Private Trust Companies in 2020

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1. What is a private trust company ('PTC')?

A PTC is a company incorporated to act as trustee of one or more family trusts. Like any other company, a PTC is run by its board of directors, who will be mandated to make trustee decisions. Whilst run by the board of directors, private trust companies (and the underlying trusts for which they act as trustees) are usually administered by a professional trustee who should be experienced in carrying out trust and corporate administration. Often this is a necessity under local regulation.

The board of directors of the PTC may include family members who can ensure that the wishes of the founder of the trust (often the patriarch and/or matriarch of the family) are given proper consideration and enable them to become familiar with, and participate in, decisions affecting family assets. These assets may include the family business interests, and the PTC can be used to provide the next generation with the training and instruction for their future role in the business. In circumstances where it is impractical, unconscionable, or undesirable for family members to be in direct control of the PTC, trusted advisers of the settlor can be appointed to the board.

Note that most jurisdictions do not allow PTCs or parties associated to them to be remunerated directly (eg BVI, Barbados, Jersey) or solicit to the public although professional directors may be paid for their services.

2. What are the advantages of a PTC?

(a) **Cost**: in many offshore jurisdictions a PTC is not subject to an expensive licensing process, although there is often the requirement for the PTC to be administered by a duly licensed financial services company so it is a process more akin to establishing an offshore company in a well-regulated jurisdiction. Therefore, in some cases the fees related to the formation and on-going administration of the structure will be less than those charged by an institutional trustee. This is especially true for trusts where an institutional trustee charges on an ad valorem basis. Note that certain ownership methods eg Foundation or purpose trust necessarily involve another structure and associated cost and legal advice in the setup of the PTC may also be chargeable.

(b) **Control**: most trusts require that the trustees exercise their discretion in the administration of assets, for example the investment or distribution of trust assets or of the companies underneath. Remember that trustees are forever spooked by the *Bartlett v Barclays Bank* case which might result in trustees being potentially held liable for all assets in a trust, including underlying company business (although in 2020 trustees will have been comforted by the decision, on appeal, in Hing Kong with Jersey trust in Hong Kong: *Zhang Hong Li and others v DBS Bank (Hong Kong) Ltd*). There is one exception to this, in

BVI's VISTA Trust law where trustees are exonerated at statute. The structure of a PTC enables family members or trusted advisers to be involved in the decision-making process by becoming directors or consultants to the PTC.

(c) **Efficiency**: the absence of licensing makes it easier, quicker, and less expensive to change directors, officers, or other structural elements. Many clients have complained about the costs and time involved in changing trustees which itself is often exacerbated or caused by slow, inexperienced and sometimes avaricious trust companies. With a PTC typically all that is required is a change of directors or the termination of a trust administration agreement.

(d) **Consolidation**: many institutional trustees are unwilling to hold certain types of high-risk assets or high risk business in parts of the world they can not even contemplate functioning. Trustees are often also required to observe investment limitations and constraints. The PTC does not have similar constraints and all the assets can be administered by a single trustee.

(e) **Familiarity**: many settlors from civil law jurisdictions (think Russia, China, continental Europe, and Latin America) are unfamiliar with trust concepts. The combination of a trust and PTC is similar in effect to a corporate or foundation structure.

(f) **Comfort**: many clients are hesitant to transfer legal ownership of significant assets to an institutional trust company in an offshore jurisdiction let alone someone they hardly know! The client might be more at ease having assets owned and administered by a PTC that they have created, and perhaps control - depending upon the taxation/economic substance issues and other factors affecting the settlor and beneficiaries.

(g) **Confidentiality**: many families are concerned about the disclosure of information regarding the family, their assets and their activities. Using a PTC makes it easier to control access to and disclosure of, confidential information. This is especially true where the company's board consists of the family and their trusted advisers.

(h) **Integration**: the PTC should work well with a Family Office, an operating company or perhaps a private philanthropic trust. It is possible to share a common name, board of directors and administrative facilities.

3. Who should act as directors of the PTC?

The choice of directors is key. Although local law may generally permit all directors to be non-resident one must ensure that the effective management and control of the PTC, and therefore the residence (and these days, the 'economic substance') of the underlying trust(s) is outside any highly taxed country. It is obviously desirable for the family beneficiaries to be represented on the board, and this provides an opportunity to create a "round table" forum in which family members can participate, perhaps together with trusted advisers. In this way, the client can be reasonably assured that there is a sufficient understanding of the family's background and dynamics and that their wishes regarding the administration of the underlying trusts will be respected. It is also possible to create various committees that will advise the Board, for example investment or audit committees. Always seek professional advice in this regard!

4. <u>Who should own the PTC?</u>

The ownership structure of a PTC is a crucial element for the effective functioning of the overall structure. In general terms the possible holding structure for a PTC includes the following, however, individuals' ownership of the shares of the PTC is strongly discouraged:

- direct settlor/family ownership;
- a second family trust owning the PTC shares alone;
- an 'orphan' trust – a purpose trust or a charitable trust, again established solely for PTC share ownership; or
- ownership by a self-owning/stand-alone entity such as a foundation.

(1) Direct ownership of the PTC shares is common in many domestic arrangements, and there are many examples of family owned PTCs in the USA, Australia and New Zealand. However, direct ownership of a PTC by the settlor may expose the overall structure to significant risks. If the trust is intended to achieve some estate planning objectives, which may involve a division of the settlor's estate in a way different from what some of the settlor's heirs expect, or applicable inheritance law may require (eg civil law countries), the entire arrangement is bound to backfire if the PTC shares are included in the settlor's estate. The settlor's heirs, possibly those whom he would have excluded from certain assets, will then take control of the PTC and thus of the trust, possibly achieving the outcome which the settlor had struggled to avoid.

(2) An alternative approach may be the formation of a PTC by the settlor's professional advisers, who may also have a role as directors. Some succession issues may arise in relation to such advisers, but they may be mitigated with an Amendment Committee or some other governance arrangement. As a variation of the same approach, the professional trustee - who would have otherwise been appointed as a trustee of the family trust if various considerations had not indicated that a PTC is a preferred option – could incorporate a subsidiary and use it as a PTC for a particular arrangement.

(3) To shelter the PTC from any issues concerning its shareholders (death, insolvency, change of ownership in case of a corporate shareholder, etc) it would be preferable for the PTC to be 'ownerless'. This may be practically achieved in two ways. Often, the PTC is owned by a purpose trust. In this case the professional trustee acting as a service provider for the PTC may also act as trustee of the purpose trust holding its shares, although in some circumstances it may be preferable to separate the two roles.

In this situation, the trust purpose would be limited to holding the shares of the PTC. An enforcer is required for the validity of a non-charitable purpose trust under the laws of many jurisdictions. The appointment of an enforcer may be an additional element in the governance of the structure, although the enforcer's role is restricted to enforcing the purpose of holding shares in the PTC. In some family set ups involving some degree of complexity, another company may be created to act as enforcer. Membership of the board of the corporate enforcer may in turn be based on family governance principles.

(4) A better alternative may be to use a foundation (in one of several offshore jurisdictions that now have suitable legislation governing foundations(eg Barbados, Isle of Man, Wyoming as well as the traditional Liechtenstein) as the holding entity for the shares in the PTC.

5. <u>Potential issues</u>

(a) <u>Risk of ineffective administration</u>

Before appointing a settlor and/or family members to the board, advisers should ensure that they have fully understood that acting on a board of a PTC is a time consuming and demanding position with possible personal liabilities (see below). While the trustee directors' only duties are to the PTC, the PTC itself has onerous legal duties and must comply strictly with the express terms of the trust instrument and the governing law. The optimal way to proceed is for the family to invite one or more professional individuals in the trust jurisdiction to join the board of directors. Even though it may be perfectly permissible for a settlor and family members to be both beneficiaries and directors of the PTC and for the settlor to retain certain powers, tax and asset protection considerations may make it prudent for the settlor and family members to be a minority on the board.

(b) <u>The risk of "sham"</u>

The sham doctrine is a significant threat to trusts administered by PTCs. The retention of substantial control by the settlor and the absence of a real and effective transfer of dominion and control over the trust assets can render the trust particularly susceptible to a sham attack. Note courts are frequently running a second argument that trusts are 'illusory' rather than 'shams and the Pugachev case (see here for more details: https://bayernlegal.com/considering-sham-trusts-trust-basics-and-trust-alternatives/) shows that one need not have any direct financial interest in trust assets any more to be deemed to be in control.

(c) **<u>Personal liability</u>**

Where a trust is administered solely by a settlor and/or family-controlled PTC, without professional director assistance, the likelihood of liability arising from a breach of trust is greatly increased, and the risk of personal liability being assessed against the directors of the PTC is a real possibility. If things go wrong and investments are lost, a PTC is unlikely to have sufficient assets or liability insurance to cover a claim. In contrast, however, the directors might be wealthy and thus the only available deep pocket source from which to seek recompense. A beneficiary under these circumstances would have little choice other than to consider a personal claim against the directors of the company for breach of trust.

The issue of whether a director can be held personally liable for a breach of trust committed by his trust company has been addressed by courts. The issue is a difficult one because it essentially raises the question of whether a director, who has fiduciary obligations under trust law, should be permitted to hide behind a cloak of company limited liability law. The position taken by most courts is that a director of a trust company owes a fiduciary duty only to the company and not to the beneficiaries of the trust that the company administers. However, several courts have implied that a fiduciary duty might be owed directly by the directors in certain circumstances (see the case of HR and others JAPT v. and Others [1997] C.L.Y.692) (this is colloquially known as a 'dog leg' claim.

(d) Perception

There is some argument that as PTCs are novel creations they are untested and that in cases of negligence or mismanagement by third party professionals PTCs might use, a trust company, with a potentially larger insurance cover, is more likely to pay out better!

6. Conclusion

A PTC often combined with a family office can be attractive to high-net-worth clients. Care must be taken to ensure that the PTC is properly and effectively administered and that its responsibility as a trustee is properly discharged. With the mantra in mind of keeping matter simple, it is suggested that a foundation or purpose/orphan trust be used to settle and 'own' the PTC although this far too highly specialised (and sensitive) an area to provide broad-brush definitive protocol.

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