

PRIVATE TRUST COMPANIES – OASES FOR WEALTH PLANNING

Edward Stone – September 2009

Private trust company structures are often appropriate for Middle Eastern families looking for long-term structures to hold their wealth, due to their inherent flexibility and, in particular, the ability to build in adherence to Shari'a law principles and for the client/settlor to retain control at both the trust and trustee level. These structures are also popular amongst Middle Eastern families as they can be used to formalise and ensure that family governance arrangements are respected in practice, and so play a significant role in helping to preserve the family wealth over the long-term.

This article sets out some of the key considerations that are relevant to the creation of successful private trust company structures, particularly in the case of Middle Eastern families. The other well rehearsed arguments in favour of private trust companies are as relevant to Middle Eastern clients as to other clients seeking to make provision as to how and when their wealth should pass on to the next generation(s), to prevent the break-up of a family owned business and to preserve confidentiality.

Although not particular to Middle Eastern families, private trust companies are often appropriate where the family wealth is tied up in an intricate web of family owned businesses, or comprises a controlling interest in a listed company or other complex commercial investments and also includes assets such as aircraft or yachts, which are considered higher risk by institutional trustees.

Shari'a Compliant Investment Policy

Where the settlor wishes to ensure that Shari'a principles are adhered to in terms of how the trust fund is invested, it is important that, irrespective of the identity of the trustee, the investment policy of the trust is carefully drafted, so that the trustees are required to only invest in businesses screened by appropriate experts as being regarded as halal or lawful under Shari'a law, and in compliance with any necessary financial ratios. An explicit list of non-permitted investments should be specified in the trust instrument, which makes it clear that the trustees do not have power to invest the trust assets, for example, in interest bearing investments, on deposit or in any investments which generate pre-determined fixed returns. Alternatively, the trust instrument may provide that as to equities the trust may only purchase those 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 for it to be enshrined in the trust instrument that any investment adviser appointed by the trustees be familiar with Shari'a principles.

Reservation of Powers

The settlor may also wish to reserve certain powers to himself during his lifetime under the trust, such as the power to direct investment, power to revoke the trust or a power of appointment over the trust assets. Alternatively, powers can be given to a protector, whether a trusted close adviser to the settlor, or possibly an alim (Islamic holy man).

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A trust drafted in broad discretionary terms may provide the most flexibility to be able to take into account changes to the settlor's family's circumstances, but the settlor may prefer for his children or descendants to take fixed interests in accordance with Islamic forced heirship rules, that male descendants shall take twice as much as females or that any non-muslim spouse shall be excluded from benefiting.

The Private Trust Company Solution

It is, however, not always easy to convince a Middle Eastern settlor that careful drafting of the trust or reservation of powers is sufficient, where the trust is administered in a distant offshore jurisdiction by persons who, although trust professionals, are not fully conversant with Islamic culture. In addition, there are different interpretations of what constitute Islamic principles within the different schools and branches of Islam, and there are often different levels of adherence within each family. The bespoke nature of the private trust company is therefore often an attractive solution.

Choice of directors

In a private trust company it is the directors who make the trustee decisions. The question of who should be directors and officers of the company is critical and needs careful consideration as does where the directors are physically located, as there may be potential fiscal, mind and management implications, and also disclosure requirements. The question of who should have power to appoint and remove directors also needs to be addressed so as to ensure continuity and provide for succession planning.

Where tax considerations are not relevant, the settlor and other members of his family can be directors of the private trust company. 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 to the exclusion of unknown third parties over whom the settlor has no control.

In most leading offshore jurisdictions hosting private trust companies, there is no requirement to have local directors, although local licensed service providers may be required to provide registered office, registered agent or secretarial services and to carry out anti-money laundering checks. It is interesting to note that Bermuda has recently changed its rules for all exempted companies, so that now it is only necessary to have either one local director or a local secretary or resident representative with these last two being individuals or companies (corporate directors are not permitted in Bermuda).

In practice, the directors of most private trust companies represent a family council comprised of a combination of senior family members, trusted longstanding advisers with one or more independent professional co-directors. Having an independent professional director with trust experience can be useful to act as a facilitator and ensure that directors' meetings are held with due respect to corporate requirements, to guide the other directors as to the exercise of their fiduciary powers under the trust and help guard against any arguments that the whole structure is a sham.

The constitution of the private trust company can be drafted so as to provide for several classes of directors and thus allow for, say, each branch of the settlor's family to have the right to nominate one or more directors to represent it. The voting rights of directors can also be configured so that the family representatives on the board shall have more votes than the non-family members, so that one branch shall have more say than another, or that one director appointed as chairman shall have more votes. This can be important where only one branch of the settlor's family is involved in the family business with the others being financially supported by the settlor; giving each branch equal voting rights could lead to disputes within the family and the family wealth becoming fractured.

Ownership

The shares of a private trust company are often held in a purpose trust as this ensures that there is no beneficial owner of the shares. Other vehicles which are beyond the scope of this article include forming the private trust company as a company limited by guarantee and holding the shares in a foundation or discretionary trust. In most jurisdictions the trustee of a non-charitable purpose trust must be a local licensed trust company (Bermuda is an exception) and typically is the local trust company providing the registered office and corporate administration for the private trust company as well as trust administration services to the underlying trusts. Although the settlor can be appointed as the protector or enforcer of the purpose trust, this may not by itself give the desired level of settlor control, as the power to appoint and remove directors will be held by the trustee in its capacity as shareholder. Although in the British Virgin Islands, it is possible through the “office of director rules” applicable to VISTA trusts, to determine how the trustee/shareholder may exercise its powers in relation to the appointment and removal of directors, in other jurisdictions alternative solutions will need to be found if the settlor wishes to retain control over the appointment of directors.

One solution that has been used is the creation of two classes of shares with only one class enjoying the right to appoint directors. The company’s constitution could thus, for example, create a nominal number of class A shares which carry with them only the right to appoint and remove directors, and a larger number of class B shares which enjoy all the other basic shareholder rights as well as any economic rights to a dividend or return of capital upon winding up of the private trust company. It might be appropriate for the settlor (or other family member) to hold the class A shares, and the class B shares can be held in a purpose trust.

Where there are no concerns over control of the private trust company, it is possible for the shares to be owned directly by the settlor and/or family members. Where the settlor is the sole shareholder of the private trust company and one of only a couple of directors as well as a beneficiary of the trusts, he will be able to exercise practically unfettered control over the structure, but this will carry the risk of difficulties arising upon the death of the settlor or if he loses capacity.

Where ownership of the private trust company is divided up between different family members, there is a risk of internal family disputes affecting the proper administration of the structure and ability to make decisions. Although provisions can be added to the company’s constitution to restrict the transfer of shares, these alone may not be sufficient if the company’s constitution can be amended by the shareholders. Succession issues will need to be considered as the shares will form part of the family member’s estate.

Shareholders’ agreement

It is often advisable where family members directly hold the shares in a private trust company to have a shareholders’ agreement, which will be binding upon all shareholders both present and future. The terms of the shareholders’ agreement can generally be as wide or narrow as the settlor wishes subject only to any local restrictions as to the ability to fetter the exercise by shareholders and/or directors of their powers. A typical agreement will include general provisions, such as that the shareholders will only exercise their powers in accordance with Shari’a principles, as well as who shall be appointed as directors, for example that no female members of the family may be appointed as directors, and dealing with the transfer and transmission of shares. Where possible under the local corporate law, any restrictions should also be mirrored in the company’s constitution.

Family governance

In addition or as an alternative to a shareholder’s agreement, the settlor may wish to prepare a less formal family governance document setting out his vision for how the private trust company and the underlying trusts should be administered. This could include Shari’a issues as well as the circumstances in which the settlor would anticipate a family business being sold and the role of family members should play in the running of the business until such time.

In summary, private trust companies allow wealthy families to create a wholly bespoke structure within which to manage and develop family wealth in accordance with Shari'a principles. The key to a successful private trust company structure is that it is able to provide a forum for discussing family concerns and business management issues. To achieve this, there will need to be good communication not only of the settlor's wishes, but also between all the persons involved so as to facilitate joint decision-making in the manner provided.

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