



TWO SEAS TRUST



Briefing: The Use of Trusts

Preface

This memorandum has been prepared for the assistance of clients considering creating a trust in Bahrain. It is intended to provide a summary of the general principles applicable to the establishment and administration of trusts. It is not intended to be comprehensive in its scope and it is recommended that a client seek legal advice on any proposed transaction prior to taking steps to implement it.

Bahrain's Position as a leading Financial Services Centre

Bahrain is widely regarded as the best regulated financial centre in the Middle East. It plays host to more than 400 financial services institutions and in recent years has become a global leader in Islamic finance. It has the largest concentration of Islamic finance institutions in the Middle East. According to the Index of Economic freedom, Bahrain is ranked 19 ahead of France and Germany.

Introduction to the Trust Concept

A trust is a legally binding arrangement whereby a person (known as a settlor) transfers assets to another person (known as a trustee) who is entrusted with legal title to the trust assets, not for his own benefit, but for the benefit of other persons (known as beneficiaries, who may include the settlor or for a specified purpose). The instructions from the settlor to the trustee as to the disposition of trust assets will normally be contained in a document called the trust instrument. This is for the benefit of all parties as it will ensure that the settlor, the trustee and the beneficiaries know precisely what their respective rights and duties are. The trust instrument will usually provide that the trustee has the power to manage the trust assets in accordance with the terms of the trust instrument and the strict duties imposed on the trustee under trust law.

In addition to the trust instrument it is also usual for a settlor to indicate to the trustee his wishes as to the management and disposition of the trust fund in the future in a less formal manner. His expression is often contained in a letter of wishes which, although not legally binding, will generally be considered by the trustee to be of persuasive effect when performing his duties and, for example, determining to make a distribution out of the trust fund.



TWO SEAS TRUST



The Trust Law in Bahrain

The Financial Trust law was promulgated on 15 August 2006 issued by Royal Decree no.(23) of 2006. It contains comprehensive regulations and rules to govern the establishment and management of financial trusts where Bahrain is considered one of the first countries in the Middle East to implement such legislation.

The Components of a Trust

The Settlor

Once a trust is created the settlor will have divested himself of legal ownership of the trust assets. The settlor may be a beneficiary and, in certain circumstances, he may also act as a co-trustee. The settlor may, also, retain a degree of control over the trust, such as the power to approve distributions, the power to appoint and remove trustees and the power to revoke the trust. However, it is essential to the validity of a trust that the settlor actually dispossesses himself of the trust assets and he may not, for example, simultaneously be a sole trustee and a sole beneficiary.

The Trustee

Legal title to the trust assets is vested in the trustee under the obligations imposed by the trust and he is responsible for the administration of the trust. A trustee is required to act with due diligence, as would a prudent person, to the best of his ability and skill and must observe the utmost good faith. A trustee must exercise his powers solely for the benefit of the beneficiaries. The trust assets, however, constitute a separate fund and do not form any part of the trustee's own estate.

The Beneficiaries

The beneficiaries are the persons entitled to benefit from the assets held on trust. As stated above, the settlor may himself be one of the beneficiaries. In order for a trust to be valid there must generally be sufficient certainty as to the identity of the beneficiaries. An express power for the addition of further persons to the class of beneficiaries may, however, be included in the trust instrument. The beneficiaries may enjoy equal or unequal benefits, as the trust instrument prescribes or, in the case of a discretionary trust, as the trustee may determine. It is also possible to include in the trust instrument a power to exclude beneficiaries from future benefit.



TWO SEAS TRUST



The Trust Fund

The assets constituting the trust fund may be of any type of movable or immovable property. At any time after settlement on trust of the initial assets further assets may be added. Indeed, a common arrangement is to establish a trust with a nominal initial amount and subsequently to add more substantial assets.

The Protector

It is not essential for the validity of a Bahraini Trust that there be any protector. However, in order to counterbalance the wide discretionary and fiduciary powers conferred on a trustee it is often found useful for the settlor to appoint a trusted friend or professional advisor to act as a protector of the trust. In such cases the consent of the protector will generally be required before the trustee may exercise certain strategic powers under the trust instrument.

Forms of Trusts

Various types of trust have been developed over time and the most appropriate structure for the settlement will depend on the settlor's particular circumstances, objectives and religious beliefs. The approach of Two Seas Trust is to tailor the trust to meet our client's requirements. For the purpose of this briefing, we have set out some of the more common types of trust based on our experience in other offshore centres.

Discretionary Trust

The discretionary trust provides maximum flexibility and is often the most efficient structure or both settlor and beneficiaries. Under the terms of a discretionary trust the trustee is given wide discretionary powers as to when, how much and to which beneficiaries he should distribute the income and capital of the trust. Such a form of trust is useful where at the time of creation of the trust the future needs of beneficiaries cannot be accurately determined. The beneficiaries are not regarded as having any direct legal rights over any particular portion of the trust fund but only a right to be considered to benefit when the trustee exercises his discretion.

Accumulation and Maintenance Trust

An accumulation and maintenance trust is one where no beneficiary has a fixed entitlement to the benefits accruing to the trust for a certain period, during which time income is accumulated and becomes an accretion to capital. The persons who are ultimately entitled to the trust capital may thus benefit from the accumulation of capital.



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The trust instrument may give the trustee a discretionary power to make distributions amongst the beneficiaries up to a specific age for their education, maintenance and benefit and to provide thereafter for a designated share of the trust fund to be distributed to each child on attaining a specified age. An accumulation and maintenance trust may be particularly appropriate where the settlor wishes to benefit a group of children, for example, his grandchildren.

Fixed Interest in Possession Trust

Under the fixed interest trust the principal beneficiary will normally be granted a vested interest in the income of the trust fund throughout his lifetime and the discretion of the trustee regarding the disposition of the trust fund will be limited. For example, the trust instrument may specify that the trustee is required to distribute all of the income of the trust fund to a particular individual during that person's lifetime and subsequently to distribute the capital of the trust fund in fixed proportions to named beneficiaries (such as the settlor's children).

Revocable Trusts

Although for tax and other reasons it is generally desirable for a trust to be constituted as an irrevocable settlement, in certain circumstances the settlor may require the additional comfort of knowing that he has retained the power to revoke the trust and enforce the return of the trust fund. Careful consideration requires to be given to the possible consequences of a revocable trust because under the jurisdiction of the settlor's domicile, residence or nationality, revocation may negate some of the expected benefits of creating the trust.

Practical Applications of Trusts

In essence a trust is a legal device, first developed under English law, under which legal ownership of assets is vested in a trustee whilst the enjoyment of the trust fund is preserved for the benefit of the beneficiaries on terms determined by the settlor.

The range of uses to which a trust may be employed is still being developed but flexibility and confidentiality are the principal advantages which a trust has over other legal forms designed to hold, preserve and transmit wealth. The trust concept has proved to be enormously adaptable and is widely used in financial planning.

Such is the flexibility of a trust that it would be impracticable to define its potential, however, some typical applications are the following:



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Preservation of Wealth

Trusts may be used to preserve the continuity of ownership of particular assets, such as a business, within a family. By vesting legal ownership of the assets in the trustee, the relevant individuals may be able to continue to benefit from the assets, whilst avoiding fragmentation of ownership amongst a large number of second and third generation beneficiaries. The use of a trust avoids, on the death of a beneficiary, the risk of a share of assets becoming owned outside the family, and thus enables settled assets to be preserved intact for the benefit of future generations.

Reservation of powers

Although once a settlor creates a trust he is deemed to have divested himself of legal ownership of the trust assets, a settlor may reserve for himself certain powers. Most commonly, settlors will wish to reserve powers in the area of investment. Other powers which can be reserved include the power to revoke, vary or amend the terms of a trust or any trusts or powers arising wholly or partly under it; to advance, appoint, pay or apply income or capital of the trust property or to give directions for the making of such advancement, appointment, payment or application; to appoint or remove any trustee, enforcer, protector or beneficiary; and to change the proper law of the trust.

Forced Heirship

Where a settlor disposes of assets during his lifetime by settling them on trust, the trust assets will not form any part of the settlor's estate upon his death. This may enable a settlor to avoid forced heirship rules which may be mandatory under the laws of his domicile, residence or nationality and which would otherwise dictate the persons to whom and proportions in which a settlor's estate will devolve.

Succession Planning

The effect of a trust is to divest the settlor of ownership of the settled assets. Accordingly, upon the death of a settlor there will be no need to obtain a grant of probate or similar formalities in order to deal with the trust fund. A trust, therefore, provides an efficient vehicle for the transfer of beneficial ownership interests on the death of a settlor. A trust can be used to hold shares in a company owning immovable property rather than directly in the real property itself, with the effect of transforming characterisation of an interest from immovable to movable, which can present attractive opportunities for financial planning. A trust may also be used to protect financially unsophisticated beneficiaries and to make financial provisions for the improvident.

24th Floor, NBB Tower, Government Avenue, PO Box 10476, Manama, Kingdom of Bahrain
t +973 1720 6800 f +973 1720 6801 info@twoseastrust.com

www.twoseastrust.com

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Asset Protection

Historically trusts have been established for the principal purpose of protecting assets from risk. In a modern context, trusts may be employed to hold assets in a secure and stable political environment. Trusts play a major role in financial planning for individuals, families and companies and are apt to serve as a shield to protect assets against the potential future liabilities of a settlor, such as punitive taxation. The use of a trust in conjunction with an underlying company can be used to convert an onshore asset into an offshore one and to interpose an additional layer of confidentiality in a chain of ownership. The use of the trust and company combination may also enable trust assets to be held in a jurisdiction which does not recognise the trust concept. Such an arrangement may be attractive to a lender for the purpose of obtaining security against assets. Trusts can also safeguard assets against strategic risks, such as confiscation or expropriation by the State in the country of the Settlor's domicile, residence or nationality. As a further protection, a modern trust instrument can provide for the proper law of settlement to be moved to another jurisdiction in the event of political or strategic emergency in the country of the trustee's residence.

Commercial Trusts

The variety of means to which a trust may be put in the commercial context has only been partly realised. Trusts have been used for the following commercial purposes:

- as a unit trust for the collective investment of capital (e.g. Real Estate Funds);
- employee share option and executive incentive schemes (as well as regular pension schemes) will benefit from being established in a politically stable, fiscally neutral jurisdiction;
- in off-balance sheet transactions, the share capital of an “orphan” special purpose vehicle will typically be held by a trustee under the terms of a charitable trust;
- in an inter-creditor agreement, the rights of one creditor group may be subordinated to the rights of other creditors and regulated under the terms of a subordination trust forming part of the overall security package; and
- asset securitisation schemes have been structured to provide for mortgages and receivables to be held pursuant to the terms of a trust.



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Trust Instrument

It is preferable for a trust to be created by the execution of a formal written instrument so that all parties will know exactly what their respective rights and duties are. Trusts created in writing may be either a Settlement of Trust signed by both the settlor and the trustee, or by a Declaration of Trust signed by the trustee alone. Following execution of the trust instrument a trust will come into existence upon settlement of the initial property, which may be supplemented later. Two Seas is able to assist with preparation of all of the appropriate documentation.

Services Offered by Two Seas Trust

In connection with the formation of trusts our team is able to provide the following services: advice and liaison with professional advisers in other jurisdictions in order to recommend the most practical and efficient structure to achieve the settlor's objectives; preparation of the trust instrument, letters of wishes and formation of underlying companies to hold the trust assets; and preparation and review of documentation relating to commercial transactions underlying the trust.

Creation of a Trust

A full range of trust administrative services is provided by Two Seas Trust B.S.C.(c) which is regulated and authorised to conduct trust company business by the Central Bank of Bahrain. Should you wish to proceed with the establishment of a Bahraini trust please contact any member of the team listed at the back of this client briefing.



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About Two Seas Trust

Two Seas Trust B.S.C.(c) is a joint venture between Ogier Fiduciary Services (Jersey) Limited and Keypoint Consulting W.L.L.

Two Seas Trust is regulated by the Central bank of Bahrain for trust company business.

About Ogier

Ogier is one of the world's leading providers of offshore legal and fiduciary services employing over 800 professional and support staff. The group has a presence in eleven jurisdictions around the world, namely Bahrain, the British Virgin Islands, the Cayman Islands, Guernsey, Hong Kong, Ireland, Jersey, London, Montevideo, Tokyo and New Zealand.

Ogier provides advice on all aspects of BVI, Cayman, Guernsey and Jersey law and associated fiduciary services through a global network of offices that cover all time zones and key financial markets including the rapidly growing Asian and Chinese markets.

Ogier continues to be recognised as a leading law firm by the leading legal directories, including Legal 500 and Chambers.

In Legal 500 Ogier has more lawyers recommended and more tier 1 rankings for individual practice areas than any other Jersey firm.

In Chambers the firm has more lawyers recommended than any other Jersey firm.

About Keypoint

Keypoint is a leading provider of statutory advisory, accounting, fund administration and recruitment services in the Middle East. Based in Bahrain they currently provide corporate administration and fund administration services to a wide variety of clients including banks, individuals, real estate and private equity houses.

Prior to 2006, Keypoint formed a part of Ernst & Young Middle East and they continue to enjoy a close working relationship.

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24th Floor, NBB Tower, Government Avenue, PO Box 10476, Manama, Kingdom of Bahrain
t +973 1720 6800 f +973 1720 6801 info@twoseastrust.com

www.twoseastrust.com

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Contact Details

Bahrain

Paul Perris

paul.perris@twoseastrust.com

t: +973 1720 6802

m: +973 3628 3882

Hanna Ylijukuri

hanna.ylijukuri@twoseastrust.com

t: +973 1720 6804

m: +973 3628 3880

Guruparan Kumarasamy

guruparan.kumarasamy@keypoint-bh.com

t: +973 1720 6881

m: +973 3961 7950



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24th Floor, NBB Tower, Government Avenue, PO Box 10476, Manama, Kingdom of Bahrain
t +973 1720 6800 f +973 1720 6801 info@twoseastrust.com

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