

The Harbour International Trust Company Limited

WHAT ARE 'FIREWALL PROVISIONS'?

In simple terms, Bermuda has taken the public policy position that settlors should be free to create Bermuda trusts, and have confidence that:

- ❖ the trusts and their trustees will be supervised by the Bermuda courts - not by foreign courts who may either not recognize the trust concept, or be hostile to the use of trusts;
- ❖ those courts will apply Bermuda's trust law to certain key questions relating to the integrity and operation of Bermuda trusts; and
- ❖ the firewall legislation will prevent the recognition and/or enforcement of foreign judgments adverse to Bermuda trusts.

BERMUDA'S FIREWALL – VERSION 2.0

Bermuda has updated and strengthened its firewall legislation with the passage of the *Trusts (Special Provisions) Amendment Act 2020* ("Act", "Amendment Act", "amendments").

It's a game of cat and mouse

Firewall provisions are not uncommon, they are found in the legislation of the leading international financial centres, including the Cayman Islands, Jersey, Guernsey, BVI, Bahamas and many others.

It has become a game where bright barristers seek to penetrate the firewall, and innovative legislators seek to anticipate and plug the holes. Crafty solicitors seek out jurisdictions which have the latest and greatest firewall legislation.

Bermuda is the latest jurisdiction to enhance its firewall legislation with the aid of some of those bright barristers and English QCs. The amendments provide a number of distinct improvements designed to prevent the latest challenges to firewall legislation, making Bermuda the leader in the game.

Highlights

Bermuda's old firewall was based on an approach that was cutting edge and popular at the time it was introduced. Over the years that drafting style has fallen out of favor - some practitioners have said that the style is convoluted and unclear. The new firewall adopts a straight forward and precise approach.

Definitions - An improved definition section clarifies and expands the scope of the firewall, for example:

"Bermuda trust" – means a trust that is governed in whole or in part by the law of Bermuda. Bermuda law gives flexibility to create a trust has part governed by Bermuda law and another part which is governed by the laws of another jurisdiction, thereby permitting the selection of favorable legislation to apply to specific parts of the trust. The new definition of Bermuda trust recognizes that the Bermuda's firewall provisions will apply to the whole of the trust. This is an improvement over the firewalls in other jurisdictions such as Jersey, Guernsey and Gibraltar.

Expanded definitions of “**foreign court**” and “**foreign order**” clarify that the firewall will prevent the interference of foreign courts, tribunals, arbitration or other judicial or quasi-judicial bodies from interfering with the Bermuda trust, regardless of whether it has issued an interim or final judgment, award, order or other decision.

Jurisdiction of Bermuda Courts – naturally one of the keys to firewall legislation is to ensure that challenges to the validity, construction, effects or administration of the trust are subject to the jurisdiction of the Bermuda courts. Amendments now clarify that Bermuda courts have jurisdiction over **both Bermuda and foreign trusts** where:

1. The trust instrument contains a clause conferring jurisdictions on the Bermuda courts. This is an improvement over a number of other jurisdictions – Jersey does not contain such a provision, Guernsey is somewhat convoluted, and Gibraltar uses uncommon wording; **or**
2. Some or all of the administration is carried on in Bermuda; **or**
3. The trustee is resident or incorporated in Bermuda; **or**
4. Trust property is situated in Bermuda (but only in respect of a claim concerning that property).

It is irrelevant that the person against whom the claim is made is not in Bermuda or that the wrongful act, neglect or default did not take place in Bermuda.

Launching the Rocket – the new firewall legislation takes a simple straight forward two stage approach:

1. **Stage One** – Subsection 10(1) and (2) of the firewall exclude the application of foreign law to key elements related to the creation of the Bermuda trust (colloquially referred to as ‘launching the rocket’). In general terms, **foreign laws** regarding forced heirship, matrimonial claims/rights, and insolvency **will not be applied** to questions related to:
 - a) the capacity of the settlor to settle property in trust;
 - b) any right or interest in/to property settled in trust;

- c) the validity of the disposition of the property to the trust; or
- d) any obligation or liability of a settlor, trustee or beneficiary of a Bermuda trust.

The firewall provides that Bermuda law is to be exclusively applied to these questions.

2. **Stage Two** - Once the rocket is launched and the trust is created, then no foreign law shall apply to the determination of any question concerning the validity, construction, effect or administration of a Bermuda trust.

Foreign Orders –it is entirely possible that a foreign court, tribunal, arbitrator or other quasi-judicial body may ignore Stage One and Two of the firewall and by applying foreign law to make an order which impacts the creation, validity, construction, effect or administration of a Bermuda trust. Section 11 of the firewall specifically provides that such foreign order will not be recognized, enforced or otherwise given effect, including by the conferral of any right, the imposition of any obligation or liability, or the raising of any estoppel. We believe that Bermuda’s section 11 is superior to the firewall legislation in a number of jurisdictions that merely prevent the application of foreign laws that are substantially different from the local law. To illustrate, Gibraltar’s firewall provides that a foreign order will not be enforce “*if and to the extent that the foreign court or tribunal applied a foreign law or laws whose relevant provisions are substantively different to those which would be applicable by virtue of the choice of rules in this section*”. This leaves a hole in the firewall. Assume that a challenge is mounted in the English courts based on the grounds of sham. The doctrine of sham is substantially the same in England and Gibraltar. Accordingly, an order of an English court setting aside a Gibraltar trust on the basis of sham would be enforceable in Gibraltar. In Bermuda the determination of sham and invalidity of a Bermuda trust is solely a matter for the Bermuda courts.

Spoiled children, Ex-spouses and creditors

Settlors often seek firewall protection from three types of challenges and challengers:

1. **Foreign Forced Heirship** – Bermuda believes in testamentary freedom. Section 10(2)(a) of the firewall prevents a challenge to the Bermuda trust based on a foreign law or foreign court order which creates, recognizes or defeats any right or interest in property by virtue or in consequence of the death of a person. It also prevents such rights or claims from taking effect indirectly, by means of a restriction on the ability of the testator to settle his/her property into the Bermuda trust.
2. **Matrimonial (or similar) claims** – Foreign laws or courts often confer property rights, obligations or liabilities on the creation, existence or dissolution of a relationship of marriage, domestic partnership (or analogous relationship), cohabitation or other familial relationship (whether by blood or adoption). The firewall prevents claims of this sort, which include those which take the following forms:
 - a. The transfer of property to the trust was invalid. This is commonly a claim from a community property regime that matrimonial property is jointly owned and as such cannot be transferred or settled into trust without the consent of the spouse. Bermuda's amended firewall is viewed as being superior to other jurisdictions which do not clearly and concisely exclude community property claims. For example, Jersey's firewall provides that the blanket exclusion of foreign law *'does not affect the recognition of the law of any other jurisdiction in determining whether the settlor is the owner of any property or the holder of any such power'*, which would seem to mean that a spouse's right to dispose of jointly owned property is a question for the foreign law. The Jersey firewall then attempts to plug the hole by a derogation from the derogation which provides that questions relating to the trust will be determined without considering whether, *"the trust or disposition avoids or defeats rights, claims, or interests conferred by any foreign law upon any person by reason of a personal relationship"*. Unfortunately there is still a hole in the Jersey firewall - the question of whether a Jersey trust will prevail over a community

property regime turns on whether the aggrieved spouse has a *"right, claim or interest"* to property, or whether the community property regime simply prevents the other spouse from disposing of jointly owned property.

- b. Alternatively, the trust property is subject to a personal claim based on matrimonial rights. For example an order of the English Family Division which seeks to vary a Bermuda trust to give a spouse a claim to the trust assets. Sections 10 and 11 of the Bermuda firewall clearly provides that such foreign orders will not be given effect to, and prevents such claims being advanced before the Bermuda courts.

Bankruptcy, liquidation or analogous insolvency process

– for public policy reasons Bermuda is not an aggressive asset protection jurisdiction. Section 36C of the Conveyancing Act 1983 provides for a domestic clawback regime where "eligible creditors" are able to recover property disposed of undervalue with the intention of to put property beyond the reach of his creditors. As noted above, Bermuda's firewall restricts claimants to the use of the Bermuda legislation, and prevents the application of foreign insolvency laws or orders to the questions related to the 'launching of the rocket', or after the Bermuda trust is launched the validity, construction, effect or administration of the trust.

Concluding comments

The purpose and policy of firewall legislation is to provide a statutory 'shield' to protect the integrity of Bermuda trusts. This policy is best served by making the shield absolute, leaving Bermuda courts to regulate Bermuda trusts solely in accordance with Bermuda law.

The new state of the art Bermuda firewall legislation achieves this purpose with clear and concise language that anticipates challenges by those bright barristers.

If you would like further information or to discuss these amendments in greater detail, please contact Randall Krebs or John Gibbons at rkrebs@harbour-trust.com, johngibbons@harbour-trust.com, or info@harbour-trust.com.

Bermuda's Firewall Legislation

Select provisions from the Trusts (Special Provisions) Act 1989, as amended

Interpretation

1A In this Act, unless the context provides otherwise—

“**Bermuda trust**” means a trust governed in whole or in part by the law of Bermuda;

“**foreign court**” means any court or tribunal (including an arbitral tribunal), or any other person or body exercising judicial or quasi-judicial functions, in a territory other than Bermuda;

“**foreign law**” means any law of a jurisdiction other than Bermuda;

“**foreign order**” means any interim or final judgment, award, order or other decision of a foreign court;

“**foreign trust**” means any trust other than a Bermuda trust; “**settlor**” includes—

- (a) a testator who grants powers under a testamentary trust by the terms of his last will and testament; and
- (b) a person who by a declaration of trust declares that assets held by him beneficially shall be held by him on the terms of the trust so declared.

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- (a) a testator who grants powers under a testamentary trust by the terms of his last will and testament; and
- (b) a person who by a declaration of trust declares that assets held by him beneficially shall be held by him on the terms of the trust so declared.

Governing law

5 (1) A trust shall be governed by the law chosen by the settlor whose choice shall be express or be implied in the terms of the instrument creating or the writing evidencing the trust, interpreted, if necessary, in the light of circumstances of the case.

(2) Where the law chosen under subsection (1) does not provide for trusts or the category of trusts involved, the choice shall not be effective and the law specified in section 6 applies.

No applicable law chosen

6 (1) Where no applicable law has been chosen, a trust shall be governed by the law with which it is most closely connected and in ascertaining the law with which a trust is most closely connected references shall be made in particular to—

- (a) the place of administration of the trust designated by the settlor;
- (b) the situs of the assets of the trust;

- (c) the place of residence or business of the trustee;
- (d) the objects of the trust and the places where they are to be fulfilled.

(2) A trust that is governed by the law of Bermuda may provided terms to change the law governing the trust from the law of Bermuda to a new governing law but such change is valid and effective only if the new governing law recognises the validity of the trust and the respective interest of the beneficiaries.

(3) A change in the law governing a trust shall not affect the legality or validity of or render any person liable for anything done before the change.

Law governing validity and construction of trust

7 The law specified by section 5 or 6 shall govern the validity of the trust, its construction, its effects and the administration of the trust and in particular the law shall govern—

- (a) the appointment, resignation and removal of trustees, the capacity to act as a trustee, and the devolution of the office of trustee;
- (b) the rights and duties of trustees among themselves;
- (c) the right of trustees to delegate in whole or in part the discharge of their duties or the exercise of their powers;
- (d) the power of trustees to administer or to dispose of trust assets, to create security interests in the trust assets, or to acquire new assets;
- (e) the powers of investment of trustees;
- (f) restrictions upon the duration of the trust, and upon the power to accumulate the income of the trust;
- (g) the relationships between the trustees and the beneficiaries including the personal liability of the trustees to the beneficiaries;
- (h) the variation or termination of the trust;
- (i) the distribution of the trust assets;
- (j) the duty of trustees to account for their administration.

Jurisdiction of Supreme Court

9 (1) The Supreme Court has jurisdiction to hear and determine any claim concerning the validity, construction, effects or administration (including in respect of any of the matters referred to in section 7(a) – (j)) of—

- (a) a Bermuda trust; or
- (b) a foreign trust to which subsection (2) applies.

(2) A foreign trust referred to in subsection (1)(b), is a trust where—

- (a) the trust instrument contains a clause conferring jurisdiction on the courts of Bermuda;
- (b) all or part of the administration of the trust is carried on in Bermuda;
- (c) a trustee is incorporated or resident in Bermuda; or

(d) trust property is situated in Bermuda (but only in relation to a claim concerning that property).

(3) The jurisdiction of the Supreme Court is applicable as provided under this section notwithstanding that the person against whom the claim is made is not in Bermuda or (where applicable) that any wrongful act, neglect or default giving rise to the claim did not take place within its jurisdiction.

Exclusion of application of foreign law

10 (1) No foreign law that is excluded under subsection (2) shall apply to the determination of any question concerning a Bermuda trust, including any question concerning—

- (a) the capacity of a settlor to dispose of property upon the trusts of a Bermuda trust;
- (b) any right or interest in or to property disposed upon the trusts of a Bermuda trust;
- (c) the validity of a disposition of, or a declaration of trust in respect of, property upon the trusts of a Bermuda trust, including whether any such disposition should be declared void or invalid, rescinded, set aside, varied or amended; or
- (d) any obligation or liability of a settlor, trustee or beneficiary of a Bermuda trust.

(2) For the purposes of subsection (1), a foreign law is excluded if it creates, recognises, or defeats, or gives a foreign court power to create, recognise, or defeat, any right or interest in or to property, or any obligation or liability on any person, by virtue or in consequence of, or in anticipation of—

- (a) the death of a person (other than as a result of a voluntary disposition, whether testamentary or otherwise, by the deceased);
- (b) the creation, existence or dissolution of a relationship of marriage, domestic partnership (or analogous relationship), cohabitation or other familial relationship, whether by blood or adoption; or
- (c) bankruptcy, liquidation or an analogous insolvency process, including a provisional process or a process for the restructuring of debts.

(3) No foreign law shall apply to the determination of any question concerning the validity, construction, effects or administration of a Bermuda trust, including any of the matters referred to under section 7(a) – (j).

(4) If and to the extent that this section excludes the application of foreign law, to that extent the court shall apply instead the law of Bermuda excluding rules of conflict of laws (save for those set out herein).

(5) This section shall not apply to the determination of any question to the extent that the question—

- (a) concerns immovable property outside Bermuda; or
- (b) relates to a severable aspect of a Bermuda trust governed by foreign law.

Restriction on effect of foreign orders

11 (1) The court shall not give effect to any foreign order that is inconsistent with section 10.

(2) In this section, to give effect to a foreign order means to recognise, enforce, or otherwise give effect directly or indirectly to that foreign order, including by the conferral of any right, the imposition of any obligation or liability, or the raising of any estoppel.