



British Virgin Islands Unit Trusts

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Preface

This publication has been prepared for the assistance of those who are considering the formation of unit trusts in the British Virgin Islands (“BVI”). It is not intended to be exhaustive nor a substitute for proper legal advice but provides a basic guide to the unit trust concept and an outline of trust law and unit trust administration in BVI for clients of Conyers Dill & Pearman.

Clients are advised that they should consider the implications in their home jurisdiction of establishing a BVI unit trust and should consult with their own legal, financial and other professional advisers as appropriate.

We also recommend that our clients seek legal advice in BVI on their specific proposals for a unit trust before taking steps to implement them.

Conyers Dill & Pearman

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1. INTRODUCTION

BVI trust law is based on English trust law, as enhanced in certain areas by BVI legislation. The principal legislation governing trusts in BVI is the Trustee Ordinance.

The origins of unit trusts are found in the trust relationship developed by the English courts of equity. A trust therefore exists in equity and is the legal relationship created where a trustee or trustees holds the legal title to certain property (the trust fund) settled on it by another person (the settlor) for the benefit of others (the beneficiaries).

2. THE UNIT TRUST CONCEPT

The foundation for unit trusts can be traced back to mid-nineteenth century England. At that time, English companies were formed by deed of settlement, rather than by registration under statute. One type of deed of settlement company was a “management trust”. These management trusts allowed a number of investors to invest collectively in a fixed or variable portfolio of investments which would be managed by the company for the benefit of such investors.

With the coming into effect of the English Companies Act 1862, registration requirements were introduced for certain types of associations. In particular, the English Companies Act 1862 provided that any association consisting of more than twenty persons, formed for the purposes of carrying on a business, that had for its object the acquisition of gain by the association or by its individual members, should, to be legal, be registered as a company under the English Companies Act 1862. The management trust structure was subsequently curtailed by the judgment in an English court case (*Sykes v Beadon* [1879] 11 Ch D170) which held that such commercial associations were illegal unless registered under the English Companies Act 1862. Accordingly, nearly all management trusts were either wound up or registered under the English Companies Act 1862 as “investment trust companies”, that is companies which hold a pool of investments for the benefit of their members.

English company law did not permit a company to buy back its own shares and distribute its assets to its members on a continuing basis. Thus an investment trust company was, and is, required to be a closed-ended vehicle. This is unattractive to those investors who wish to have the right to require the redemption of their interest in an investment structure during its lifetime at a price relating to the net asset value of the underlying portfolio.

However not all management trusts became investment trust companies following the introduction of the English Companies Act 1862 and one, the Submarine Cables Trust, successfully reversed the *Sykes v Beadon* decision on the grounds that the management trust was a trust established under the general law of trusts and therefore did not require registration under the English Companies Act 1862 (*Smith v Anderson* [1880] 15 Ch D247). Indeed the argument was that the Submarine Cables Trust was a “partnership” consisting of a greater number of persons (twenty) than was permitted by the English Companies Act 1862. The court drew the distinction between a trust and an association in respect of the Submarine Cables Trust because its deed did not provide for the carrying on of a business, but rather for the single purpose of holding of trust property vested in the trustees, albeit that the trustees also had certain management powers. The court also held that the investors were not “in association” as they had no relationship with each other, only with the trustee.

Despite the judgment in *Smith v Anderson*, no more management trusts were established in England until the 1930's, when the first "unit trusts" were seen. These investment structures were called "unit trusts" because each investor, although the beneficial owner of a share of the investments held by the trustee, had only an undivided share in those investments. Accordingly, an investor did not have an entitlement to the specific investments comprised in the trust fund, but just the right to redeem his share in the assets of the trust fund, known as a "unit", for cash at a price based on the value of the investments of the trust fund. A unitholder does not therefore, prior to the termination of a unit trust, have a proprietary interest as an equitable co-owner of the trust fund.

3. TRUST INSTRUMENT

A unit trust is constituted by a trust instrument either in the form of a declaration of trust made by the trustee alone or in the form of a trust deed executed by both the trustee and the manager.

The trust instrument will contain a declaration by the trustee that it holds the trust fund for the benefit of the unitholders and will administer that property accordingly to the terms of the trust instrument.

In a declaration of trust, all the powers and duties of the trustee regarding the administration of the trust are specified in the declaration. The trustee will then enter into an agreement with the manager for the provision of investment management services, under which the trustee delegates certain of its powers, primarily the investment decisions regarding the trust fund, to the manager.

In a trust deed the responsibilities of each of the trustee and the manager are set out.

Unlike a company, a unit trust has no separate legal personality and the trustee as holder of legal title to the trust fund would be the party which sues or is sued in relation to the trust fund.

4. FORMS OF UNIT TRUST

Unit trusts are suitable for a variety of investment structures, including the stand-alone trust and the umbrella trust.

4.1. Stand-Alone Unit Trusts

A "stand-alone" trust will be used where the trust intends to pursue a single investment objective and strategy. Such trusts may issue a single class of units to investors, or a number of classes within the same unit trust. In the latter type of "multi-class" unit trust, each class of units will have different rights and terms, such as different fees and expenses and may also be used where the offering of units distinguishes between different types of investors, such as institutional and retail investors. However, the trust fund will be invested as a single portfolio and each unit of any class will participate equally in that portfolio relative to the total net asset value.

4.2. Umbrella Unit Trusts

An "umbrella" unit trust is a flexible structure whereby the trustee holds different pools of investments allocated to different "sub-trusts" and where investors subscribe for units (of one or more classes) attributable to a particular sub-trust. Whilst there is no statutory segregation of assets and liabilities of unit trusts in the BVI, the trust instrument would allow the trustee (and the manager in the case of a dual-

party trust deed) to create “sub-trusts”, each of which may have a different investment objective and strategies and/or different types of investors.

The trust instrument will state that a sub-trust is established as a “separate and distinct trust” but it should be noted that this only goes to the terms of the relationship between the unitholders of the relevant sub-trust and the trustee (and the manager in the case of a dual-party trust deed) in respect of their participation in the wider umbrella trust arrangement established under the trust instrument. In the absence of separate limitations being included in any contractual arrangement with third parties, such persons will not be bound by the segregation envisioned in the “umbrella” unit trust in their dealings with a particular sub-trust.

The trust instrument for an umbrella trust can be structured in a number of ways, including providing that the trustee will have the power to establish each sub-trust by trustee resolution or by a supplemental trust deed.

Where a sub-trust is established by supplemental trust deed, the principal deed should itself establish a “head” trust by settlement of property on the trustee. That settlement may be made by the manager or the trustee itself and may be of a nominal amount. In the absence of such settlement there will not be a valid trust because a trust cannot exist without there being property owned by a person who has obligations as a trustee. Accordingly, unless the “head” trust is established by the principal deed, there will be no valid trust until the first sub-trust is established.

Whilst a structure in which a “head” trust is not established may be intended to emphasise the “separate and distinct trust” concept for each sub-trust, in the absence of a “head” trust, the power to create a sub-trust (or, more accurately, a trust) is not derived from the principal deed, but rather from the supplemental trust deed itself which, upon execution, incorporates such powers of the principal deed by reference. Accordingly, the provisions of the principal deed are not effective until the execution of the first supplemental trust deed and then only in respect of the sub-trust established by such supplemental trust deed. The principal deed would therefore simply amount to contractual terms incorporated into the terms of a trust relationship only upon the establishment of each sub-trust. This may undermine the intended “umbrella” nature of the structure because a separate series of trusts will be created by supplemental trust deed without them necessarily having any trust relationship to each other.

5. POWERS, DUTIES AND TRUST ADMINISTRATION

5.1. The General Law of Trusts

Under BVI trusts law, a number of general fiduciary duties are imposed on trustees. Whilst these duties apply generally to unit trusts, unlike a private trust where the investment and trust administration functions are vested only in the trustee, a unit trust will have a manager and a trustee, both of whom are responsible for such functions in the unit trust. Accordingly, whilst there has been only limited judicial consideration of the respective responsibilities of the trustee and the manager of a unit trust, the English case, *Galmerrow Securities Ltd. & Others v National Westminster Bank PLC* [2002] WTLR125 did so consider.

In the *Galmerrow* case, it was recognised that there are a wide range of trusteeships known to the law, starting at the one extreme with a bare nominee (holding property on trust absolutely for a person and acting on any directions given to the trustee by the beneficiary), and ending with trustees who take full

responsibility for dealing with the trust property and exercise all trust powers themselves. Within this range there existed “commercial trusts”, including unit trusts, where the functions of the trustees are divided between two or more bodies of persons.

It was further recognised that the terms of the trust instrument governed the respective roles of the trustee and the manager, and that the fiduciary duties of the trustee are limited by the terms of the trust instrument. Accordingly, each of the trustee and the manager was only responsible for those duties which had been allocated to it under the terms of the trust instrument. Neither was responsible for the supervision of the other except as specifically stated in, or implied by, the trust instrument.

On the facts in the *Galmerrow* case, the trust instrument provided that the acquisition, management and realisation of the trust fund was the sole responsibility of the manager and that the manager had full powers of dealing with the trust fund as if it was the beneficial owner. The duty of the trustee of the unit trust was to act on the directions of the manager and it was held that the trustee owed no duty of care to check those directions in order to ensure they were likely to benefit the unitholders. The trustee was required to act in good faith but, so long as it did so, no act of management could be charged against it. The court held that the trustee therefore had no duty to exercise a general supervision over the manager’s choice of investments but merely had to check that it was within the investment limits prescribed by the trust instrument.

Accordingly, the manager of a unit trust could be characterised as an agent of the trustee performing certain duties which under the general law of trusts would be performed by the trustee. However, the alternative view leading from the *Galmerrow* case is that the relationship between the trustee and the manager is one where they were co-fiduciaries. Accordingly, the manager carries out the investment decisions and the day-to-day administration of the trust, leaving the trustee with the duty of safe-keeping the trust fund and looking after the interests of the unitholders. On this basis it would not be correct to characterise the manager as an agent of the trustee, for whom the trustee as principal is, under the law of agency, ultimately responsible.

Indeed, the trustee could be characterised as a custodian trustee and the manager as a managing trustee.

If the trustee and the manager are co-fiduciaries, they each can appoint their own agents to perform functions for which they are ultimately responsible, and in such case the trustee would not be responsible for the manager’s agents (such including brokers appointed by the manager) and vice versa.

5.2. Contractual Arrangements

A unit trust is not a separate legal entity from the trustee and thus it is not possible to enter a contractual arrangement on behalf of the trust itself. Further, under BVI law it is possible for a trust instrument to provide that a trustee shall not be personally liable under a contract if properly entered into by the trustee so long as the trustee discloses its fiduciary capacity in the contract or the other party is otherwise aware of it. If the trust instrument does not so provide, the default position under BVI law is that, where a trustee properly enters into a contract and discloses its fiduciary capacity or the other party is otherwise aware of it, the trustee will be personally liable for any sum payable under the contract but only to the extent of the value of the trust fund when the payment falls due. Whether or not the trust instrument so provides,

a claim may be brought under a contract entered into by a trustee against the trustee in its fiduciary capacity so that the claimant shall be entitled to satisfaction out of the trust fund directly, rather than by way of subrogation to the trustee's right of indemnity.

Subject to that, where a trustee enters into a contract pursuant to a power under the trust instrument or the general law, the trustee can be sued by another party to that contract (the "third party") under the law of contract and, under the law of trusts, any other trustee must administer the trust in order to meet any liabilities under the contract. However, the third party will only have a claim directly in contract against the other trustee(s) of the trust if the trustee had authority to act as agent for those other trustee(s) when contracting with the third party.

Whilst there is judicial authority to show that a manager of a unit trust has a fiduciary role with some of the same duties as those of the trustee, it is less clear whether the authorities would go so far as to describe the manager as a co-trustee of the unit trust. If the analysis is that the duties and powers of the manager under the trust deed are indeed those of a trustee under the general law, then each of the manager and the trustee will be principals with respect to the trust fund. On this basis it should not matter to the third party whether the trustee or the manager enters into the contract.

However, if the manager is not to be regarded as a trustee in relation to the unit trust, even though the decision-making functions for contracts with third parties may have been given to the manager under the trust instrument, any contract will only bind the trustee under the law of contract if either the trustee is a party to the contract or the manager is authorised to enter the contract as agent for and on behalf of the trustee.

Even though the third party may only have a claim against the manager, if the manager is sued under the contract it would claim against the trustee. The trustee would be required to administer the trust fund in accordance with the trust instrument. Accordingly, the manager would need to ensure that the trust instrument specifies it has the power to enter into contractual arrangements.

5.3. Security interests

Where the manager is not regarded as a trustee in relation to the unit trust, the fact that the third party does not have a direct claim against the trustee because only the manager entered the contract, may place the third party at a disadvantage. For example, a security interest in favour of a third party may not be fully effective unless the trustee as legal owner of the trust fund, or the manager as agent appointed by the trustee, enters into the security document. In such circumstances, the manager may be regarded as creating a security interest over the trust fund which it had no right to do as the trustee holds the legal title to the investments of the trust fund.

Accordingly, where the security interest is created pursuant to an express power of the manager provided in the trust instrument, if the third party wishes to have direct contractual recourse against the trustee as holder of the legal title of the trust fund in order for a charge or other security to be granted over the trust fund, the trustee should also be a party to the contract or the manager should be authorised as agent of the trustee to enter into the relevant contract.

6. APPOINTMENT OF SERVICES PROVIDERS

Where a separate custodian or sub-custodian is appointed it will typically be a company in the trustee's group and thus appointed by the trustee. Where a sub-custodian in a particular jurisdiction falls outside the global network of custodians in the trustee's group of companies, such sub-custodian may also be appointed by the trustee, albeit that the applicable supervisory and liability threshold of the trustee may then be different.

However, where a prime broker is appointed, the trust instrument may provide that it is the manager who effects such appointment, in consultation with the trustee. The usual rationale for this is that, as the manager instructs the prime broker, the prime broker should be appointed by the manager.

This may, however, be erroneous reasoning in that it is a fundamental duty of the trustee, recorded in the trust instrument, to bring and keep under its control the trust fund. The prime broker will take custody of, and legal title to, (at least part of) the trust fund. In the absence of an express provision in the trust instrument, the trustee should not allow the manager to appoint any prime broker (or indeed a custodian) without, as a minimum, consultation with the trustee regarding such appointment.

Where (part of) the trust fund is in the safe-keeping of another person on the instructions of the manager, the trust instrument should include a provision to the effect that the trustee will not be responsible for the (part of the) trust fund placed with that person.

7. TRUSTEES' LIABILITIES

Under the general law, the level of care which a trustee is obliged to show in performing its duties is that of an "ordinary prudent man of business in managing his own affairs", but in the case of professional corporate trustees, there is a higher test of "special care and skill". In addition, a paid trustee is expected to exercise a higher standard of diligence and knowledge than an unpaid trustee.

Whilst the trustee's duties require active participation in the administration of the trust, the extent of its responsibilities will be determined by the trust deed. For example, the trust deed will usually make it clear that the manager alone has the right and the duty to make investment decisions. In such circumstances, the trustee's function is not to assess the investments decisions of the manager, provided that the investments themselves are in line with the investment parameters of the trust and the custody requirements of the trust instrument. Accordingly, whatever the level of care which may be required of the trustee under the general law, the duty to which it applies is only that set out in the trust deed.

The Trustee Ordinance contains relieving provisions in respect of liability for the acts of third parties. Section 31(1) of the Trustee Ordinance provides that the trustee should be accountable only for its own acts and not for those of third parties unless the same happens through its own wilful default. In the context of an exclusion clause such as Section 31(1) of the Trustee Ordinance, the term "wilful default" means a deliberate breach of trust (*Armitage v Nurse* [1998] Ch244).

Section 24 of the Trustee Ordinance, provides that trustees may act through agents and shall not be responsible for the default by any agent employed in good faith. However, caution should be applied in relying on this provision as its terms may be construed strictly against a trustee, particularly for

professional corporate trustees. It is also the case that the trustee must exercise proper care in the selection of an agent and review the agent's performance at periodic intervals.

8. LICENSING REQUIREMENTS

A unit trust which falls within the definition of "mutual fund" in the Securities and Investment Business Act of BVI will need to be regulated under that Act.

The BVI Financial Services Commission ("FSC") will regard the trustee of the unit trust as the regulated entity. In the context of a stand-alone unit trust or an umbrella unit trust whose sub-trusts are not established by supplemental trust deed, application for regulation as a mutual fund with the FSC will be made following the execution of the declaration of trust or trust deed. For an umbrella fund where its sub-trusts are established by supplemental deed, application may be made to the FSC for registration of each sub-trust rather than the "head" trust.

This publication should not be construed as legal advice and is not intended to be relied upon in relation to any specific matter. It deals in broad terms only and is intended merely to provide a brief overview and give general information.

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