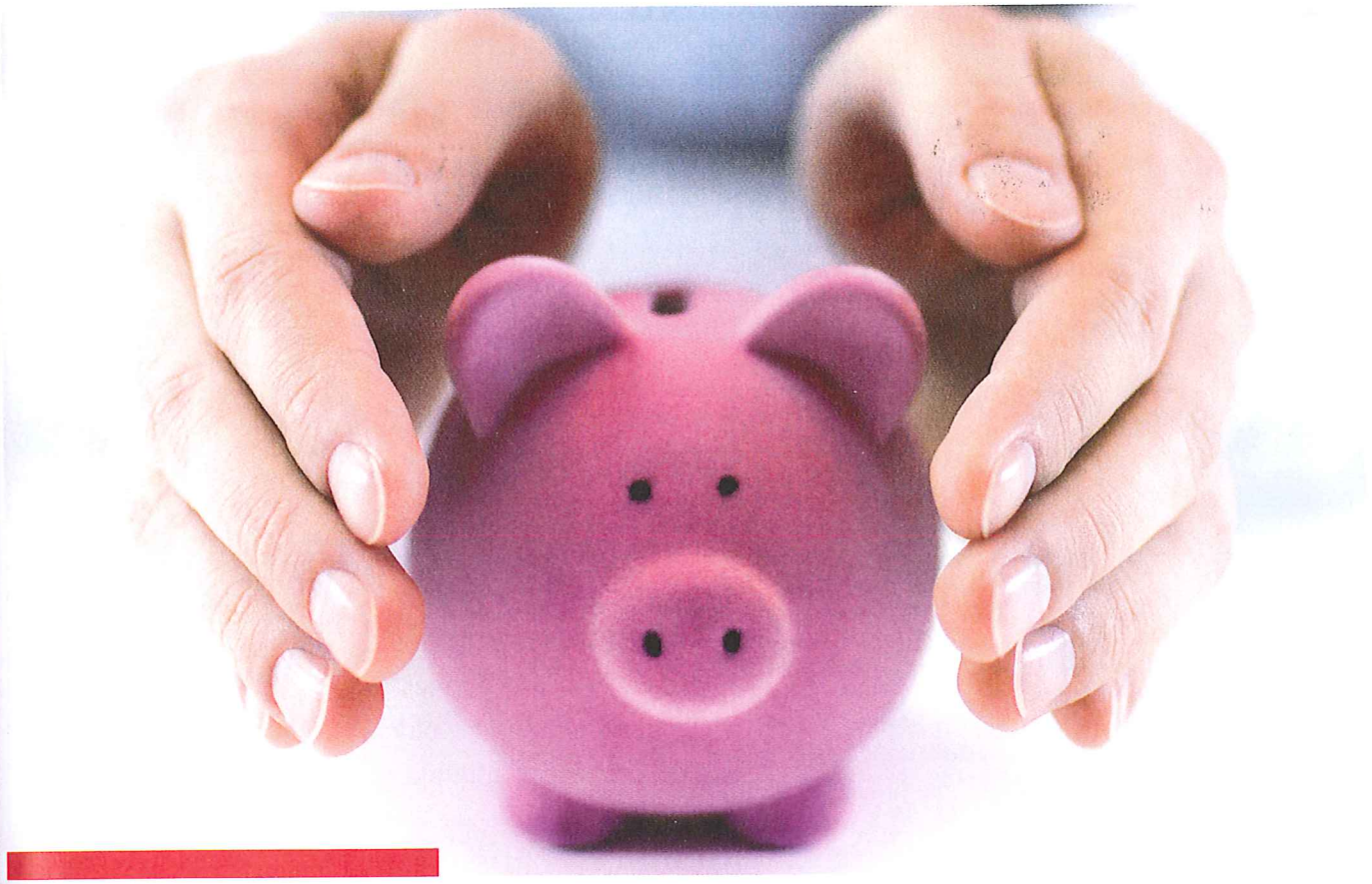

DESERVED RECOGNITION

PHILIPPE DE SALIS ON THE ACKNOWLEDGMENT OF TRUSTS AS EVIDENCED BY THE HAGUE CONVENTION, AND THE IMPORTANT ROLE OF THE SWISS ASSOCIATION OF TRUST COMPANIES

Switzerland has long been a draw for wealthy international families and individuals looking to apply maximum tax efficiency to their financial affairs. The global economic crisis that followed the collapse of Lehman Brothers three years ago added to Switzerland's allure for the wealthy. The country's relatively strong and stable economy added safe-haven status to its already long list of fiscal attractions, including, in particular, its forfeit or lump-sum taxation system for foreigners relocating to Switzerland.

The crisis triggered a boom for many wealth professionals in Switzerland and, among other things, fuelled growth in the country's trust business. This industry had already doubled in size from 2002 to 2007, and continued to grow in the aftermath of the financial meltdown. This rapid growth has once again shone a spotlight on the regulation of trusts in Switzerland.

DEFINING CONVENTION

Given that Switzerland has long been a destination for wealthy international individuals and families, it is perhaps surprising that it does not have its own substantive trust law, as trusts remain a central tool for those seeking to protect and allocate capital through the generations. Switzerland is not the only country without formal trust law, and such were concerns about producing a protective international framework for trusts that in 1985 the Hague Conference developed multilateral rules to recognise trusts and define the substantive law governing them. The *Hague Trust Convention* came into force on 1 January 1992 and has been ratified by 11 countries to date.

Switzerland chose to accept the convention at the end of 2006, recognising the need to clarify the rules for trusts with Swiss-based trustees which were, by necessity, governed by trust rules from other jurisdictions. This ratification and the implementation of accompanying internal legislation made clear a number of important points that were uncertain before, including, in particular, the legal qualification of trusts under the Swiss rules on conflicts of laws or the ring-fencing of trust assets in the case of a Swiss-based trustee's bankruptcy. This gave significant comfort to clients whose financial affairs are run from Switzerland through trust mechanisms.

However, something has become more and more apparent in the wake of the financial crisis and the various scandals that came to the forefront: an increasingly internationally mobile and wealthy community is seeking surety and greater legal protections when it comes to conserving money.

VOLUNTARY SUPPORT

In Switzerland, at about the same time the *Hague Trust Convention* was enforced in July 2007, a group of trust companies decided, on recognised experts' initiative and with STEP's help, to set up a voluntary organisation of like-minded professionals who would lobby and look after the interests of those in the trust industry. The Swiss Association of Trust Companies (SATC) comprised 12 founding members, who represented a wide range of interests in the trust industry.

The main aims of the organisation are to engage in furthering and developing

trustee activities in Switzerland and to ensure a high level of quality and integrity, as well as to adhere to certain professional and ethical standards in the trust business in Switzerland.

SATC also aims:

- to bring together entities with operative offices in Switzerland that are active in the trust industry for the exchange of know-how, information and ideas on trust-related matters
- to build up and strengthen the standing of the trust industry in Switzerland, enhance the reputation of trustee activities and increase the acceptance of the services of those engaged in the trust business
- to advance technical knowledge and support high-level education in respect of managerial, legal, administrative and other relevant trust-related subjects
- to become an association recognised and supported by the Swiss government and other influential bodies, associations and commissions in Switzerland and internationally
- to undertake and support studies and research, and to make suggestions and representations of a technical, practical and non-political nature to governments and other bodies, and to ensure and promote high quality and ethical standards in the trust industry;
- to improve the industry's legal basis in Switzerland.

Since the formation of SATC four years ago, much work has been done on producing a general code of ethics and business conduct for those working in the trust industry in Switzerland. The latest code of ethics, which was passed by the SATC committee in April 2008, comprised a group of overarching principles for those working in the trust industry.

An approach based on a code of principles rather than on a strict legalistic framework mirrors the original structure of the UK Financial Services Authority, the lead UK regulator, which bases complex rules on a series of core values.

The SATC brought in seven principles for the trust industry to work with: professionalism, competence, diligence, integrity, confidentiality, transparency and fairness. These values have underpinned Switzerland's trust industry for the past three years and provide trust professionals with a practical framework to operate their businesses.

However, among the larger trust companies in Switzerland, there is a gathering momentum of opinion that endorses the introduction of business regulation in Switzerland, in addition to the existing anti-money laundering regulation to which trust companies are subject, to give comfort to the many internationally wealthy individuals who choose to have their finances managed in the country.

MEASURING DEMAND

A recent survey conducted by STEP in conjunction with SATC found that about 45 per cent of companies in the trust industry believed it would be beneficial for the trust industry in Switzerland to be further regulated, compared to the 43 per cent of those questioned who believed that they were already over-regulated. Many of those questioned said, understandably, that their support for introducing further regulation was conditional on the detail of any new rules. Another recent survey, conducted by the Swiss Federal Department of Finance, also found that there was demand within the financial industry for the introduction of a substantive trust law.

Currently, in legal wrangles in Switzerland, given the absence of Swiss substantive trust law, Swiss courts have to rule in disputes using rules drawn up in other jurisdictions, which can be time-consuming and costly for those involved.

However, Swiss judges are used to applying foreign law, as they have to do this regularly under the internal rules on conflicts of laws. In such cases, the Swiss judges can rely on the expertise of the Swiss Institute of Comparative Law in Lausanne to assist them with establishing the foreign law content. They may also have recourse to opinions from foreign state agencies or private legal experts.

'A PROPER TRUST STRUCTURE IS RECOGNISED LEGALLY EVEN IN UBS DISCLOSURE CASES'

LEGAL RECOGNITION

Recent decisions by Swiss courts have shown that the Swiss judges have a good understanding of the trust concept and the final decisions were mostly favourable to trusts. Three of these judgments have already been reported in *STEP Journal* (January 2011, Vol19Iss1) by Dr Thomas Mayer in his article 'Trust Law in Switzerland'. Probably the most important of these decisions was the judgment handed down by the Swiss Supreme Court in November 2009, which clarified that the rule contained in article 335(2) of the *Swiss Civil Code*, which prohibits the establishment of family foundations solely for the purpose of maintaining their beneficiaries, was not part of the Swiss public policy (*ordre public*). As a result, this rule is not applicable to an entity that is governed by the laws of another jurisdiction. In the case under review, it was a foundation governed by the laws of Liechtenstein, but this also applies to trusts.

As recently as March, the Swiss Federal Administrative Court rendered two decisions relating to disclosure of information to the Internal Revenue Service (IRS) in the matter of the Swiss bank UBS. The Court ruled that where assets are held in a discretionary and irrevocable trust, potential discretionary beneficiaries cannot be seen as 'beneficially owning' these assets under the provisions of the relevant agreement between Switzerland and the US, even if they are (or were at some point) mentioned as 'beneficial owners' on the 'know your customer' (KYC) forms of the bank.

In these two cases, the disclosure of information to the IRS was therefore refused. These decisions are very important, as they show that a proper trust structure operated professionally and with integrity is recognised legally even in the context of the UBS disclosure case. However, you must be able to prove without any doubt that the relevant assets have been validly settled unto and are held within the trust, failing which the Swiss authorities will continue to rely on any evidence pointing at individuals as beneficial owners of the relevant assets, including, in particular, the KYC forms of the bank. This is what happened in two other cases that were ruled upon by the Swiss Federal Administrative Court in April, where disclosure was granted because the individuals concerned failed to demonstrate that the assets were held in trust[1].

Back to the business regulation of the trust industry in Switzerland, the SATC firmly supports a sensible and practical regulation and is actively involved in that respect. It remains to be seen whether this will take the form of voluntary self-regulation or of compulsory, state-imposed regulation. While there are solid arguments in favour of compulsory regulation, this supposes that a legislative bill will be passed to that effect. As the regulation of the trust industry does not seem to be high on the agenda of the Swiss authorities, a meaningful development of the existing SATC principle-based rules to a more detailed business self-regulation may provide a valid alternative, as SATC's standards will increasingly be regarded as constituting the industry's best practice.

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1 These decisions are on www.trusts.ch, maintained by David Wilson of Schellenberg Wittmer, Geneva