

Having your cake and eating it – How to retain settlor control in BVI and Cayman trust structures

The BVI and the Cayman Islands have both been long viewed as attractive and sophisticated jurisdictions for offshore trust and corporate structuring by Asian clients and their professional advisors. The generic flexibility of trusts has come to be appreciated by high net worth individuals and families in the region who, for a variety of reasons, have sought to structure offshore.

On the other hand, however, some features of a classic trust are now considered by some as inherent restrictions and in recent years there has been a growing demand for more innovative and user-friendly trust solutions. The leading offshore jurisdictions, such as BVI and Cayman, have sought to meet this demand via specific legislative amendments to classic trust principles.

Both BVI and Cayman are dependant territories of the United Kingdom. The general principles of the trust law in both jurisdictions are derived from the principles of English common law and equity, which are supplemented by domestic statutory legislation. Such statutes are again in the main based on English statutory law, but there are some key additional provisions which have been enacted in BVI and Cayman so as to make them appealing jurisdictions for establishing trusts.

Demand for Control

The reasons for such additional legislative provisions partly stem from a demand for the person establishing the trust, known as the settlor, to be able to retain an element of control once the trust has been constituted. A trust is not itself a separate legal entity, but rather the trustee is the legal owner of the trust assets which he holds not for himself, but for the benefit of beneficiaries of for the furtherance of a purpose.

Leap of Faith?

It is the fact that the establishment of a trust requires a settlor to transfer legal ownership of the assets to a third party trustee which is very much a leap of faith for individuals, especially for those who are largely unfamiliar with the basic concept of a trust. Furthermore, one of the core duties of the trustee will be to act in the best interests of the beneficiaries and not in the best interests of the settlor. Consequently, the trustee is required to act

prudently in relation to the trust assets and this creates a potential clash of investment approach between that of a conservative corporate trustee and that of a risk-taking settlor who may have built up his wealth over time through his own entrepreneurial flair (the “Prudent Investor Problem”).

Prudent Investor Problem

This Prudent Investor Problem was keenly felt in both BVI and Cayman because trusts in these jurisdictions are commonly used to hold shares in a BVI or Cayman company, which itself is a holding vehicle for a family business. BVI and Cayman trusts are frequently used in such a scenario for succession planning reasons and thus it can be of great discomfort to a settlor that the trustee may have a duty to alter the make-up of the trust assets (i.e. by seeking to reinvest away from the family business) because the trust was specifically established as a holding vehicle for that family business.

Retention of Control Options

The retention of control options for settlors in BVI and Cayman trust structures can be broken down into three categories:

a) Reserved Power Trusts

The BVI was the first offshore jurisdiction to introduce legislation for Reserved Power trusts¹, which enables a settlor to reserve powers to himself or another, typically a protector, or to require that the trustee obtain the settlor’s consent before exercising a trust power. For example, a settlor may reserve himself (or to a protector) the power to add or exclude beneficiaries from the trust or to require that the trustee obtain his consent (or that of the protector) before making a distribution to a beneficiary. Such reserved powers are also permitted in Cayman, where the legislation has gone further so as to create a statutory presumption that the settlor intended to create a trust with immediate effect and this presumption will not be rebutted by such reservation of powers to the settlor.²

b) VISTA Trusts & STAR Trusts

The Virgin Islands Special Trusts Act 2003 (“VISTA”) was specifically enacted in the BVI to solve the Prudent Investor Problem in relation to BVI companies held in trust. The key conditions of a VISTA trust are that the trust must only hold shares in a BVI company (or companies), the sole trustee must be a BVI licenced trust corporation and the trustee cannot be a director of the underlying BVI company. If these conditions are satisfied and it is expressly provided in the trust instrument that VISTA will apply to the trust, the result is that the trustee is prohibited in interfering in the management of the BVI

¹ Section 86 Trustee Act 1961 (as amended by the Trustee (Amendment) Act 1993 and the Trustee (Amendment) Act 2003.

² Sections 13 and 14 Trusts Law (2011 Revision)

company (except in extreme circumstances known as intervention calls). There is a restriction on the trustee's ability to sell the BVI company shares, which must be retained indefinitely, thereby solving the Prudent Investor Problem. Except when acting or being required to act on an intervention call, a trustee of a VISTA trust "shall have no fiduciary responsibility or duty of care"³ in respect of the BVI company shares or "the conduct of the affairs of" the BVI company.

A settlor can thereby transfer shares in a BVI company into a VISTA trust safe in the knowledge that the trustee will not have a duty to sell those shares or intervene in the running of the company.

STAR trusts, on the other hand, were enacted via the Special Trusts – Alternative Regime legislation in Cayman.⁴ They are arguably the most flexible and advanced trust product available for three reasons:

- i) They may exist indefinitely;
- ii) The trust assets can be held for **both** specific purposes and human beneficiaries;
- iii) The concept of beneficial entitlement and the enforcement of a trust are split because all rights of enforcement are vested in the office of the enforcer such that the beneficiaries have no automatic right to information about the trust, nor to bring proceedings against the trustee.

Settlors of STAR trusts are therefore able to stipulate that holding the shares in the underlying BVI/Cayman company or family business or following a business plan to develop that business is the purpose of the trust. This means that the trustee cannot be criticised for continuing to own the shares and not reinvesting into more conservative investments.

c) Private Trust Companies

Since 2007 in the BVI and 2008 in Cayman, it has been permitted to establish unlicensed Private Trust Companies ("PTCs"). Conditions are attached to the activities of PTCs, such as a prohibition on soliciting business or contributions from the public and restrictions on the type of trust business which they can carry out.

It is thus possible for high net worth individuals or families to establish their own corporate trustee in the BVI or Cayman to be trustee of one or more family trusts. The PTC will potentially be more responsive and efficient than an external trust corporation, but the office of trustee remains a fiduciary

³ Section 15(1) Virgin Islands Special Trusts Act 2003

⁴ Sections 95 to 109 inclusive of the Trusts Law (2011 Revision)

position and trustee duties must still be discharged to the requisite standard of care.

Careful consideration must be given to the make up of the board of directors of the PTC, but typically the directors might be a combination of family members, trusted advisors (e.g. the family lawyer) and industry experts if the underlying trust assets include an operating business.

One also needs to consider how the ownership of the PTC is to be structured. PTCs can be limited by guarantee, but it is more common for them to be limited by shares. Practitioners will advise against shares in PTCs being owned by individuals outright so as to avoid the usual succession problems which come with outright ownership, such as the requirement of obtaining a Grant of Probate in Cayman or BVI after the death of the owner of the PTC shares. It is therefore common for the shares in PTCs to be owned by non-charitable purpose trusts which take advantage of the VISTA (if the PTC is a BVI PTC) or STAR regimes.

Conclusion

The introduction of legislation in the BVI and Cayman concerning Reserved Power trusts, [VISTA and STAR trusts and PTCs has enabled settlors of trusts in these jurisdictions to establish a structure where they are able to retain a satisfactory level of control over the administration of the trust and more importantly, the management of the underlying trust assets. This inherent flexibility, which is appreciated especially by those unfamiliar with trusts or where the trust is used as a succession vehicle for an operating family business, as is commonly the case in Asia, has caused the BVI and Cayman to remain attractive and popular jurisdictions for the establishment of trusts for high net worth families all over the globe.

Further Information

The foregoing is for general information purposes only and not intended to be relied upon for legal advice in any specific or individual situation.

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April 2012