

Another string to the bow - the Cayman Islands new foundation company legislation

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Key Points

What is the issue?

At the end of 2017, the Cayman Islands became the latest jurisdiction to introduce a foundation vehicle onto its statute book.

What does it mean for me?

The introduction of the foundation company adds a new option for structuring in the Cayman Islands. STEP members should be alive to the opportunities it presents and how the structure may be applied in practice.

What can I take away?

An insight into how the Cayman vehicle differs from foundation structures in other jurisdictions, and its possible application. It is expected that activity will focus on wealth planning, as well as holding vehicles and special purpose vehicles for commercial transactions and cryptocurrency offerings.

THE ENACTMENT OF the Cayman Islands *Foundation Companies Law, 2017* (the Law) in October 2017 is a welcome addition to the Cayman legal landscape. The creation of a Cayman foundation has been mooted for many years, and it may seem that the jurisdiction is relatively late to the game as many offshore centres have implemented ‘foundations’ legislation in recent years.

However, the Cayman Islands has been able to take a different, more innovative approach to the legislation, which has resulted in a structure that has many advantages over foundations offered by other offshore jurisdictions, and over a trust or not-for-profit company. The Cayman foundation

company is a highly flexible vehicle, designed to achieve a wide range of private client, family business and philanthropic objectives.

Rather than introducing a completely new legal entity, the Cayman Islands decided to build on the traditional company structure by adding (or taking away) certain features. One of the biggest advantages of this approach is that foundation companies will benefit from the Cayman Islands' substantial company case-law history, so there will be a good degree of certainty as to how the courts will treat this new creation.

The Cayman foundation company has features and flexibility that allow it to function like a civil-law foundation or common-law trust, while retaining the separate legal personality and limited liability of a company. The approach taken by the Law is unique, and it is anticipated that this creative solution will appeal to many clients.

VARIED USES

Given the flexibility of the Cayman foundation structure with regard to its purpose, management and supervision, we expect its uses to be many and varied.

From the outset, the Cayman legal draftsman looked to add another string to the bow of options for the wealth planning industry, while keeping an eye on other, wider commercial strategies.

For example, as discussed below, foundation companies can be used to hold shares in private trust companies (PTCs), as standalone special purpose vehicles (SPVs), or as vehicles in finance or commercial transactions. The structure is versatile and easily customisable, allowing it to meet the founder's objectives and desired tax treatment.

We have already seen significant interest in foundation companies in the ever-growing cryptocurrency and fintech industries. The option to have an 'ownerless' structure is particularly appealing to those who may be looking to set up a robust, trusted and familiar framework that can provide confidence to those investing in coin or token offerings.

For private clients, foundation companies may be an attractive alternative to trusts, particularly for those in civil-law jurisdictions, where there are concerns about the tax treatment of trusts.

The main difference between a trust and a Cayman foundation company is that a foundation company has a separate legal personality and so, for example, it will transact with third parties in its own right, rather than through its trustee. This is a fundamental difference between the two concepts.

A foundation company offers many of the features that make trusts ideal succession planning and

asset-protection vehicles, such as the ability to separate the control from the economic benefit derived from assets. Clients from common-law jurisdictions may also be attracted to a foundation company for holding higher-risk assets, such as shares in family businesses, as there is no fiduciary duty owed to beneficiaries, only the company itself.

The 'ownerless' features mentioned above mean that foundation companies are likely to provide simple solutions in the context of PTCs, management shares of investment funds or wider commercial transactions. It is anticipated that foundation companies will be used as holding vehicles for shares in PTCs, as protectors or enforcers of trusts, and as SPVs in structured finance or commercial transactions.

REQUIREMENTS

Like a traditional company, a foundation company will have a memorandum and articles of association, as well as stated objects. Unlike a traditional company, however, the foundation company's objects can include beneficiaries. Further, the foundation company's memorandum must prohibit the payment of dividends or other distributions to its members.

A foundation company must appoint a secretary, and this person must be a licensed service provider. The secretary's role is very important to the foundation company, as, in addition to maintaining the foundation company's books, including the usual statutory registers of members and directors, the secretary must sign off on all of its activities and records.

Though any person can transfer assets to a Cayman foundation company, the secretary must confirm that there are no objections to the transfer under any regulatory laws. This is an important anti-money laundering safeguard, but it is one that will no doubt significantly add to the secretary's responsibility.

UNIQUE FEATURES

A foundation company is not required to have any members at all, if permitted by its memorandum and provided that the company has a supervisor. The supervisor role is newly created and, as a minimum, the supervisor must have a right to attend and vote at general meetings.

Though, in theory, a foundation company's management will be carried out by its directors, its constitution can give any powers to another person or entity, whether they be members, directors, supervisors or founders. The legislation provides a non-exhaustive list of the type of rights and powers that can be delegated, including appointing or removing supervisors and directors; supervising the management and operations of the foundation company; altering the constitution; and powers to wind up the company.

In contrast to a trust, duties (whether owed by directors or otherwise) are owed only to the foundation company itself and rights can be enforced against only the company and not the directors.

Importantly, beneficiaries have no automatic powers or rights. This means that a foundation company may be able to hold higher-risk investments, such as shares in a family business or cryptocurrency, because beneficiaries will not have direct rights of action against the foundation company.

Another key issue that a foundation company can resolve for clients is the concern over rights to information. In the case of a foundation company, reports and accounts, for example, must be provided only to 'interested persons'. The foundation company's constitution can define who its interested persons are.

The Law is able to resolve uncertainty over arbitration clauses, which are a well-known headache for trust lawyers, since it is not possible to commit a beneficiary to use arbitration without their agreement, and the beneficiaries of a trust are rarely party to a trust deed. The Law expressly provides that a foundation company's constitution can mandate the resolution of disputes by arbitration (or indeed by any other lawful method).

The resolution of any dispute through arbitration, or specified alternative dispute-resolution mechanism, can be set aside only if a party has acted fraudulently or conducted itself in bad faith.

Though the foundation company may be used as an alternative to a Cayman trust, a number of features specific to Cayman's trust law have also been wrapped up into the foundation company vehicle, which should prove beneficial to investors and private clients. In particular, the 'firewall' feature of the Cayman Islands' trust legislation has been extended to foundation companies.

In a wide range of circumstances, this gives the foundation company robust protection against judgments by foreign courts in relation to the structure itself and the transfer of assets to it.

Another hugely successful feature of the Cayman Islands' trust legislation is the ability for trustees to apply to the Grand Court for opinions, advice or directions. This function of the Grand Court has been extended to foundation companies.

POSITIVE RECEPTION

The response from the market to the foundation company has been positive.

The Law has been hailed as an innovative piece of legislation, demonstrating Cayman's ability to respond to the needs of the offshore client through the foundation company, along with other new

structures recently introduced, such as the limited liability company and limited liability partnership.

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