

Swiss Trusteeships: Regulators and Practical Issues for the Future

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On 1st July 2007 Switzerland's ratification of the Hague Convention on the international recognition of trusts will enter into force. Unlike other countries, which have already ratified the Convention, Switzerland is also introducing specific rules in its private international law dealing with the international jurisdiction and the recognition/enforcement of judgments in trust-related matters. The ratification of the Hague Convention will create a firm legal basis for Switzerland's growing trustee business. At the same time the Convention will enter into force, the Swiss Federal Council has already enacted parallel amendments to Swiss federal legislation on international private law, and debt enforcement and bankruptcy. On the international private law level, there will be freedom of choice with respect to a legal forum. For example, a beneficiary will be able to sue a Swiss trustee in Switzerland and, in the absence of a trust jurisdiction clause, also in the jurisdiction under the laws of which the trust is governed. On the other hand, it shall be possible for Swiss trustees, to apply to the courts of that jurisdiction. As regards, debt enforcement and bankruptcy, the Swiss government amended the Federal Debt Enforcement and Bankruptcy Act to explicitly distinguish between the personal assets of the trustee and the trust in Swiss based debt enforcement proceedings even though Articles 11(a) and (b) of the Hague Convention state that the recognition of the trust concept must imply in particular "that the personal creditors of the trustee shall have no recourse against the trust assets and that the trust assets shall not form part of the trustee's estate upon his insolvency or bankruptcy".

Although in the past trusts were already broadly recognised by the Swiss courts, the legal situation remained encumbered with considerable uncertainty. There is obviously a significant economic interest in greater

legal certainty, in particular, as a solid legal foundation creates a better climate for the setting up and administration of trusts in Switzerland, and thereby promotes the country's appeal as a perfect location for private wealth management.

The Swiss financial sector has been very keen with respect to these legal developments. Indeed, bankers and trust practitioners are not often "blessed" with the possibility to adopt a new "product" or service with potentially significant international competitive and comparative advantages. However, several practical issues and challenges face the Swiss financial community: the appropriate degree of trustee regulation and the future role of the banks as trustee promoters.

The Swiss Bankers' Association ("SBA") has openly advocated that trustees, who are not directly subject to any Swiss financial market prudential supervision, or form part of a consolidated supervised entity, should be subject to a licensing requirement. The SBA justifies this position with an eye to ensuring the "seriousness" of the trustee profession. By adopting this position the SBA clearly would like to see the vast majority of existing trust companies, lawyers and independent asset managers excluded from acting as professional trustees.

Largely joining the Swiss banks in the quest for trustee regulation in Switzerland are the advisers and trust companies from English speaking jurisdictions who have increasingly established a business presence in Switzerland for essentially two reasons. The initial one materialised nearly a decade ago as a defensive strategy. At that point in time jurisdictions such as Jersey and Guernsey became increasingly (over) regulated and as a result many Channel Islands trust companies looked to alternatives for their clients. The second reason for this presence is of course the commercial opportunity of entering the world's largest private wealth management

market with expertise in equitable trusts against the backdrop of the Swiss recognition of trusts.

These practitioners have largely come out in favour of the establishment of an adequate regulatory framework, advocating as yet undefined “minimum standards”, a code of ethics and the establishment of a “recognised level” of professional credentials. It is the objective of such practitioners to create a Swiss Association of Trust Companies (“SATC”), the purpose of which will be “to engage in the furtherance and development of trustee activities in Switzerland and to promote the adherence to certain professional and ethical standards.”

The Swiss government however has decided not to introduce a specific regulatory framework for trustees in Switzerland. The current regime will thus continue, whereby basically any financial intermediary can act as a trustee and can use terms such as “trustee(s)”, “trust services” or “trust company” in a company name. In a memorandum justifying this decision, the Swiss government suggested that the majority of trustees will already be regulated in their capacity as financial intermediaries, and so introducing rules specific to trustees would result in superfluous bureaucracy. As financial intermediaries, trustees have the obligation to obtain an authorisation from the Federal Money-Laundering Control Authority or to be affiliated to a “SRO” (self-regulatory organisation). This requirement has above all the objective to ensure that financial intermediaries, such as trustees, prevent money laundering acts and to oblige them to report suspicious transactions. It is noteworthy to point out that the dispositions of Article 14 of the Swiss Money Laundering Act states much broader conditions to obtain the authorisation to carry on a fiduciary/trust business in Switzerland, namely that the financial intermediary:

- “a) is registered in the commercial register under a business name or has been officially authorised to carry on business;*
- b) has established internal directives and is organised in such a manner as to ensure compliance with obligations under this Act; and,*
- c) is of good repute and provides all necessary guarantees that it will comply with obligations under this Act, this provision applying also to persons responsible for administering or managing the intermediary’s business.”*

Furthermore, the practical application of this Money Laundering Act in the form of regular independent audits, result in the effective, regular monitoring of financial soundness, internal governance and of the overall reputation of trust companies.

The Swiss government also considered that no objective or pressing need for

further regulation had been demonstrated. Hence, in the years to come, it is unlikely that we would witness the elaboration of any federal Act on financial services or any new chapter dedicated to trust companies, or for that matter even independent asset managers. The latter category of financial professionals is still not regulated in Switzerland, except as regards money laundering. The imminent advent of a new integrated financial services regulatory agency “FINMA” will not change anything to the present situation, as the law establishing it is merely an organisational legislation, regrouping existing banking, insurance and anti-money laundering supervisory bodies.

The government’s stance on trustee regulation was hardly a surprise and it remains to be seen to what degree the banks and Swiss-based equity/common law practitioners will push their case. It goes without saying that the entire Swiss financial sector has a vested interest in the highest professional standards for trustees. Yet it is intellectually inconsistent to argue for increased regulation of trustees, but not necessarily of independent asset managers, or fiduciaries as such. This very partial approach would imply that non-trustee type of activities of Swiss fiduciary/trust companies are somehow less accountable, “serious” or complex than trusteeships. In other words, it would appear that advocates of trustee regulation would seriously envisage a two-track regulatory approach under which professional foundation board memberships or company directorships, as well as all the related financial intermediation, remain untouched by new trustee regulations, contrary to the equitable type of trusteeships, for which only banks and bank like institutions would automatically qualify as sufficiently regulated.

The rather hastily adopted positions by the SBA and the founders of the future SATC are not only problematic with regards to the sheer size and diversity of the Swiss non-banking financial sector; they also strike a blatant mercantile cord. Consider a recent STEP advertisement, which states: “the banks take the view that this (Hague Convention) ratification will enable them to develop their asset-structuring and tax-planning activities and give the Swiss financial centre a leading future role in the domain of trusts.” Especially, the larger Swiss banks openly advertise their tax planning and trust-related services on websites and brochures. In the past, banks in Switzerland frequently used foreign affiliates in the Cayman or Channel Islands to provide trustee services. In principle, nothing prevents them now from rendering these services out of Switzerland.

The strategies of banks in Switzerland today encompass both extremes: some institutions internalise trust and fiduciary functions, similar to the US and UK models, whereas others have chosen to

systematically “outsource” non-banking and investment needs of their clients, including trust and fiduciary work. A third category can be defined as those banks which internally offer non-complex legal structures, but externalise everything else. With regard to Swiss trusteeships one of the principle challenges for the banks will be how to avoid conflicts of interest and self-dealing.

Daniel Martineau, Managing Director of Close Trustees (Switzerland), once wrote that “cross selling was another word for conflict of interest” and that “the problem most often arises in the situation where the bank-owned trust company is making a choice of investment manager. (and) that most banks will have little or no interest in acting as trustees unless, at least some portion of the. . . . assets are managed within the bank to improve the overall profitability to the bank.”

As with all other fiduciary activities, the selection of trustee service providers should be based exclusively upon the best interest of final beneficiaries, and not on the ancillary services or benefits that specific services may provide to the bank or its trust division. Basing such relationships upon ancillary services could represent a breach of the duty of loyalty and a conflict of interest. In this context, banks in Switzerland may also want to carefully analyse in detail the (reputational) risks which go along with an active role in acting as Swiss trustees (who may be sued by beneficiaries in Swiss courts).

In conclusion, the regulation and supervision of independent trustee companies remains an open political issue, even though major changes are unlikely in the short term. Currently, the liberal money laundering regulatory approach seems to prevail, despite the protectionist calls in favour of a licensing based system from the Swiss Bankers’ Association, as well as from common law inspired professionals. It would be in the interest of all actors in the Swiss financial system to maintain and strengthen the current level playing field regulatory system, which has been successful for the past eight years and to avoid the proliferation and adoption of activity based types of supervisory legal regimes and specific rules of conduct for trustees. A wiser approach would be to take a “wait and see” attitude in order to assess the situation at a later point in the future, last but not least, to grasp a better understanding of the evolution of the banks’ positioning and strategies towards the growing demand for Swiss trusteeships.



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