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News Update

Benefiting from bilateral investment treaties in wealth planning

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As the number of bilateral investment treaties continue to grow, the investor protections designed to foster greater foreign direct investment between developed and developing countries are proving to be a surprisingly fertile ground for wealth managers to structure additional layers of protection for the wealth of their clients.

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Institutional investors and multinational corporations have been more alive to the benefits afforded by bilateral investment treaties but the wealth management industry is gradually taking into account the opportunities presented by BITs – that is, bilateral investment treaties – to advise their clients about where to put their money and how to do so.

In a nutshell, BITs offer powerful protection of cross-border investments against political risk. They incorporate certain standards of treatment by governments toward foreign investors that, if proven to have been violated, entitle investors to damages.

However, not all BITs are created equal and their differences mean some offer stronger or more extensive investor protections than others. Wealth managers planning long-term strategies for clients can therefore parse the complex web of investment treaties to structure the most appropriate vehicle to safeguard their client's interests. High net worth individuals looking to move their assets globally should also carefully consider how BITs can enhance the long-term security of their wealth.

The basics

Bilateral investment treaties are treaties entered into by two countries for the reciprocal promotion and protection of foreign investments. As a product of international law, they generate rights and obligations beyond contractual terms which protect investors against the risks of adverse government action by the host country. BITs enable investors to bring claims directly against governments in an independent arbitral tribunal and, depending on the relevant treaty, in accordance with clearly defined arbitration rules. Investors who cannot rely on a BIT are forced to argue their case within the host state's domestic legal system.

Accessing the most beneficial treaty

Bilateral investment treaties vary in terms of who is deemed to be an investor, the investments that are eligible for protection, and the nature of the obligations owed by the host government. Furthermore, one country may be a signatory to numerous BITs. As such, the threshold question for a wealth planner is which is the most preferable investment treaty for the client having assessed the available treaties and taking into account all of relevant circumstances of the client?

The next issue is how to satisfy the requirements of the identified BIT to access the investor protections. The two preliminary conditions are that your client meets the definition of 'investor' under the BIT and that the investment vehicle contemplated constitutes an acceptable 'investment'.

Both individuals and corporations may qualify as 'investors' making investments in the host country but they must be nationals or an enterprise of the sending state. Your client may be prevented from availing themselves of the advantages of BITs if their investment is not properly made through a vehicle that falls under the scope of the relevant treaty.

What bilateral investment treaties offer

Although the specifics of BITs vary from one to another, the most common standards of protection your client may expect if their investment is structured appropriately include:

- Expropriation – where an investor is entitled to prompt, adequate and effective compensation for direct (eg seizure or nationalisation of the investment) or indirect expropriation (eg cancellation of a license which destroys the investment)
- Fair and equitable treatment – which protects investors from a denial of justice, serious failures of due process or arbitrary treatment
- National treatment and most favored nation treatment – which protect investors from unjustified discrimination compared to the treatment of domestic investors or investors from another country
- Free transfer of funds – where an investor is protected against improper restrictions on the repatriation of profits.

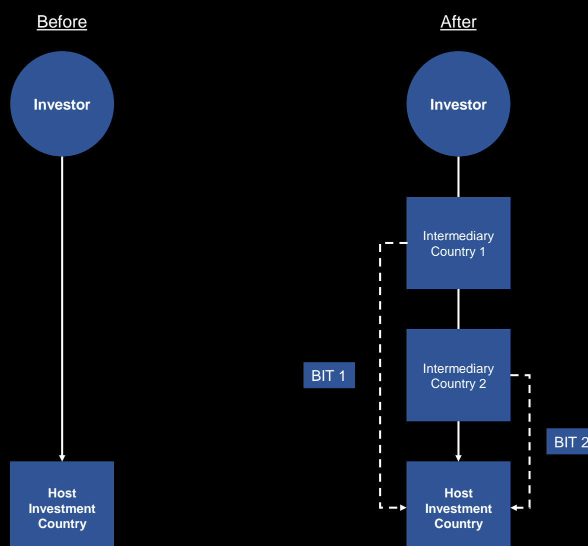
Allowable forms of investment

The form in which the investment is made should be carefully chosen so as to fall within the meaning of 'investment' within the relevant BIT. In this regard, 'investment' has been construed broadly to include not only tangible assets but also intangibles such as certain financial instruments or even patents. For example, the US model BIT defines an investment as being 'every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.' The investment may be allowed in different forms, including an enterprise, shares, stock and other forms of equity participation in an enterprise. It is common for the definition of investment to be a broad asset-based definition with a non-exhaustive list of examples, such as the case of the US model, although this is not generally a difficult threshold to satisfy.

The investment structure

Given the proliferation of BITs, it is likely that wherever your client does business, one or more BITs will be potentially available. In the case that more than one BIT is available it should be possible to design the investment structure in a way that will allow the best protections to become available. There are of course multiple other factors that influence the choice of investment vehicles but the considerable network of BITs should present a number of options for structuring an investment.

However, there are important conditions that investors need to be aware of in seeking to gain the protection of a BIT. There are some limits on the ability of investors to structure an investment so as to access a BIT. Many BITs have a 'denial of benefits' clauses, which can be used to exclude investments which do not have a genuine connection with the sending country (eg an investment made through a shelf company) and these should not be overlooked when planning the investment.



Investors may very well not think about the benefits of BIT protection until a dispute has arisen. But waiting to gain BIT protection until a dispute exists brings significant risk and has been found to be improper by arbitral tribunals.

There are significant gains to be made by the astute wealth manager from bilateral investment treaties to protect the wealth of their clients. Although the system of BITs is complex and dense, this also presents opportunities to design investment strategies that have long-term protections built into investment structures. It is critically important for any wealth manager planning protections for their clients to examine and understand the specific scope of each BIT as there exists significant variation between investment treaties. These variations have a major impact on whether an investment is effectively protected or whether a client's wealth is exposed to great political risk.

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