

## EU POLICIES REGARDING THE DEVELOPMENT OF TRUST-LIKE DEVICES - RECENT CHALLENGES, ACHIEVEMENTS, PROSPECTS AND TERMINOLOGICAL INSIGHTS

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**Abstract:** *“Trust” is a versatile instrument which is suitable for a great variety of purposes. Many scholars believe, that the original form of this institution appeared in common law, while in the 20<sup>th</sup> century the process of globalization stipulated the “internationalization” of the trust mechanism. The starting point of this process was the conclusion of the Hague Convention on the Law Applicable to Trusts and on their Recognition. Initially, the civil law jurisdictions were unable to adopt “trust” structure in which common-law power and equity power belonged to separate entities. Despite this fact, in the recent years, trust-like devices have been introduced in certain economic-juridical systems of Europe. Their rapid implementation raised the question of the establishment of innovative policies. This paper will discuss the latest achievements and existing challenges based on the example of the German juridical-economic system. The aim is to make useful proposals for the successful planning of the European entrusting processes.*

**Keywords:** globalization; trust; trust-like device

**JEL Classification:** K3

### Introduction

EU has not escaped the “overwhelming” process of globalization. It is vividly felt in almost all branches of the economic, social and juridical spheres. Rapid developments are predicted in all areas of human activities.

It’s a well-known fact, that the economy of a particular country as well as the law is not a static, but a dynamic phenomenon. It is a vivid result of a historical evolution which did not happen on its own, as if in a vacuum. Today’s globalizing processes stipulate the emergence of the institutions which facilitate intensive financial transactions, profitable investments and increased flows of money. The common law “trust” and its European “descendants” (German “*Treuhand*”, Italian “*Fondo patrimoniale*”, French “*Fiducie*”, etc.) can be regarded among these institutions. The English “trust” “is undoubtedly an extremely versatile instrument which is suitable for a great variety of purposes, even leading some commentators to qualify it as a “universal fix-it” (Koessler, 2012, p. 13). Many scholars believe, that the original form of this unique institution appeared in the common law of the Middle Ages. In 1872 the trust law was adopted in the State of Connecticut, while the first trust

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company was created in 1806 according to the recommendation of financier and politician A. Hamilton. During the 19<sup>th</sup> century, the given legal institution became popular in the American business sphere. It offered several economic and legal advantages, especially through mutual and pension funds, while at the end of the 20<sup>th</sup> century, the process of globalization stipulated the “internationalization” of the trust mechanism. The starting point of this process was the conclusion of the “Hague Convention on the Law Applicable to Trusts and on their Recognition” (1985) and its ratification by 12 countries. Initially, the civil law jurisdictions were unable to adopt the “trust” structure in which common-law power and equity power belonged to separate entities. Despite this fact, in the recent years, “trust-like devices” have been introduced in certain economic-juridical systems of Europe. Their rapid implementation raised the question of the establishment of innovative policies for the management of the functioning of these newly-emerged constructions. This paper will discuss the latest achievements and existing challenges on the example of German juridical-economic system. Moreover, it will make proposals, which will be useful for a successful planning of the European entrusting processes and terminological nomination of the concepts related to them.

## 1. German vis-à-vis English

It’s a well-known fact, that today’s Europe makes distinction between the civil and common legal traditions. In our paper these traditions are presented by England (common law) and Germany (civil law).

Many scholars believe that the greatest inconsistency between English and German jurisdictions is presented in the area of “Property law”. The German legal system comprises an absolute notion of ownership, which may be equalized with the Roman “*dominium*”. In the German reality, “the owner of a corporeal object is the person who is in principle entitled to “deal with the thing as he pleases and exclude others from any interference”. It belongs to him, and only him” (Häcker, 2009, p. 36). In contrast to the German law, the English juridical system embraces a non-absolute notion of ownership. “Firstly, English law adopts a system of relative titles as opposed to absolute entitlements. Secondly, the recognition that equitable interests are in some sense “proprietary” has led to the idea of ownership being “split” into bare legal title and an equitable (or beneficial) interest” (Häcker, 2009, p. 35-36). This division has historical roots. Moreover, it gave birth to the unique and remarkable common law institution named “*trust*”.

The “*trust*” can be described as an arrangement whereby property is managed by one person (*trustee*) for the benefit of another (*settler* or *beneficiary*). It has the following characteristics:

- a) “the assets constitute a separate fund and are not a part of the trustee’s own estate;
- b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;
- c) the trustee has the power and the duty ... to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law”<sup>1</sup>.

It’s a well-known fact, that “German case law does not recognize the institution of the trust, as the trust is incompatible with the dogmatic foundations of German law and does not resemble the legal relationship of the *Treuhand*” (Sandor, 2014, p. 250). Moreover, “nowhere in German law can one find any single institution which by itself performs all those functions for which the common lawyer deploys the trust” (Kotz, 1999a, p. 85). However, the study of the contemporary German legal system reveals the existence of several “*trust-like devices*”, which work differently, but perform functions similar to the “*trust*”. B. Häcker directly indicates, that “in some situations a person holds rights for the benefit of another, via a device described by the umbrella term *Treuhand*... A *Treuhand* arises only in a limited number of particular instances (scattered throughout the BGB and developed outside the statutory framework), each subject to its own specific rules and principles” (Häcker, 2009, p. 39-40). Well-known German jurist Hein Kötz distinguishes three types of such institutions: “the *Testamentvollstreckung* and *Nacherbschaft*, which are used to control succession to property for several legatees (and typically for many years), the *Stiftung* which serves to collect and administer funds for charitable purposes, and the general *Treuhand* by which an estate is administered for the benefit of one or more persons” (Grundmann, 1998, p. 489). *Stiftung*, *Testamentvollstreckung* and *Nacherbschaft* are often regarded as *Quasitreuhands*, while *Treuhand* is a prime example of fiduciary arrangements of the German law.

### ***1.1. Treuhand***

The “*Treuhand*” is usually flexible and exempt from the state control. It considers the transference of ownership based on “*Vertrauen*” (trust) and “*Treue*” (loyalty). It can be established in three major ways: “through a full transfer of legal title (*fiduziarische Vollrechtstreuhand*), through a transfer of legal title with conditions precedent (*deutschrechtliche Treuhand*), and with a mandate granting dispositional rights (*Ermächtigungstreuhand*)” (Sandor, 2014, p. 253).

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<sup>1</sup>CONVENTION ON THE LAW APPLICABLE TO TRUSTS AND ON THEIR RECOGNITION, available at: [http://www.hcch.net/index\\_en.php?act=conventions.text&cid=59](http://www.hcch.net/index_en.php?act=conventions.text&cid=59)

Generally, the “*Treuhand*” “is created by a transfer of assets to the *Treuhänder* coupled with a contractual agreement made between him and the transferor under which he assumes, normally in consideration of a fee, a contractual duty to manage the assets in a particular way for the benefit of the beneficiaries” (Kotz, 1999a, p. 89). In other words, “*fiduziarische Treuhand*” is a fiduciary construction by which an individual transfers the full right *in rem* to the other individual. Therefore, the entrusting relations consider the following major elements:

- ***Treugeber*** (settlor/beneficiary) - an individual, which transfers the full right *in rem* to the other individual, who is obliged to deal with the assets in the manner specified by the contract;
- ***Treuhänder*** (trustee) – an individual, who is obliged to deal with the transferred assets in the manner specified by the contract.

“The *Treuhand* can exist without any written underpinning document. It can be concluded between any two persons capable of being party to a contract” (OECD, 2013, p. 39). Although in most cases the “*Treuhand*” represents a two-party relationship, it can include third party relationships. The “*Treuhand*” may take different forms: “hidden (*verdeckte Treuhand*) or disclosed to third parties (*offene Treuhand*)” (OECD, 2013, p. 39-40).

It is also worth mentioning, that although the ***Treugeber*** transfers his juridical ownership to the ***Treuhänder***, he retains the economic ownership. Therefore, a trustee (***Treuhänder***) becomes a legal owner, whose duties are called fiduciary duties: “The *Treuhänder* acquires a full and unrestricted title to the *Treuhand* assets, whereas the beneficiaries’ interests are, at least in theory, merely the ordinary rights *in personam* of parties to a contract” (Kotz, 1999a, p. 93). The ***Treuhänder*** can transfer the legal title to a third person, while the ***Treugeber*** has only damages claims in those cases when the transferor violates the obligations. It means that the “*fiduziarische Treuhand*” does not fully protect the rights of the ***Treugeber***. Therefore, the practical implementation of this construction seems quite risky.

However, the German legal system gives the ***Treugeber*** an opportunity to make a safer agreement (the so-called ***Ermächtigungstreuhand*** - trust by authorization), under which he (she) does not transfer the full right *in rem* to the ***Treuhänder***, but simply authorizes him (her) to manage or dispose of the assets in a specific manner. When the trustee exceeds his authorization the disposal of the assets is not valid ... no real separation of property takes place and the protection of the settlor is of minor importance because he is still the legal owner with all of his power” (Rehahn *et al.*, 2012, p. 100-101).

### 1.1.1. *Stiftung*

*Stiftung* is usually identified with a “charitable trust”. It belongs to the group of juristic entities capable of owning property and of suing and being sued. If a person wants to dedicate assets to charitable purposes or to devote patrimony to specific aims, he/she “must declare such an intention in writing or by will (testamentary foundation), the *Stiftungsgeschäft* or endowment transaction” (Rehahn *et al.*, 2012, p. 102). The given transaction consists of two parties:

- a **founder (Stifter)**, which transfers a patrimony to a new legal entity and sets up rules of administration;
- a **foundation (Stiftung)** – a newly-created legal entity, which administers assets, but is supervised by the Bundesland.

The “*Stiftung*” can be created only with the permission of the “Bundesland”, or the federal state, where a newly-created legal entity will have its seat. It is worth mentioning that “apart from the creation of a new legal entity, the trustor can also transfer the property to an already existing person with the declaration that the transferee must separate these assets from his own property and has to administer them on a continuing basis as the trustor has set it up” (Westebbe, 1993). Such type of a transaction is nominated as “*Stiftungstreuhand*” or “*unselbständige Stiftung*”. The latter considers the transference of a smaller amount of property. The founder “transfers assets as a gift *inter vivos* or by will to another natural or juristic person – e.g. a university, a church, a museum, a charitable association - on the understanding that the transferee keeps the assets transferred separate from his own assets and that the gains made from the assets shall be used to further the charitable purpose prescribed by the founder” (Kotz, 1999b, p. 52). It is worth mentioning that in the case of “*Stiftungstreuhand*” or “*unselbständige Stiftung*” (*foundation trust* or *dependent foundation*), the trustee’s creditors are not able to take legal actions in respect to the separated assets. These actions can be impeded by a founder or by beneficiaries. This is a unique example of *Sondervermögen* (separated patrimony). The existence of *Sondervermögen* emphasizes the fact, that German law “accepts” the notion of “splitting-up” - owning of more than one patrimony by one person. Such separation of assets is determined by the concept of patrimony rather than that of property, because the German property law is not based on the distinction between legal property and equitable property. The major reason for splitting is that “the separated patrimony serves specific functions such as providing liable patrimony for specific creditors, a particular administration of that patrimony or the protection of certain persons. The creation of a *Sondervermögen* is only possible within the limits of statutory law” (Rehahn *et al.*, 2012, p. 95).

Therefore, an in-depth study of *Stiftung* reveals its similarity to a “charitable trust”. However, there are certain differences between these two institutions - the *Stiftung* (foundation) should be registered, “the representatives of foundations do not act in their own name, and the founder may not be exclusive manager (Vorstand) of the foundation. As an additional difference, the representatives are also liable to third parties” (Selbig, 2006, p. 167). The establishment of *Stiftung* is quite expensive. Therefore, a trustor can use a simpler and cheaper way. He/She may transfer “assets to another on the understanding that the assets shall constitute a separate fund, shall not form part of the transferee’s own estate and that the transferee shall have the power and the duty to manage the assets for the charitable purpose specified by the transferor” (H. Kotz, 1999a, p. 88). This type of relationship between parties can be analyzed as “*fiduziarische Treuhand*”, which has already been discussed.

#### 1.1.2. *Contractual Trust Arrangements (CTAs)*

German “*trust-like devices*” have gained the greatest importance in the sphere of the economy, especially, through company law. Since the 90s of the 20<sup>th</sup> century the so-called *Contractual Trust Arrangements* (CTAs) have been increasingly utilized by different types of German companies. These agreements enable each company “to improve its balance sheet ratios and creditworthiness in accordance with the International Financial Reporting Standards (IFRS), the United States Generally Accepted Accounting Principles (US-GAAP) and German accounting rules pursuant to the German Commercial Code by removing both the pension obligations towards its employees and the covering assets from the balance sheet” (Rehahn *et al.*, 2012, p. 103). *Contractual Trust Arrangements* are focused on the following:

- outsourcing obligations to a third person;
- ensuring the settlement of employees’ pension claims;
- protecting the covering assets against the access of the creditors in the event of the insolvency of sponsoring undertaking.

The lack of a coherent trust concept in German law leads to difficulties during the fulfillment of the last activity, because “in the event of the opening of insolvency proceedings regarding the assets of the sponsoring undertaking, the trust agreement shall expire which would normally establish a duty of the association to return the property to the insolvency administrator” (Rehahn *et al.*, 2012,

p. 104). The given problem is usually solved by the creation of a second trust. This is the case of the “*doppelseitige Treuhand*” (two-way trust).

In certain cases the members of personal companies or shareholders of public companies transfer their rights of shareholders to a third party/a third person, who performs the functions of a trustee. This trust solution “concerns a *Kommanditgesellschaft*, in which as a personally liable partner a limited liability company participates with dozens, sometimes hundreds, of individual investors as limited partners (*Kommanditisten*). Here, it would be impracticable to invite all those investors to general meeting of the company so that each could separately exercise his rights as partner” (H. Kotz, 1999b, p. 56). Therefore, the best management option in such cases is the transference of the limited partners’ interests to a single trustee, who is obliged to exercise them in the interest of investor-partners. This mode of management is called “*Gesellschaftsanteile*” (administrative trust of company shares).

### *1.1.3. Terminological Insights*

An in-depth study of the contemporary German economic-juridical “*trust-like devices*” and their English equivalents enables us to make some terminological insights. The major emphasis ought to be put on the term “*Treuhand*”, because it is used “as a collective term in German legal literature and legal practice, which summarizes many different legal relationships of property management” (Sandor, 2014, p. 254).

The carried out terminological study vividly reveals that “Routledge German Dictionary of Business, Commerce, and Finance” presents the following English equivalents of the German lexical units related to the “*Treuhand*”:

“*Treuhand* – Trust;

*Treuhänder* – Trustee, fiduciary;

*Treugeber* – settlor, transferor, trustor (AmE)” (Routledge German Dictionary of Business, Commerce, and Finance, 1997)

The same data is presented in H. Haschka and H. Schmatzer’s well-known work “Aspects of U.S. business and law (An English-language survey with German-language comments)”. This book directly indicates, that “the essential elements of a trust are:

- A trustor or settler (*Treugeber*).
- A beneficiary (*Begünstigter*).
- A trustee (*Treuhänder*).

- A fund or corpus (zweckgebundene Vermögensmasse) the title to which passes to the trustee” (Haschka *et al.*, 1990, p. 167).

Additionally, “Collins English-German Dictionary” presents the following German equivalents of the common law term “*trust*”:

- “(law, finance) Treuhand (schaft) *f*
- (= property) Treuhandeigentum *nt*
- (= charitable fund) Stiftung *f*<sup>2</sup>.

The existence of all the above mentioned equivalents makes the essence of „*Treuhand*” obscure and equalizes it with the Anglo-American “*trust*”. Some scholars have thoroughly discussed this question, for instance, Sh. A. Stark directly indicated, that the term „*Treuhand*” had a purely German origin: “the German word “*treu*” means true and implies faithful” (Stark Sh., 2009, p. 3). Despite this explanation “the word *Treuhand* is not a clear term in German, it cannot be exclusively described as a trust in English either. For this reason, it is best to continue using the German word *Treuhand* because it has no equivalent in English” (Stark Sh., 2009, p. 3). J. Rehahn and A. Grimm share Stark’s idea and state: “German law is neither able to produce exactly the same effects as a trust in common law nor has it one specific concept that works as a trust... the German law does not know a homogeneous concept of a trust...” (Rehahn *et al.*, 2012, p. 94). According to J. Rehahn and A. Grimm the term „*Treuhand*” must be translated as „*German trust*”. The scholars directly indicate, that this will help with the “eradication” of any ambiguities during the process of translation. The same English equivalent (*German trust*) of “*Treuhand*” is presented in the following passage of the book “Property law and economics”: “Concerning the unitary ownership characteristic, society has created different kinds of ownership, which can be seen as forms of divided ownership, as the Treuhand (*German trust*) and fiducie-gestion (*French trust*)” (Bouckaert, 2010, p. 28). We believe, that „*German trust*” is the best English translation of the term „*Treuhand*”. Moreover, it is recommended to translate the “*Treugeber*” as the “German trustor/settlor” and to nominate the “*Treuhänder*” as the “German trustee”.

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<sup>2</sup>Collins English-German Dictionary, available at: <http://www.collinsdictionary.com/dictionary/english-german/trust>

## Conclusions

Therefore, the juridical-economic study of the contemporary German reality vividly reveals that it has no single institution which performs all the functions performed by the common law “*trust*”. Even the “*Treuhänder*” - a prime example of fiduciary arrangements - is irreconcilable with the “*trust*”, namely, in the third party relationships. Some scholars directly indicate that German law cannot cope with the doctrine of the “real subrogation”. This means that in those cases, when the “*Treuhänder*” buys assets with the money supplied by the *Treugeber* “or with the proceeds of sales of the original property, or obtains property it exchanges for the original property, it is not clear whether the beneficiaries will be awarded a proprietary right in the substitute property and on this basis take priority over the *Treuhänder*’s private creditors” (Kotz, 1999a, p. 95).

All the above mentioned directly indicates to the following prominent fact: the German court has no general competence in exercising the supervisory and administrative functions needed to make the “*Treuhänder*” as effective as the “*trust*” in the issues of the management of property. Therefore, the rules of the German law regulating the “*fiduziarische Treuhänder*” need clarification and improvement via defining the questions of third party relationships and “real subrogation”. Moreover, significant changes must be made in the terminological sphere in order to reflect the difference between the common law “*trust*” and German “*Treuhänder*”. We believe that „*German trust*” is the best English translation of the term „*Treuhänder*”. Moreover, we recommend to translate “*Treugeber*” as the “German trustor/settlor” and to nominate the “*Treuhänder*” as the “German trustee”.

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