'Isle of Man Trusts: The European Market Awaits'

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Introduction

The asset protection features of an Isle of Man trust, modern trust service providers' legislation, and the geographic proximity of the Manx jurisdiction to the Continent makes an Isle of Man trust a desirable product for promotion into the European market for securitisation and other wealth management purposes. The vibrant property market on the Continent is not simply isolated to Iberia, but has spread to other parts of the recently enlarged European Union. The increasing demands for ownership of property in Europe can be satisfied with the removal of obstacles that impede the free movement of capital, the solution being the creation of harmonisation in European law in relation to mortgages. Such obstacles can be overcome by using the trust in securitisation structures due to its flexibility, with the way forward being the widespread promotion of the trust concept into Continental systems. To achieve such acceptance, greater understanding of the trust by civil law advisors must take place, the method of such communication being on the focus of similarities shared by both the common law and civil law systems. The following seeks to develop the idea that in removing the legal obstacles confronting harmonisation of European mortgage laws, the trust and specifically Isle of Man trusts, will play an important role in the successful acceptance of the trust concept into civil law jurisdictions.

Trusts in the Isle of Man

Trust law in the Isle of Man has its origins in English trust law, and but for a few minor variations[1], mirrors the legal position in England and Wales. Decisions of the English courts, although not binding, are persuasive in the Manx courts and are generally followed unless there is a clear decision to the contrary or where there is a local Manx condition that provides for not following a particular English decision[2]. The rules of equity continue to shape and refine trust law in the Isle of Man, with legislation[3] being used merely as a tool to guide the development of equitable concepts put at jeopardy with uncertain court decisions and subsequent undesirable practices. Legislation is the way forward for when case law becomes indigestible[4] but thus far in the Isle of Man, the need to enact corrective legislation has not taken precedence. Indeed, the decision of the Manx High Court in *Re Heginbotham*[5] is illustrative of both the progressive environment in which the law as it relates to trusts continue to evolve, creating instead, a greater degree of legal certainty, desirable practices and enhanced flexibility in the use of an Isle of Man trust as an asset protection device.

The case of *Re Heginbotham* involved a petition under the Fraudulent Assignments Act 1736[6] for an order that the petitioner could enforce a judgment against 2 Isle of Man companies. The petitioner, Mr. Heginbotham, had previously claimed damages against a company called Ashbrooks Ltd, in fact by way of counterclaim in proceedings originally brought by the company. Mr. Heginbotham secured judgment in default when the company did not defend the claim and subsequently lodged the petition stating that assets of the company had been transferred to other companies and that there was "no reasonable ground or purpose" for the transfers and that "the sole purpose thereof was to avoid the consequences of the litigation and ultimately of the judgment entered against Ashbrooks Limited in the action and any award of damages flowing therefrom". Mr. Heginbotham then asserted that the transfer was a sham and constituted a fraudulent transfer within the meaning of the Assignments Act 1736, seeking an order to enforce the judgment he had obtained against Ashbrooks Ltd. against transferees of its assets. For many years in the Isle of Man, up to this point, there remained a great deal of uncertainty in relation to the law of fraudulent transfer—uncertainty that would be resolved, due to this case, after in depth consideration of the Statute of Elizabeth 1571[7] and the Fraudulent Assignments Act 1736.

The basic principle of the Statute of Elizabeth 1571 is that a transfer can be set aside and a trust declared void where a person effects a transfer to a trust with the intent to defeat any future creditor. In his determination, the High Court judge (called a Deemster in the Isle of Man) rejected Mr. Heginbotham's petition after referring to *Corlett v Radcliffe*[8], *Re Corrin's Bankruptcy*[9] and *Lloyds Bank Limited v Marcan*[10]. He held that:

> "(1) for the 1736 Act to apply, there must be an intent to defraud creditors of present debts, not contingent or future debts which might never materialise. Present debts include known and ascertained debts which are to fall due on a date in the future; and,
>
> (2) at the time of the transfers to the companies, the petitioner had not served his defence and counterclaim to the action. The judgment debt was not therefore a present debt. The transfers were bona fide and not contrived to defraud creditors."

The significance of this decision is its determination that the Statute of Elizabeth had never been accepted into Manx law, with the consequence that a transfer of an asset to a trust cannot be set aside at the instance of creditors whose debts were not known and ascertained at the time of the transfer[11]. The decision incorporates into Isle of Man law the idea that a properly constituted trust is safe as an asset protection vehicle so long as at the time of the establishment of the trust, (i) the settlor had no intention of defrauding creditors, (ii) was able to meet all known ascertainable creditors; and (iii) was solvent.

Isle of Man trusts, therefore, are automatically asset protective to the extent that the assets of a properly constituted trust have passed from the beneficial ownership of the settlor into the legal ownership of the trustees. The requirement to enact fully aggressive and specific asset protection legislation in the Isle of Man is unnecessary. The absence of such aggressive legislation should be viewed as a unique selling proposition in the promotion of Manx trusts, on the basis that potential claimants may assert, in the presence of enacted asset protection legislation, that the only reason the settlor selected the jurisdiction was to effectuate a fraudulent transfer. Viewed simply as a product then, the Isle of Man trust offers superior advantages to similar devices created from specific or corrective legislation.

Trust Service Providers ("TSP")

Both the regulator and the regulated in the Isle of Man have liaised closely to produce exemplary trust service providers' legislation expected to come into force in early 2005. It is predicted that this legislation will be the envy of service providers and regulators in other international financial centres as a result of the circumstances out of which it is borne. In developing the legislation, a comparison was made amongst existing legislation in a selection of jurisdictions to ensure that industry standards were adequately met and that the mistakes of others were not duplicated. The legislation will reflect current and future regulatory concerns in the present global climate, with the Isle of Man being at the forefront in the creation of relevant and practical regulatory regimes. The ubiquitous goal of not only preserving the financial services industry, but of promoting the Isle of Man as the premier international financial centre of choice, served to foster collaboration and consultation between both the public and private sectors.

The regulator in the Isle of Man, the Financial Supervision Commission ("FSC"), chose to enact legislation that would regulate corporate and trust service providers in 2 stages. The Corporate Service Providers ("CSP") Act 2000 with ancillary Regulatory and Clients' Money codes were passed into law to initially begin the process, in line with OECD, FATF, IMF and EU guidelines. In implementing the 2nd stage, the FSC consulted with the Isle of Man Law Society, the Isle of Man Branch of the Institute of Chartered Accountants, the Association of Corporate Service Providers and STEP Isle of Man. The expected legislation in early 2005 will effectively be an amendment to the CSP Act 2000, whereby CSPs and TSPs will be known collectively as "fiduciaries", with the requirement that the relevant class of fiduciary licence being held by any person who provides CSP and/or TSP services. The Fiduciary Services Bill 2004 is presently scheduled to resume its progress through the House of Keys and Legislative Council in October 2004 and provided that the Bill proceeds successfully in these latter stages, the FSC anticipates that it will be inviting applications for TSP licences in the first quarter of 2005.

Trusts & Securitisation

The *Trusts and Trustees* opinion of March 2004, entitled "*New wine in old bottles*" introduced the new book by Sergio Nasarre-Aznar[12] which investigates the financing of property transactions in Europe by providing a comprehensive analysis of the deeper operations of the European mortgage market. Dr Nasarre-Aznar adopts

an interdisciplinary approach to deal with the practicalities and possibilities of the harmonisation of this market in Europe by focussing on the introduction of mortgage bonds in the UK and the restructuring of the classical mortgage backed securities in continental Europe. The work discusses "the legal problems that need to be overcome in order to harmonise the passive operations of the mortgage market"[13] by examining the law relating to the funding of mortgages through the issue of mortgages, mortgage backed securities (MBS) and mortgage bonds. The author points out that the goal of the EC to harmonise European law as it relates to mortgages in order to promote the free movement of capital throughout the EU has yet to become a reality. He further states that the present obstacle is due to the fact that the structure of the mortgage security, resulting from a mortgage securitisation process (and in Europe mainly used in the UK), is suited to the rules of the common law. On the other hand, mortgage bonds follow the pattern of the civil law, and although present in all of continental Europe, is unknown in the UK.

According to Dr. Nasarre-Aznar, "...the best solution to create efficient and secure MBS structures in civil law countries is to introduce a flexible framework for fiduciary operations (the trust) and a flexible security over rights in land."[14] Further,

> "Trusts have been revealed as more flexible, cheaper and quicker instruments to securities mortgages than corporations. Therefore, trusts are a very good alternative to structure securitisation in the jurisdictions where they are present. They are important in developing a secondary mortgage market (organised conveyance of mortgages from the originator to an SPV) and to establishing new and secure securitisation structures. The widespread use of the trust in USA securitisation is due to the homogenous mortgages that conform the pool and its bankruptcy-remoteness"[15]

The author basically concludes that the proper regulation of both types of securities would allow a true European securities market that would improve the development of real estate in each of the 25 EU member states, bringing benefits for mortgagors, originators and investors.

Common Law v Civil Law - Bridging the gap

Shibboleths such as "never underestimate the value of local knowledge" and "think globally, locally" should not be in the exclusive remit of a bank in its marketing of banking products and services, but can equally apply to efforts geared to the widespread promotion of the use of the trust device in civil law jurisdictions, whether for mortgage securitisation structures or other asset protection and wealth management purposes. Success at introducing the concept in a workable form that fulfils commercial needs can be achieved by not only having a total grasp of the trust relationship, but by having an appreciation of the local market into which the trust is to be exported. It is therefore important to acknowledge, and focus on, the historical similarities shared by both the common law and civil law systems in relation to trusts. To begin, the work of Helmholz and Zimmermann's Itinera Fiduciae: Trust and Treuhand in Historical Perspective[16] aptly reveals that:

> "Most of the trust-like devices that existed for so long in England and on the Continent depended in some measure upon Roman Law. This is perhaps the most surprising theme of parallel development in the contributions to this volume. Continental legal historians are surprised to find that trust-like institutions, making use of civilian sources, were in place on the Continent, and that they were not simply the fideicommissa of Roman Law. In both legal arenas, similar institutions drew from Roman Law sources...If, as seems to be happening today, modern European Law incorporates the trust, there is much to suggest it will be will be building upon historical foundations."

The notion of trusteeship duties in Roman law can be found in the fideicommissum and the fiducia. Fideicommissum evolved into a testamentary means of A disposing of property on his death to B, with B under an obligation on a particular event to pass the value of the property on to C, who might also be under an obligation to pass it on to D. Fiducia were of 2 types, being a fiducia cum amico and a fiducia cum creditore. The former involved the transfer of property to a friend, for safe keeping, until the transferor's return, while the latter dealt with the situation where property was transferred to a creditor as security for the performance

of some obligation, subject to the property being retransferred to the transferor once the obligation was performed.[17]

On the Continent from about the thirteenth to sixteenth centuries, it was common for testators to create secret trusts for illegitimate children and mistresses, and for plurality of ownership of ecclesiastical benefices to be achieved via a confidential beneficialis.[18] Landed families also used fideicommissary substitutions to preserve their wealth and influence until such substitutions were made prohibitive by the Code Napoleon.
The German code and case law developed the concept of the Treuhand, involving a fiduciary agency concept of a bipartite principal-agent relationship where property is immune from creditors in a situation where S transfers property to T as Treuhander for the benefit of S or of B so that if S, but not B, claims the immunity, B is exposed unless S has pledged to B his right to benefit from a release of the property from attacks of T's creditors[19]. Indeed, other Continental codes and case law provides for the principle of an indivisible patrimony as in the testamentary secret trust in Spain known as the Catalan herencia de confianca and the segregated fondo patrimoniale in Italy in which parents own assets for the exclusive benefit of their children. Of course, Liechtenstein introduced in 1926 its Law of Persons and Companies, which provides for Liechtenstein trusts with Luxembourg in 1983 introducing the general notion of a fiduciary contract whereby approved credit institutions segregate fiduciary assets for its own patrimony. More recently, the Hague Convention on the Law Applicable to Trusts and their Recognition was drafted to prepare common private international law rules for the recognition and the giving of effect to trusts of assets located in non-trust countries. The Convention requires the recognition of a separate fund immune from claims of the trustee's creditors, and where the trustee-owner can sue and be sued as trustee.

The Italian Example

The successful acceptance of trusts in Italy provides favourable evidence to support the contention that the trust concept can be successfully incorporated into a civil law jurisdiction. According to Professor Maurizio Lupoi, trusts have been positively received in the Italian jurisdiction because:

> "...trusts are understood in Italy while they are not in other civil law countries. English writers have done their best, from Maitland onwards, to surround trusts with an aura of Englishness and civilians have willingly obliged. It is however, a fact that objections currently raised in other civil law countries against trusts are no longer heard in Italy and that has paved the way for their acceptance."[20]

Case law in Italy has determined that Italians can form trusts in Italy with Italian assets and for Italian beneficiaries so long as a foreign law governs the trust. Such a trust is called "trusts interni", with the understanding of the word "interni" meaning domestic. The understanding of trusts in Italy is also due to a commitment by Italian professionals in embracing the concept as a solution to problems that cannot be solved by local law, with the result that trusts are not merely seen as tax-planning devices or tools for the facilitation of wealth management. The dismantling of the "aura of Englishness" will certainly assist in the acceptance of the concept once common law promoters understand that civil law jurisdictions are resistant to the idea of becoming another English legal colony.
A role for the Isle of Man trust in Europe

This past May Day witnessed the expansion of the European Union from 15 members to 25, taking in 10 new members mostly from central Europe. One of the benefits of this expansion is that it helps countries that, through an accident of geography, suffered for years under the communist yoke. The Isle of Man, through an accident of geography, finds itself uniquely positioned to market its financial products and services, in particular the trust, by taking advantage of it physical proximity to Europe. In the present regulatory climate, the importance of face-to-face meetings cannot be overestimated in facilitating proper KYC or extra due diligence procedures within CSP and TSP organisations. For potential clients, as well, the need to physically see the "bricks and mortar" of where their structure is administered and managed, and to meet the individuals in charge of their wealth are key considerations. But the cost and inconvenience of long haul flights over the Atlantic, with connections via JFK then onwards to St. Thomas, or to Miami connecting via San Juan, for example, frustrates the facilitation of this process. In addition to the cost and inconvenience, there are also

fears surrounding the safety of passengers due to the persistent threat of terrorist attacks in the air.

But the rapid growth in low cost airlines in Europe eases both the expense and inconvenience of travel within the continent. Europeans can now fly direct to numerous UK destinations that offer connections to the Isle of Man in order to meet face-to-face with an advisor, view the providers' office premises, and "do the business". Once on the Island, clients can be introduced to banking institutions that offer modern and efficient services and other products, facilitating the overall due diligence process and adding some extra comfort to the bank's compliance personnel with a personal introduction. For those European clients who are overly cautious about air travel, a scenic drive through Europe followed by a ferry to the Isle of Man will help ease whatever concerns they may possess about travel by air.

Geography and the knowledge that trust service providers are properly regulated in the Isle of Man will no doubt encourage a measure of confidence in the minds of those seeking financial services in the Manx jurisdiction.

Conclusion

Interesting times lie ahead for the trust and the goal of its widespread implementation into civil law jurisdictions. The Italian example illustrates that the goal is achievable when the trust concept is properly understood as a solution to problems unsolvable by local law. The present property frenzy that is fuelling the need for flexible financing arrangements should progress matters, with the Isle of Man trust being centre stage.

END NOTES

[1] There is no rule in the Isle of Man to prevent the accumulation of income by a trustee throughout the life of a trust.
[2] FRANKLAND v. R. MLR 65 (PC).
[3] The Isle of Man Trustee Act 1961 and the Trustee Act 2001 follow the English Trustee Act 1925 and Trustee Act 2000 in dealing with the powers and obligations of trustees.
[4] John Goldsworth, Trusts and Trustees, Volume 10, April 2004.
[5] Re the Petition of Christopher Jollian Heginbotham 1999 2ITELR 95.
[6] Also referred to as the Evidence Act 1736.
[7] Fraudulent Conveyances Act 1571, 13 Eliz 1 Cap 5.
[8] (1859) 14 Moo.121; 15 ER 251 (PC).
[9] 1912, Kneen CR (unreported). This case, being unreported and no transcript of the judgment being available, the Deemster held that the comments attributed to Knee CR must be treated with caution.
[10] [1973] 2 All ER 359.
[11] Subject to a decision of a higher court.
[12] Dr. Sergio Nasarre-Aznar, Securitisation & mortgage bonds: Legal Aspects and harmonisation in Europe, Cambridge 2004, Gostick Hall Publications.
[13] Ibid, pg.1.
[14] Ibid, pg. 91.
[15] Ibid, pg. 93.
[16] Cited in "The Development of the Trust Concept in Civil Law Jurisdictions" by David Hayton, Journal of International Trust and Corporate Planning, September 2000 pg. 1.
[17] Ibid, pg. 2.
[18] Ibid, pg. 3
[19] Ibid, pg.3.
[20] Professor Maurizio Lupoi, "Italy: an independent approach to trusts in a Civil Law country", Trust & Trustees, Volume 9, May 2003, pg. 9.