

## Structuring from the foundations to the stars: Cayman foundation companies and STAR trusts

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Cayman boasts a variety of innovative and flexible vehicles and structures beyond the basic trust instrument, which can meet the structuring requirements of a range of entities, from charities to commercial ventures. Foundations and STAR trusts are among the structuring options available, and while similar in terms of the flexibility they afford, both vehicles have distinct properties which may make one more suitable than the other depending on circumstances and requirements.

#### STAR Trusts

##### Overview

STAR in star trust stands for "special trust alternative regime". This came from the original enacting legislation from 1997 which was known as the STAR Law. The STAR Law is now Part VIII of the Trusts Act of the Cayman Islands. STAR trusts are essentially non-charitable purposes trusts that can take a variety of forms and are usually discretionary in nature, albeit with some powers reserved, usually to the enforcer. STAR Trusts are unique to the Cayman Islands.

The law relating to STAR trusts is the same as for ordinary trusts (e.g. discretionary trusts) unless expressly provided for in Part VIII of the Trusts Act.

##### Purposes and persons

The main difference between an ordinary trust and a STAR trust is that a STAR trust can exist for "non-charitable purposes", rather than for persons or beneficiaries. For example, a "non-charitable purpose" may be to own and operate a particular business. A STAR trust can also have beneficiaries however.

## **Trustee**

The trustee of a STAR trust must have or include a licenced trust company or a private trust company in the Cayman Islands.

The trustee of a STAR trust must also ensure that the settlor understands who will have standing to enforce the trust.

## **Enforcer**

The legislation therefore introduces this concept of an enforcer which is the only person or entity which is able to enforce the terms of the trust against the trustee.

## **Reserved powers**

The enforcer can hold one or more reserved powers, common examples might include:

- (a) to vary or amend the trust deed
- (b) to appoint the income and / or capital of the trust fund to beneficiaries
- (c) to act as director of a company owned by the trust
- (d) to make investment decisions
- (e) to appoint or remove trustees
- (f) to add or remove beneficiaries
- (g) to change the governing law of the trust; and
- (h) to restrict the exercise of any trustee powers or discretions by requiring that they shall only be exercisable with the consent of the settlor / protector
- (i) In addition to the basic function of "enforcing" the trust, the role of enforcer can also include certain "protector" functions

## **Beneficiaries**

One of the key features of a STAR trust is that the concepts of benefit and enforcement are separated. A beneficiary of a STAR trust does not have any standing to enforce the trust. This means that beneficiaries of STAR trusts have no rights to information or to hold the trustee to account. Rather, those rights are held by the enforcer.

This makes STAR trusts incredibly popular because of the ability to restrict beneficiaries' rights and

to give the enforcement power to a single, trusted individual; the enforcer.

## **Perpetuities**

It should also be noted that the rule against perpetuities does not apply to STAR trusts. They are not therefore subject to a 150 year lifespan as with an ordinary trust.

### **How are STAR trusts used in practice?**

STAR trusts in combination with some form of reserved powers trusts remain the most common form.

They remain popular due to striking the right balance of the settlor retaining a degree of control and the trustee avoiding liability from a large class of beneficiaries, with enforcement being vested in an enforcer.

Popular uses include in dynastic family business trusts, philanthropic purposes, aircraft or yacht holding trusts, hedge fund structures, art holding trusts, litigation avoidance trusts and also in typical estate planning structures.

## **Foundation companies**

### **Overview**

The foundation company is a form of company that permits distributions to beneficiaries, rather than to shareholders. It was introduced to the Cayman Islands by the Foundation Companies Act, 2017 and was designed as a corporate alternative to a trust.

The constitution of a foundation company is comprised of memorandum and articles of association. It is registered with the Registrar of Companies and, upon incorporation, it receives a certificate of incorporation.

A foundation company does not normally have a shareholder or member and, indeed, if it does have a shareholder or member, it cannot pay dividends or make distributions to such person. It is therefore effectively "ownerless" and economic benefits are provided as distributions to the foundation company's beneficiaries.

In terms of corporate governance, interested persons in the foundation company would be the directors and supervisor.

### **Board of directors**

Day-to-day management of a foundation company, including the investment of the foundation company's assets, is conducted by its board of directors.

As a matter of good practice, we recommend that the board meets regularly and that its meetings are recorded in board minutes.

## **Supervisor**

A foundation company does not have to have a member (e.g. a shareholder or a guarantee member) but, if it doesn't, it must have something called a supervisor. The supervisor may also be a director, although this would weaken the structure from an asset protection perspective if there wasn't a separation of roles.

Subject to any greater role provided by the constitution, a supervisor's main function, as the name suggests, is to supervise the board of directors' management of the foundation company. The supervisor can be a single individual or a supervisor committee that is established.

## **Secretary**

A foundation company must have a secretary that is licenced or permitted to provide companies management services under the Companies Management Act (Revised). A foundation company must also have a registered office in the Cayman Islands, located at its secretary's business address. The question of who will provide the secretary is an important one to consider. There are a number of service providers on island that have developed a certain speciality in this field.

## **Beneficiaries**

A foundation company is prohibited from making distributions to its members but can make distributions in "furtherance of its objects". The objects of a foundation company can include beneficiaries.

But, perhaps similar to a STAR Trust, beneficiaries do not, unless otherwise provided for, have any powers or rights relating to the foundation company, its management or its assets; in other words, the default position is that claims can only be made against a foundation company by its supervisor or by third parties. Beneficiaries, in their capacity as such, would have no rights to distributions (or even to be considered for distributions) or to call for reports, accounts, information and explanations concerning the foundation company's business and affairs. So in that way there are definitely similarities to STAR Trusts and a beneficiary's place.

In establishing a foundation company, the founder therefore has considerable flexibility in designing the "beneficial" provisions of how and when beneficiaries will benefit.

## **Founder - reserved powers**

Although day-to-day management of a foundation company is conducted by its board of directors, a foundation company's constitution can give any rights, powers or duties to its founder or indeed its supervisor. Those rights, powers or duties can, among other things, relate to:

- (a) appointing or removing its supervisors
- (b) appointing or removing directors
- (c) the supervision of the management and operations, including
  - (i) adding or removing beneficiaries; and
  - (ii) making distributions
- (d) the enforcement of duties
- (e) the calling of, and attendance at, its general meetings; and
- (f) altering the constitution

The founder therefore also has considerable flexibility in designing the corporate governance structure, including building in checks and balances for the exercise of important powers.

## **Firewall**

The "Cayman firewall" is a set of provisions contained within the Trusts Act (Revised). The effect of these provisions is that the Cayman courts will not enforce foreign court orders made against Cayman law governed trusts where such order was made due to a personal relationship between a person and the settlor or beneficiary of the trust. This is an excellent protection against foreign divorce orders.

The Foundation Companies Act, 2017 extends the "Cayman firewall" to also protect foundation companies.

## **How are foundation companies used in practice?**

When the foundation company legislation was first enacted, foundation companies were extremely popular and widely used in the crypto and blockchain space for ICO and STO transactions. They have become increasingly popular in more traditional wealth planning arrangements such as being used as private trust companies, wealth holding vehicles and for philanthropic and charitable purposes. A notable example in the Cayman community of the foundation companies legislation in full effect was the formation of a charitable foundation company last year in the Cayman Islands in response to the COVID-19 pandemic.

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## Key Contacts



[Anthony Partridge](#)

Partner

[Cayman Islands](#)

E: [anthony.partridge@ogier.com](mailto:anthony.partridge@ogier.com)

T: [+1 345 815 1810](tel:+13458151810)

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