Article

Trustees & Private Wealth Practitioners: Time to Review, Reset & Reload

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Recent world events have offered both individuals and businesses across the world an opportunity for introspection. In a period of constant change, the businesses that thrive will be those capable of rapidly adapting to new challenges and changing circumstances. For trustees and those operating in the private wealth sector, it is likely that recent events will accelerate and exacerbate existing challenges and trends. As such, there is no time like the present to review governing documents, corporate governance procedures and succession planning to ensure that it is fit for purpose in light of the current crisis and those to come. This article will consider some practical considerations for trustees and private wealth practitioners as they look to the future.

Investment Performance

One of the few certainties of the current crisis is that it will have a major and long-lasting impact on global financial markets. The initial hopes for a "V-shaped recovery" no longer seem plausible and the consensus now seems to be that the world is facing a genuine, and not short-lived, economic crisis.

The downturn obviously puts pressure on private wealth practitioners, particularly those that have custody or control of assets. For trustees, the value of most trust funds will be diminished, meaning a raft of potential claims from disgruntled beneficiaries seeking to recoup their losses. Notwithstanding that the downturn has been prompted by circumstances beyond their control, many trustees will find themselves in the firing line. This could even be the case where trustees consider that they are blameless or that they have adequate protection from liability under the terms of the relevant trust deed.

It was the 2008 global financial crisis (the "GFC") that precipitated the circumstances in the case of Zhang Hong Li v. DBS Bank[1], which was recently determined by the Hong Kong Court of Final Appeal. The case concerned a Jersey trust which was structured (at the settlors' request) to allow one of the settlors to direct the Trust's investments. To achieve this goal, a common investment structure was put in place whereby the settlor was appointed as investment advisor to the underlying company which held the Trust's investments. Furthermore, the Trust Deed contained a provision which broadly provided that the Trustee was not responsible to supervise the underlying company's investment decisions (referred to as an "anti-Bartlett" clause).

However, in the wake of the GFC the Trust sustained significant losses as a result of the settlor's high-risk investment strategy. Notwithstanding the anti-Bartlett clause or that the investment structure had been put in place to facilitate the settlors' wishes, the settlors then, in their capacity as beneficiaries of the Trust, brought proceedings against the trustee alleging in essence that it had failed to adequately supervise the underlying company's investments.

At first instance, the Court found that the trustee had been in "serious and flagrant" breach of its duties and that it should not have approved the various investment decisions of its underlying company because, notwithstanding the anti-Bartlett clause, it owed a "high level supervisory duty" with regard to the purchase of high-risk investment products. While that decision was ultimately overturned (and with it the purported "high level supervisory duty"), the case, and the fact that the defendant had to appeal to the highest level, should still act as a warning to trustees. In different factual circumstances, there may indeed be other grounds for attacking the validity of an anti-Bartlett clause as such clauses do not always sit comfortably with a trustee's broader fiduciary duties.

[1] Zhang Hong Li and others v. DBS Bank and others

Thus, while the case should provide comfort to trustees, so too should it act as a reminder of the need for vigilance both in drafting and reviewing trust deeds, and more generally in the administration of a trust. Trustees cannot simply rely on template clauses for general and absolute protection from claims. With that in mind, trustees should review existing anti-Bartlett provisions to determine whether they are in fact fit for purpose. Trustees should carefully consider the scope of existing provisions and the type of conduct and investments that fall within scope. Consideration should also be given to provisions permitting the trustee to intervene in carefully defined circumstances.

It is important to also note that there are specific statutory trust regimes which address some of the issues (and uncertainties) that arise with anti-Bartlett clauses. Where it is desirable for a settlor (or some other party) to have control of a Trust's underlying company, Cayman STAR trusts and BVI VISTA trusts each offer attractive alternatives to anti-Bartlett. Furthermore, given that such trusts are supported by legislation, STAR and VISTA trusts are likely to provide much greater certainty for trustees and settlors alike.

Corporate Governance

It is in times of crisis that corporate governance procedures are put to the ultimate test. This applies across the spectrum including to private wealth structures such as a trust's underlying corporate entities, foundations (such as Cayman Foundation Companies), private trust companies and management or advisory committees.

In times of crisis, it is important that boards continue to hold regular meetings which are recorded by accurate and appropriately detailed minutes. Given that litigation (or even insolvency) often follows periods of crisis, minutes of meetings will often become critical in the determination of any disputes and/or assessing the appropriateness of the board's (and its individual member's) actions and conduct.

Even for entities and structures which consider themselves relatively unaffected by the current circumstances, it is a fitting time to review whether existing corporate governance procedures are fit for purpose in that they are capable of responding to a variety of challenges (both known and unknown). Where they are not, remedial action should be taken sooner rather than later.

By way of example, corporate governance issues which have arisen recently include the following:

- Whether the governing documents (such as articles of association of a company) contain adequate provisions with regard to conducting meetings by electronic means. While most modern documents contain provisions allowing attendance via phone or video, such provisions are not always fit for purpose, especially where meetings are to be conducted wholly electronically. It is therefore timely to consider whether there are appropriate rules and procedures in place for the facilitation of electronic meetings. In certain circumstances it may be appropriate to address matters such as how voting takes place and whether meetings should be recorded when conducted electronically.
- How to facilitate meetings where the governing documents (or some other legal requirement) stipulate that meetings must occur in a specific place, for example the jurisdiction in which the trust or company is resident. Because of the current restrictions on travel, questions may arise as to how such a requirement applies to attendance via electronic means, and whether a quorum can be achieved by appointing proxies to attend and vote at a meeting on a board member's behalf.
- Whether there are adequate rules and procedures in place in the event that a director (or other power/officeholder) is incapacitated. This can be particularly important in a private wealth context where entities, such as private trust companies or underlying companies of trusts, are often controlled by a small number of people (and sometimes even a single person). Succession planning will therefore be critical to ensuring that a company is not paralysed at a time of crisis when it may need to act quickly. In this context, it is important to review whether governing documents provide for the appointment of an alternate director or reserve director who can immediately act in the event of a vacancy. It is worth noting that BVI VISTA Trusts can expressly provide, under its office of director rules, to deal with such events should the need arise to appoint replacement directors to the board of the VISTA trust's underlying BVI company.

Regulatory Issues

Private wealth practitioners have been subject to an ever-increasing regulatory burden over the last few years. However, for anyone hoping that recent events may offer a reprieve, this seems highly unlikely. Albeit that regulators have in certain instances extended filing deadlines (as described below), this should not be interpreted as an indication of leniency. On the contrary, regulators may be under increased pressure to seek out and prosecute firms and practitioners for breaches of regulatory standards.

The financial pressure the COVID-19 crisis has inflicted on world economies and national budgets has already prompted various politicians to further malign jurisdictions they perceive as having harmful tax practices. Ultimately this may mean that regulators in offshore jurisdictions need to work even harder to counter any perception that they do not have adequate regulatory frameworks and enforcement mechanisms in place to address money laundering, tax information sharing and economic substance. Trustees and their advisers must therefore be ever vigilant to ensure that they do not fall foul of regulatory standards.

Furthermore, it should be noted that current circumstances will not necessarily excuse non-compliance. For example, in jurisdictions with economic substance laws, it will be necessary to consider how the restrictions on freedom of movement have affected the extent to which an entity has adequate substance in the relevant jurisdiction (i.e. in the way of personnel and operating expenses). In the Cayman Islands, the regulator has confirmed that while such circumstances will be taken into account, this will be assessed on a case-by-case basis.

While regulatory authorities in the Cayman Islands have offered the following extensions to reporting deadlines:

- companies have been granted until 30 June 2020 to complete their annual returns and make their economic substance notification filings; and
- CRS & FATCA reporting deadlines have been extended to 16 November 2020.

Such extensions relate only to the filing of information and so do not excuse anyone from a failure to comply with the relevant legislation. Thus, notwithstanding the disruption to business, regulatory compliance must remain a priority and entities should seek advice where they consider current circumstances have impacted the extent of their compliance with regulatory requirements such as economic substance.

In the British Virgin Islands, as result of the ongoing impacts of COVID-19, the Virgin Islands International Tax Authority in the BVI ("ITA") announced that the deadline to submit FATCA and CRS filings has been extended as follows:

- the deadline for FATCA enrolments has been extended to 31 July 2020, and for filings to 31 August 2020.
- the deadline for CRS enrolments has been extended to 30 June 2020 and for filings to 31 July 2020.

Should a BVI FI be unable to meet the filing deadlines it may apply to the ITA to request an extension giving reasons. Extension applications will be assessed by the ITA on a case-by-case basis

"Flee" clauses in Trust Deeds

Many trusts (particularly those subject to older deeds and governed by offshore laws, such as Cayman and the BVI) contain a "flee clause" which purports, on the occurrence of specified events, to trigger the transfer of the trusteeship and administration of the trust to another jurisdiction.

In principle, the motivation behind a flee clause is to safeguard against jurisdictional risk, with typical triggers being events like war, rebellion and other national emergencies. While such clauses may initially appear sensible, their true purpose may have had more to do with marketing than safeguarding the assets of a trust. Such clauses often appear more effective at easing the concerns of anxious settlors (who may lack confidence in the political stability of the jurisdiction in which the trust is being established), than achieving their purported goal of protecting assets in the event of a crisis. Furthermore, poorly drafted flee clauses can often raise significant prospects for unintentional consequences. This is particularly so given that many flee clauses are invoked automatically and so can be triggered without the awareness of the relevant parties.

By way of example, many flee clauses are triggered by a declaration of a state of emergency in their resident jurisdiction. To this end, we note that a state of emergency was declared in the United States on 13 March 2020 with many countries in Europe and around the world following suit. This included the Bahamas, a jurisdiction in which many trusts are resident and administered, which declared a state of emergency on 18 March 2020.

It is apparent that the Bahamian trust industry was alive to the risk of inadvertently triggering flee clauses, because on 19 March 2020 (the day after the declaration), the Government of the Bahamas amended the relevant regulations such that for Bahamian trusts with clauses which otherwise would have been triggered, such clauses were not so triggered because the trust instrument was to be treated as having a proviso that the flee clause did not extend to the proclamation of a state of emergency as a result of a pandemic.

While it is sensible to save trusts from the uncertainty and administrative headache that would have otherwise resulted, the Bahamian government's actions also demonstrate the risks and ineffectiveness of many flee clauses in the first place. For example, if a flee clause is designed to protect against a nationalising government, it makes a nonsense of such clause if the government can simply pass legislation to overcome the effect of such clause (setting aside the question of whether a nationalising government would really care for the niceties of trust law and beneficial ownership anyway).

Thus, it is apparent to the author that traditional flee clauses are generally not fit for purpose and do not effectively manage the jurisdictional risk that they seek to address. However, this is not to discount the concept of emergency provisions in their entirety. In certain circumstances, provisions which provide for a particular course of action in the event of a crisis may in fact be desirable. Such emergency provisions were last discussed by the industry in the context of 'hostage' scenarios following the detention of many of Saudi Arabia's business elite at the Ritz-Carlton Hotel in Riyadh. What is clear, is that wherever flee or emergency provisions are to be used, they should be carefully drafted and bespoke to the relevant circumstances.

Practical considerations for trustees:

- Identify trusts which contain flee clauses, take note of the specific trigger events and be alive to circumstances which may inadvertently trigger the clause.

- Even where a flee clause is not triggered by the current crisis, consider whether the clause gives rise to the potential for unintended consequences in the future. If so, can the trust deed be amended to either remove the clause or to make it more palatable. For example, the trustee or protector may be provided with some discretion as to whether the clause has been triggered.

Estate Planning

COVID-19 has been a two-pronged sword, threatening both health and financial security in its rapid spread across the globe. The uncertainty that has accompanied the virus has prompted many people to confront their own mortality and consider whether their financial and succession planning is adequate for whatever the future holds. With these issues at the forefront of people's minds, now presents the ideal time for individuals and their advisors to review and, where necessary, revise existing arrangements, a matter often overlooked until it's too late.

For high net-worth individuals and families, the goal should be to ensure that wealth management structures remain workable in the event that a key person dies or is incapacitated. Outcomes and planning will differ depending on how assets are held (either in an individual's personal capacity or a trust), and whether adequate provisions exist with regard to automatic succession of key roles (such as the protectorship of any trusts). With good planning, individuals and family groups can ensure that wealth structures are not "paralysed" by the loss of a key individual, an outcome which would invariably add to a family's difficulties in times of crisis.

Significant global wealth is held in Cayman or BVI company shares. Failure to put appropriate succession plans in place may result in unanticipated or undesired outcomes which will inevitably involve both delay and increased cost in dealing with company shares after death. This, in turn, may have significant and adverse consequences for the commercial life of the company which may, effectively, be put on hold. The adverse consequences will be exacerbated if the shareholder in question is also the company's sole director and no reserve director has been nominated – a situation that occurs with surprising frequency – since in such circumstances the assistance of the local Court will be required to break the management impasse.

With regard to the ownership of Cayman or BVI company shares, succession planning may take the form of a Cayman or BVI Will dealing exclusively with Cayman or BVI shares respectively, or the establishment of a Cayman or BVI trust.

A Cayman or BVI Will may be the simplest and most appropriate form of succession planning where, at least, the individual is not subject to "forced heirship" rules. It may also be the most appropriate vehicle for individuals who are subject to such rules but where there is no desire to make any provisions inconsistent with them.

In either case, a Will may be advisable because a foreign representative of the deceased's worldwide estate (or a person beneficially entitled to it under foreign law) will have no title under BVI or Cayman law to deal with BVI or Cayman situated assets. For example (and the same rule applies to Cayman company shares) shares in a BVI business company are, for this purpose, treated as BVI situated under BVI law. Accordingly, even a validly appointed foreign representative of a deceased person's estate will have to make application to the BVI Court for a grant of representation before there may be any lawful dealing with the BVI company shares. It is, however, significantly less costly and quicker for the executor of a BVI Will which deals with the BVI company shares to obtain a grant of probate of that Will in the BVI.

It is common for an individual to be sole shareholder and sole director of a BVI or Cayman company. Upon such an individual's death, there will be no director authorised to update the shareholder register, or pass a shareholder resolution to appoint a new replacement director. However, it is possible to avoid this problem by nominating a reserve director whose appointment is effective upon the death of the sole director.

With regard to shares in a Cayman or BVI company (which are classified as movable rather than immovable property for succession purposes), the relevant local law treats the law of the jurisdiction of domicile at death as the law governing succession to movable property. If the provisions of a Cayman or BVI Will contravene the law applicable to the testator's domicile at death, they will not have effect. Accordingly, a more robust structure is needed and a trust will, in many cases, meet that need since no transfer of property into a BVI or Cayman trust may be set aside by the local Court on the ground that the transfer defeats heirship rights - or rights conferred on a person by reason of a personal relationship, including marriage or former marriage - under foreign law.

With good planning, individuals and businesses in the private wealth sector can look to the future with optimism. Given recent global events, this is a good time for trustees and private wealth practitioners to review trust's governing documents, corporate governance procedures and succession planning to ensure that it remains fit for purpose.

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