Trustee Liability in Selected Civil Law Jurisdictions

Dr. Stephan Ochsner, LL.M.

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I. Introduction

The trust is a legal arrangement with a high degree of international acceptance. Although it is used primarily in common law countries, Liechtenstein included the trust in its civil law already in 1926 and is still the only continental European country to have done so.

The trust is a legal relationship involving three parties: the settlor, the trustee,[1] and the beneficiaries. Unlike foundations, the contributed assets in the case of

[1] The Law on Persons and Companies (Personen- und Gesellschaftsrecht; PGR) uses the term "Treuhänder" (trustee) for this purpose. The Professional Trustees Act also uses the term "Treuhänder" (professional trustee, fiduciary), but in a different context: These are persons whose main business

a trust become the property of the trustee, who manages or uses those assets as trust property in the trustee's own name as an independent legal entity for the benefit of one or more third parties (beneficiaries) with effect toward all other persons.[2]

Currently, trusts are often still mentioned in connection with the problem of tax evasion. Sometimes, their very right to exist is called into question. It is overlooked in this regard that the trust as a legal form is not problematic as such, but rather only its occasional misuse. Just as cars as such are not called into question after a car accident, trusts should be treated the same way.

However, it can be observed that the demands and therefore the risks involving trusts are continuously increasing. A trustee runs the risk of aiding and abetting tax evasion or committing a similar offence if he or she knows or should know that the contributed assets are not taxed. The steadily increasing transparency in this domain, extending to automatic information exchange in tax matters, is making this an even more sensitive issue.

Also beyond the domain of taxation, the liability risk for trustees is continuously increasing. In part, this may be because a liability claim is more likely to be filed against the trustee in the event of alleged breach of duty if the assets are taxed than if they are not taxed. Another reason is probably also the general increase in litigiousness in the financial services sector. Trustees are therefore advised to know their risks and to take measures to mitigate these risks to the extent possible.

II. Trustee liability in Liechtenstein

A. Applicable law

The trust is governed by articles 897 to 932 of the Law on Persons and Companies (PGR) and is referred to as "Treuhänderschaft" in German. Additionally, article 932a PGR incorporates the Trust Enterprise Act (Treuunternehmengesetz; TruG), which governs commercial trusts, into the PGR. Finally, the Hague Trust Convention entered into force for Liechtenstein on 1 April 2006.

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involves establishing on a professional basis, in their own name and on the account of third parties, legal persons, companies, and trusts for third parties (see article 2 of the Professional Trustees Act). Where the term "trustee" is used in the following in the Liechtenstein context, the term is meant to refer to the PGR, unless explicit reference is made to the Professional Trustees Act.

[2] Article 897 of the Law on Persons and Companies (PGR).

According to Article 910(1) PGR, the interpretation of the trust relationship involving the settlor, the trustee, and the beneficiaries is governed primarily by the content of the trust deed. If the content of the trust deed conflicts with the mandatory provisions or public order of the country, the trust deed must be interpreted so that it is compliant, unless otherwise specified by law or in the trust deed itself.[3] If the trust deed does not address a particular question, the provisions of the PGR apply on a subsidiary basis.[4]

This already makes clear that the content of the trust deed plays a crucial role in regard to the liability of the trustee. There is considerable flexibility in the design of a trust deed. The trustee should therefore make sure that his or her duties are set out as clearly as possible in the trust deed, so as to prevent vulnerabilities in the future.[5]

B. Duties of the trustee

1. Duty to adhere to the trust deed

According to article 922 PGR, the trustee is required to observe the provisions of the trust deed and the subsidiary provisions of the PGR that do not conflict with the trust deed. Beyond this, the trustee is required to safeguard and manage the trust property with the care expected of a prudent businessperson and, where appropriate, to insure the assets against foreseeable risks. The Liechtenstein Supreme Court has even demanded greater care from the trustee than in the trustee's own matters.[6] In principle, the care demanded of the trustee is likely to increase as the complexity of the matters involved increases.

2. Limited instruction right of the settlor

The trust deed may provide a limited right of the settlor to give instructions. According to Article 918(1) PGR, however, the settlor is not entitled to oblige the trustee to act in accordance with continuous instructions of the settlor. As a matter of principle, it should be noted in this regard that any right of instruc-

[3] Article 910(2) PGR.
[4] Article 910(3) PGR.
[5] See also Schurr, Verhältnis des Trustee zum Errichter und zu den Begünstigten beim liechtensteinischen Trust, Liechtenstein Journal 1/2011, p. 8.
[6] Collection of Decisions of the Liechtenstein Courts (Sammlung der Entscheidungen der liechtensteinischen Gerichte; LES) 1987, 114.

tion on the part of the settlor has consequences not only under civil law, but also under tax law. If the settlor has a right of instruction, the assets of the trust are often attributed to the settlor for purposes of tax law. Sometimes, this may be intended or desirable from a tax perspective. It therefore cannot be said that the settlor should never have the right of instruction for trusts – just as it cannot be said for other legal entities. It may also make sense to set out the settlor's right of instruction in a mandate agreement in order to describe and delineate it clearly. Attention must be paid, however, that the provisions of the mandate agreement do not contradict the provisions of the trust deed. If this were the case, the trustee would be subject to a conflict of interest and run the risk of breaching the duty of trust if he or she does not adhere to the trust deed.[7]

If the overall appraisal of the circumstances leads to the conclusion that, contrary to Article 918(1) PGR, the trustee is bound by continuous instructions of the settlor, this may mean that the trust relation is not effective at all and should instead be considered a sham.[8] For this reason, it is most likely the trustee's responsibility to ensure that this threshold is not exceeded in the case of an (intentionally) controlled trust; even where a right of control is desired for tax purposes, it should be designed in such a way that it does not lead to invalidity of the trust under civil law.

C. Liability of a trustee

1. Breach of trust

According to article 924(1) PGR, the trustee is personally liable to the settlor or, where there is no longer a settlor, to the beneficiary in accordance with the principles of contract law[9] to the full extent of the trustee's assets if the trustee breaches duties set out in the trust deed and on a subsidiary basis in the PGR (breach of trust). Third parties acting in bad faith are liable to the settlor and the beneficiary in accordance with the principles governing prohibited acts, but

[7] Along these lines, see also Schurr, Verhältnis des Trustee zum Errichter und zu den Begünstigten beim liechtensteinischen Trust, Liechtenstein Journal 1/2011, p. 9.
[8] See also Schurr, Verhältnis des Trustee zum Errichter und zu den Begünstigten beim liechtensteinischen Trust, Liechtenstein Journal 1/2011, p. 9.
[9] § 1295 et seq. of the General Civil Code (Allgemeines Bürgerliches Gesetzbuch; ABGB). General preconditions of liability are conduct contrary to law or duty and the fault of the trustee, a causal relationship between the fault and the loss, and the actual occurrence of a loss.

only to the extent the settlor and beneficiary did not themselves bring about the breach.

Unless the trust deed provides otherwise, co-trustees have unlimited, joint and several liability for breach of trust, unless they can prove that they acted with the care expected of a prudent businessperson in supervising the conduct of their co-trustee. This rule does not affect the right of recourse to the guilty party.[10]

According to article 924(3) PGR, the trustee is also liable for acts and omissions of third parties to whom the trustee has transferred the performance of trust activities or whom the trustee has otherwise used for that purpose – at least to the extent nothing else is entailed by the nature of the individual trust. Here again, the rule does not affect the right of recourse to the third party.

2. Transactions for the trustee's own benefit

Unless otherwise stipulated in the trust deed, and with the exception of the right to reimbursement and compensation, the trustee is not entitled to gain any advantages from the trust relationship.[11]

3. Does the business judgment rule apply?

Since 1 April 2009, the business judgment rule (BJR) has been codified in Liechtenstein in article 182(2) PGR. The provision is based on the BJR model in American law as well as German stock corporation law. According to the BJR, directors of a company act in accordance with the principles of prudent business management and representation if their entrepreneurial decisions are not guided by extraneous interests and if they can reasonably assume that they are acting on the basis of appropriate information for the benefit of the legal person. It is a basic purpose of the BJR to create a "liability-free core area of entrepreneurial discretion for business decisions".[12]

Formally, the BJR is applicable only to legal persons. However, the Liechtenstein Supreme Court applied the BJR – at least before its codification – to trus-

[10] Article 924(2) PGR.
[11] Article 925(1) PGR. Article 925(2) to (5) PGR contain further details on this principle.
[12] Schwärzler/Wagner, Verantwortlichkeit im liechtensteinischen Gesellschaftsrecht, 2nd ed. 2012, p. 94.

tees of trusts as well.[13] Some of the literature rejects the applicability of the BJR to trustees.[14]

D. Potential liability risk of trustees

1. General remarks

- Insufficient trust deed: The trust deed does not specify the duties of the trustee or is insufficiently clear. If negative developments occur, the trustee runs the risk of being accused that the damage would not have occurred if the trustee had acted differently. Ultimately, it is probably up to the judge to decide, by interpreting general terms of law (e.g., "care expected of a prudent businessperson"[15]), whether the trustee acted properly or not.
- The trust is a sham: Due to a continuous right of instruction, the trust might be considered a sham and therefore non-existent. Persons suffering a loss (e.g., the beneficiaries of the trust) might be accused of not having taken account of this point when establishing the trust and thus to have given wrong advice.
- Liability of third parties: For the performance of certain activities (e.g., asset management), the trustee has involved third parties but failed to select, instruct, and supervise them carefully. The trustee is in principle liable for acts and omissions of third parties to whom the trustee has transferred the performance of trust activities.[16]
- Knowledge of foreign law: In general, the question arises as to the extent of the trustee's knowledge of the law in the country of residence of the settlor or the beneficiaries. This question does not have a clear answer. Schwärzler/Wagner argue as follows:

  "In the view of the authors, advice given by a Liechtenstein trustee[17] or lawyer – whether as governing bodies of a company or equivalent legal persons – can and should not replace the legal and especially tax advice in

[13] See, e.g., LES 2008, 82.
[14] See, e.g., Schurr, Haftung des Trustee für Investitionsentscheidungen – Rechtsvergleichende Überlegungen zum Breach of Trust unter Berücksichtigung der Asset Protection, LJZ 1/2012, p. 38.
[15] See Article 922(1) PGR.
[16] See Article 924(3) PGR.
[17] "Trustee" here refers to a professional trustee under the Professional Trustees Act. The statement can easily be applied to trustees under the PGR, however.

the country of origin of the client. Nevertheless, it is unavoidable for Liechtenstein trustees and lawyers to know the state of legislation and case law in countries such as Germany […]. This is all the more important given that Liechtenstein law by its nature has strong international links and Liechtenstein companies now enjoy international recognition to a large extent.[18] […] The Liechtenstein trustee certainly never should or can replace the legal or tax advisor operating in Germany. But the Liechtenstein trustee or lawyer should nevertheless know the basic tax defence measures. In this way, the Liechtenstein trustee or lawyer can "recognize the resulting consequences, draw attention to them, and avoid any serious advising mistakes."[19]

2. Taxes

- Aiding and abetting tax evasion: The tax authorities of certain countries, first and foremost the United States and Germany, have for several years increased their aggressive prosecution not only of individuals evading taxes, but also of their helpers. It is conceivable that a Liechtenstein trustee might be considered to have aided and abetted tax evasion or a similar offence if the relevant foreign criminal law for tax offences is applied.[20] This might be the case, for instance, if the Liechtenstein trustee knew that the assets contributed to the trust were not taxed but the trustee nevertheless established the trust for the settlor – or even recommended that the trust be established in order to evade taxes. The possible application of the criminal offence of aiding and abetting tax evasion to the Liechtenstein trustee is of course not a question of Liechtenstein civil law. But in light of its importance, it still makes sense to discuss the issue in this context.
- The same is true of the potential liability of the Liechtenstein trustee for the breach of reporting requirements vis-à-vis foreign tax authorities (e.g., in France) and the potential liability of the trustee for unrecoverable foreign tax debts.
- In contrast, mistakes made in the context of tax advice, by the trustee or by a third party mandated by the trustee, are a question of civil law. The dam-

[18] Schwärzler/Wagner, Verantwortlichkeit im liechtensteinischen Gesellschaftsrecht, 2nd ed. 2012, p. 29.
[19] Schwärzler/Wagner, Verantwortlichkeit im liechtensteinischen Gesellschaftsrecht, 2nd ed. 2012, p. 29, with reference to Hosp, Liechtensteinische Juristen-Zeitung (LJZ) 2003, pp. 8 et seq.
[20] Liechtenstein trustees are not directly subject to foreign criminal tax law. But if the foreign state initiates criminal tax proceedings against the Liechtenstein trustee and issues an international arrest warrant, the trustee might risk being arrested if he or she travels to a foreign country.

ages – overpaid taxes – might be asserted by the injured party against the trustee. Especially in the case of foreign tax advice, the question will arise as to how extensive the Liechtenstein trustee's knowledge of foreign tax law must be.[21]

3. Management of bankable assets

- "Care expected of a prudent businessperson": Trustees usually do not manage the assets of the trust themselves but rather mandate an asset manager for that purpose. Even if the trustee wanted to take care of asset management of the trust himself or herself, the trustee would not need a licence under the Asset Management Act. The reason for this is that a trustee is considered to manage "own" assets from a legal perspective, compared to an asset management company managing third party assets. Moreover: As a trustee[22] licensed in Liechtenstein, the trustee would be unable to obtain an asset management licence; a separate asset management company would have to be established. In terms of supervisory law, the trustee is thus not expected to comply with the rules applying for an asset manager. But what is the situation under civil law? The trustee must exercise the "care expected of a prudent businessperson". In my view, it would go too far if this care were deemed equivalent to the care and obligations of an asset manager licensed under supervisory law. The legislative power has clearly separated the field of asset management from the field of trusts. Thus, the care of a prudent trustee cannot be equal to the care of a prudent asset manager with respect to sometimes very formalistic supervisory asset management obligations. Nevertheless, the trustee usually acts on a professional basis and is responsible for the assets of the trust. Thus, it would be wrong to treat the trustee as lay person in the field of asset management, too.
- Lack of investment expertise and experience on the part of the settlor: Liechtenstein asset management companies must establish a client profile in order to provide the services and recommend the financial instruments suitable for the client. For this purpose, the asset management company obtains the information necessary to establish the client profile from the client, namely the client's financial situation, investment goals, and investment expertise and experience.[23] The question now arises whether Liechtenstein trustees are subject to similar duties. In principle, the ques-

[21] See above point II./D./2.
[22] "Trustee" here refers to a professional trustee under the Professional Trustees Act. The statement can easily be applied to trustees under the PGR, however.
[23] Article 15(1) and (2) of the Asset Management Act.

tion must be answered in the negative, given that the Asset Management Act is precisely not applicable to trustees.[24] According to article 913 PGR, trusts should generally be subject to the "guiding principle" of an extremely conservative and low-risk investment strategy.[25] Article 913 PGR does in principle amount to dispositive law that can be trumped by the content of the trust deed. Additionally, paragraph 4 of that article specifies that these limitations do not apply to trusts involving the assets of persons living abroad. Nevertheless, settlors are advised to be highly cautious in this regard, to pursue a conservative and low-risk investment strategy, and to describe the permissible financial instruments as precisely as possible in the trust deed. Since every trust deed is a reflection of the settlor's ideas on how to deal with assets,[26] this should be true to an even greater extent if the settlor has less investment expertise.

- Conflict of interest in selecting the asset manager: When selecting an asset manager, the trustee is not prohibited from considering a company that, for instance, belongs to the same financial group as the trustee. However, where the BJR is applied, a "safe harbour" is in any event no longer provided given the existing conflict of interest. In such a case, the trustee is advised to supervise the asset manager closely and also to document that supervision.

- Lack of control of the asset manager: In principle, a trustee is liable if there is a causal connection between a breach of trust and a loss of assets.[27] Whether a breach of trust has occurred is decided mainly by looking at the content of the trust deed. It is therefore advised to set out in the trust deed to what extent the trustee is expected to control the asset manager. Strict liability of the trustee should in any event be excluded; culpability of the trustee should be made a precondition for liability.[28]

- Performance below benchmark: If the returns of a portfolio fall below the returns of a benchmark index, the question arises whether the trustee should be required to act. This question does not have a simple answer.

[24] "Trustee" here refers to a professional trustee under the Professional Trustees Act. The statement can easily be applied to trustees under the PGR, however.
[25] See Schurr, Haftung des Trustee für Investitionsentscheidungen – Rechtsvergleichende Überlegungen zum Breach of Trust unter Berücksichtigung der Asset Protection, LJZ 1/2012, p. 39.
[26] See Schurr, Haftung des Trustee für Investitionsentscheidungen – Rechtsvergleichende Überlegungen zum Breach of Trust unter Berücksichtigung der Asset Protection, LJZ 1/2012, p. 39.
[27] See Schurr, Haftung des Trustee für Investitionsentscheidungen – Rechtsvergleichende Überlegungen zum Breach of Trust unter Berücksichtigung der Asset Protection, LJZ 1/2012, p. 39.
[28] See Schurr, Haftung des Trustee für Investitionsentscheidungen – Rechtsvergleichende Überlegungen zum Breach of Trust unter Berücksichtigung der Asset Protection, LJZ 1/2012, p. 40.

First of all, it is not always easy to define a suitable benchmark for a given portfolio. The question also regularly arises in the context of asset management of how high the theoretically assumed risk (Sharpe ratio) was for a given return. An absolute comparison of returns without considering the theoretically assumed risk is inadequate. Moreover, a return may be higher than the benchmark one year and lower the next. If, however, a portfolio's return is below the defined benchmark over several years and if the Sharpe ratio does not provide counterarguments, it is difficult to argue that the trustee should not be expected to act. In practice, constellations have been observed in which a portfolio is divided among three asset managers and the asset manager with the lowest return is periodically replaced. Even in such a case, however, the content of the trust deed is primarily decisive for the question of whether the trustee has a duty to act.

4. Management of non-bankable assets

If the trust deed does not contain any special rules on the management of non-bankable assets (e.g., movable property, real property, companies, etc.), the standard of care set out in article 922(1) PGR applies (care expected of a prudent businessperson). In the case of movable and real property, insurance questions generally arise that must first be settled. Complex questions may also arise in regard to the management of companies, especially if the companies are operative.

In its decision of 14 June 2007,[29] the Liechtenstein Supreme Court held the following in regard to the duties of a trustee when managing companies:

"The standard of care set out in article 922(1) PGR applies to trustees. Trustees are required to observe the provisions of the trust deed and the law, and they must safeguard and manage the trust property with the care expected of a prudent businessperson. In the present case, the trust deed has granted the trustees broad discretion for their decisions. Beyond this, […] the trust deed clearly specifies that the trustees are not required to intervene in the management of a company or the administration of companies in which the trust is invested. Within the framework specified by the trust deed, they must act in the best interest of the trust assets. How they do this is in principle left to the trustees. If the decisions of the trustees relating to the trust assets, especially the companies of the trust, are made within the scope of discretion granted by the trust deed, based on solid information, free of conflicts of interest, and in good faith

[29] LES 2008, 82.

that their decisions are in the best interest of the managed assets, then the trustees are acting in conformity with their obligations. […] This means: If, on an informed basis, the trustees assign the functions of business management and administration of the parent and subsidiary companies of the trust to persons who have been considered and selected in accordance with the criteria referred to above for the optimal administration of these companies, then they have acted unobjectionably. This does not mean that they have 'dispensed with' their duty of care in any way, as […] mistakenly argues; on the contrary, they have a high degree of responsibility when selecting these persons. […] For this reason, there is just as little reason to believe that the trustees' duty of care gives rise to the demand […] that the trustees must themselves serve on the boards of directors of the companies."

E. 10 possible actions to mitigate risks

1. In the establishment phase of a trust, sufficient time should be invested to ensure that the trustee fully understands the needs of the settlor and that the settlor in turn understands how the trust works and is intended to be set up.
2. The trust deed should set out all essential issues to serve as a "manual" for the trustee's actions. The more detailed individual duties are described, the greater is the legal certainty of the trustee. On the other hand, this entails the trustee's obligation to fulfil these duties in sufficient detail and to document fulfilment accordingly.
3. If the trust deed is complex and difficult to comprehend, a checklist with the most important duties of the trustee should be compiled. If the trustee is expected to carry out certain controls (e.g., in regard to an appointed asset manager), the performance of these controls should be documented.
4. The trustee should have at least a rough understanding of the relevant legal landscape in the home country of the client.
5. The decision-making process should correspond to the BJR and be documented comprehensively. Where the trustee's expertise does not suffice, external experts should be involved.
6. Conflicts of interest should be avoided wherever possible. Where this is not possible, the measures should be documented comprehensively that

have been taken to resolve the conflict of interest in the best way possible.

7. The settlor should declare in writing that the assets contributed are properly taxed. In individual cases, it is recommended that additional documents or confirmations be obtained.

8. It should be ensured that the trustee's contract templates (including any general terms and conditions) are up to date. Where it is necessary or makes sense to do so, indemnification and hold harmless declarations should be obtained.

9. It should be avoided that a third party is given the power to sign as a sole signatory on behalf of the trust.

10. In a larger organization, effective compliance and risk management should be implemented to identify existing risks and to mitigate them to the extent possible. Trust companies are less regulated in this regard than banks, for instance. But this does not mean that trust companies do not have similar risks.

III. Trustee liability in Switzerland

A. Applicable law

Chapter 9a of the Swiss Federal Act on International Private Law (IPRG) was included in the IPRG as a consequence of the Hague Trust Convention, which entered into force on 1 July 2007, and governs the following areas:

- Article 149a IPRG defines the trust, referring to the Hague Trust Convention.
- Article 149b IPRG sets out the preconditions for a valid choice of jurisdiction.
- Art. 149c IPRG refers to the Hague Trust Convention in regard to the law applicable to the trust. This means that in principle, the law designated by the settlor is applicable to the trust.
- Art. 149d IPRG contains special provisions governing the entry of certain types of trust assets in public registers.
- Art. 149e IPRG governs the recognition of foreign decisions.

B. Conclusion

The trust is not a part of Swiss civil law. However, the (foreign) trust has long been an economic and legal reality in Switzerland.

Since entry into force of the Hague Trust Convention on 1 July 2007, the trust has been officially recognized in Switzerland.

In practice, the trust will be governed by foreign law, even if the trustee is based in Switzerland. This is also the reason why there is no Swiss legislation or case law dealing with the liability of trustees.