its pay and conditions have left workers in 'poverty'. 'Poverty pay' is a toxic slogan – no matter what explanations are given that a fund is for workers in adverse circumstances due to extraneous factors.[45] This accusation can often be smoothed over by including in the class to benefit ex-employees, relatives, dependants, etc. However, in the age of the start-up, many recent businesses have no immediate prospect of a significant body of long-serving ex-employees they can point to, in order to credibly claim that those who have left and fallen on hard times since are the real concern. While euphemisms can be used in place of 'poverty', this runs the risk that they may be interpreted as going outside the legal meaning of 'poverty'. Furthermore, applicants to such funds may be more likely to apply, and more comfortable applying, if the potentially stigmatising label of 'poverty' is not associated with the funds.

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42 [1946] Ch 194 (CA).

43 From 1940 to 1944 employees of a company made regular contributions to a war emergency fund. Its main purpose was to help contributors who were victims of air raids; no means test was imposed on help. This was held not charitable.

44 It is possible that even relieving poverty is not charitable – or at least not unless there is a discretion involved: see the review of the cases in William Henderson, Jonathan Fowles and Julian Smith (Eds), *Tudor on Charities,* 10th Edn (Sweet & Maxwell, 2015), paras 1.058–1.063. And, on the other hand, there is equally authority that charitable status is not restricted to relieving poverty: *Neville Estates Ltd v Madden* [1962] Ch 832 (Ch), esp 853–54 (and see also *London Hospital Medical College v IRC* [1976] 1 WLR 613 (Ch)).

45 And no matter how prevalent in-work poverty is: the Joseph Rowntree Foundation indicates 13 per cent of workers are in poverty, rising from 10 per cent 20 years ago, with more people in poverty now living in a working household than a non-working household ('UK Poverty 2019/20', JRF Annual Report).

The words 'financial hardship' would probably be much more acceptable to all: but given the argument made here, that financial hardship is wider than poverty, these words only confer charitable status in this context if the same special public benefit rules apply to both. If our agenda is to update charity law to match contemporary social circumstances, it is suggested there is a strong case for adopting the same public benefit approach now to financial hardship as has been taken in the past to poverty.

A consequence of the suggested approach would be treating financial hardship in the same way as poverty when it comes to the relief of relatives, as well as employees, but this does not seem materially more anomalous or objectionable than the current position regarding relatives.[46]

Avoiding unnecessary distinctions in the law

An advantage of having the same public benefit test for both poverty and financial hardship would be eliminating any need for the courts to scrutinise the borderline between the two when determining charitable status – doubtless a troublesome borderline to draw. If both are charitable on the basis of the same public benefit test, only the wider outer limits of financial hardship need to be delimited. Unfortunately, the exact borderline of poverty would still need to be drawn for some legal purposes (for example, deciding whether a charity whose objects were limited specifically to the relief of poverty was straying outside it, or how the charity's property should be used when applied under a cy-près scheme[47]) but we would at least be minimising the need.

Consistency with the scheme of the legislation

Is the argument here for similarity of treatment when it comes to the public benefit requirement consistent with Charities Act placing poverty and financial hardship in distinct paragraphs of the statutory code – especially when it might potentially lead to financial hardship being treated differently in public benefit terms from the other items listed together with it in the same paragraph (need from youth, age, ill-health, disability, or other disadvantage)? There is an obvious connection between poverty and financial hardship suggesting similarity of treatment on public benefit is appropriate, despite their appearing in different paragraphs: they are both points on the same continuum of financial difficulties – they are simply degrees of the same thing. The public benefit test is well known for varying from purpose to purpose,[48] but relieving either poverty or financial hardship can be seen as basically serving the same purpose, despite being placed in different statutory paragraphs; while there would be nothing exceptional about one item in a paragraph being treated differently from another item within the same paragraph.[49] The paragraphs are simply a list of purposes whose structure appears to indicate nothing about the separate public benefit requirement, which is pervasively flexible throughout.

46 Likewise for others: in *Re Young* [1955] 1 WLR 1269 (Ch) the relief of poverty among members of a testator's club was held charitable.

47 CA 2011, s 67(3).

48 Above, n 22.

49 Above, n 8, for a suggestion by the judges that 'prevention' may be treated differently from 'relief' of poverty within the same paragraph.

Reasons for the continuing relevance of relief of poverty

A possible objection to the overall argument made here is inconsistency: we have suggested that financial hardship must be different from poverty because everything in a statute should be seen as independently significant – but we are concluding from this that poverty is therefore redundant in the statute because subsumed within the wider category. It is tempting to suggest that relief of poverty was included as a faithful codification of the earlier law; the fact that financial hardship might subsume it was simply not considered. However, that would be to seriously underestimate the very considerable perspicacity of the Office of the Parliamentary Counsel. Assuming the issue was foreseen, from a drafting perspective the acknowledged doubts about whether the courts would find that relief of poverty *is* completely subsumed within relief of financial hardship – particularly with regard to the applicable public benefit test – would have made separate listing of these two essential. And there are good legal reasons for listing the relief of poverty, even if it is covered by the wider relief of financial hardship. Its inclusion affirms beyond any question the charitable status of existing charities for the relief of poverty, and it provides an explicit framework, for the future, for those charities that wish to do so, to limit their objects to the relief of poverty specifically – those charities that wish to ensure their relief is directed solely to the most deprived and which are then able to utilise this focus in fundraising, recruitment of volunteers, etc. Including both poverty and financial hardship in the statute as separate categories is therefore meaningful despite the fact that one includes the other. The relationship between the two is perhaps best expressed by saying that relief of poverty is now a subcategory of the wider relief of financial hardship; a subcategory that charities may wish to adopt from choice.

Conclusion

Conservatism is, of course, a powerful force in the law. The traditional focus on the relief of poverty in books, the teaching of law, and in legal practice, can be expected to continue. But, technically, the charitable purpose of relieving poverty now seems to be reduced to a subcategory – although the charitable purpose of *preventing* poverty retains some modest independent territory. The position is not entirely clear, but the suggestion here has been that, on the better view of the law, the *more extensive* charitable purpose of relieving those in need because of financial hardship now encompasses all that relieving poverty covers and more. Relying on this wider category to claim charitable status eliminates the need to engage with the potentially troublesome issue of what amounts to 'poverty'. However, there will clearly be charities that, from choice, wish to limit their objects specifically to the relief of poverty.

Is a move in charity law from 'poverty' to 'hardship' desirable? If such a change were (contrary to the argument made here) merely one of legal vocabulary – exchanging two different names for essentially the same thing – it might nevertheless still be desirable. Questions have been asked pertaining to the legal aptness of the word 'poverty' in the context of the modern welfare state.[50] Ideas of 'relative poverty' can be resorted to; but 'financial hardship' might perhaps be more universally assented to than 'poverty'. But if a move from 'poverty' to 'hardship' is one of real substance – a significant expansion to the scope of charity – whether that is desirable is

50 Michael Chesterman, *Charities, Trusts and Social Welfare* (Weidenfeld and Nicolson, 1979), pp 139–44. Although, of course, much charitable work is carried on abroad where that context does not exist in the same way.

largely a matter of political sympathies and is liable to be contentious. Some would undoubtedly not welcome yet another extension, beyond helping only the truly deprived, for the public fiscal subsidy of charitable status enjoyed by privately directed philanthropy. However, others will undoubtedly argue that assisting those in temporary need through a difficult period is more in the true spirit of charity than continually promoting welfare dependency. Perhaps we all need a little more charity …

Book Review

Moffat's Trust Law: Text and Materials (7th Edition)
Jonathan Garton, Rebecca Probert and Gerry Bean
Cambridge University Press, 2020
ISBN 978 110879 644 6
1080 pages
Price: £42.99

Receipt of the seventh edition of this venerable text has been most welcome, its predecessor being first published back in 2015. While remaining consistent in its updates, the previous editions being published in five to six-year intervals, developments in the law of trusts since the sixth edition have been numerous. While the authors acknowledge that these changes are not revolutionary, they are, nevertheless, evolutionary and of undoubted importance. Judgments of the Supreme Court have been of particular note and authorities such as *Patel v Mirza* [2016] UKSC 42 on the law of restitution and the effect of illegality, the salaciously-themed *PJS v News Group Newspapers Ltd* [2016] UKSC 26, *Marr v Collie* [2017] UKSC 53 on the further potential extension of *Stack v Dowden* [2007] UKHL 17, *Morris-Garner v One-Step (Support) Ltd* [2018] UKSC 20 on methods of quantification for losses suffered as a result of an injunction being refused, and *Burnden Holdings v Fielding* [2018] UKSC 14 with its focus on interpretation and application of s 21(1) of the Limitation Act 1980 are integrated well within their respective chapters. In addition to the domestic precedents laid down by the Supreme Court, it is pleasing, although unsurprising, that further developments by the Privy Council are also addressed. Highlights include *Gany Holdings (PTC) SA v Khan* [2018] UKPC 21, an interesting look at the continuing impact of legal presumptions and gratuitous transfers of property. In this reviewer's opinion, however, the jewel of Privy Council decisions handed down since the sixth edition of the text must be *Federal Republic of Brazil v Durant* [2015] UKPC 35, with all of its implications and tantalising consequences for the doctrine of backwards tracing. With so much mutability, the new edition also incorporates an admirable survey of leading academic literature on these and existing issues, together with the possible impact of the United Kingdom's impending departure from membership of the European Union on the law of trusts.

As an academic with extensive classroom teaching experience at both undergraduate and postgraduate level, the tone of this new edition is also rather refreshing. While the latter students will no doubt benefit greatly from this text's commentary and interpretation of trusts law, it is clear that the main audience for this work are those studying at the former. As such, the tack it takes is of a much more purposive character and this decision makes the text much more approachable than previous iterations. This edition does not seek to merely examine the law, both basic and advanced, and present it as fact. Instead, it looks at the dynamic and shifting context of trusts, whether social, political, economic, legal or a combination of several; this includes both domestically and, in the final chapter, offshore jurisdictions. Using this context as a background, the text then explains how and why trusts arise and the purposes that they serve. By relating the material, almost universally alien to new students of this challenging area of law, in this manner it is much more accessible and assists students in their understanding of *why* trusts exist and not merely that they do. From a pragmatic perspective, it also feels like a sensible decision to remove the previous edition's chapter on

taxation and its relationship to the express trust. While undoubtedly an important and practical area related to trusts law, there are copious other resources available on such *lex specialis* if investigation into the intricacies of taxation is desired. There is ample material on trusts law to cover numerous volumes of an academic text and focusing on this, rather than a peripheral issue such as taxation, is eminently prudent.

With the removal of the chapter on taxation, the opening section feels much more intuitive and its flow is improved. The trust is introduced in the first chapter, which is a somewhat thankless task, made even more difficult given that equity as a system of law is not examined in any great detail (and nor should it, given that this is a text exclusively on trusts law). The following three chapters then examine the creation of the express trust, although there is also reference to resulting trusts and the specific well-taught saga centring around the dispositions of one Guy Anthony Vandervell. This neatly ties up the opening section of the book and provides the reader with a good understanding of what trusts are, why one would wish to create one, and how they come into being.

Following on from this basic introduction, the chapter on trusts and public policy is a very useful holdover from previous editions of the text and one that is too often neglected in more rudimentary works. The importance of public policy and the discretion sometimes inherent in the adjudication of trusts matters by the courts is laid bare, illustrated by such important issues as discrimination, illegality, insolvency and the concealment of assets. A brisk but informative examination of beneficiary rights is also entered into, an essential element that is far too often misunderstood, including material on an issue that is often the focus of student queries: the variation of trusts.

What follows is, for those students planning for a career as a legal professional, the most relevant part of this text. The duties and obligations of trusteeship, together with the management of trusts, their breach, and liability are examined. Given the focus of the text, it is another sensible decision not to focus overtly on the complex and often confusing subject of fiduciary duties at this point and so the discussion is more unsullied than in other contemporary works. While fiduciary duties are discussed later in the text, the lack of confluence at this stage is to the student's advantage. As with the other sections of the book, a holistic approach allows students to better contextualise the complex issues raised and see them in a more practical manner. In the author's own experience, it is an exercise in futility to present the law in anything other than this way if one is to engage with the target audience. The relevance of statute is reiterated throughout, and the impact of changing case law is also explained well.

If there is one particular area of disappointment in the text, it is the relegation of implied trusts and their use in the context of a shared family home to a single chapter. To those well-versed in the teaching of this area, it is recognised as one of the most relevant to the general public and an issue that many readers will have actual or forthcoming experience of. The law itself is also extremely challenging and a deeper look at implied trusts generally and their application in this context specifically would have been extremely useful. Unlike taxation, this issue is one integral to the study of trusts and further development in future editions would be a welcome edition. Inclusion of how this matter is handled by other jurisdictions at the end of the chapter is a nice touch but it is this author's opinion that it does not balance out the lack of content elsewhere.

The law in action focus of this section continues with an examination of the trust's role in the world of commerce. As with the previous chapter, it would have been preferable to dedicate more of this impressive exercise in scholarship to the law on tracing as this also feels somewhat underdeveloped.

Strangers' liability, however, is examined thoroughly and there is helpful focus on the nature of liability and the often-difficult semantic differences between claims. While it is understandable that equitable remedies were included in this section on trusts in commerce, they do still feel somewhat superfluous and the section would have felt more satisfying had tracing been given the advantage of extra depth, which excision of this material would have allowed. Nevertheless, the authors' commitment to an examination of equitable remedies will be welcomed by many of those studying this area of law at the undergraduate level, given its general inclusion in standard curricula.

The final sections of the book include several chapters on charities, which is unsurprising given that this is a particular focus of Professor Garton's. While this may superficially seem somewhat excessive, the law on charities as they relate to trusts did need a substantial update. The impact of statutes entering force since the previous edition, such as the Data Protection Act 2018 and the Charities (Protection and Social Investment) Act 2016, needed to be assessed and explained. In addition, the work undertaken by the Law Commission in relation to charities and charitable purpose trusts is helpfully summarised and applied to existing and future developments. While the law related to charities and trusts for charitable purposes may not appeal to every reader's interests, it is still an impressive summary of this often-daunting area of trusts law and addresses the vast majority of questions that any of them may have.

It is a nice touch, in this reviewer's opinion, to dedicate the final pages of this tome to trust law in an international context. This addition assists in relating this often-cited 'English' construction of equity to both domestic and international students and continues the book's purposive theme. By examining jurisdictions beyond our own shores, the rationale behind them and the contexts in which they may arise is conveyed. It is also helpful to see how other jurisdictions handle aspects of trust law and have developed their own rules, which may or may not one day become incorporated into our domestic law. The importance of offshore jurisdictions and the implications for domestic wealth and taxation has been reported extensively by the media in recent times and it is helpful that questions related to these vehicles may be answered in the ultimate section.

Overall, while this author has been critical of some of the decisions made in the composition of this latest edition of *Moffatt's*, it does not alter the impressive work of scholarship that it undoubtedly represents. As such, the copy in my possession will, undoubtedly, become well-worn and dog-eared in the years until the next edition is published.

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Index to Volume 34

This index details all items in Volume 34 of *Trust Law International*, including articles by title and author, case reports, case notes, case summaries, book reviews and any other miscellaneous items.

Article (by author)		**Page**
Campbell, J C	The Undesirability of the Rule in Hardoon v Belilios	131
Glister, Jamie	Trust Property and Knowing Receipt	3
Lam, Jeremy	Trustee's Duties in the Teeth of an Anti-Bartlett Clause and Equitable Compensation	74
Low, Kelvin F K	Trusts of Cryptoassets	191
Morris, Alec J	Private Purpose Trusts and the Re Denley Trust 50 Years On	165
Pawlowski, Prof Mark and Brown, Dr James	Sale of Land and Personal Property: The Purchaser as Beneficial Owner?	63
Pollard, David	Some Oddities of the Law on Age: So You Thought You Reached Age 21 on Your 21st Birthday?	21
Pollard, David	The 'Prudence' Test for Trustees in Pension Scheme Investment: Just a Shorthand for 'Take Care'	215
Pollard, David	Applying Wednesbury Reasonableness to Legal Review of Trustee Discretions after Braganza and Pitt v Holt	86
Tamaruya, Masayuki	Japanese Law and the Global Diffusion of Trust and Fiduciary Law	35
Wilde, David and Moore, Imogen	Charity Law's Transition from 'Poverty' to 'Financial Hardship'	249

Articles (by article)

Applying Wednesbury Reasonableness to Legal Review of Trustee Discretions after Braganza and Pitt v Holt

David Pollard 86

Charity Law's Transition from 'Poverty' to 'Financial Hardship'

David Wilde and Imogen Moore 249

Japanese Law and the Global Diffusion of Trust and Fiduciary Law

Masayuki Tamaruya 35

Private Purpose Trusts and the Re Denley Trust 50 Years On

Alec J Morris 165

Sale of Land and Personal Property: The Purchaser as Beneficial Owner?

Prof Mark Pawlowski and Dr James Brown 63

Some Oddities of the Law on Age: So You Thought You Reached Age 21 on Your 21st Birthday?

David Pollard 21

The 'Prudence' Test for Trustees in Pension Scheme Investment: Just a Shorthand for 'Take Care'

David Pollard 215

The Undesirability of the Rule in Hardoon v Belilios

JC Campbell 131

Trust Property and Knowing Receipt

Jamie Glister 3

Trustee's Duties in the Teeth of an Anti-Bartlett Clause and Equitable Compensation

Jeremy Lam 74

Trusts of Cryptoassets

Kelvin F K Low 191

Case Note

The Potentially Transformative Nature of a Trustee or Fiduciary's Custodial Duty

Myron Phua 117

Book Reviews

Jonathan Garton, Rebecca Probert and Gerry Bean, Moffat's Trust Law: Text and Materials (7th Edition)

Reviewed by Matthew E Carn 260

David Pollard, Pensions, Contracts and Trusts: Legal Issues in Decision Making

Reviewed by Ian Greenstreet 185

Professor Tang Hang Wu, Principles of the Law of Restitution in Singapore

Reviewed by Tay Yong Seng 125