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Hungarian Fiduciary Asset Management Contracts in the Context of Czech Law

I Introductory Remarks

The new Hungarian and Czech Civil Codes[1] have both recently adopted the legal institution of trust in some form. The concept is known in the Czech Republic as a 'trust fund' and in Hungary as a 'fiduciary asset management contract'.

The Czech legislator has surprisingly taken inspiration from beyond Europe in the Civil Code of Quebec. The Hungarian regulation follows the continental legal tradition represented by the laws of Liechtenstein and Luxembourg. The result is that the approach to trusts varies in each country: the Czech trust fund is conceived as part of property law and the Hungarian trustee asset management as part of contract law.

This paper highlights the pivotal, fundamental and far-reaching topics that most determine the functionality of trusts in both countries. As such, only the following issues are covered: creation of trust, notion of ownership, protection of creditors, duties of the trustee, and asset-tracing vehicles and termination of trust.

II Creation of Trust

Generally, a trust is a relationship where property is held by one party for the benefit of another. A trust is created by a settlor who transfers some or all of his property to a trustee, who then holds that property for the trust's beneficiaries.[2]

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1 Hereinafter the 'HCC' and the 'CCC'.

2 See David Hayton, Paul Matthews, Charles Mitchell, *Underhill & Hayton's Law Relating to Trusts and Trustees* (18th edn, Butterworths Law 2010, London) 2.

1 Formal Requirements

Under Czech law, a trust may be established only by contract or will,[3] free or in return for payment.[4] The contract may be bilateral or multilateral and may be oral or written; even the will need not be in writing.[5] A trustee need not be a party to the contract, so the trust is established once a trustee starts to manage the entrusted assets,[6] as it is not desirable to set up a trust where nobody takes care of the property. A trust is not subject to any registration.

Also in Quebec the contract may be executed orally, for example by phone, without being subject to registration.[7] The same applies, for example, in England,[8] Japan, South Korea and Taiwan.[9]

However, under Hungarian law, the contract must be in writing,[10] like in Liechtenstein and Luxembourg.[11] The trustee must always be a party to the contract.[12] Like in the Czech Republic, the contract is not subject to any registration. In this regard, the HCC significantly deviates from the Liechtenstein model of a trustee contract.[13]

2 Privileged Will

As shown, if the Czech trust is established by will, it is created upon the settlor's death. If the appointed trustee does not accept the management of assets, another one is appointed by the court.

The Hungarian legislator has adopted a different approach as the provisions of a will take effect only upon the trustee's acceptance of the appointment under the conditions set out therein, and the courts may not intervene.[14] A will is not privileged in any way, which means that the intention of the settlor to set up a trust does not enjoy any special protection.

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[3] Section 1448 para 1 CCC. Trust may be also created by law, see Explanatory report to the CCC, p. 353.

[4] See Explanatory report to the CCC, p. 353.

[5] Section 1532 CCC.

[6] Section 1451 CCC. This does not apply in case of will, where trust automatically arises ater dech of the settlor.

[7] Rainer Becker, *Die fiducie von Quebec und der trust: ein Vergleich mit verschiedenen Modellen fiduziarischer Rechtsfiguren im civil law* (Mohr Siebeck 2007, Tübingen) 290 and 296.

[8] See Maurizio Lupoi, *Trusts: a comparative study* (Cambridge University Press 2000, Cambridge) 97 or Hayton, Matthews, Mitchell (n 2) 206.

[9] Makoto Arai, 'Trust law in Japan: inspiring changes in Asia, 1922 and 2006' in Lusina Ho, Rebecca Lee (eds), *Trust Law in Asian Civil Law Jurisdictions: A Comparative Analysis* (Cambridge University Press 2013, Cambridge) 28. Wu Ying-Chieh, 'Trust law in South Korea: developments and challenges', ibid, 49 and Wang Wen-Yeu, Wang Chih-Cheng, Shieh Jer-Shenq, 'Trust law in Taiwan: history, current features and future prospects', ibid, 71.

[10] Section 6:310 para 2 HCC.

[11] See also Miloš Kocí, Luboš Tichý, 'Trust – Srovnávací studie' in Luboš Tichý, Kateřina Ronovská, Miloš Kocí (eds), *Trust a srovnatelné instituty v Evropě* (Centre for Comparative Law of the Faculty of Law of the Charles University in Prague 2014, Prague) 226.

[12] Section 6:310 para 1 HCC.

[13] Kocí, Tichý (n 11) 226–227.

[14] Section 6:329 para 2 HCC.

3 Irrevocable Unilateral Act

Like in Liechtenstein,[15] Hungarian trusts may also be established by means of a unilateral statement, which is not possible under Czech law. This requires the fulfilment of two conditions: (i) the settlor and the beneficiary are the same person and (ii) the statement is executed in an authenticated instrument.[16] It is inconsistent that the Hungarian legislator does not require a subsequent written consent in this case if it is required when the trust is established by will, though it is commonly accepted that a will is a unilateral act sui generis.

Furthermore, the first condition of an irrevocable unilateral act is problematic. It would be more appropriate if the identity of the settlor and trustee were required instead of the current solution. In this constellation, entering into a contract is not possible; however, the legislator should still find a way to enable the establishment of a trust for the benefit of third parties. This solution is used, for example, in Japan and South Korea.[17]

4 Conclusions

– With regard to the creation of trusts, the HCC is more formalistic than the CCC.
– Hungarian courts should be allowed to intervene to protect the intention of the settlor if the appointed trustee does not accept the conditions set out in the will.
– If, under Hungarian law, the consent of the trustee is required in the case of a will, it should also be required in the case of an irrevocable unilateral act.
– Both the Hungarian and Czech legislators should enable the establishment of a trust by an irrevocable unilateral act also where the settlor and the trustee are the same person, since the settlor should be allowed to manage the assets for the benefit of third parties.

III Notion of Ownership

1 Different Approaches to Ownership

The CCC has taken over a unique concept of ownership from the Canadian province of Quebec. This concept has brought a revolutionary element into fiduciary relationships: when a trust is created, a separate and independent set of assets arises, not owned by anybody, including the trustee, settlor or beneficiary.[18] This concept of autonomous ownership has only one analogy in Czech legal history, the so-called *hereditas iacens,*[19] and is in sharp contrast with

[15] Section 899 para 2 of the Personen- und Gesellschaftsrecht, Law of 20 January 1926, LGBl No. 4 of 19 February 1926 (the 'PGR').
[16] Section 6:329 para 1 HCC.
[17] See Arai (n 9) 28–29 and Ying-Chieh (n 9) 49.
[18] Section 1448 para 3 CCC.
[19] Section 545 ABGB.

the tradition of Civil Law.[20] The trustee is only nominally registered as owner of the trust property where necessary, but always with the appendix 'trustee'.[21]

What are the reasons for this concept of ownership? There are no jurisdictions beyond Quebec and the Czech Republic where it would be applied, so we must immerse ourselves in Quebec's legal history to understand it.

In the past it was disputed in Quebec who actually is to be regarded as the owner of the trust assets. The owner could be the settlor, based on the resolutive condition, the beneficiary, based on the theory of suspended ownership, or the trustee, because he manages the assets. The problem is that none has full and unlimited ownership; not even the trustee has all proprietary rights as he lacks *usus, fructus* and *abusus*. Moreover, the Civil Law jurisdictions do not know the concept of dual ownership as it must be fully attributed to only one entity.[22]

Hence, both Quebec and Czech legislators endorse the concept of autonomous, separate and independent ownership because it circumvents these theoretical problems. The result is, inter alia, that personal debtors of the settlor, trustee and beneficiary may not claim the assets of the trust because it is not owned by any of them. This concept may be understood as a modality of ownership or an interlude in ownership, but clearly "ownership will revive in full force when a *fiducie* comes to an end."[23]

The HCC does not solve this issue explicitly. It does not even state that the ownership must be transferred from the settlor to the trustee. The applicable provisions only provide that '[u]nder a trustee asset management contract the trustee undertakes to manage the assets in his own name and on the beneficiary's behalf'[24] and that 'the trustee shall have the right of disposition over the managed assets according to the conditions and within the limits set out in the contract.'[25]

However indispensable the transfer of ownership may seem, another provision only says, '[m]anagement of the assets shall cover the exercise of entitlements stemming from the ownership […] and the performance of obligations arising therefrom.'[26] Moreover, no HCC provision states that the trustee is to be entered into public registers as owner of the property.

Inevitably, the following questions must be asked: Must ownership really be transferred under the HCC? If yes, in what quality? Is it exclusive or dual ownership?

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[20] John B. Claxton, *Studies on the Quebec Law of Trust* (Thomson Carswell 2005, Toronto) 27–28.

[21] Section 1456 CCC.

[22] For further details see Yves Caron, 'The Trust in Quebec' (1980) McGill Law Journal 25 (4) 421–444.

[23] Yaëll Emerich, 'The civil law trust: a modality of ownership or an interlude in ownership' in Lionel Smith (ed), *The Worlds of the Trust* (Cambridge University Press 2013, New York) 40.

[24] Section 6:310 para 1 HCC.

[25] Section 6:318 para 2 HCC.

[26] Section 6:318 para 1 HCC.

2 Protective Trusts under the HCC

The possible answers have major significance for protecting assets against creditors. Should the trustee or beneficiary be regarded as owner of the property, then the property is sufficiently protected against their personal creditors by special provisions of the HCC.

However, if the settlor remained owner of the assets, the trust under the HCC would provide no protection against the settlor's personal creditors. This would mean that the Hungarian trust could not – contrary to the regulations in Quebec and the Czech Republic – be used as a 'protective trust', which under certain circumstances allows the settlor to protect part of his property against future debtors.[27]

3 Security Trusts under the HCC

A further restriction imposed on Hungarian trusts is the impossibility to establish them for security purposes, which does not follow only from unclear provisions governing the transfer of assets. This option is explicitly excluded by the legislator, who considers a trustee collateral arrangement null when it provides, '[a]ny clause on the transfer of ownership, other right or claim for the purpose of security of a pecuniary claim, or on the right to purchase, with the exception of the collateral arrangements provided for in the directive on financial collateral arrangements, shall be null and void.'[28]

This is in contrast with prevailing practice not only in Europe. Securitisation by means of trusts or trust-like legal institutions is possible under French[29] and Quebec[30] law as *fiducie-sûreté,* and in England as security trusts.[31] Also one of two basic kinds of German *Treuhand* serves this purpose, the so-called *Sicherungstreuhand.*[32] Security trusts play a relevant, and sometimes even irreplaceable, role in the provision of funds to companies in financial distress and could be definitely beneficial to businesses also in Hungary.

4 Conclusions

– The Hungarian legislator should clarify if a transfer of assets is required for a trust to be created.
– The Hungarian legislator should clarify whether protective trusts are permitted.

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27 Becker (n 7) 273.

28 Section 6:99 HCC.

29 It may be even used for the purposes of restructuring a company, see Fabrice Anselmi, 'La fiducie-sûreté pourrait faciliter les restructurations d'entreprises', an article from 29 October 2009 for L'AGEFI Hebdo. Downloadable at http://www.agefi.fr/articles/la-fiducie-surete-pourrait-faciliter-les-restructurations-d-entreprises-1112554.html.

30 Becker (n 7) 265.

31 Hayton, Matthews, Mitchell (n 2) 60-66.

32 Rainer Kulms, 'Německo mezi trustem a Treuhandem' in Luboš Tichý, Kateřina Ronovská, Miloš Kocí (eds), *Trust a srovnatelné instituty v Evropě* (Centre for Comparative Law of the Faculty of Law of the Charles University in Prague 2014, Prague) 20.

– The Hungarian legislator should enable the creation of a security trust by introducing a special provision amending the current trust legislation.

IV Protection of Creditors

1 Voidability of Legal Acts

The specific of Trust Law is that the debtor, if he settles a trust, may use the trust property as the beneficiary and behave as the owner. The objection that a trust is just another kind of contract is not convincing because, if the debtor decided to circumvent the law by using some more traditional type of contract (such as a donation or sale contract), the risks are intimidating. Once the property is transferred (even if just formally) to another person, the original owner loses control over the assets and has no rights attributed to the settlor or beneficiary under trust law (e.g., to appoint a new beneficiary or trustee). This makes a trust a more comfortable vehicle for fraudulent purposes compared to other legal institutions.

Under Czech law, any legal act may be invoked ineffective only within objective periods amounting to (i) five years if the debtor deliberately acts to impair satisfaction of the creditor and the acquiring party has knowledge of such an intention and (ii) two years if the intention of the debtor must have been known to the other party or the legal act was gratuitous.[33]

The right to claim damages is subject to the general subjective limitation period of three years[34] commencing when the impaired party gets knowledge about the damage and the wrongdoer.[35] The same rule applies to unjustified enrichment. This means that, under Czech law, once the ownership is transferred to the trustee and five years elapse, the transfer of ownership is irreversible, even in cases of fraud. Of course, the damaged party may start criminal proceedings or claim damages, but it will not be possible to reinstate the assets.

However, in Quebec a one-year subjective period is applicable to voidability of legal deeds and commences from the day on which the damaged party gets knowledge of the impairing act.[36] In the Czech Republic, like in Quebec, trusts are not subject to any registration, and therefore this protection of the damaged party should be introduced also into Czech law.

In Hungary the situation is quite different, since '[a] contract by which the basis for satisfying a third person's claim has been deprived entirely or in part shall have no legal force in respect of such third person if the acquiring party acted in bad faith or had a gratuitous advantage originating from the contract'[37] and 'at the third party's request, the acquiring party is obliged to tolerate satisfaction from the acquired property and enforcement against such property.'[38]

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[33] See Sections 589 et seq. CCC.
[34] Section 629 para 1 CCC.
[35] Section 620 para 1 CCC.
[36] Section 1635 of the Civil Code of Quebec.
[37] Section 6:120 para 1 HCC.
[38] Section 6:120 para 3HCC.

The HCC does not provide for any period for voidability, therefore ineffectiveness of legal acts may be invoked during the whole general limitation period of five years.[39]

2 Conclusions

– With respect to the specifics of Trust Law, the provisions on voidability of legal acts should be amended in the Czech Republic.
– The HCC provides for a sufficient protection of creditors with regard to the Trust Law.

V Duties of the Trustee

Both the HCC and the CCC comprise a relatively detailed – and potentially mutually inspiring – regulation of the trustee's duties, which reflects the fact that the trustee is a key figure in any fiduciary arrangement, including trusts.

1 Inspiration for the CCC

The HCC stipulates a special provision on the independence of the trustee, according to which, '[t]he settlor and the beneficiary may not give instructions to the trustee and any clause to the contrary shall be null and void.'[40] Enhancing independence of the trustee is necessary because he may also be personally liable for his acts (e.g., for breaching his powers).[41]

The HCC further imposes on the trustee special confidentiality requirements: '[t]he trustee shall keep confidential all facts, data and information about which he gained knowledge in the course of or in connection with carrying out his trustee responsibilities.'[42] Surprisingly, there is no such provision under Czech law. The CCC only stipulates that the trustee may not use any information acquired during management of the property for his own benefit, unless he has the consent of the beneficiary.[43]

The HCC also pays special attention to the protection of third parties: '[t]he trustee shall bear unlimited liability with his personal assets for claims arising from obligations undertaken to the burden of the managed assets, if such claims cannot be satisfied from the managed assets, and the other party did not know or should not have known that the commitment by the trustee reached beyond the limits of the managed assets.'[44] Under Czech law, the trustee is personally liable only if he trespasses his competences, but he does not need to inform a third party that

[39] Section 6:22 HCC.
[40] Section 6:316 HCC.
[41] Section 1420 CCC.
[42] Section 6:319 para 1 HCC.
[43] Section 1415 para 2 CCC.
[44] Section 6:323 para 2 HCC.

his commitment reaches beyond the limits of the managed assets. In this case, therefore, the third party's good faith is not protected under Czech law.

Finally, the CCC is missing any settlement obligation of the trustee, unlike the HCC: '[i]f the termination of trustee asset management puts the managed assets at risk, the trustee shall take measures as necessary according to the contents of trustee asset management until the time of settlement.'[45] Currently, such an obligation can be only deduced on the basis of legal fiction under the CCC.

2 Inspiration for the HCC

The HCC provides, '[u]nder the principle of reasonable commercial practices, the trustee shall have the obligation to protect the managed assets from foreseeable risks.'[46] But how will this objective be achieved? The Czech legislator gives some clues:

– the trustee must consider the return on and expected profit of the investments and, if possible, spread investment risk to achieve a ratio between fixed income and variable revenues that reasonably corresponds to economic conditions;[47]

– the trustee may not acquire more than 5% of stocks of the same issuer for the beneficiary;[48] and

– the trustee may not acquire for the beneficiary a share, bond or other debt securities of a person who breached the duty to pay revenue from the securities; the trustee also may not provide a loan to such a person.[49]

The HCC is missing any provision on insurance of the managed assets. Under the CCC, '[t]he trustee is authorised to insure the administered property against usual risks at the expense of the beneficiary'[50] and '[…] has the right to get property liability insurance under the administration at the expense of the beneficiary if he exercises the administration gratuitously."[51] The right of the trustee to have, under some conditions, the managed property insured at the expense of the beneficiary should be positively anchored also in the HCC.

3 Conclusions

– De lege ferenda the Czech legislator should get inspiration from the HCC's provisions governing independence and confidentiality of the trustee, protection of third parties and the settlement obligation of the trustee.

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45 Section 6:327 para 2 HCC.
46 Section 6:317 HCC.
47 Section 1432 CCC.
48 Section 1433 CCC.
49 Ibid.
50 Section 1427 para 1 CCC.
51 Section 1427 para 2 CCC.

– De lege ferenda the Hungarian legislator should get inspiration from the CCC's provisions governing cautious investments of the trustee and his right to have the managed assets insured at the expense of the beneficiary.

VI Asset Tracing

1 Hungarian *Spurfolgerecht*

In England[52] and Liechtenstein, we know of asset tracing vehicles that serve to protect the trust property. Especially the *Spurfolgerecht* under Liechtenstein law is very interesting:

> [i]f third party acquires a thing or a right and is aware that it belongs to the trust and the trustee is not entitled to dispose thereof, certain persons (settlor, other trustee, beneficiary or trustee appointed by the court) may claim that these assets be reinstated by such a third party or they can file an action for recovery of unjustified enrichment.[53]

The HCC seems to have been influenced by this provision because it follows its logic, stating, '[i]f the trustee […] unlawfully transfers any part of the assets he manages to a third party, the settlor and the beneficiary shall have the right to recover such assets and to have it reinstated among the managed assets, if the third party did not act in good faith or there was no pecuniary interest.'[54]

Hungarian regulation of asset tracing is even stricter than the *Spurfolgerecht,* because it covers not only bad faith of the third party but also all gratuitous transfers, and potentially even infringes upon the good faith of third parties.

It is a mistake that the CCC has no comparable legal regulation, making it more complicated for the settlor and beneficiary to protect the trust assets against unlawful dispositions of the trustee. The general provisions of the CCC on acquisition of the right of ownership from a non-entitled person, which assume the good faith of the acquirer,[55] apply, but gratuitous transfers are not covered by the CCC.

2 Conclusions

– The HCC has adopted a modern and effective asset tracing vehicle.
– The CCC has adopted no asset tracing vehicle and compared to the HCC makes trust assets more vulnerable to unlawful dispositions of the trustee.

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[52] Hayton, Matthews, Mitchell (n 2) 1286.
[53] Section 912 PGR.
[54] Section 6:318 para 3 of the HCC.
[55] Section 1109 CCC.

VII Termination of Trust

1 Rule against Perpetuity

The CCC and HCC have fundamentally different approaches to the rule against perpetuity. Under Czech law, the duration of trusts created for charitable purposes is not limited, whereas the existence of trusts created for private purposes is limited to approximately three human lives.[56] Contrary to this, under the HCC, '[i]f the trustee asset management contract is signed for an indefinite duration, or for a period of more than fifty years, it shall terminate after fifty years. Any clause to the contrary shall be null and void.'[57]

This rule against perpetuity is strict and does not differentiate between trusts created for private and charitable purposes, although foundations are not time-limited by the HCC, either. There is no functional need to limit the existence of trusts to 50 years, the less in the case of charitable trusts. The HCC should be revised and significantly amended in this regard.

2 Absence of the Trustee

Under the HCC, '[t]rustee asset management shall terminate if there is no trustee managing the assets for a period of over three months, at the time of termination of the trustee mandate.'[58] The Czech legislator has adopted a more sensitive approach than the harsh consequence of termination and states that the '[s]ettlor, beneficiary or other person with legal interest may suggest to the court that […] a trustee be recalled or new trustee be appointed.'[59]

Contrarily, an intervention of the Hungarian courts is allowed only under the assumption that the trustee has seriously breached the contract and no settlor exists: '[i]n the event of the settlor's death or dissolution without succession, if there is no other settlor for the managed assets, the court shall have powers to recall the trustee at the beneficiary's request, and shall appoint a replacement trustee at the same time, if the trustee has seriously breached the contract.'[60]

However undesirable it is for a trust to exist without a trustee, its automatic termination whenever the trustee is absent may harm not only the trust assets but also the best interests of the beneficiary. Therefore, the HCC should be amended to allow appointment of the trustee by the court to avoid automatic termination of the trust when the trustee is not given.

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[56] Section 1460 CCC.
[57] Section 6:326 para 3 HCC.
[58] Section 6:326 para 1 item *c)* HCC.
[59] Section 1466 para 1 CCC.
[60] Section 6:325 para 2 HCC.

3 Conclusions

– The HCC's strict rule against perpetuity should be moderated to reflect the difference between trusts created for charitable and private purposes.
– Absence of the trustee should not automatically result in termination of trust, and the HCC should be amended accordingly.

VIII Final conclusions

The Hungarian legislator should clarify the process of creation of trust and the related concept of ownership. The HCC should clearly allow security trusts, and the HCC's rules governing the duration of a trust and reasons for its termination should be revised.

The Czech legislator should adapt the regulation of voidability of legal acts and introduce some asset tracing vehicle after models applied in Hungary or Liechtenstein.

Both the Hungarian and Czech legislators should enable the establishment of a trust by an irrevocable unilateral act, where the settlor and the trustee are the same person.

Finally, the CCC and the HCC can inspire each other when it comes to the trustee's duties.