

## 1001 WAYS TO USE OFFSHORE TRUSTS

*Edward Stone – January 2010*

In late 2009, the ripples of the global economic crisis hit the shores of the Middle East, and Dubai in particular. The worst appears to have been overcome for now, with Dubai renaming the world's tallest building the Burj Khalifa in honour of its neighbour and financial saviour, the price of oil rising from its lows of early 2009 and the regions' sovereign wealth funds making significant returns from bailing out banks in the UK and US.

Wealthy families from the Middle East though continue to be sheltered from the voracious appetites of governments elsewhere desperate to squeeze additional tax dollars, euros or pounds out of their citizens and accordingly their goals, when structuring their wealth, tend to be focussed on long term political stability and family protection rather than short term tax planning advantages. Trusts in general are one of the most appropriate long term planning tools available, due to their inherent flexibility but the additional malleability of offshore trusts with their longer or even unlimited perpetuity periods, settlor reserved powers and special trust regimes, as well as the relative political stability of the offshore jurisdictions can often provide the most appropriate solutions for clients.

Whilst offshore trusts have long been used in the Middle East for estate planning purposes, the use of offshore trusts in Islamic finance transactions has grown significantly and non-charitable purpose trusts are now regularly used by financiers in the region for a wide variety of finance and structured finance transactions.

### **Personal trusts**

When drafting trusts for Middle eastern families, incorporating compliance with Islamic principles can be as complicated as taking into account fiscal considerations – given that the different interpretations of what constitute Islamic principles within the different schools and branches of Islam and the often different levels of adherence within each family.

Many Muslim clients are keen to ensure that Islamic principles are adhered to in the investment of their offshore assets; powers to invest trust funds in interest bearing investments, on deposit, or in any investments which generate pre-determined fixed returns may be considered inappropriate. The investment policy of the trust may need to be restricted; an explicit list of non-permitted investments can be specified in the trust instrument and/or the trustee restricted to purchasing equities listed on one of the various established Islamic indices, such as the Dow Jones Islamic Market Indexes or FTSE Global Islamic Index Series.

The settlor may also wish to reserve certain powers to himself during his lifetime under the trust, such as the power to direct investment himself or to appoint and remove the investment adviser, power of veto over certain trustee decisions or to give binding directions to the trustee. He may also want the power to choose and appoint a protector to exercise such powers in succession to himself.

The settlor may be concerned that Islamic forced heirship rules should continue to apply so that male descendants shall take twice as much as females or that any non-Muslim spouse shall be excluded from benefiting. Alternatively, given that a Muslim has freedom to make lifetime gifts of his property, the assets within the trust may be intended wholly for a particular child.

A Middle Eastern settlor, like any settlor without personal experience of trusts, may not be wholly convinced that careful drafting of the trust or the reservation of certain powers will be sufficient to ensure his intentions are respected where the trust is administered in a distant offshore jurisdiction by persons who, although trust professionals, are not fully conversant with Islamic culture. The bespoke nature of the private trust company is therefore often an attractive solution.

Where tax considerations are not relevant, the settlor and other members of his family can retain control of the private trust company through being its shareholders and directors. Participation in trustee decisions ensures that the settlor and his family retain control over, for example, how the underlying trusts are invested, who is appointed as investment adviser and when and how distributions are made. Trust decisions can thus be retained within the family, even if the administration of the company is being carried on by a local professional service company.

### **Trusts and Islamic finance**

The use of trusts in Islamic finance has grown alongside the considerable growth in recent years of Islamic finance through sukuk structures. Under the popular sukuk al ijara, the originator (or borrower) seeking financing “sells” the assets (such as aircraft) to a special purpose vehicle (the “SPV”) which is frequently incorporated in an offshore jurisdiction. The SPV then issues sukuk, or trust certificates, and invests the proceeds in assets. The issuer of the sukuk will then hold the assets on trust for the benefit of the holders of the sukuk, using the income from the assets to make periodic payments to the sukuk holders. The SPV is typically owned by a purpose trust established in same offshore jurisdiction.

Where an SPV is used in an ijara sukuk (or in its variants such as an ijara sale and leaseback or a musharaka structure) the use of an offshore company wholly-owned by an offshore trust provides a means by which bankruptcy remoteness can be achieved, while enabling the transaction to be effected “off balance sheet” or as an “orphan” structure in relation to its originator. Neutrality can also be achieved by appointing an independent locally licensed trust company as trustee of the offshore trust.

Bermuda is a popular jurisdiction for such Islamic finance structures as it was the first jurisdiction, in 1989, to introduce legislation expressly permitting the creation of non-charitable purpose trusts (“purpose trusts”). That original legislation has now been the subject of amendment so that there is no longer any requirement for a Bermuda purpose trust to have an enforcer (although one is usually appointed) nor a local or licensed trustee. Most other offshore jurisdictions have since followed suit so that purpose trusts can now be created in many jurisdictions provided generally that their particular purposes are sufficiently certain, capable of fulfillment, lawful and not immoral or contrary to public policy.

Purpose trusts, because there is no beneficial owner of the trust assets, are particularly attractive for effecting off-balance-sheet transactions and financing commercial transactions, both conventional and Shari’a compliant. In a typical ijara financing transaction, the purposes are normally to (a) subscribe for the shares of the SPV, (b) hold those shares, (c) support the SPV in pursuing the particular transaction in question, (d) enter into the relevant transaction agreements and (e) unwind the structure at the completion of the transaction.

In many typical Islamic finance structures, the SPV will declare itself as trustee of the assets it owns in favour of the investors. When this happens care must be taken to ensure that the SPV does not require licensing for carrying on trust business as this will inevitably lead to increased regulation, administration and costs.

One way to avoid any licensing requirements is to ensure that the SPV can benefit from an exemption from the trustee licensing rules, usually by qualifying as a private trust company on the basis that it acts as trustee of a limited number of connected trusts or some other specific exemption.

Bermuda private trust company legislation is particularly attractive to Islamic finance practitioners because of the simplicity of its provisions with regards to the trustee licensing exemption. Provided that the SPV's capacity as trustee is limited to the trusteeship of a trust or group of trusts specified in its memorandum of association, it will be exempt from licensing. There is no requirement to demonstrate that the SPV is issuing any particular type of financial instrument, that it is unremunerated or that any parties are connected to the others.

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**Notes to Editors**

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