

The business of trusts is one of the quiet mainstays of international business in Bermuda.

By Scott Neil

Who knows how many trusts there are in Bermuda? There is one estimate that puts it squarely in the thousands. That being the case, the trust industry on the Island likely accounts for many hundreds of millions of dollars in assets — if not billions.

Yet to many people it is an unseen world, something that they've heard about, but not really taken a lot of interest in, perhaps concluding that trusts are something that exist only for the super wealthy.

Trusts are a financial success story for Bermuda, and one that continues to prosper and build upon the established reputation the Island has earned in its ability to accommodate, run and regulate these legal entities.

Trusts are also widely considered to be the most innovative contribution to the English legal system, and when the scope and variety is fully appreciated, it is not difficult to see why.

For what reasons has the Island done so well in this niche market, and will the good times continue?

The trust industry is not solely confined to offshore jurisdictions; it is widespread across the world. Offshore rivals to our south certainly have their share of the business. However, Hildeberto ('Hil') Frias, of Mello Jones & Martin, who has been working in the trust industry for 13 years, believes the future remains bright in this arena for Bermuda, locally and internationally.

He sees the trusts enshrined in Bermuda law as offering competitive distinctions that set them apart from other places, and that, coupled with the reputation of the Island for being a good choice in terms of reputation, workability and regulation, has driven business Bermuda's way.

"I see the industry here prospering. We have international trust companies here in Bermuda that administer international trusts which are governed by Bermuda law and by other countries' laws, such as the Caymans, but they choose to be here," said Mr. de Frias.

"And as laws change in onshore jurisdictions — particularly revenue laws — there will be additional legal and administrative work to be done to restructure those trusts already here that also tends to spin off other business, such as company incorporations.

A booming area is the private trust companies — they have taken off.



"These are privately owned companies that act as trustees for a family trust or a group of related trusts. Private trust companies are finding clients who have previously had traditional trustees, such as a bank, and who have now decided that they want to have closer involvement and control or oversight," Mr. de Frias explained.

"The banks still provide a valuable service to the trusts that they were formerly trustees to, as often they are engaged to provide administration services to these private trustees."

Trusts come in many shapes and forms, from commercial purpose trusts to charitable trusts, and others. For Bermuda residents the most common trust is one that holds and protects real estate. With the cost of a home on the Island averaging above \$1 million, real estate probably represents the biggest single chunk of personal wealth that most local clients possess.

Until very recently, owning a home in Bermuda meant facing estate stamp duties upon the death of the registered owner — a figure on a sliding scale that rapidly hits 15 percent of the value of the asset given the average house price in Bermuda. That is a big burden on a person's estate, which would eat into the value passed on to any heirs.

However, if the property had been placed into a trust, it would not be considered part of the deceased's estate and would therefore be exempt from the stamp duty demand.

This potential hardship has been alleviated in Bermuda, up to a point, by the Stamp Duties Amendment Act of 2005, which exempted the primary family home from stamp duty upon the death of the Bermudian owner. That new legislation has led to some dwindling of family trusts in Bermuda. But for people who own more than one property the stamp duty must be paid for all subsequent properties upon the owner's death. So a trust is still desirable,

because if those properties are in a trust, they remain exempt from such estate duties.

It isn't only real estate that can be placed into trusts. Assets of all kinds, from investments, stocks, cash, bonds, works of art, and even yachts, cars and aircraft can be included. It is a way to pass on wealth and assets safely for the benefit of heirs with a minimum risk of loss of value.

A trust is basically a relationship between a person who intends to settle a trust by placing assets into the hands of trustees who then hold and invest those assets for the benefit of other persons, who are called beneficiaries.

More often than not the originator of the trust is one — if not the prime — beneficiary. However, by placing assets into a trust, the trust settlor hands over control of the assets to the trustees who are then obliged to hold and invest those assets in a prudent manner and to preserve their value. That obligation might not sit well with a trust settlor who, for example, had been used to controlling the assets and doing as he pleased with them, and now finds that the trustees do not need to follow his 'instructions' with respect to the investment and distribution of those assets.

Mr. de Frias recognises that this 'losing control' is something that can put off some from creating a trust. But it has to be that way. Trustees are under strict obligations to act in such a responsible manner to protect, preserve and enhance asset value, and they face legal repercussions if they don't. Also, a trust that is not administered properly runs the risk of being called out as a 'sham trust' and nullified in the eyes of the law with all the possible negative consequences.

Many who create trusts do so as a form of asset protection. Assets in a trust can be protected from creditors, providing they were placed in a trust without an intention to put such

photo by Aidi Simmons

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assets out of the reach of known or foreseeable creditors.

Company bosses, lawyers, attorneys, and others who might find themselves open to unlimited liabilities in their professional career, can protect their personal assets and engage in long-term estate planning by placing them into a trust.

Mr. de Frias doubts there are any accountants or attorneys in Bermuda without a family trust to protect and preserve family wealth.

The use of offshore trusts for asset protection and tax avoidance has been reduced considerably over the years to an extent by changes in the revenue laws of some countries, such as the US and Canada. But there is still plenty of tax driven business out there, particularly from the UK and Europe.

Mr. de Frias said: “Bermuda does not take the same overly aggressive approach as other countries to tax avoidance, as opposed to evasion, which is illegal, or these days called ‘tax mitigation’. The Bermuda authorities understand that it’s acceptable to put in place a properly structured estate plan that might include a trust to minimise the incidence of tax and preserve wealth.”

Because of the secretive aspects of trusts, they have been linked with money laundering concerns in the past. Mr. de Frias points out that Bermuda’s sound business practices, tighter and tighter regulations, and the ability of the likes of the Bermuda Monetary Authority to conduct inspections of licensed trustees, has by-and-large squeezed out such fears of dirty practice.

As for the professional trustees that administer the trusts, they are paid for their guardianship of the assets. They are duty bound to invest the assets prudently, and in respect of real estate must ensure that such property is properly maintained, land tax is paid, rent is collected and a proper rental agreement exists. The larger trust companies administering huge trust funds tend to provide their services for a fee based on a percentage of the value of the assets, while smaller trust companies work out a fixed fee based on the estimated administrative costs of administering the trust each year.

Looking to the future, Mr. de Frias said: “Will we continue to see Bermuda used as a trust jurisdiction? I think so. There may be a dwindling of trust business as onshore jurisdictions get rid of revenue loss avenues much as the US and Canada have done, but we will see a restructuring of existing trusts to accommodate changes and there will still be benefits for

internationally mobile clients.”

As he mentioned earlier, as revenue loss laws are tightened, they create spin off possibilities for new types of trusts.

For those in Bermuda thinking of setting up a trust, he recommends firstly they take proper advice from an attorney. After that, if they decide to go ahead, they should bear in mind that people with few assets will be spared much of the cost that those with more significant assets might encounter in paying stamp duties as they transfer over their assets to a trust.

Furthermore, anyone starting a business would find benefits from settling a trust immediately to hold such business at start-up and thereby minimise the incidence of stamp duty on a future transfer of a business to a trust after it has taken off and become more valuable — not to mention the estate planning benefits of not having such business forming a part of one’s estate.

Innovation and evolution of trusts have already served Bermuda well. The jurisdiction created strengthened its international leadership in this field in 1989 when it pioneered the new concept of trust legislation, known as purpose trusts. This allowed the creation of non-traditional trust vehicles for commercial purposes and was enshrined by the Trusts (Special Provisions) Act 1989.

Miranda Conway, corporate trust officer at Butterfield Bank, said: “At the time, Bermuda received much criticism for the concept, but its success as a commercial vehicle has led other jurisdictions to pass purpose trust legislation of their own. Bermuda continues to be an industry leader in this area.”

Purpose trusts have proven to be highly flexible and therefore of use for a range of purposes, such as transfer of responsibility and risk, while offering a high degree of confidentiality.

Mrs. Conway said: “Purpose trusts developed under Bermudian legislation have proven to be very attractive arrangements for the reinsurance sector. When analysing the issue of risk, a reinsurer must first determine, ‘do I spread it, retain it or transfer it?’ Should the answer be ‘transfer it’, a fully collateralised trust structure allows for the transfer and securitisation of risk giving the reinsurer more control should a trigger event occur.

“In the reinsurance industry, a fully collateralised trust is created to hold funds invested into Special Purpose Vehicles such as side cars and catastrophe bonds.

“With side cars, the trust structure is an

alternative to the creation of the start-up company. The timeliness and ease of creating these structures helps the reinsurance capital to be applied more efficiently and in line with market shifts. It avoids the added time and stress of incorporating a company and hiring new staff.”

Corporate Trust, which is part of the larger Butterfield Bank Group, pitches itself as a leading provider of purpose trust solutions to the reinsurance industry and has a team dedicated to research and development of new products such as ‘just-in-time’ cars to facilitate quick and efficient side cars.

The world of corporate trust vehicles covers many bases such as protecting pension and benefit arrangements and employee share ownership.

Mrs. Conway said: “There are several other ways in which commercial trust structures can be utilised. Within the structure of a commercial trust, third party trustees like Butterfield can be used to oversee the terms of the trust agreement and hold cash and securities for multiple parties. In this manner, parties to the trust can be assured that a particular transaction will close after one party has fulfilled its obligations to another.”

She adds: “Bermuda also allows for the use of a trust structure as an investment vehicle in the form of hedge funds or mutual funds, referred to as ‘unit trusts.’ A unit trust allows multiple investors to invest in the same assets through contributions of varying sizes.

“Alternatively, multiple individuals can lend to a company through the bond trust structure. Lenders receive marketable securities issued by the trustee, which holds upon trust, the right to enforce repayment of the loan. This structure is designed to increase protection of persons with a financial interest in a company yet with little or no control over day-to-day management.”

The world of trusts is many-layered, and there are plenty of rivals out there competing for the millions of dollars of business. But Bermuda is not resting on her laurels.

The Bermuda International Business Association has been advocating for changes to the law to keep Bermuda’s competitive edge, and the fruits are expected to be seen soon after legislative proposals by BIBA’s trust sub-committee were submitted to Government. The proposed changes will repeal the rules of perpetuities and accumulations, although it is likely that a proviso will be to continue the rule where it applies to interests and estates in land in Bermuda.

BIBA CEO Cheryl Packwood acknowledges that the Island has done well in the field of trusts and has gained wide-reaching respect for its approach and ability to carry out trust work “understand the issues and work with the private wealth clients.”

How wide-reaching is Bermuda’s trust reputation? Ms Packwood illustrates: “Japan likes to use Bermuda because of our highly respected reputation, experience and professionals.”

As of today things appear to be staying rosy for Bermuda’s slice of the trust action. **BL**