

## Article

# Distant relations—common pitfalls and traps when administering a Cayman Islands trust from abroad

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### Abstract

Cayman Islands trusts are increasingly administered outside the Cayman Islands. This article briefly looks at the Cayman Islands as a trust jurisdiction before examining the risks of administering Cayman Islands trusts abroad.

It is increasingly common for Cayman Islands trusts to be administered outside the Cayman Islands. Switzerland, in particular, is an administrative hub for many Cayman Islands trusts. However, what are the associated risks, if any, of administering a Cayman Islands trust from elsewhere? Before we explore this question, let us take a brief overview of the Cayman Islands as a trust jurisdiction.

The Cayman Islands offers a wide range of trusts, including traditional discretionary, fixed interest, charitable, reserved power, exempted, registered trusts, and private purpose trusts (known locally as STAR trusts). The Cayman Islands also offers a facil-

ity for the establishment of private trust companies, and legislation is currently in draft which should introduce Foundations into Cayman Islands law.<sup>1</sup>

The Cayman Islands have become a popular destination for trusts due to its progressive legislation, solid legal system based on the English model (with ultimate appeal to the Privy Council), depth and breadth of skilled professionals, zero tax environment, favourable time zone, stable government, and compliance with international efforts to stamp out money laundering. As a result, the Cayman Islands continues to attract discerning settlors and professional trustees. This brings us back to our original question of whether a Cayman Islands trust can be properly administered from outside the Cayman Islands. The answer: it is not usually a problem, but pitfalls can and do arise, as are outlined below.

### STAR Trusts

Private purpose trusts (known locally as STAR trusts) are permissible under Part VIII of the Trusts Law

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1. The legislation will likely come into force in 2010/11.

(2009 Revision). This pioneering legislation introduced in 1997, permits a wide range of non-charitable purposes to be included as beneficial objects alongside traditional beneficial objects (if desired). The only restriction is that such purposes must be lawful and not contrary to public policy.<sup>2</sup> STAR trusts do, however, have unique administrative requirements which must be strictly observed.

These features can be summarized as follows:

1. the necessity of an enforcer;
2. the necessity of a 'Trust Corporation';
3. the physical presence of documentation in the Cayman Islands; and
4. restrictions on the holding of land in the Cayman Islands.

## Enforcer

Every STAR trust must have an enforcer appointed<sup>3</sup> to it. An enforcer is the only person with standing to enforce the terms of a STAR trust.<sup>4</sup> If for some reason there is no enforcer,<sup>5</sup> a trustee of a STAR trust must take steps to have a replacement appointed without delay, and with the assistance of the court, if necessary. Failure by the trustee of a STAR trust to take steps to appoint an enforcer is, in fact, a criminal offence in the Cayman Islands and trustees can face fines of up to CI\$10,000 (approximately US\$12,000).<sup>6</sup>

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A trustee of a STAR trust should ensure that an enforcer is named in the body of the trust deed,<sup>7</sup> and that there is a comprehensive mechanism to deal with retirement, removal, incapacity, or situations where they have become incommunicado. It is vital to ensure a system is in place to alert a trustee if an enforcer wishes to retire and/or is unable or unfit to act or if the enforcer is a company, has gone into liquidation. In such instances, it becomes incumbent upon the trustees to appoint a successor enforcer within a 30-day period or they risk the possibility of criminal sanctions. Trustees must, therefore, be aware of any changes to the circumstances of the enforcer at all times. Given the special status and powers vested in the enforcer, it is also vital that enforcers are aware of their statutory duties. The trust deed should also specify whether their powers are fiduciary or personal, as that will directly impact how their powers are exercised. As such, the enforcer should have sufficient expertise to appreciate the distinction between personal and fiduciary powers.<sup>8</sup>

## Trust corporation

A trustee of a STAR trust must<sup>9</sup> be or include a Cayman Islands trust corporation.<sup>10</sup> A 'trust corporation' is defined as:

a body corporate licensed to conduct trust business [in the Cayman Islands] or a private trust company.<sup>11</sup>

Hence, there are two requirements: a trustee must be or include a 'corporate body', and it must be licenced under the watchful eye of the Cayman Islands

2. See s 99(3) of the Trusts Law (2009 Revision).

3. See s 100(2) of the Trusts Law.

4. This right has been removed from beneficiaries of STAR trusts by s 100(1) of the Trusts Law; however, this will not prevent beneficiaries from being appointed as enforcers so long as they are specifically designated as such.

5. A STAR trust must have an enforcer; however, there may be instances where an enforcer dies, or being a corporation is wound up, or is otherwise unable to act for some reason.

6. Being convicted of a criminal offence can also have wider implications for the trustee, including reputational damage, and potential loss of the trustee's trust licence which could put it out of business.

7. The enforcer should ideally also be joined as a party to the trust deed to evidence acceptance of his office.

8. This topic is outside of the scope of this article however.

9. Unless authorized by and order of the Cayman Islands Court, which would be extremely rare.

10. See s 105(1)(a) of the Trusts Law.

11. See s 105(2) of the Trusts Law.

Monetary Authority<sup>12</sup> (CIMA). It is therefore not lawful, for example, for a natural person (even one resident in the Cayman Islands) to be a sole trustee of a STAR trust. This can often be overlooked at later stages of the administration, where changes of trustees can occur without thought to this requirement.

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Accordingly, it is not possible for a foreign trustee, either an individual or a corporate entity, to be the sole trustee of a STAR trust. In the early stages of the administration, this is usually not an issue as the attorney preparing the trust deed should name a Cayman Islands trust corporation as at least one of the trustees. Things can start to go wrong when there is a change of trustees and the incoming trustee is not a Cayman Islands trust corporation, and it is the Cayman Islands trust corporation that is being replaced. If a Cayman Islands attorney has prepared the deed of retirement and appointment, usually he will draw attention to the trust corporation requirement; however, sometimes such deeds are prepared by foreign attorneys, and the point can be overlooked. For the outgoing Cayman Islands trust corporation trustee, there is no liability, so it will be unconcerned about the omission;<sup>13</sup> the liability rests solely with the incoming trustee.<sup>14</sup>

## Documentary records

A trustee of a STAR trust is required<sup>15</sup> to retain the following records:

1. the terms of the STAR trust;
2. the identity of the trustee and the enforcers;

3. all settlements of property held on the STAR trust and the identity of the settlors;
4. the property subject to the STAR trust at the end of each accounting year; and
5. all distributions or applications of the trust property.

While many foreign trustees may be aware of these requirements, the requirement that such documentary records must be:

kept in the [Cayman] Islands at the office of the trust corporation<sup>16</sup>

is often overlooked.

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The purpose of this requirement is to allow CIMA to inspect such records by way of the random audit. Certain institutional trustees may be able to meet this requirement by holding records at their satellite office in the Cayman Islands. There is some debate whether electronic records will suffice, but many professional trustees do have a dedicated database, which is physically present in the Cayman Islands in order to satisfy the requirement. What is less certain is what happens to foreign trustees who do not have offices in the Cayman Islands. If the reader recalls, a trustee of a STAR trust must be or include a 'trust corporation'. Therefore, in order to be compliant there should be a Cayman Islands co-trustee at all times. As it has been stated, it is possible that during the course of the administration, the requirement to have a Cayman Islands trust corporation might be overlooked—and so might the requirement that documentary records

12. This is the primary governing body for trust companies/trustees in the Cayman Islands. Certain private trust companies have less stringent reporting requirements however. See the article 'Embracing Change' by Carlos de Serpa Pimentel and Orchid Morrison which is available on the Appleby web site <[www.applebyglobal.com](http://www.applebyglobal.com)> for further details of how private trust companies operate in the Cayman Islands. Unregistered private trust companies are subject to fewer restrictions and oversight by CIMA.

13. Although, an outgoing trustee should be concerned that any incoming trustee is a suitable replacement.

14. Or their attorneys.

15. See s 105(1) of the Trusts Law.

16. See s 105(10(b) of the Trusts Law.

be kept in the Cayman Islands. Failure to observe this requirement is serious; it includes the possibility of hefty fines<sup>17</sup> and potential imprisonment.<sup>18</sup> Crucially, these sanctions apply to foreign trustees as well.<sup>19</sup>

For a trustee based outside the Cayman Islands, it is, therefore, vital that these documentary records are kept on file with its Cayman Islands co-trustee to avoid the serious implications of non-compliance.

## Land in the Cayman Islands

Section 109 of the Trusts Law prohibits a STAR trust from holding land or an interest in land either directly or indirectly. This stems from a specific public policy concern that land situated in the Cayman Islands should not be tied up indefinitely.<sup>20</sup>

Thankfully, there is an exception within section 109 so that a STAR trust can hold an interest in a company, partnership, or other entity which holds land or an interest in land in the Cayman Islands. Structuring the holding of land is, therefore, straightforward; however, it is an important point which might be overlooked by a foreign trustee.

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## The section 6(c) trap

Section 6(c) of the Trusts Law (the 'Section') is perhaps one of the most overlooked provisions in the Trusts Law, and failure to observe the Section can have very serious consequences for incoming and outgoing Cayman trustees.<sup>21</sup>

The Section requires that where a trust had originally appointed more than two trustees, a retiring trustee shall not be discharged as a trustee unless—subject to a contrary intention in the trust deed<sup>22</sup>—there is a trust corporation<sup>23</sup> or at least two individuals to act as trustees and perform the trust.<sup>24</sup> There are separate requirements for trusts established before or after 11 May 1998.<sup>25</sup>

With respect to trusts established post 11 May 1998, where there was only one trustee originally appointed, the appointment of a new trustee (even a foreign trustee) will constitute a proper discharge of the retiring trustee. *Prima facie*, it seems that there was no such exception with respect to contrary intention prior to 1998 because it does not appear in the provisions of the Section of the Trust Laws that pre-date 1998. Although, the concept of 'contrary intention' did appear under the section titled 'Application of Law' before and after 1998.

The position with respect to trusts established before 1998 is clear: no trustee will be validly discharged as trustee of a trust unless a trust corporation or at least two individual trustees are appointed in

17. Ranging between CI\$10,000 and CI\$500,000 (approximately US\$12,000 to US\$610,000).

18. Ranging between one and five years depending on whether the conviction is a summary conviction or a conviction on indictment.

19 S 105(4) states:

Whoever, in the Islands *or elsewhere*, knowingly administers a special trust while there is a breach of paragraph (a) of this subsection . . . [emphasis added]

However, how and whether this provision would be enforced on a foreign trustee is an open question.

20. This provision originates from English law, which resulted in the introduction of perpetuity periods to trusts. Given that STAR trusts can be perpetual, the provision was deemed necessary.

21. A trustee who fails to be properly discharged will retain all of the duties and obligations imposed upon them; however, they may be operating under the false assumption that they have been discharged from their duties and obligations.

22. The concept of 'contrary intention' was inserted into the Trusts Law effective on 11 May 1998.

23. A trust corporation as defined by the Trusts Law as a body corporate incorporated under the Companies Law (as revised) with a registered office in the Islands or a body corporate registered as a foreign company under pt IX of the Companies Law (as revised) and in both cases holding a licence to carry on trust business granted pursuant to the Bank and Trust Companies Law (as revised). As such, where a new trustee of a Cayman Islands trust (ie a trust governed by the laws of the Cayman Islands) is a corporation, its appointment would only be valid where: (i) it is a Cayman Islands incorporated company; (ii) it holds a relevant Cayman Islands trust licence; and (iii) a contrary intention was expressed in the trust deed. Hence, in relation to trusts pre-1998 the appointment of a foreign corporation as a successor trustee would not constitute a valid discharge of the original trustee unless the trust deed contained a contrary intention.

24. In addition, if the trust is a STAR trust, there must be at least one Cayman Islands trust corporation as previously discussed.

25. Before or after 11 May 1998 when the Section was amended.

place of a retiring trustee unless a contrary intention is expressed in the trust deed.

Equally, except where the trust deed contains a contrary intention, the appointment of a foreign corporate trustee<sup>26</sup> as a sole trustee of a trust where two individual trustees were the original trustees of the trust would not constitute a valid discharge of trusteeship of the original trustees.<sup>27</sup>

Much turns on the meaning of 'contrary intention'. The term is not defined in statute, but the common law suggests that the term can be interpreted as 'unless expressly forbidden'. One must, of course, examine the construction and the intention of the trust instrument as a whole. Mere inferences and/or implications of a contrary intention will not suffice.

Lack of a contrary intention, that is, lack of an express prohibition by the trust deed, would mean that the provisions of the Trusts Law might prevail over, or be supplemental to, the provisions of the trust instrument. A deed which specifically states that:

the stipulation of s 6(c) of the Trusts Law (2009 Revision) of the Cayman Islands or any statutory modification or reenactment thereof is hereby excluded

should suffice to displace the statutory position.

Where the trust deed is amendable and the trusteeship has not yet been transferred to a foreign trustee, there are two possible solutions:

1. where the deed is amendable, the trust deed should be amended to include a contrary intention; or
2. pursuant to section 110(4) of the Trusts Law, the whole of the Trusts Law, including the revised

section 6(c), may be extended to apply to any trusts established before 11 May 1998 by deed executed by the trustees.

The trustee should take a practical approach and determine which option is most expedient.

## CIMA

Relatively few people outside the Cayman Islands appreciate the important regulatory work CIMA does in the Cayman Islands.<sup>28</sup> It is the watchdog of the Cayman Islands financial industry, including its trust industry. It has the power to audit, monitor, fine, and revoke the trust licence of any Cayman Islands trust corporation. As a direct result, the Cayman Islands remains one of the most well-regulated trust jurisdictions in the offshore world. The same cannot be said for other jurisdictions, particularly those lacking a substantial history of trusts or trust regulation. Switzerland, as mentioned earlier, is a popular base for the administration of Cayman Islands trusts, but few settlors/beneficiaries realize that Switzerland does not have any equivalent regulatory body, but merely has a voluntary association<sup>29</sup> of trust companies, with no official enforcement powers. For many it may come as something of a surprise to know that their Swiss trustees are unregulated and settlors/beneficiaries must rely completely on the integrity and reputation and capitalization of the trust company in question,<sup>30</sup> rather than an independent regulator.

CIMA has statutory authority<sup>31</sup> to preserve the integrity and standards of trust companies in the Cayman Islands. Trust companies in the Cayman Islands are subject to stringent net worth requirements, ownership restrictions, capital funds

26. That is, not a Cayman Islands Trust Corporation.

27. See *Adam and Company International Trustees Ltd and Others v Theodore Goddard (a Firm)* [2000] WTLR 24, *Times*, 17 March 2000, where Mr Justice Evans-Lombe held the appointment of one new trustee was incapable of discharging two retiring trustees, in that, the deed of retirement and appointment of trustees, was not effective to appoint the first claimant as sole trustee of the trust, nor was it effective to discharge the retiring trustees, as trustees of the settlement. It is likely a similar finding would result if the same fact pattern came before a Cayman Islands court.

28. See the CIMA web site for more detail: <<http://www.cimoney.com.ky/>>

29. The Swiss Association of Trust Companies.

30. This is even more worrisome if the Swiss trustee(s) is an individual.

31. Under the Banks and Trust Company Law (2009 Revision).

requirements, and capital adequacy ratios. Annual accounts must also be audited and submitted to CIMA.

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## To stamp or not to stamp?

The Stamp Duty Law (2007 Revision) requires, amongst other things, that deeds of any kind, including settlement deeds, must be stamped with the appropriate level of stamp duty<sup>32</sup> at the time of execution. Many foreign trustees do not, as a matter of practice and/or policy, apply the correct (or any) stamp duty. It is thought that the territorial scope of the law is limited, and as such, only those deeds/documents which are executed in or brought into the Cayman Islands should be stamped.

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*Deeds of any kind, including settlement deeds, must be classified with the appropriate level of stamp duty at the time of execution*

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It is important to note, however, that while the Stamp Duty Law is silent on its territorial scope, there are potential consequences for foreign trustees for failing to apply the correct stamp duty. The most notable consequence is that any unstamped deed/document which needs to be presented as evidence in a Cayman Islands Court will not, as such, be inadmissible. However, in order for unstamped deeds (or inadequately stamped deeds) to be enforceable such

deed/document must be ‘stamped up’ with 20 times the amount of the deficiency. So, for example, an unstamped trust deed would require CI\$800<sup>33</sup> (approximately US\$975) to be ‘stamped up’. Other deeds would require CI\$1000<sup>34</sup> (approximately US\$1200). If there are numerous unstamped deeds, the costs could add up quite quickly. In addition, accrued interest charges could be added to the value of the total amount of duty unpaid at a rate of up to 20 per cent per annum.<sup>35</sup> Also, if a trustee has deliberately failed to stamp an instrument with intent to defraud the Cayman Islands government, there are serious criminal penalties as well.<sup>36</sup>

Trustees must, therefore, weigh up the benefits of avoiding the stamp duty against the potential liabilities—this point is often overlooked by foreign trustees. But if there is a Cayman Islands co-trustee, it is possible that they could be called to account for the failure to apply the correct stamp duty.

## Trust deed restrictions

Before a Cayman Islands governed trust can be administered outside the Cayman Islands, it is important to review any restrictions which might be present in the trust deed. As a general principle, a Cayman Islands trust can usually be administered outside the Cayman Islands so long as this is not prohibited by the terms of the trust deed.<sup>37</sup> Therefore, it is extremely important to check the terms of the trust deed to ensure that there are no restrictions which might prevent the administration to be carried outside the Cayman Islands.<sup>38</sup>

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32. For settlement deeds the duty is currently CI\$40 (approximately US\$50), and for other deeds the duty is currently CI\$50 (approximately US\$60).

33. Approximately US\$1000.

34. Approximately US\$1200.

35. See s 22 of the Stamp Duty Law.

36. See s 30(1) of the Stamp Duty Law. A fine of CI\$500,000 and five years imprisonment is specified.

37. And that it complies with Cayman Islands law, particularly with respect to STAR trusts (as already discussed).

38. Many trust deeds will have an express clause permitting the administration to be carried on outside the Cayman Islands. As set out earlier in this article, STAR trusts have special requirements.

## Conclusion

There are numerous pitfalls for the unwary foreign trustee, and sometimes for the unwary settlor as well. It is always vital to take into account the factors which could impact on foreign trustees when a Cayman Islands trust is administered abroad. With heightened awareness and vital input obtained from Cayman attorneys, however, these

risks can be successfully managed and foreign trustees can continue confidently as trustees of Cayman Islands trusts.

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