VISTA TRUSTS FOR OFF-BALANCE SHEET FINANCING

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INTRODUCTION

The Virgin Islands Special Trusts Act 2003 (VISTA) came into force on 1 March 2004 and enables special new British Virgin Islands (BVI) trusts, which are known as VISTA trusts, to be set up to hold shares in BVI companies. When a VISTA trust is established, the trustee is in effect disengaged from management responsibility for the underlying company and the shares in BVI companies and their assets can be retained as long as the directors think fit.

VISTA has already received a great deal of (positive) international attention and, whilst most trust practitioners have so far focused on its uses in the context of family succession planning,[2] commercial lawyers, accountants and bankers were quick to identify the advantages of the new legislation in the context of off-balance sheet financing.[3] Essentially these advantages, which are considered in greater detail below, are that the VISTA legislation can be utilised so that trustees are not obliged to concern themselves in the transactions which the directors of underlying companies are proposing to enter into, and that the shares in these companies can be appropriately retained in trust for so long as the structure is required.

This article will first briefly consider the nature of off-balance sheet structures. It will then go on to consider the ability to create charitable and non-charitable purpose trusts in the BVI, and why it is now advisable to establish trusts which are

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[1] Walkers.

[2] Some of the main situations in which a VISTA trust should seriously be considered for succession planning are as follows: (i) whenever the settlor wishes to retain control (since matters can, if appropriate, be structured so that settlor control can be retained at the director (company) level); (ii) whenever the settlor intends the shares which he wishes to settle in trust and/or the underlying assets of the company to be retained; (iii) whenever trustee involvement in the underlying company's affairs is inappropriate; and (iv) whenever the underlying assets of a trust are to comprise speculative investments (or investments which involve a degree of risk, which would otherwise be regarded as inappropriate for the trustees of a non-VISTA trust).

[3] For further commercial uses of VISTA trusts see Craig Murphy's article on the 'Commercial Applications for VISTA Trusts' (2004) 10(4) *Trusts and Trustees* 14.

used for off-balance sheet structures as VISTA trusts. After summarising the key features of the VISTA legislation and the BVI's new legislation on trustees and dealings with third parties, in addition to analysing a number of structuring issues which will be relevant to the trust and its terms, the advantages of using a BVI company as part of the structure will be considered.

BASIC OFF-BALANCE SHEET STRUCTURES

The essential element of a structured finance transaction is the conversion of various types of assets into marketable securities. Typically, a special purpose vehicle (SPV) will purchase an asset or pool of assets from a corporate or other financial institution. The SPV funds the purchase of the asset or assets by the issue of securities.

The SPV will typically be an 'orphan' company owned by a share trustee, which holds the shares in the SPV on trust for charitable or non-charitable purposes; this is because an essential element of these types of trust is that there is no beneficial owner of the trust's assets. This in turn means that the assets of the SPV will not appear on the balance sheet of any party to the transaction and will be 'bankruptcy remote'.

The asset or pool of assets acquired by the SPV will generate a cash flow to pay interest on the securities. The arranger will also use part of the issue of the securities to pay all fees and expenses on behalf of the SPV, and the SPV will receive a small fee in order to establish that it has generated a corporate benefit for itself. Ultimately the redemption proceeds of the underlying assets (or occasionally the sale proceeds) are used by the SPV to redeem the securities upon maturity.

BVI TRUST LAW

The basic principles of BVI trust law derive from those of English law,[4] as supplemented by BVI statute. Until 1993, with a few exceptions, the BVI's law of trusts largely followed English trust law, but numerous improvements, some of which are considered below, have since been made. BVI trust instruments are exempt from any form of registration in the BVI, and BVI trusts will in general be exempt from local taxation, although (unless the trust is a charitable trust) BVI trust duty of $100 will be payable; this duty is paid by affixing a revenue stamp or stamps

[4] The principles of English common law apply in the BVI by virtue of the provisions of the Common Law (Declaration of Application) Act of 1705 and those of English equity apply by virtue of the West Indies Associated States Supreme Court (Virgin Islands) Act.

for $100 to the trust instrument and cancelling them in accordance with the requirements of BVI legislation.[5] Statute prohibits the document from being submitted to the BVI authorities for the duty to be paid.

The ability to create BVI law-governed charitable and non-charitable purpose trusts will now be considered.

CHARITABLE TRUSTS IN THE BRITISH VIRGIN ISLANDS

BVI law has always permitted charitable purpose trusts to be established. For further information relating to BVI charitable trusts, readers are referred to Appendix A.

NON-CHARITABLE PURPOSE TRUSTS IN THE BRITISH VIRGIN ISLANDS

As an alternative to setting up trusts for charitable purposes, the BVI, in common with other leading offshore jurisdictions, has for some time now had on its statute books laws which enable the creation of non-charitable purpose trusts ('purpose trusts'). A substantial amount of use is made of this legislation, particularly in the commercial context. For further information about BVI purpose trusts, readers are referred to Appendix B.

OPTION TO SET UP CHARITABLE AND NON-CHARITABLE PURPOSE TRUSTS AS VISTA TRUSTS

As long as the conditions which are set out in s 4(4) of VISTA are satisfied, not only trusts for beneficiaries, but also trusts for charitable or non-charitable purposes can be set up as VISTA trusts.

The conditions specified in s 4(4) of VISTA are as follows:

- the trust must be created by, or on the terms of, a written testamentary or inter vivos instrument;

- a 'designated trustee' (ie a holder of a licence under the BVI's Banks and Trust Companies Act 1990)[6] must be the sole trustee of the trust;

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[5] Section 92 of the Trustee Act.

[6] It follows from this requirement that the trustee would always be a 'designated person' within the meaning of s 84A of the Trustee Act, with the result that one of the conditions for establishing a non-charitable purpose trust would always be satisfied.

- the terms of the trust must require that any successor trustee must be a 'designated trustee' acting as sole trustee; and

- the trust must not be created in the exercise of a power conferred by another trust.

WHY SET UP A CHARITABLE OR NON-CHARITABLE PURPOSE TRUST WHICH HOLDS SHARES IN AN SPV AS A VISTA TRUST RATHER THAN AS AN ORDINARY TRUST?

At this stage it is worth considering the background to VISTA and the problem which the Act addresses.

Prior to the enactment of VISTA it had become increasingly clear that the familiar rule of English trust law which requires a trustee to act prudently in relation to trust investments[7] was impeding the use of trusts as vehicles for holding controlling interests in companies. The problem was particularly acute when trusts were needed to provide for succession to incorporated family businesses, but it also prevailed generally in circumstances in which the intention was for the trustees to *retain* the shares which were held in trust (or for the underlying assets of the company to be retained) or whenever trustee involvement in the company's affairs was undesirable or inappropriate.

The problem of English trust law arises from the specific obligations that the duty of prudence places on trustees when the trust fund consists of a controlling shareholding in a company. The obligations are, briefly, as follows:

- To monitor the conduct of the directors of the company and to intervene, where necessary, in the company's business (for example to prevent the company from entering into an unduly speculative venture).[8]

- To exploit the shareholding to maximum financial advantage – which may require the trustees to accept a financially attractive takeover bid for the company, or to seek out and take opportunities for spreading the trust's financial risk by selling the company or its underlying assets and reinvesting in a diversified portfolio.

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[7] In some jurisdictions this may be the so-called prudent man of business rule, as stated by Lindley J in *Re Whiteley; Whiteley v Learoyd* (1886) 33 Ch D 347, 355. In others it may have a statutory basis.

[8] *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515. See also *Re Lucking's Will Trusts; Renwick v Lucking* [1968] 1 WLR 866.

Experience has shown that these obligations fail to meet the requirements of a typical settlor of company shares, and pose significant difficulties, both from the perspective of the settlor (or those involved in setting up such a trust) and from that of the trustee.

Whilst it might be thought that a professional trustee should not shrink from performing the relevant obligations – after all they are part of the duty of care that is at the heart of a trustee's normal function – the reality is that they do not fit comfortably into most off-balance sheet situations. The reasons are, briefly, as follows:

- A professional trustee rarely has, or can be expected to have, the skills to do this, or to understand the complexities of the transactions which it is intended that the SPV or underlying companies will be entering into. While a trustee can – and normally would be expected to – employ lawyers and other consultants to advise on the structure and the proposed terms of the transaction documents, this is unlikely to be a wholly satisfactory solution, since it would inevitably mean that the transaction documents would need to be drawn up in such a way as to ensure (inter alia) that the value of the shares in the SPV are not at any stage diluted, ie so as to make sure that the trustee's exposure to liability is limited as far as possible or so as to ensure that they will not at any stage be required to sell the holding.

- The monitoring procedures necessary to be sure of avoiding exposure to claims against the trustee adds substantially (and disproportionately, from the perspective of many advisers) to the cost of the trust's establishment and/or its administration.

- Professional indemnity insurance cover for a trustee who is involved in the activity of providing its services as trustee of these sorts of trusts may be or become problematic or prohibitively expensive.

- The trustee faces the prospect of being squeezed between, on the one hand, exposure to potential liability for failure to dispose of the shares (either in order to achieve a good price or in order to diversify investments) and, on the other hand, pressure from those involved in setting up the structure to retain the shares in the SPV or its underlying assets, on the basis that such a sale would be wholly disastrous from a commercial perspective.

- Conceivably a court could be persuaded to support a trustee's decision not to dispose on the basis that it was the implicit term of the trust that the assets

should be retained, but this is relatively uncharted territory, particularly so far as shares are concerned.[9]

When a charitable or non-charitable purpose trust is set up to hold shares in an SPV, the intention will invariably be that the trusteeship should, to all intents and purposes, remain relatively 'passive'. It is certainly never intended that trustees should need to monitor or involve themselves in the underlying transactions to which the SPV or underlying companies are parties: indeed, the expectation is that those involved in setting up off-balance sheet structures will recoil from the prospect of trustee intervention in the affairs of the SPV, since this could thwart the intention behind setting up the structure. The trustee, on the other hand, is potentially liable for making good any losses caused by any failure on his part to monitor, and where necessary intervene in, the conduct of the SPV's business.

Similarly, those behind establishing such a structure can be expected to find equally unwelcome the prospect of a compulsory sale of the shares in the SPV (or its underlying assets) merely to satisfy short-term financial considerations. On the contrary, they intend the shares in question to be retained by the trustee of the charitable or non-charitable purpose trusts for as long as the structure is needed. Because holdings in a single company typically carry a significantly greater degree of financial risk than a well spread investment portfolio, diversification is usually a priority for the trustee, in direct conflict with the wishes of those who are involved in setting up the structure.

VISTA, of course, circumvents all these difficulties and some of the key features of the Act will be considered in the next part of this article.

Whenever advisers are contemplating setting up an off-balance sheet structure, serious consideration should be given to establishing a VISTA charitable or non-charitable purpose trust to own shares in the SPV, which would take the form of a BVI company. The use of BVI SPVs is considered at the end of this article.

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[9] *Lewin on Trusts* (Sweet & Maxwell, 17th edn, 2003) suggests (at para 35-150) that there is some scope for trustees to have regard to the wishes of the settlor to retain shares, but this turns on the wording of a particular English statutory provision (Trustee Act 2000, s 4(3)), which requires trustees to have regard to 'the need for diversification of investments of the trust, insofar as is appropriate to the *circumstances* of the trust' (emphasis added). There is no BVI equivalent to this provision, and the English provision places the trustees in a position of uncertainty (as is apparent from the discussion in *Lewin*).

KEY FEATURES OF VISTA[10]

The primary purpose of the Act is stated in s 3 as being:

> 'to enable a trust of company shares to be established under which:
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> (a) the shares may be retained indefinitely; and
> (b) the management of the company may be carried out by its directors without any power of intervention being exercised by the trustee.

The aim of VISTA is to enable a trust of shares to be established that disengages the trustee from management responsibility and permits the company and its underlying assets to be retained as long as the directors think fit. This is achieved in general terms by:

- first, authorising the entire removal of the trustee's monitoring and intervention obligations (except to the extent otherwise required);

- secondly, by permitting the trustee to fulfil a role more suited to a trustee's abilities, namely a duty to intervene to resolve specific problems;

- thirdly, by allowing trust instruments to lay down rules for the appointment and removal of directors (so reducing the trustee's ability to intervene in management by appointing directors of its own choice);

- fourthly, by giving directors and (where relevant) beneficiaries,[11] or (in the case of purpose trusts) the enforcers, or (in the case of charitable trusts) the Attorney-General, the right to apply to the court if trustees fail to comply with the requirements for non-intervention or the requirements for director appointment and removal; and

- lastly, by prohibiting the sale of shares without the directors' approval.

Some of the features of the new Act are as follows:

- The Act does not apply to BVI trusts *generally*: it only applies where there is a provision in the trust instrument directing the Act to apply.

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[10] For further information on VISTA trusts, see Christopher McKenzie's chapter on VISTA trusts in *Thomas and Hudson – The Law of Trusts* (Oxford University Press, 2004), paras 40.22–40.65, reproduced in J Glasson (ed), *International Trust Laws* (Jordan Publishing Ltd, 1996), at paras A6.133–A6.180 and [2004] JTCP 63, at pp 63–81.

[11] This will not be relevant in the case of a trust of shares in an SPV, since the trust will be a charitable or non-charitable *purpose* trust, with no beneficiaries.

- Where the new Act applies, designated shares will be held on 'trust to retain' and the trustee's duty to retain the shares as part of the trust fund will have precedence over any duty to preserve or enhance their value, The trustee will not, therefore, be liable for the consequences of holding (rather than disposing of) the shares.

- The Act specifies that, subject to any contrary provisions in the trust instrument, unless the trustee is acting on an 'intervention call' (as defined in the Act), the trustee may not exercise its voting or other powers so as to interfere in the management or conduct of any business of the company; the management or conduct of the company's business will be left to those appropriate to deal with it, namely its directors, whose fiduciary duties to the company will remain intact, except to the extent that the trustee/shareholder is restrained qua trustee from exercising some of the powers of a shareholder.

- The new statute also provides that the trust instrument may include 'office of director rules' specifying how the trustee must exercise its voting powers in relation to appointment, removal and remuneration of directors – and the trustee is generally required to follow these rules. Except in compliance with these rules, the trustee must generally take no steps to procure the appointment or removal of the company's directors.

- The Act further provides that the trust instrument may specify that the trustee may intervene in the affairs of the company in specified circumstances, ie when required to do so by an 'intervention call' by a beneficiary,[12] an object of a discretionary power of appointment,[13] a parent or guardian of either of them,[14] the Attorney-General (in relation to charitable trusts), the enforcer (in relation to purpose trusts) or other specified persons.

- The Act specifies that (unless the trust instrument provides otherwise) the trustee is permitted to dispose of designated shares in the management or administration of the trust fund, but can only do so with the consent of the directors of the company (and that of such persons as are specified in the trust instrument).

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[12] This will not be relevant in the case of a trust of shares in an SPV, since the trust will be a charitable or non-charitable *purpose* trust, with no beneficiaries.

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- The new statute contains provisions enabling beneficiaries,[15] directors and others[16] to apply to the court for enforcement of the terms of the Act and, on the application of a specified person, the court is empowered to authorise the trustees to sell designated shares where retaining them is no longer compatible with the wishes of the settlor.

- The Act is confined to shares in BVI companies, but there should be no reason why shares in non-BVI companies (or other assets) should not be held *by* a BVI company to which VISTA applies, if it is the intention that those assets should (effectively) be held subject to a VISTA trust.

- The trustee of a VISTA trust must be a company which holds a licence to undertake trust business under the Banks and Trust Companies Act 1990.

- The company law duties of directors remain unchanged and the Act does not in any way alter the restraints placed on directors and others by criminal law.

OTHER SIGNIFICANT RECENT BVI TRUST LAW DEVELOPMENTS

With a view to making BVI trusts significantly more attractive in the commercial context, a number of new sections which relate to dealings between trustees and third parties have been inserted into the Trustee Act. These provisions have been inserted into that Act by the Trustee (Amendment) Act 2003, which also became law on 1 March 2004. The provisions in question are based on provisions which were made by the English Trust Law Committee,[17] but with a number of modifications, and relate to both VISTA and non-VISTA trusts, although *some* (but not all) of these new provisions would not, in general, be capable of applying to VISTA trusts.

Some of the new sections of the Trustee Act (namely ss 97, 101 and 102) only apply if there is, in the trust instrument, an express statement to the effect that the relevant sections apply to the trust.

As a result of the new ss 95 and 96 of the Act, banks and other third parties dealing with trustees will be able to have recourse to the trust fund (and other protection) where, when entering into transactions, they have made reasonable enquiry that the

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[16] These include the Attorney-General in the case of charitable trusts and the enforcer in the case of non-charitable purpose trusts.

[17] Trust Law Committee Report, *Rights of Creditors against Trustees and Trust Funds* (June 1999), which followed its April 1997 Consultation Paper.

trustee has the express power to enter into such transactions and has complied with any express requirements (such as requirements for consent) contained in the trust instrument.

If (and only if) there is a provision in the trust instrument to the effect that s 97 of the Trustee Act applies, the trustee of a trust will not be personally liable under any contract which it enters into with another if it has disclosed (or the other party was aware) that it was contracting *as trustee* (unless the contract provides otherwise). Furthermore, a claim based (inter alia) on such a contract may be satisfied out of the trust fund. In the case of a charitable or non-charitable purpose trust for an off-balance sheet structure, taking advantage of this new optional provision is, however, probably inadvisable, ie given the overriding criteria that there should be no beneficial owner of the shares of the SPV and in view of the extent of the rights which the new statutory provision would give to those who contract with trustees of charitable or non-charitable purpose trusts.

On the other hand, if the trust has not opted into the provisions of s 97 of the Trustee Act (and if the trust instrument does not provide otherwise), the new s 98 of the Trustee Act specifies that where a trustee enters into a contract, having disclosed his fiduciary capacity, it will be personally liable under the contract to the third party *only* to the extent of the value of the trust fund when the payment falls due (including the amount of any distributions made after the contract was entered into).

The new s 99 of the Act (which is based on the wording of a new US statutory provision[18]) provides that a trustee will only be liable for torts committed in the course of administering the trust if it is personally *at fault*.

The new s 101 of the Act, which only applies where the trust 'opts in' to this provision, specifies that, where a person who lends money to trustees requests the trustee to do so, the trustee may *restrict* its future powers of investment and distribution (and the powers of appointment and removal of trustees) in order to protect that person. The purpose of this new provision is to address the legitimate concerns of those lending money to trustees, to the effect that their rights might be diluted as a result of the manner in which the trust is administered after the liability has been incurred. A further 'opt in' provision, which enables trustees to create various forms of charges over trust assets in favour of creditors, has also been included in the new s 102 of the Trustee Act. Again, these two optional provisions

[18] Section 1010(b) of the draft US Uniform Trust Code. This is now in force in the following states: the District of Columbia, Kansas, Maine, Missouri, Nebraska, New Hampshire, New Mexico, Tennessee, Utah and Wyoming.

would not really be relevant to a VISTA trust, since the powers in question would not, in general, be capable of being exercised.

Often, of course, contractual liabilities incurred by trustees of BVI trusts will be in favour of persons resident in foreign jurisdictions. This being the case, with the aim of ensuring that foreign law does not override the relevant new provisions of the BVI Trustee Act, the third party should consider protecting its position further by stipulating that all questions pertaining to the contract, or at least all relevant questions, will be governed by BVI law.

Although, as indicated above, some of these new provisions will not be relevant to VISTA charitable and non-charitable purpose trusts for SPVs, it is considered that, in general, the new provisions of the Trustee Act which relate to trustees and dealings with third parties generally now make BVI trusts significantly more attractive in the commercial context. A number of the new statutory provisions will, furthermore, undoubtedly be attractive to those wishing to set up trusts for off-balance sheet structures, particularly since the broad impact of the new legislative provisions is to shift the balance of protection more equitably in favour of third parties dealing with trustees and the trustees themselves.

STRUCTURING ISSUES

Apart from obviously needing to pay particularly careful attention to drafting issues in general, when considering the terms of a VISTA trust, careful thought should be given to a number of other important points, and some of these are referred to below.

First, the objects of the trust should be considered. If a charitable trust is selected, it is often thought appropriate that the trust, so as to provide flexibility, should be one for 'general' charitable purposes. If, on the other hand, a non-charitable purpose trust is selected, careful consideration will need to be given to the terms of the trust's objects clause so as to ensure that the trust is one which satisfies the requirements of s 84A of the Trustee Act.

In order, furthermore, to ensure that the trust is not a sham (or is not otherwise invalid), it may very well be advisable to structure matters so that sufficient monies are transferred to the SPV at the outset, so that funds are available to pay for (so long as the structure is likely to remain in place):

- the trustee's fees;

- the annual government licence renewal fees and the associated costs for maintaining the SPV in good standing; and

– the costs of its liquidation and the dismantling of the structure at the end of the day.

It would also be prudent (especially in the case of a charitable trust) to transfer an additional sum of cash to the SPV at the outset so that charitable donations can be made, for example when the structure is dismantled.[19]

The 'office of director' rules in the trust deed should be considered carefully. It is generally considered wise to take advantage of the provisions of s 7 of VISTA which permit the trust instrument to lay down rules (which trustees are generally obliged to follow) for determining the manner in which voting and other powers attributable to designated shares should be exercised in relation (inter alia) to the appointment and removal of directors. A possible option might be to require the trustee to procure that the SPV's original directors retain office and then to provide for a mechanism for the appointment of successor directors of the SPV (for example with reference to the trustee being obliged to exercise its shareholder powers of appointment and removal of directors in accordance with the written directions of the 'protector' of the trust).[20]

It is also advisable to include (albeit limited) grounds for intervention in the trust instrument, so that the trustee will be required to intervene in the SPV's affairs should anything wholly untoward happen – for example so that it can do so in the unlikely event that the directors of the SPV make off with its assets or fail to carry out the original intentions of those who set up the structure. However, it is clearly imperative that the relevant grounds for intervention should be framed in such a way that these do not fail for uncertainty.

THE BRITISH VIRGIN ISLANDS SPV

As has been stressed above, VISTA can only apply directly[21] to shares in BVI companies, with the result that the SPV which is incorporated for the purposes of an

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[19] Although a distinction needs to be made between the assets of the trust (the shares in the SPV) and the assets of the underlying company, and although it cannot be doubted that shares are property (see *Gower's Principles of Company Law* (Sweet & Maxwell, 5th edn, 1992), at p 360), such a course of action is recommended if there is any risk that the validity, say, of a charitable trust might be challenged. Such a challenge might conceivably be made on the basis that *if* no funds will *ever* be available to benefit the trust's charitable purposes, there can never have been any charitable intent in setting up the trust.

[20] The appointment of a protector would be advisable in any event, since this would assist in enabling the provisions of s 8(8)(c) of VISTA to be satisfied.

[21] VISTA would nevertheless generally also affect the trustee's powers and duties in relation to underlying companies and other underlying assets.

off-balance sheet structure (or its holding company) would need to take the form of such a company.

The development of the BVI as a successful offshore financial centre has, to a large extent, been due to the immense popularity of the Territory's international business company (the IBC) as a flexible, user-friendly corporate vehicle. Since the introduction of the International Business Companies Act (IBC Act) in 1984, over 635,000 IBCs have been incorporated, giving the jurisdiction an estimated global share of 45%. The attractiveness of the IBC is further enhanced by being statutorily exempt from BVI taxes and stamp duty, the limited statutory filings required and the general ease of administration and operation.

IBCs benefit from flexible, up-to-date legislation, some of the important aspects of which are as follows:

- An IBC may be incorporated for any object or purpose provided it is not prohibited by BVI law (for example criminal activities), other than certain proscribed activities.[22]

- An IBC may be incorporated with power to perform all acts and engage in all activities irrespective of corporate benefit.

- An IBC may, subject to any limitations in its memorandum or articles, continue as a company incorporated in another jurisdiction as provided by the laws of that jurisdiction and so cease to be incorporated within the BVI.[23]

- Where a foreign government expropriates or imposes confiscatory taxes upon the shares or other interests in an IBC, for example debentures, the IBC or any person holding shares or other interests may apply to the court for an order that the IBC disregard the action of the foreign government and continue to treat as members or interest holders those persons whose shares or interests were subject to such action.

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[22] It may not: (i) carry on business with persons resident in the BVI; (ii) own an interest in real property situated in the BVI other than office premises from which to communicate with members or where books and records of the company are prepared or maintained; (iii) carry on banking or trust business unless it is licensed to do so under the Banks and Trust Companies Act 1990; (iv) carry on business as an insurance or reinsurance company, insurance agent or insurance broker, unless it is licensed under an enactment authorising it to carry on that business; (v) carry on the business of company management unless it is licensed under the Company Management Act 1990; or (vi) carry on the business of providing the registered office or agent for companies incorporated in the BVI.

[23] This may provide a method of changing the domicile of any trustees and/or protectors incorporated as an IBC.

- An IBC is exempt from the provisions of the BVI Income Tax Act.[24] It is also exempt from stamp duty on documents in respect of transactions carried out by it or relating to its shares or debt obligations.

- There is no public record of the identity of the shareholders or directors of an IBC, although there is an option to file this information with the Registrar of Companies.

- There are no minimum capital requirements unless the company is carrying out activities governed by the Banks and Trust Companies Act 1990, the Company Management Act 1990 or the Insurance Business (Special Provisions) Act 1991.

- Incorporation procedures are simple and can be completed in a relatively short time.

- There are no annual filing requirements for an IBC, other than payment of the annual government licence fee.

- An IBC may create a register of mortgages and charges and thereby protect the security interests of creditors as to priorities in any action that might be commenced in the BVI, in relation to securities created after 1 January 1991.

The IMF's April 2004 *Assessment of the Supervision and Regulation of the Financial Sector*[25] concluded that 'the regime for registering and maintaining IBCs in the territory meets or exceeds most best practices'.

Further advantages of incorporating a BVI IBC as a SPV as part of an off-balance sheet structure are as follows:

- There are no restrictions relevant to off-balance sheet transactions relating to a SPV: it can lend, borrow or issue debt securities without being required to be licensed under BVI law. Nor is there any specific regulation of debt issues by the BVI's Financial Services Commission.

- No filings are required in the BVI in relation to the issue of debt securities and there are no local audit requirements.

- There is no minimum capital requirement for a SPV, although it is normal practice for a SPV to have an issued ordinary share capital of US$1,000.

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[24] Income tax has in any event (since 1 January 2005) been zero-rated in the BVI.

[25] IMF Country Report No 04/92.

- As already indicated, BVI law is based on the English common law so that the central issues of corporate power, directors' fiduciary duties, corporate personality, limited liability and corporate benefit are, in all substantive respects, the same as under English common law. At the same time, however, BVI commercial legislation benefits from being much less cumbersome in many of the areas that have caused considerable difficulty and uncertainty under the corresponding English statutes. For example, while under English law it is unlawful for a company directly or indirectly to provide financial assistance for the acquisition by a third party of its own shares, which is generally referred to as 'financial assistance', there is no similar statutory prohibition in the BVI. Nonetheless, every director, in carrying out the business of the company, must act honestly and in good faith with a view to the best interests of the company and must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

- An IBC has wide powers under the IBC Act. Specifically, an IBC has the power, irrespective of corporate benefit, to perform all acts and engage in all activities necessary or conducive to the conduct, promotion or attainment of the objects or purposes of the company, including the power to issue common, preferred, limited or redeemable shares; to issue shares that entitle participation only in certain assets; to issue convertible securities; to purchase, redeem or otherwise acquire and hold its own shares; to guarantee a liability or obligation of any person; and to secure any of its obligations by mortgage, pledge or other charge over any of its assets for that purpose.

- IBCs can create and register charges at the company's registered office. In the event of an application being made to the court in the BVI to enforce any charge over a company's assets (where such assets are subject to two or more charges), notwithstanding the provisions of any other law, priorities are determined in accordance with the date of entry in the internal register. It is also possible to file a copy of the IBC's internal register of mortgages and charges at the Companies Registry, thereby giving notice to any third party inspecting the company's public records. Otherwise, there is no perfection process as such in respect of any charge over assets of an IBC. Contractual subordination is therefore supported by BVI law. Consequently, both those structuring transactions and creditors can be confident that a priority of payments agreed by a BVI issuer is enforceable by creditors, even if those creditors do not have the benefit of an associated security interest. This ensures that a 'waterfall' will bind all creditors, even where the company has granted only a negative pledge rather than a more rigid form of security interest. This creditor-friendly approach obviously gives more flexibility in structuring transactions.

- Whilst the BVI was always generally considered to be a creditor-friendly jurisdiction, the Territory has further benefited from the implementation of the provisions of the Insolvency Act 2003. This Act provides modern alternatives to winding up, such as creditors' voluntary arrangements and administration proceedings, and has codified the law on receivers. Creditors may agree, outside of winding-up proceedings, to compromise their claims against the company: such arrangements, with the approval of the requisite majority, are binding on creditors who did not consent to the arrangement. The provisions governing the actual winding up of the company, including the appointment of provisional liquidators and the status of liquidators, have been expanded and much of the uncertainty of the old law and practice has been removed. In addition, the Act provides certain exemptions from insolvency set-off provisions and permits netting in defined market contracts, which are particularly relevant in the context of securitisation business and capital markets transactions generally.

An arranger (and its rating agency) will want to be comfortable on a number of issues:

- First, that the SPV is bankruptcy-remote and that there is a true sale to remove the underlying asset pool from the arranger's estate and it is only in very specific cases that the separate corporate personality of a SPV will be ignored so as to allow creditors access either to the SPV or its shareholders; most relevant cases have typically been English and have involved fraud. It is, of course, essential that the corporate formalities for the SPV are followed, ie to ensure that there is no risk that the company would be treated as an agent of the arranger or a sham. This is part of the role of the local service providers.

- Secondly, that the business of the SPV is restricted to the activities which ensure a sufficient cashflow to pay the securities. The objects clause of the memorandum of association of the SPV would therefore need to be drafted accordingly.

- Thirdly, that there is non-petition language in the agreements between the SPV and the transaction parties which, together with the limited recourse language, is effective under BVI law in limiting the creditor's right to petition as an unpaid creditor.

- Fourthly, that the share trustee (who will hold the voting shares) will not exercise his rights as a shareholder to liquidate the SPV until after an agreed period or, indeed, do anything to cause the SPV not to comply with its contractual covenants in any of the transaction documents. This is generally dealt with in the trust document executed by the local service provider acting as

share trustee and the provisions of VISTA which are referred to above will give the arranger a great deal of comfort in this regard.

NEW BVI BUSINESS COMPANIES ACT

Notwithstanding the historic success of the IBC, a new BVI Business Companies Act (BVIBCA) took effect on 1 January 2005, with transitional provisions in place to completely replace the current IBC by January 2007.[26] Developed in consultation with the local private sector, the Attorney-General's Chambers and the Financial Services Commission, the new legislation has been designed to appeal to international clients, while at the same time providing a suitable legal framework for companies undertaking domestic business.

The BVIBCA retains many of the core aspects of the IBC Act, including:

- exemption from all BVI taxes and stamp duty;
- a high degree of confidentiality;
- limited statutory filings;
- ease of administration and operation; and
- a same-day incorporation procedure.

In addition, the BVIBCA introduces a number of new features, amongst which the key improvements include:

- the seven different types of companies which may be incorporated under the new Act, including not only the traditional company limited by shares, but also companies limited by guarantee (with or without a share capital), unlimited companies (again, with or without share capital), restricted purpose companies and segregated portfolio companies;

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[26] The transitional provisions, which will ultimately affect all IBCs when they re-register under the BVIBCA, will operate as follows: (i) 1 January 2005 – 31 December 2005: companies can be incorporated under either the IBC Act or the BVIBCA. Existing IBCs are able to re-register under the new Act; (ii) 1 January 2006 – 31 December 2006: companies will only be able to be incorporated under the BVIBCA. Existing IBCs can continue to operate under the IBC Act and will be able to re-register under the BVIBCA; (iii) 1 January 2007 – any IBCs not already re-registered under the BVIBCA will be automatically re-registered.

- statutory recognition to restricted objects clauses through the restricted purpose company, which must have SPV in its name. The memorandum of association of a limited company is entitled to state that the company is a restricted purpose company and such statements cannot be deleted or modified. The memorandum and articles of the company may be entrenched such that those provisions may not be amended. Further, it is expected that such a SPV will be carved out of the proposed administration provisions in the Insolvency Act (which have not yet come into effect) and will not be subject to the moratoria under that statute. It is likely that these SPVs will provide attractive vehicles for structured finance and will provide rating agencies with an extra degree of comfort;

- new provisions regarding registration of security and priority of charges;

- innovative provisions allowing, under particular circumstances, a director to act in the interests of a holding company or particular parent company rather than in the interests of his own company;

- clarified procedures regarding disclosure of directors' interests;

- a statutory solvency test to determine payment of distributions; and

- flexible provisions governing a company's ability to acquire its own shares.

The new Act also reinforces the credibility of the BVI as an attractive jurisdiction in which to set up SPVs.

CONCLUSION

If properly structured, a VISTA charitable or non-charitable purpose trust to hold the shares of a BVI SPV should provide a cost-effective solution which ensures that the commercial benefits of the off-balance sheet structure are not capable of being thwarted.

Appendix A: charitable trusts in the British Virgin Islands

There is, in the BVI, no statutory definition of a 'charitable' purpose and, as a consequence (as under English law), whether or not a purpose will be regarded as charitable will be determined in accordance with the common law and equitable principles of English law. There is, in the BVI, no equivalent to the English Recreational Charities Act 1958. Accordingly, a purpose will be regarded as

charitable if it falls within any of the four heads of charitable purpose classified by Lord Macnaghten in *The Commissioners for Special Purposes of the Income Tax v Pemsel*.[27] These heads are as follows:

- The relief of poverty.
- The advancement of education.
- The advancement of religion.
- Other purposes beneficial to the community.

There have been a considerable number of English (and Commonwealth) cases laying down the rules relating to the question of whether or not a particular object will fall within one of these four heads and some quite sophisticated principles have been developed, but consideration of these principles is beyond the scope of this article.

In addition, to qualify as a charitable purpose, the 'public benefit' test must be satisfied, and this differs depending on which charitable purpose is being considered and, again, the principles laid down by English case-law will be relevant in terms of determining whether this test is satisfied.

Furthermore, in order to qualify as a charitable purpose, the purpose must be 'exclusively charitable'. This means, in effect, that (subject to the ability now to create 'non-charitable purpose trusts' which is considered in Appendix B, below) if a trust is created with some purposes that are charitable and some that are not, the trust may well be invalid.

Charitable trusts in the BVI are enforced by the Attorney-General: there are, in the BVI, no equivalents of the Charity Commissioners for England and Wales.

The BVI's Trustee (Amendment) Act 2003 inserted into the Trustee Act a number of new sections, which include some desirable reforms relating to charities. All of these reforms (which are to be found in the new ss 105–109 of the Trustee Act) reflect provisions which are to be found in the English Charities Act 1993. It is worth commenting on two of these reforms. First, the BVI court's *cy-près* jurisdiction has been extended along the lines of those set out in the English Charities Act 1993. These new statutory provisions will ensure that, when the purposes of charitable trusts fail, the court has a fairly wide jurisdiction to make a scheme for the application of the trust property for other charitable purposes 'as near as possible' to

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[27] [1891] AC 531, at 583.

those intended by the donor. Secondly, the new s 107 of the Trustee Act contains provisions, similar to those contained in the English Charities Act, which enable the court to authorise particular transactions, compromises and applications of property. In practice it is understood that a great deal of use is made of these very flexible provisions in England and Wales and it is considered that their inclusion within the Trustee Act will be beneficial to those who administer charities.

Appendix B: non-charitable purpose trusts in the British Virgin Islands

Prior to the most recent reforms, the BVI's purpose trusts legislation was to be found in s 84 of the Trustee Act, which came into effect in November 1993, but this legislation was recently reviewed comprehensively in the light of amendments which have been made to other offshore jurisdictions' legislation, various commentaries which have been written by experts, and some issues which arose in practice since s 84 of the Trustee Act came into effect.

The Trustee (Amendment) Act 2003, which came into force on 1 March 2004, also introduced new purpose trusts legislation which provides a more comprehensive, clearer and more robust regime for all purpose trusts that are created on or after that date.

The new s 84A of the Trustee Act enables valid trusts for non-charitable trusts to be established, provided that the trust's purposes are specific, reasonable and possible and not immoral, contrary to public policy, or unlawful. However, at least one trustee of the trust must be a 'designated person' (which includes a company which holds a general or restricted trust licence under the BVI's Banks and Trust Companies Act 1990) and the trust instrument must appoint a person as an enforcer of the trust (who must either be a party to the trust instrument or consent to act as enforcer in the manner prescribed by the new section) and must provide for the appointment of successor enforcers.

The BVI did not copy other jurisdictions in abolishing the role of the enforcer, on the basis that it was considered that to do so would give rise to a number of undesirable practical and conceptual consequences (for example, the right to enforce the trust is believed to be conceptually critical both to its existence and its effective administration). Instead, requirements were included in the new statutory provision with the objective of ensuring that purpose trusts *always* have enforcers (ie to prevent an argument to the effect that, if there is at any time no enforcer, the trust will fail).[28]

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[28] The new section makes it clear, however, that the statutory procedure for appointing an enforcer need not be invoked where it is likely that a new enforcer will be appointed in the very near future, in accordance with the mechanism in the trust instrument for effecting such an appointment.

Nor did the Territory copy other jurisdictions in abolishing the requirement to the effect that one of the trustees of a purpose trust must be a 'designated person' (such as a licensed BVI trustee), since this requirement was regarded by the KPMG Report[29] as a beneficial protective mechanism, and it was considered that such abolition might lead to abuse. Instead, amendments were made to the Territory's purpose trusts legislation to ensure that a designated person *always* serves as the sole trustee (or as one of the trustees) of a purpose trust.

Other key features of the new section are as follows:

- The heavily criticised definition of a 'trust for any purpose' (specifying that a purpose trust must not be for the benefit of 'particular persons' or of 'some aggregate of persons') is omitted from s 84A, with the result that there are now certain analogies between the BVI's purpose trusts legislation and the Cayman Islands STAR trusts legislation.[30]

- The new section makes it clear that the validity of a trust which would have been valid apart from the Territory's purpose trusts legislation is wholly unaffected, and that the validity of (and the Attorney-General's power to enforce) charitable trusts is unaffected by the legislation.

- A specific provision has been included in the new section making it clear that the enforcer cannot be or become one of the trustees of a purpose trust.

- The enforcer has been given the express statutory power and duty to enforce the trust.

- The court has been given a discretionary power to make an award in relation to the enforcer's costs in enforcing the trust.

- The new section makes it clear that purpose trusts are exempt from the rule against perpetual trusts.

- Section 84A no longer requires the trust instrument to specify a terminating event, since there should be no reason, in principle, why perpetual purpose trusts should not be capable of being set up. Instead, trust instruments have been given the option of specifying a terminating date or event, of providing for the disposition of trust assets on the trust's termination, and of providing that

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[29] *Part III of the Review of Financial Regulation in the Caribbean Overseas Territories and Bermuda* (KPMG, 2000).

[30] The Special Trusts (Alternative Regime) Law 1997.

(before the trust's termination as a purpose trust) the trustees will owe no duty to any persons entitled on such termination.

- Provisions enabling purpose trusts to be varied (to cater, for example, for circumstances which have changed since the trust was set up) have been included in the new section, subject to a number of desirable modifications (which do not appear in the corresponding laws of other offshore trust jurisdictions) to make it clear to which factors the court is to have regard to when varying the trust.

- The Territory has taken up the recommendation that was made in the KPMG Report to the effect that the designated trustee of a purpose trust should be required to retain certain essential trust records in the Territory.

- Section 84A of the Trustee Act also effectively includes an amendment to the BVI's law relating to theft to make it clear that an offence will be committed if the trustee and the enforcer dishonestly appropriate assets of a purpose trust.

This robust and comprehensive new legislation has greatly enhanced the attractiveness of BVI purpose trusts.

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