The Future of trusts: a Swiss perspective

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Reference

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A Swiss Perspective
Luc Thévenoz

Abstract
If the Swiss experience with trusts is notable in any way, it must be because, over the last two decades of the 20th century, we eagerly embraced a legal institution with so few roots in the recent civil law tradition, and we did so without purporting to create an equivalent instrument under Swiss law. Why and how we embraced it, what difficulties we faced in doing so, what came out of it and what awaits us in the future are points that are worthy of interest.

Ladies and Gentlemen, thank you for still being here; this is a busy day and it’s already the second half of the afternoon. Thank you also to Professor Paul Matthews and to the organisers of this fascinating conference for inviting me.

When Paul Matthews asked me to offer a Swiss perspective on the recent developments of trust law, I wondered if there was any specific Swiss angle to that story. We do not have our own trust law, but use the laws of other nations. Our legal system recognises trusts validly created under their proper law, but our courts sometimes bluntly disregard an individual trust because they (falsely) believe it is the only way to protect the widow and the orphan. There is a flourishing, though unregulated (except for anti-money laundering purposes), community of trustees and trust service providers in Switzerland, but more actual expertise would certainly enhance the protection of beneficiaries. Swiss banks have played a significant role in introducing trusts to their, mostly international, clients, both for tax reasons and to create a long-term bond with clients and families; but I would assume that this is not unique to Switzerland.

If the Swiss experience with trusts is notable in any way, it must be because, over the last two decades of the 20th century, we eagerly embraced a legal institution with so few roots in the recent civil law tradition, and we did so without purporting to create an equivalent instrument under Swiss law. Princely Liechtenstein has had its own trust-like Treuhand since 1926. The Grand-Duchy of Luxembourg upgraded its fiducie at the time it ratified the Hague Trusts Convention. France, the monarchic Republic, recently created its own fiducie, a younling without many teeth, and ignored the need to better recognise foreign trust by adhering to that same Convention. Of the signatories of the Hague Trusts Convention, Italy and Switzerland are different because they chose to provide better legal certainty to trusts created under other laws without first creating their own avatar of it. That may explain why Professor Maurizio Lupoi and I are the only two Continental lawyers invited to address you today.

Where however the Swiss and Italian experiences differ is in the fact that most trusts connected with Italy were created for Italian families over Italian assets (trust interni), whereas most trusts connected with Switzerland were created by and for non-resident persons, even though they often include very sizeable assets located or deposited in Switzerland. I believe that this difference is not explained by cultural or legal biases, but merely by taxation. This is not my topic, however, and I will not dwell on it any further.
Splitting control from benefits

Before we look any closer at the interaction of trusts with Swiss law, I would like to make a more general point, one of those general comparative aspects that Professor Matthews referred to this morning.

I do believe that trusts exist because there is a fundamental need in every jurisdiction to be able to split the control over certain assets from the benefit of those assets. Paul said this morning “management and enjoyment” and I’m expressing the same idea but with different words. All legal systems have to accommodate this need for a number of purposes, from business ventures (and this is what gave rise to the limited company) to the management of assets, especially when these assets need to be managed for multiple persons. I’m thinking here of pension funds, investment funds, and security interests for multiple creditors. And even though the idea of giving sounds so very simple, the same need for splitting control from benefit applies to gifts, when the intended benefits must spread over the course of time.

I would say that ring-fencing, which is a central feature of trusts and of some similar institutions in different jurisdictions, is not the key element, but rather an important side effect, or a necessary feature of a legal institution that was first and foremost designed to split control and benefit. Ring-fencing is not an end in itself, it’s rather a means to an end. We can then look at various legal systems and see how they responded to that need and what type of instruments and institutions they developed to respond to that need. The beauty and the uniqueness of a trust is that it is a single instrument that is so flexible and adaptable that it has made many other instruments unnecessary or superfluous. It’s so flexible that it responds to a variety of different needs whereas other jurisdictions had to develop several different institutions to address different purposes.

Three features of Swiss law

Three features of Swiss law are important to note when trying to understand how trusts are recognised in Switzerland.

The first feature is the strong distinction made by civil law systems between obligations and property. Swiss law offers limited flexibility in dividing up property interests. The keyword here is “numerus clausus.” For a long time, most lawyers and virtually all scholars would deny the possibility to fully recognise trusts because they believed it would be against the “numerus clausus” of property interests.

The second feature, which Swiss law shares with the French, German, and other civil law systems, is the old Republican idea that everyone has one patrimony, and one only. I know that “patrimony” is not really an English word, and I should probably use the word “estate” instead, but estate focuses too much on death, while I am now really referring to living estates, or rather to the estates of people alive. Under Swiss law, everyone has but one patrimony, and I cannot divide my estate into different parts for different purposes because this would open the window for defrauding the interests of creditors, of spouses, etc. One is not allowed to create a separate, ring-fenced patrimony by a mere disposition of one’s property. This explains why Swiss law and other similar legal systems developed and relied extensively on companies and the incorporation of legal entities (including foundations) to divide some part of one’s patrimony and apply it to some specific purpose. Legal entities do the trick. Neither contracts nor dispositions of property can ring-fence assets.

The third and most famous (or, for some, infamous) feature of Swiss law is forced heirship. Switzerland is one of those forced heirship jurisdictions and trusts, though recognised and enforceable, are not allowed to circumvent or avoid forced heirship provisions. These do not prohibit settlements, but they narrow significantly the portion of one’s patrimony that can be subject to trusts.

How did private trusts appear in Switzerland?

They were first set up by and for foreign nationals, wealthy visitors or expatriates from England, the US and other common law jurisdictions, who liked Switzerland, wanted to settle there and brought their
needs, their habits and their ways of doing things with them. Though these trusts were not usually administered in Switzerland, they had dealings with Swiss banks and occasional (if unwanted) contacts with Swiss courts or revenue authorities. At some point in time, during the last quarter of the 20th century, the trust idea caught up and spread internationally. With such a broad base of international clients, Swiss banks had to respond to their new needs and demands. They opened accounts for trustees, helped their client create their own trusts, and sometimes even marketed some standardised “trust product” using set-form trust deeds. Quite a dangerous idea indeed!

Nonetheless, lawyers and private bankers alike tend to be traditionalists. Swiss people in general tend to be conservative. Altogether you would thus expect general counsel from Swiss banks to be extremely conservative, and so they were. Of course some of these banks were internationally diversified early on, before and after World War II. They had experience with trusts in their London or New York offices. They had to deal there with trusts for their private clients as well as for investment banking types of transactions. But they relied on local staff to do this and had no real expertise in their home base.

In 1985, at the time the Hague Convention on the Law Applicable to Trusts and on Their Recognition was signed, the question was put to the legal and banking communities in Switzerland whether they saw the need for this Convention. The answer was a definite “No, we don’t need it. Trusts are dangerous. There are risks in there that we don’t understand and don’t want to cope with.” That answer came from the top people in the legal departments of the top banks. At the same time, advisors were opening accounts for trustees or helping their private clients setting up trusts. So there was this gap between the practice at the front and the legal thinking at the top of the banks, and this inconsistency existed for about fifteen years.

Why did things change? I would say: globalisation and a change of generation. Globalisation does not only apply to the economy or to the financial systems: it applies to people, too. People move, money moves, even lawyers move. An increasing proportion of the most talented young lawyers began studying abroad, especially in the US or the UK. They had more understanding of trusts and equity; they were less reluctant to work with legal instruments unheard of in their own legal tradition. They were advising clients, staffing banks’ legal departments. That is probably how legal departments and general counsel caught up with the expansion of trusts in many different contexts, not only in the estate planning context, but also in securitisation or collateral transactions. And they finally acknowledged the need to provide better legal certainty in how trusts are recognised in Switzerland.

In the first five years of this century, the Hague Convention was looked at more closely, discussed more extensively, and finally adopted. Switzerland ratified the Hague Convention in 2007. Why was this a decisive step? I see two reasons. First, ratification was authorized by an act of Parliament and supplemented by a few statutory amendments. Even though one still cannot settle a trust under Swiss law, because there is no such thing as a Swiss law of trusts, there is no more doubt that the effects of trusts are not repugnant to Swiss legal principles and that they must be recognised by Swiss courts. Second, and not least, the framework for this recognition is laid down in treaty provisions that are self-executing. We, lawyers of the civil law tradition, will always be more comfortable when our arguments can build upon statutory (or statutory-like) provisions. We know how to read them and construe them, even when (at it should be) we disagree on their exact meaning. And so do courts.

From an alien whose legitimacy and recognition was still disputed, the trust institution became a feature of the legal landscape, something that must be recognised and given effects, at least most of the time. In that sense, the Convention turned out to be “the mouse that can roar.”

**Benefits and risks**

Even though the general benefits and risks of trusts are the same most everywhere, it may be interesting to consider them from a Swiss perspective.
I’ll start with the tax benefits even though taxes are rarely, if ever, the sole reason for setting up a trust. As far as foreign settlors and foreign beneficiaries are concerned, Swiss tax laws are irrelevant. The trust itself is not subject to taxation. Obviously, if the trustee is established in Switzerland, the income derived from its office will be subject to taxes, but this is no different from any other service provider. This idyllic picture changed over a very short period of time, however. Even where the Swiss tax man is not concerned with foreign residents, Swiss trustees and banks must take into account the extraterritorial reach of foreign tax systems. FATCA, the US Foreign Account Tax Compliance Act, is the best (or rather the worst) example of this. The EU Savings Directive, reflected into a bilateral convention between the EU and Switzerland, is another. Even where Swiss taxes do not apply, the taxation part of a trust is becoming a significant compliance risk for Swiss advisors and for the Swiss banks that have custody of the trust assets.

On the downside of taxes, the treatment of Swiss-resident beneficiaries and settlors is very unfavourable. So much so that trusts are used in Switzerland mostly for foreign residents, and only marginally by or for people based in Switzerland.

Second on my list of benefits and risks is “long-term”. As Mrs Maurice said earlier in this conference, a trust is an “enduring” situation, and this is attractive to settlors, sometimes beyond measure: some settlors have some sort of dynastic projection that they want to rule their family over many generations. Long term is also attractive to banks because the relationship they enjoy with the settlor, as far as they can build up that relationship with the trustee as well, will go on even after the settlor’s demise. The relationship between banks and trustees can be even cosier where the trustee is a subsidiary of the bank.

Long-term trusts raised one concern that was recently set aside. Swiss law has a prohibition about dispositions upon death extending over several generations. That includes Article 335 of the Civil Code stating that fideicommissums are no longer allowed. This provision became effective in 1912. While it did not invalidate existing fideicommissums, it prohibits the settlement of new owns. This provisions obviously applies to fideicommissums governed by Swiss law, but the concern was whether it also applies to international situations, such as where something akin to a fideicommissum, governed by a national law other than Swiss law, becomes part of a litigation before Swiss courts. In other words, is Article 335 a “loi de police”, one of those provisions of the law of the forum which must be applied even to international situations, irrespective of rules of conflicts of laws which are reserved by Article 16(1) of the Hague Trusts Convention? There was a long debate and much uncertainty about that until just four years ago, when the Federal Tribunal, Switzerland’s highest court, decided that Article 335 wasn’t applicable to a Liechtenstein foundation, even where that foundation had significant connections with Switzerland. Although a foundation is not the same as a trust, the reasoning and the conclusion are equally authoritative for any trust created under any proper law.

If long-term trusts do not raise that issue any more, other risks arise from the dynastic ambition of certain trusts. The desire of many settlors to organise their affairs and the devolution of their fortune over a long period of time is quite understandable. But the longer the trust is to last, the greater is the risk that it runs afoul of the context, constraints and needs of subsequent generations of beneficiaries. This in turn increases the risk of litigation. As we know, trust litigation is one of the fastest growing segments of this industry. Litigation is hugely costly, in monetary and other terms. It is often the worst scenario that can be contemplated by the settlor, with its potential to thoroughly upset what he or she intended to create.

Under the Hague Trusts Convention, settlors have an unlimited choice of the proper law of the trust. Offshore jurisdictions have relentlessly sought to improve their trust statutes and make them more attractive for settlors and trustees. The abolition of

the perpetuity period has become a *de facto* standard. So have reserved powers, private trust companies and non-charitable purpose trusts. This offshore trust, as it has emerged from twenty years of intense competition among offshore jurisdictions, is far remote from the traditional Anglo-American trust on which the negotiations of the Hague Convention were predicated.

This pursuit of trusts that can be aggressively tailored to the needs and desires of the settlors, including an almost unfettered degree of control over the management and distribution of trust assets during the settlor’s lifetime, creates an increasing risk that courts, especially in non-trust jurisdictions, will become critical of and protective against such trusts in particular, and trusts more generally, throwing out the baby with the bathwater. As suggested by two very recent Swiss cases, some courts will find within the provisions of the Hague Convention or without them the weapon to essentially disregard such trusts. At the same time as courts in England, Australia, New Zealand or the Channel Islands have greatly restricted the notion of sham trusts, other courts will be tempted to look elsewhere and find the silver bullet with which they can annihilate what they perceive as the sheer abuse of the trust idea.

From my small vantage point in Switzerland, the compliance risk in dealing with trusts and their tax incidence is significant, but the risk of increasing suspicion that offshore trusts, and trusts generally, are mere instrumentalitys in the hands of overreaching settlors is much more disruptive. This is a concern that should be openly acknowledged and addressed within the international trust community.

**Two current debates**

It will take years before the full potential of trusts and the exact limits of their recognition is explored and defined by Swiss courts. Yet two debates are going on about whether some further legislative action is necessary or useful. None has yet received political attention, so statutory amendments are presently a remote perspective.

The first debate is about whether trustee services provided in or from Switzerland should be regulated and supervised beyond the existing anti-money laundering framework. The example of many offshore financial centres suggests a positive answer. The influx or creation of trust companies, and even more the provision of trust-related services by firms that have little trust expertise, create a reputational risk and increase the justification for some form of regulation over trustees. However, setting up such a regulatory framework for trustees in a jurisdiction where there is no (domestic) trust law is quite a challenge, if not a paradox. The expertise in designing the regulation and supervising trustees cannot build upon local expertise only; it must draw significantly from the experience made in other similar jurisdictions. I am clearly of the opinion that Switzerland must follow that way, and better now than in the wake of future scandals. This opinion is shared by a large number of STEP members in Switzerland and is supported by SATC, the Swiss Association of Trust Companies. The difficulty lies much more with convincing the government and the legislature rather than the trust community.

The second debate is whether we need a Swiss trust act and the possibility to settle a trust governed by Swiss law. Why add this possibility when settlors can now choose among a long list of foreign trust laws and pick most of them with the confidence that their trust will be fully recognised? What are the chances for a Swiss Trust Act to become an attractive alternative to laws that enjoy decades or even centuries of refinement brought by case law and legal practice? I do not believe that a Swiss Trust Act would stand many chances of broad adoption by international settlers. However, I do believe it would yield a number of benefits. Swiss nationals not versed in international transactions would certainly find it easier to rely on a

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Swiss statute to create their own trust. If the legislature were to take up this issue, it would however need to solve the tax conundrum that presently penalises the use of trusts in domestic situations. A Swiss statute would also promote the idea and understanding of trusts in a broader circle of lawyers, public notaries, and civil courts than is now the case. Adopting a Trust Act would not contribute to internationally enhancing Switzerland as a good place to manage trusts and invest trust assets, but I believe it would contribute to the expansion and vulgarisation of the trust idea. There is nothing vulgar to vulgarisation. Professors do that a lot, which may explain why I find the idea to be very attractive, even if it seems a less pressing and remoter objective than regulating trustees.

In a conservative and prudent country such as Switzerland, good ideas often come long before their political time. This is not a reason to refrain from giving them form and substance. And it is always a pleasure to discuss them with such a learned and distinguished audience such as yours.

Thank you for your attention.

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Thévenoz is President of the Swiss Takeover Board, the regulatory agency supervising the takeover market. He has previously served as a commissioner of the Swiss Federal Banking Commission (2001–2007). He has contributed to a number of legislative and regulatory projects in the areas of trusts, intermediated securities, takeovers and unclaimed assets.