Ratification of the Hague Trusts Convention

On July 1st, 2007 the Convention on the Law Applicable to Trusts and on their Recognition (Hague Trusts Convention) has come into force. Related to this event several modifications have been made in Swiss law. The recognition of the Convention means that certain rules on the conflict of laws and on the law applicable to trusts have been introduced and the issue of the acknowledgement of a trust has now been settled. However, this does not mean that the convention has introduced the trust as a legal institution into the Swiss legal system. In fact, the jurisdiction of the Federal High Court has already some years ago recognised the elementary principles of a trust. The Hague Trusts Convention will strengthen and simplify the application of that jurisdiction and further the use of trusts as an instrument of asset management in Switzerland.

The **legal term** trust refers to a legal relationship created by a person (settlor) through which certain assets are transferred to one or more persons (trustees) for the purpose of their administration and for the benefit of certain beneficiaries or of a specified purpose. The term trust has its origin in the common law and has been adopted in the meantime by many countries which have a codified legal system (civil law). In addition to the Commonwealth countries and the USA trusts do exist i.a. in Panama and the Principality of Liechtenstein.

A trust may be set up by an **unilateral act** of the settlor or e.g. by a last will. The consent of the trustee is not a necessary element of the constitution of a trust. If a trustee is unwilling to act, the competent court will appoint another trustee. The unilateral nature of the creation of a trust is the significant difference to the fiduciary arrangement as it is known under Swiss law. A fiduciary relationship is based on a contractual relationship between a principal and a fiduciary. Contrary to a foundation which is defined as assets dedicated to a specific purpose and is a legal entity, the trust is not a legal entity and, therefore, lacks the capacity to act or to acquire rights. Consequently, the assets held on trust become the property of the trustee and not of the trust as such.

Upon the **transfer of the assets** from the settlor to the trustee the former looses all influence over the property in trust. However, the settlor may provide that he himself may be a beneficiary or that he may revoke the trust or change the content of the deed of trust. If the settlor retains too much control over the trust, he risks that the trust may be considered a sham.

Any person or legal entity who has the legal capacity and the capacity to act may become **trustee**. In practice, banks, asset managers, attorneys and trust companies act as trustees. The main duty of a trustee is to manage and administrate the trust's assets in accordance with the terms and conditions laid down in the trust deed by the settlor and the applicable law in the best interest of the beneficiaries. In general, the trustees have certain discretionary powers with regard to such asset management and the execution of their duties. The trust's assets must be held separately from the trustee's assets.

The **beneficiaries** have a so called "equitable right" to the trust assets. They can sue the trustees for benefits due to them under the trust deed and or for damages resulting from the trustees negligence. If trust assets or surrogates thereof are given to third persons which do not qualify as beneficiaries, the trustees can be sued for breach of trust and the assets which are wrongfully acquired by third persons may be reclaimed by so called tracer proceedings. The beneficiaries have certain rights with regard to information and inspection. Frequently, the settlor will appoint one or more trustworthy persons, so called protectors, which are charged with the supervision of the trustee's activities.

Prior to the ratification of the Hague Trusts Convention the **Swiss law** had no provisions law dealing with trusts. However, Swiss courts have recognised the trust concept in various decisions and applied foreign trust law. Yet the courts had to apply conflict of laws rules originated for foreign companies. This caused different problems of qualification of trusts. The ratification of the Hague Trusts Convention allows now to accept the concept of trust as an instrument of the common law which leads to more predictable legal results in Switzerland.

The Hague Trusts Convention states that a trust shall be primarily governed by the **law chosen** by the settlor. If no such choice has been made, the trust will be submitted to that legal system with which it has the closest connections. This provision intends to prevent that a trust which has points of contact with several legal systems is submitted to several legal systems.

The Convention applies only to trusts created voluntarily and evidenced in writing. If the trust is **recognised under the Hague Trusts Convention**, it follows that the trust assets are to be treated

as property separated from the trustee's assets. Therefore, a creditor of the trustee cannot seize the trust assets. In case of bankruptcy of a trustee the trust assets have to be separated. Furthermore, trust assets cannot become part of matrimonial assets or of a trustee's estate. If for any reason assets of a trust are mixed with assets of the trustee, a separation of the assets may be requested. The trustee may as such sue or be sued in Swiss courts and he may act as trustee on behalf of the trust vis-à-vis notary publics and officeholders. In summary, it can be said that that the former insecurity as a result of the application of Swiss law to a legal structure which does not exist under Swiss law will cease.

With the ratification of the Hague Trusts Convention the Swiss legislators have modified certain provisions of the Swiss Federal Act on International Private Law and the Bankruptcy Law. The International Private Law Act deals now with the **competence of jurisdiction** in trust matters as well. Primarily a court appointed in the trust instrument shall be competent. Instead of choosing a jurisdiction in the trust instrument a specific person may be authorised in the trust instrument to make a choice of jurisdiction. If not provided otherwise in the trust instrument, such court shall be exclusively competent to deal with all issues of trust law. In the absence of a choice of a jurisdiction, a Swiss court is competent if the defendant party (e.g. the trustee) has his domicile or, in absence of such domicile, his ordinary residence in the court's district. The same applies if the trust has its seat or a trustee has a branch (for claims related to acts of this branch) in the court's district. It follows that it will become much easier to sue trustees or protectors in Switzerland. Therefore it is advisable to consider carefully which jurisdiction and which applicable law to choose. The International Private Law Act also deals with questions about the recognition of foreign decisions in trust matters which will make the execution of such decisions in Switzerland easier.

The adoption of the bankruptcy law aims at the clarification of the special status of trust assets in **bankruptcy proceedings**. Personal creditors will have no access to trust assets. If on the other hand a creditor wants to enforce a claim against the trust he will have to start collection proceedings against the trustee as the representative of the trust's assets. Collection proceedings must be started either at the place determined in the trust instrument or if that place is not in Switzerland at the place where the trust is actually managed.

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