

Article

The Swiss Legal Framework on Foundations and Its Principles About Transparency

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“Sunlight is said to be the best of disinfectants.”

This article deals with issues of transparency applicable to grant-making foundations in Switzerland and analyzes the legal regime in this regard. This analysis is contextualized by functional aspects typically affecting the performance of foundations.

The article concludes that the Swiss regime is minimalist and that it might not be sufficient in terms of setting standards on transparency. However, we identify positive developments in the self-governing rules included in the Swiss Foundation Code (SFC). This Code provides a very effective complementary tool. It constitutes a laudable effort on the part of Switzerland’s philanthropic sector to reinforce self-regulation by setting transparency standards.

Introduction

Transparency is a contested issue in the regulation of grant-making foundations. In principle, one might argue that transparency should be the norm under which foundations operate. After all, grant-making foundations are institutions established by and for civil society. Therefore, by definition, foundations themselves ought to be interested in opening access to the flow and democratization of information within the philanthropic sector.¹ Yet vehement criticism has been voiced against foundations owing to their lack of compliance with transparency rules, managerial omissions, and their tax-exempt status—failings perceived by many critics as unjustifiable privileges.² But at the same time, one must be cautious in dispensing criticism³ so as to avoid false conclusions and unwarranted generalizations.⁴

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¹ Third sector institutions engage civil society in their activities, such as advocacy, charitable assistance, higher education, health care, arts performance, residential nursing, and religious ceremonies. Steinberg, R. & Powell, W., Introduction, in *The Nonprofit Sector: A Research Handbook*, 2nd ed. (New Haven: Yale University Press, 2006), pp. 1-9.

² Indeed, non-profit and tax-exempt status do not entail a withdrawal from economic activity. Posner, R. and Philipson, T., “Antitrust in the Non-Profit Sector,” NBER Working Paper Series, March 2006, p. 2.

³ Foundations, as legally tax-exempt institutions, have often been under threat for financial or political reasons. Hammack, D., “American Debates on the Legitimacy of Foundations,” in *The Legitimacy of Philanthropic*

The need to formulate a legal regime⁵ aimed at increasing transparency across the third sector is now seen as essential, not only by the government but also by these institutions themselves.⁶ In this article, we focus on the legal regime of Switzerland.

In order to contextualize the rest of the article, we shall outline some preliminary assumptions: (a) The revolution in digital technology is constantly diminishing the distance between institutions, both private and public, and the community. (b) There has been an increase in the amount of self-regulation undertaken, in the number of legislative reforms issued, and in the scholarships awarded, all of which are aimed at improving transparency in grant-making foundations' managerial activities. This might indicate a greater need to adopt standards within this sector.⁷ (c) The Civil Code reform⁸ does not appear to have satisfactorily addressed transparency issues. (d) The Swiss philanthropic sector has autonomously adopted newer and stricter rules on transparency standards with its introduction of the Swiss Foundation Code (SFC).⁹

The article is structured in four parts. Part I provides a picture of the Swiss grant-making foundation today. Part II categorizes the elements, tools, and limits of the grant-making foundations. Part III deals with the issue of transparency and its limits from different functional and socio-political angles: technological limits, limits of international legislation, limits imposed by the internal legal structure of foundations, limits defined by the legislation on gift-giving, and functional limits to the implementation of transparency standards. Part IV comments on Swiss legislation relevant to foundations and relates these points to the provisions in the Swiss Foundations Code.

Foundations: United States and European Perspective, Prewitt, K., Dogan, M., Heydemann, S., & Toepler, S. (eds.) (Russell Sage Foundation, 2006), p. 49.

⁴ Examples of well-established organizations in the third sector are the Red Cross and the Salvation Army. Although they might be considered standard organizations for this sector, they operate under very different strategic management principles from most other institutions in this sector. Hansmann, H., "The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation," *Yale Law Journal*, Vol. 91: 54 (1981), p. 65.

⁵ The legal regime applied to foundations is complex and often diversified. Grant-making foundations normally straddle different branches of the law: Private Law and Public Law; Federal Law and Local (Cantonal) Law; Tax Law; Canon Law; Constitutional Law. Dr. Peter Lex, "Die Grundzüge des Stiftungsrechts," in *Stiftungen in Theorie, Recht und Praxis: Handbuch für ein Modernes Stiftungswesen*, Graf Strachwitz, R., & Mercker, F. (eds.) (Duncker & Humblot, Berlin, 2005), pp. 205-209.

⁶ To assess the relevance of the discussions on the operation and management of grant-making foundations in this regard, see, for example, "Public Policy for Nonprofits: A Report on ARNOVA's Symposium of October 2010," <https://netforum.avectra.com/eWeb/DynamicPage.aspx?Site=ARNOVA&WebCode=symposium>.

⁷ In 2011, the European Foundation Centre (EFC) issued the report *Exploring Transparency and Accountability Regulation of Public-Benefit Foundations in Europe* (2011).

⁸ The Swiss Civil Code was reformed in 2007. The issue has become more relevant, since it is expected that new tax-estate reforms are likely to introduce more changes to the sector, increasing the amount of capital channeled to foundations annually. See Breitschmid P., "Sale": *Schlussverkauf für die Erbschaftssteuer* (NZZ-23.11.11).

⁹ Numerous codes of conduct issued by European countries for the third sector deal expressly with the issue of transparency. See EFC, *Exploring Transparency*.

I. The Swiss NPS and Foundations at a Glance

Given the size of the country and its population, Switzerland has a large nonprofit sector. Some 90,000 nonprofit organizations exist, accounting for 4.7 percent of GDP. When the value of volunteering work is included, this figure rises to 6 percent of the GDP.¹⁰

The foundation sector in particular plays a unique role. By contrast to the Anglo-American definition, a foundation in the Swiss legal context can be a grant-making, an operating, or an organizing institution. Of the 12,715 charitable foundations in total, two-thirds are grant-making.¹¹

Over the past twenty years, more than half of charitable foundations have been less than ten years old, and total foundation assets have risen from CHF 30 billion (USD 32 billion) to CHF 70 billion (USD 75 billion). As a consequence of this enormous growth, public interest in the foundation sector is increasing.¹²

Besides the statistical increase, the foundation sector has been subject to changes in managerial and structural organization.¹³ Two associations that serve foundations currently exist, covering activities such as lobbying, convening, and publications. In terms of management, the Swiss Foundation Code has gained international attention; it is the first foundation governance code in Europe.¹⁴

II. Location, Tools, and the Bottom-Line Foundations Today

In a civil law system such as the Swiss regime, a foundation is normally defined as legal entity established by the endowment of assets for a specified purpose.¹⁵ In theory, this purpose must be one of public interest. Besides the fundamental civil-law requirement that the founder has an autonomous will (i.e., possesses legal capacity), a foundation's constitution contains two formation requirements: the endowment, as the material element; and the purpose, as the subjective element. The endowment is what distinguishes a foundation from other institutions within the non-for-profit sector¹⁶ (or civil society¹⁷), such as associations and advocacy groups.¹⁸

¹⁰ Cf. Helmig, B., Gmür, M., Bärlocher, Ch., & Bächthold, St., "Statistik des Dritten Sektors in der Schweiz," in Helmig, B., Lichtsteiner, H., & Gmür, M. (eds.), *Der Dritte Sektor der Schweiz* (Bern, 2010), p. 174.

¹¹ Cf. Purtschert, R., von Schnurbein, G., & Beccarelli, C., "Switzerland," in Anheier, H.K., & Daly, S. (eds.), *The Politics of Foundations* (London, 2007), p. 310.

¹² Cf. Eckhardt, B., Jakob, D., & von Schnurbein, G., *Der Schweizer Stiftungsreport* (Basel, 2012).

¹³ Von Schnurbein, G., & Timmer, K., *Die Förderstiftung* (Basel, 2010).

¹⁴ Sprecher, Th., Egger, Ph., & Janssen, M. (eds.), *Swiss Foundation Code 2009: Principles and Recommendations for the Establishment and Management of Grant-Making Foundations* (Basel, 2011).

¹⁵ Art. 80 of the Swiss Civil Code: "A foundation is established by endowment of assets for a particular purpose."

¹⁶ This distinction comes from Roman law, which differentiates between foundations (*Universitas Rerum*), as institutions based on assets, and associations (*Universitas Personarum*), as institutions based on membership. Prewitt, K., "Foundations," in *The Nonprofit Sector: A Research Handbook*, 2nd ed., Powell, W. & Steinberg, R. (eds.) (New Haven: Yale University Press, 2006), p. 355.

¹⁷ The term *civil society* is used to describe associations of public interest that involve a nexus between the family, the state, and the market. Departing from the notion of citizenship, the concept of civil society has been defined by philosophers since the time of classical liberalism. See the definition in Anheier, K. H. *et al.*, *A Dictionary of Civil Society, Philanthropy, and the Nonprofit Sector* (Routledge, 2005), p. 54.

Thus, foundations belong to an economic sector that emerges independently of markets and states. But the tools of this sector differ considerably from the resources available to the other sectors. While governments generate their incomes by exacting taxes (compulsory payments), and markets generate their incomes by creating financial surpluses (profits), foundations are not directed at generating income. The structure of society itself is a consequence of government, as there would be no civil order without centralized power, and anarchy would reign.¹⁹ Markets work properly when private initiative and individual ambitions can flourish.²⁰ The government, markets, and society act interdependently. The third sector, by contrast, does not exist on the basis of a social mandate, nor do its institutions compete in a market. However, it nevertheless realizes a purpose that may belong either to the government or to the market.²¹

But the pursuit of these objectives is not *per se* a warranty of a foundation's survival. If a government considers that a foundation's role is not being performed adequately, the government might try to take over the task of the foundation or even eliminate it.²² Similarly, if a company sees an opportunity for financial profit in any of the foundations' activities, it might seek to pursue them itself.

Therefore, foundations exhibit singular characteristics. First, they operate by performing activities that originally belong to the public sector, yet they cannot obligate society. Second, foundations can canvass for sponsors, resources, and popular support, but without offering profit in return. Therefore, although they can attract resources, they cannot function like classical investment schemes by offering a return on capital.

This commitment to delivering public goods without being subject to the controls of a centralized power or for-profit incentives raises questions as to how foundations can exist and sustain themselves over time.²³ These considerations lead us to ask what essential criteria allow

¹⁸ Together, these institutions form part of what is known as "the third sector." The term was introduced by Amitai Etzioni and later adopted by the International Society for Third-Sector Research (ISTR) as a unifying label. The term highlights the fact that this sector emerged independently of the market (the first sector) and the State (the second sector). Anheier *et al.* suggest that the term "the third sector" is being replaced by "the third system." This latter expression is used to identify an array of organizations that are neither governmental agencies nor for-profit firms. The term is deemed broader than the third sector, as it includes elements of the informal economy. Anheier, K. H. *et al.*, *A Dictionary of Civil Society, Philanthropy, and the Nonprofit Sector*.

¹⁹ "When governments no longer provide public goods or services, failure looms." Rotberg, R., "Failed States in a World of Terror," *Foreign Affairs*, vol. 81, no. 4 (July-August 2002), p. 131.

²⁰ Applying also to John Locke's views on freedom and the granting of property rights, the absence of which would menace the freedom of human beings to achieve social and economic development. For example, the Universal Declaration of Human Rights (UNHRD), Article 27 (2), states: "Everyone has the right to the protection of the moral and material interests resulting from any scientific, literary or artistic production of which he is the author." UNHRD adopted in December, 1948.

²¹ Prewitt, "Foundations," p. 356.

²² Or conversely, due to a foundation's high level of performance, a government might find its legitimacy threatened vis-à-vis society.

²³ We are not suggesting here that either the public sector or market players have a guaranteed survival. When a majority of the people turn against their government, they usually cause it to fail. At the same time, markets work properly when some players win while others fail. See Prewitt, "Foundations," p. 357.

institutions to be defined as grant-making foundations and to investigate whether transparency plays a role in establishing these criteria.

In principle, the fundamental assets that constitute a foundation are its dedication to its purpose and the value of its endowment. Do other characteristics constitute a foundation's specific identity? The answer is yes: A foundation depends on the goodwill and financial support that it receives from both public and private sources.

The various legal frameworks that govern foundations demonstrate the government's interest in ensuring that their status is protected by its regulations. These regulations support foundations by granting them status as independent legal entities, by exempting them from the tax regimes, and by introducing tax waivers on gifts and donations that may be capitalized. In addition to these benefits, governments can support foundations directly by contracting with them, granting them funds, and outsourcing certain public activities to them. Companies can also support foundations by donating tax-exempt funds and by directly contracting with them to develop charitable activities.

In fact, if a foundation is able to exploit a favorable legal framework, its activities can be both permitted by the government and supported by the private sector. This privilege implies that the foundation conveys its message to society and that society endorses its credibility. Reputation is therefore important to foundations. It functions as a kind of "moral credit," which can generate resources and help establish a favorable regulatory environment.

Furthermore, foundations are normally not alone in their domain. They are compelled to monitor the memberships and responsibilities of other foundations.²⁴ Thus, the philanthropic sector, like the for-profit sector, is driven by a kind of competitive dynamic.²⁵ Because foundations must strive to survive, this competitive dynamic must be embedded in their founding criteria.

Therefore, in addition to the endowment, foundations need a strong relationship with the public and the private sectors of society in order to function. The endowment gives the foundation a kick-start, but its relationship with the community is what sustains it in the long run.

Consequently, if foundations rely on reputation to function successfully, it can be logically assumed that rules and principles on transparency will play an important role. However, this role must also be contextualized. Part III outlines the issues relating to transparency and its limits in this context today.

III. Transparency and Its Limits

Here, we discuss the general aspects of transparency and its limits with regard to the constitution and operation of foundations. These issues are of a functional character, and therefore apply equally to Swiss- and non-Swiss-based foundations.

A. Transparency and Access to Information Today

First of all, it seems undeniable that today's unprecedented access to information can trigger changes in the relationship between economic actors and the community. Communication

²⁴ Prewitt, K., "Foundations," p. 355.

²⁵ Posner, R. and Philipson, T., "Antitrust in the Non-Profit Sector," NBER Working Paper Series (March 2006), p. 2.

technologies matter more than ever before. Never before has the human being enjoyed such an abundance of available information. The challenge is not about looking for the information; it is rather about processing it.²⁶ Although this surfeit of information does not necessarily result in “improved” knowledge, it renders traditional cases of secrecy almost impracticable.

Issues such as digital technologies, the convergence of media, and the architecture for distributing information—both legal and illegal—have dramatically changed with the introduction of Internet Web 2.0.²⁷ Furthermore, devices to process information are inexpensive, and sophisticated skills are not required to operate, edit, and distribute information. This has provoked a radical shift in the way society and its institutions communicate with each other. Traditional practices based on secrecy are no longer acceptable. Foundations should follow this trend and avoid old-fashioned strategies based on scarcity of information.²⁸

B. Transparency as an Integral Component of the Current International Legal and Economic Order

Today, transparency has an increasing role to play across different sectors. In the converging dynamic that has existed since the early 1990s, national governments seem to “cede” sovereignty, economic integration takes place,²⁹ and private players progressively adopt business models that operate across several jurisdictions.³⁰ Issues of transparency are of particular importance in intergovernmental operations and public-private sector relations³¹ where it is essential to avoid any secrecy that might undermine the business climate, sociopolitical opportunities for change, or global security.³²

²⁶ Capurro, R., “Towards an Information Ecology,” in Wormell, I. (ed.), *Information and Quality* (London: Taylor, Graham, 1990), 122-139.

²⁷ An iconic example of this was the decrypting and releasing of a video, entitled CollateralMurder.com., which shows the murdering of civilians, journalists, and children in Iraq. Sifry, M., *Wikileaks and the Age of Transparency* (New Haven: Yale University Press, 2011).

²⁸ For example, a Spanish study provides a model that allows the level of transparency of different NGOs to be assessed online. Gálvez Rodríguez, M., Caba Pérez, M., & López Godoy, M., “Determining Factors in Online Transparency of NGOs: A Spanish Case Study,” *Voluntas*, International Society for Third-Sector Research and Johns Hopkins University, 2011.

²⁹ The conclusion of the GATT Uruguay Round and the establishment of the WTO are part of this trend, which, in fact, can be traced back to the Bretton Woods Agreement in 1944 and the founding of the World Bank and the International Monetary Fund, whose aim was to build a more integrated economic order. See Bhagwati, J., *Protectionism* (Cambridge: MIT Press, 1989), ch. 1.

³⁰ For a critical view from the perspective of global economic regulation, see Braithwaite, J., & Drahos, P., *Global Business Regulation, Part I* (Cambridge University Press, 2000).

³¹ Transparency also plays a role in the financial sector, although it has been said that: “The money markets rely more on trust than transparency, because transactions are so quick that there is little time to assess information.” “Full Disclosure: The Case for Transparency in Financial Markets is Not Clear-cut,” *Economist*, Feb. 19, 2009.

³² For example, within the WTO System, transparency is a fundamental principle of the organization that aims to regulate information flows among trading partners. Hoekman, B., & Kostecki, M., *The Political Economy of the World Trading System: The WTO and Beyond*, 2nd ed. (New York: Oxford University Press, 2001), p. 61. Likewise, International Standards of Supreme Audit Institutions (ISSAI) of the International Organization of Supreme Audit Institutions (INTOSAI) sets transparency standards for public finance at Principles of Transparency and Accountability ISSAI 20. www.issai.org.

The third sector is also affected by this. For example, after the terrorist attacks of September 11, 2001, financial regulations were among the first to be affected³³ in order to trace movements of capital by private players, especially in the recommendations of the Financial Action Task Force (FATF) of October 2003 and its nine³⁴ supplementary recommendations.³⁵ The eighth recommendation addresses the regulation of non-profit organizations:

Depending on the legal form of the NPO and the country, NPOs may often be subject to little or no governmental oversight (for example, registration, record keeping, reporting and monitoring), or few formalities may be required for their creation (for example, there may be no skills or starting capital required, no background checks necessary for employees). Terrorist organizations have taken advantage of these characteristics of NPOs to infiltrate the sector and misuse NPO funds and operations to cover for or support terrorist activity.³⁶

In an economically integrated world, this recommendation constitutes a strong warning call for the global philanthropic sector. The need for instruments and regulations aimed at avoiding secrecy, albeit for different reasons, is just as clear for the third sector as it is for other key economic areas, such as trade and public finance.

C. Transparency and the Essence of the Legal Structure of Foundations

If transparency is considered a key asset in the theoretical constitution of a foundation, this must be reflected in its actual operations. Yet well-accepted legal principles are not necessarily self-explanatory. However well accepted these principles are in theory, their formulation does not easily translate into practice. Historical and structural factors can conspire against the straight execution of accepted principles.

In the case of foundations, it might even be argued that, as legal institutions, they do not appear to have any immediate connection with transparency issues. This might be because foundations are not publicly associated with a democratic ethos that categorically requires transparency. The fact that wealthy people can divert resources—which would otherwise have to be contributed through taxes to the public budget—in order to satisfy what *they* personally and independently determine to be an unmet need of public character, is hardly aligned to any democratic axiom.³⁷

In fact, the philosophical underpinnings of foundations reveal a *laissez-faire* heritage. That is, this sector's principles have little to do with public policy issues.³⁸ The architecture of third-sector institutions omits to identify precise beneficiaries who can assert rights against a

³³ Pieth, M., *Financing Terrorism* (Kluwer Academic Publishers, 2002), p. 158.

³⁴ http://www.fatfgafi.org/document/28/0,3746,en_32250379_32236920_33658140_1_1_1_1,00.html.

³⁵ Of 2001, incorporating all subsequent amendment until 2008. http://www.fatfgafi.org/document/9/0,3746,en_32250379_32236920_34032073_1_1_1_1,00.html.

³⁶ http://www.fatfgafi.org/document/22/0,3746,en_32250379_32236920_43757718_1_1_1_1,00.html.

³⁷ Consequently, it is not astonishing at all that foundations have been labeled “quasi-aristocratic institutions.” Anheier, H. K., & Daly, S., *Politics of Foundations*, p. 4; Prewitt, K., “Foundations,” p. 374.

³⁸ Brody, E., “The Legal Framework for Nonprofit Organizations,” in *The Nonprofit Sector: A Research Handbook*, 2nd ed., Powell, W. W., & Steinberg, R. (eds.) (New Haven: Yale University Press, 2006), p. 243.

foundation—an approach adopted by many people who establish charities using a foundation. These factors conspire against transparency.

For example, when contrasting the structure of a foundation to that of a company, one marked difference is that the latter is vested with a board that is obliged to submit a periodic account of its actions to its principal—that is, its shareholders.³⁹ This requirement has a tremendous impact on the field of corporate law.⁴⁰ The structure of a foundation has no such internal control mechanism. Once a foundation has been established, it operates by following the directives of its board of management. As the foundation board does not have the duty to distribute periodic benefits to stakeholders, there are no parties entitled to demand accountability for the foundation's actions. The foundation is not required to report on the size of gifts and donations, for example, or on the use of the dedicated assets.⁴¹

Thus a foundation operates solely under the management of the board. The board's main duty is to fulfill the founder's will (the foundation's purpose). In this sense, the will of the founder attains a sort of legal character *vis-à-vis* the authority before the foundation is registered, and sometimes even in face of the tax authority. But as foundations are normally expected to continue their existence beyond the life of the founder, the task of determining who has the right to enforce the will of the founder is not simple. Of course, to some extent the public authority has the right to monitor the functions of a foundation. But once a foundation has been established, the supervisory vigilance of the state is not mandatory.

At the same time, if the government were to introduce an aggressive supervisory policy over the foundations registered within its jurisdiction, there would very likely be a strong reaction in defense of the foundation's independent status. Beyond the standard accounting rules common to all economic actors vested with a legal personality, foundations are not legally compelled to provide information to the regulatory authority. In this sense, it can be said that, even though the will of the founder has some legal character, and the status of legal entity ensures that a framework exists to fulfill that will, there is no legislation to ensure that foundation funds are handled systematically. Moreover, even in cases where the public authority obliges funds channeled through foundations to undergo closer scrutiny, this is normally done to identify dishonest tax avoidance, not to shed light on the foundations' management activities.

³⁹ Milton Friedman: “[T]he whole justification for permitting the corporate executive to be selected by the stockholders is that the executive is an agent serving the interest of the principal.” Friedman, M., “The Social Responsibility of Business is to Increase Its Profits,” *New York Times Magazine*, September 13, 1970.

⁴⁰ “Much of corporate law can be understood as an effort to control the agency problems that arise from the opportunist managers *vis-à-vis* shareholders, controlling shareholders *vis-à-vis* minority shareholders, and the company *vis-à-vis* its non-shareholders' constituencies such as creditors and employees.” Hertig, G., Kraakman, R., & Rock, E., “Issuers and Investor Protection,” in *The Anatomy of Corporate Law: A Comparative and Functional Approach*, Kraakman, R., Davies, P., Hansmann, H., Hertig, G., Hopt, K., Kanda, H., & Rock, E. (eds.) (New York: Oxford University Press, 2004), p. 195.

⁴¹ Albeit that active fundraising operations actually trigger some regulatory duties *vis-à-vis* the public authority.

D. Transparency and the Privacy Aspect of the Act of Giving

Apart from the initial endowment, foundations are nourished by gifts and donations. It would therefore be reasonable to track not only where these funds originate, but also where they go.⁴²

In principle, a philanthropic gift in the form of a contribution or a donation constitutes the voluntary, irrevocable transfer of an asset (money, property, rights of exploitation, etc.) by one person to an organization dedicated to a public purpose. Generally, this act is made without an expectation of receiving something in exchange. The only condition normally attached to this transaction is that the assets given be dedicated to the purpose for which they were transferred.⁴³ Moreover, when a foundation ceases operation after receiving a gift, then the gift will most likely be channeled to another charitable institution with a similar purpose rather than returned to the donor. Gifts, once given, do not find their way back to the giver.

The act of giving anonymously can be especially revered. The reason for this is rooted in religious traditions and other beliefs as well as in psychological motivations. From this perspective, confidentiality may be important enough for the philanthropic sector to want to protect it against hostile regulation or operating rules.⁴⁴ However, anonymity certainly contributes toward obfuscating the sector.

New trends in philanthropy suggest that the sector is being modernized. Donors are increasingly assisted by well-established financial planners specialized in this sector, who can provide a more holistic view of a charitable portfolio.⁴⁵ However, nothing suggests that old and new approaches to philanthropy cannot coexist.

E. The Work of Foundations and the Limits of Transparency

Rules on transparency are normally understood as a bulwark against institutional abuses relating to trade, taxation, or other economic activities—that is, situations in which pernicious private interests pursue objectives that undermine the market or the public.

Banks and foundations differ considerably, yet they perform similar roles. Banks reduce the transaction costs between lenders and borrowers of money. Beyond their own endowment, foundations perform a similar role in the philanthropic market, by gathering contributions and donations to be channeled to the different social programs. Just as banks are intermediaries between lenders and borrowers of credit, foundations are intermediaries between funders and

⁴² In Spain, for instance, there is a foundation that tracks the transparency of NGOs as a guide for donors. See: <http://www.fundacionlealtad.org/web/home>

⁴³ See also Anheier, H. K. *et al.*

⁴⁴ For an economic analysis of the different reasons that prompt people to donate and provide gifts for charitable purposes, from hedonistic motives to normative reasons, see Kolm, S., “Introduction to the Economics of Giving, Altruism and Reciprocity,” in *Handbook of the Economics of Giving, Altruism and Reciprocity: Foundations*, Vol. 1, Kolm, S., and Ythier, J. M. (eds.), Handbooks in Economics (Elsevier, 2006), pp. 52-90.

⁴⁵ Havens, J. J., O’Herlihy, M. A., Schervish, P. G., “Charitable Giving: How Much, By Whom, To What, and How?,” in *The Nonprofit Sector: A Research Handbook*, 2nd edition, Powell, W., and Steinberg, R. (eds.) (Yale University Press, 2006), p. 560.

beneficiaries of aid. In the end, both institutions mediate the problems created by information asymmetries.⁴⁶

Notwithstanding these similarities, banks are subject to far more regulation than foundations. Banking regulations are substantially stricter in the realm of transparency. This is related to the banking business model expressed in the deposit contract, by which the depositor keeps the upside of the business (which is limited) and assumes the whole downside loss.⁴⁷ This context highlights why transparency is so important in this industry.⁴⁸

However, transparency can at times undermine the banking business model. Particularly in times of financial stress, full transparency can reduce a bank's flexibility. Depositors may withdraw their funds at once.⁴⁹ This may worsen the crisis and potentially induce a market collapse.

In the foundation sector, the general trend towards transparency is facilitated by new technologies and contemporary approaches to communication, as well as by recent international legal recommendations. On their own, some foundations have started to provide detailed information about their organization and activities on their websites.⁵⁰ It is in the foundation's interest to implement transparency rules in all its operations. Improved transparency helps attract funding, volunteers, and permanent memberships. It also communicates a message to society that foundations warrant people's trust. Such trust is a foundation's most valuable asset.

Nonetheless, as illustrated by the banking regulation case, caution is appropriate. Foundations undertake activities of a public character that are not addressed by the State or the private sector.⁵¹ In pursuing their objectives, sometimes foundations need to operate under a veil of discretion. This is because their activities often relate only to a small segment of society, whose members do not have the opportunity or the skill to form a powerful democratic presence.⁵² Furthermore, foundation activities can draw a harsh reaction. Examples of charitable acts that might arouse public concern include attempts to integrate potential terrorists into society, studies on the benefits of euthanasia, research on gender change, and help for asylum seekers. In an open society, foundations should have the freedom to pursue social change⁵³ and

⁴⁶ As in the case of "lemons," where the "the purchaser's problem is to identify quality," elaborated by Akerlof, G., "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism," *Quarterly Journal of Economics*, vol. 84, no. 3 (August 1970), p. 495. We can suggest that the primary problem people face when lending or giving away money is identifying the most efficient institutions in which to place their assets.

⁴⁷ Allenspach, N., "Banking and Transparency: Is More Information Always Better?", Swiss National Bank, Working Papers (2009/11), p. 3.

⁴⁸ However, it has been said that the banking sector needs disclosure more than transparency. Since financial information tends to be very complex, only the disclosure of relevant items of information by top managers to rating agencies and insurance firms really has an effect on the market. See Healy, P. M., Krishna, G., Palepu, K.G., "Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature," *Journal of Accounting & Economics*, 31 (2001), pp. 405-440.

⁴⁹ Allenspach, N., p. 3.

⁵⁰ See for example <http://www.grstiftung.ch/en.html>.

⁵¹ Or sometimes activities differently undertaken, either by the state or the private sector.

⁵² Otherwise these groups would be able to force the state to act on their behalf.

⁵³ Prewitt, K., p. 355.

to challenge established limits.⁵⁴ They must have sufficient autonomy to undertake unpopular tasks.⁵⁵

A foundation may also need privacy when it operates outside its jurisdiction in undemocratic countries. A requirement at home that it fully account for its actions can produce devastating consequences for the people it is trying to help and protect.⁵⁶ Therefore, transparency legislation must not obstruct the foundation's mandate, its manager's strategy, the assignment of its assets, or any other aspect of its work.⁵⁷

To strike the optimal balance, a strategy should distinguish between structural transparency and performance-related transparency. Structural transparency relates to the internal framework of the foundation, including the purpose, quantity of assets, board members, and rules on the destination and the granting of funds. Performance-related transparency relates to the activities of the foundation, including their relationship to its purpose.

Arguably, the public wants principally to be able to assess the individuals responsible for administering the foundation assets. Structural transparency is likely to suffice in establishing credibility. By contrast, transparency regulations that focus on the activities of the foundation can jeopardize its ability to fulfill its purpose.

As will be explained below, Switzerland's transparency regulations deal predominantly with a foundation's structure rather than its activities.

IV. Swiss Legal and Institutional Framework for Foundations

Swiss law establishes three main forms of foundation: classic foundations, known also as charitable foundations, which are regulated primarily in the Swiss Civil Code (SCC); family and ecclesiastical foundations, which are not specifically regulated in the SCC; and foundations consisting of retirement schemes for employees, which are regulated under other special legal regimes. In addition, there are business foundations, which, though "unregulated" by the SCC, seem to be recognized in jurisprudence.⁵⁸

In Switzerland, the law applicable to foundations is laid down in Articles 80 through 89bis⁵⁹ of the Swiss Civil Code,⁶⁰ whose last reformed version⁶¹ entered into force on January 1,

⁵⁴ *Id.*

⁵⁵ An example of this is the work of the Ford Foundation and the African-American civil rights movement during the 1960s. Berman, H. E., "The Foundations' Role in American Foreign Policy: The Case of Africa, Post-1945," in *Philanthropy and Cultural Imperialism: The Foundations at Home and Abroad*, Anove, R. F. (ed.) (Boston: G. K. Hall & Co., 1980), p. 205.

⁵⁶ For example, German foundations that are extensively involved in efforts to democratize foreign countries since 1960 include the Friedrich Ebert Foundation, the Konrad Adenauer Foundation, the Henrich Boell Foundation, the Hanns Seidel Foundation, and the Rosa Luxemburg Foundation. However, these foundations no longer exist as foundations; in fact, today, they are associations. Alexander Mohl analyzes their work in Mohr, A., *The German Political Foundations as Actors in Democracy Assistance* (Boca Raton, FL: Universal-Publishers, 2010).

⁵⁷ For example, for decades U.S. Government aid was not welcome in China, the Soviet Union, and many developing countries, whereas U.S. foundations were allowed to operate in them. Berman, H. E., p. 205.

⁵⁸ See the study by [Würmli, M., Das gemeinnützige Unternehmen, \(s. 901\). Pratique Juridique Actuelle, Dike Verlag AG, AJP \(2010\).](#)

⁵⁹ Article 89bis is not analyzed in this paper, as it concerns employee benefits schemes.

2006,⁶² pursuant to Article 1 of the Concluding Section of the SCC.⁶³ A legal regime applicable to the auditors of foundations is stipulated in the Federal Ordinance of August 24, 2005.⁶⁴ The Swiss Confederation, through the Federal Supervisory Authority on Foundations of the Secretariat of the Federal Department of Home Affairs (FDHA),⁶⁵ exercises oversight authority over foundations registered in Switzerland which have a national (or sometimes international) purpose.⁶⁶ This supervisory authority is based on Article 84.2 of the SCC, by which “The supervisory authority must ensure that the foundation’s assets are used for their declared purpose.”⁶⁷ (Foundations are also supervised locally at cantonal level, a topic that lies beyond the scope of this article.)

A. Transparency and the Law

Few legal provisions directly address transparency; instead, provisions of this kind are implicitly included within the different sets of legal regulations. Basically, the transparency-related regulations applicable to grant-making foundations can be divided according to two implementation phases: when the foundation is formed, and when the foundation is administered.

The scope of regulation dealing with the formation of foundations can be extended to investigate two issues. First, regulations seek to trace and determine the origin of gifts and donations which are incorporated into the endowment, but which do not form part of the original endowment itself. The purpose is to ensure that foundations do not host illegal assets and do not get used to divert assets. Second, regulations may come into play when the foundation’s purpose is changed, including upon the request of the founder. Such a change will alter the subjective aspect of a foundation.

The scope of regulation dealing with the administration of the foundation covers three areas. First is the management process for ensuring that grants are allocated on an objective and systematic basis. Second, regulation addresses the obligations and duties associated with annual reporting and accounting. These managerial functions aim to ensure predictable levels of expenses and to provide a rational approach to administration that will help secure the foundation’s long-term survival. A third category of regulations concerns the rules, duties, and assignment of managers, as well as the organization of the foundation’s managerial bodies in their relations with external auditors. These specifications seek to address and avoid the so-called

⁶⁰ Swiss Civil Code (SCC), Part One: Law of Persons, Title Two: Legal Entities, Chapter Three.

⁶¹ It is the first reform of Swiss foundation law since 1907.

⁶² It is worth noting that the reform of the Swiss Civil Code provisions related to foundations occurred independently, and not as part of any attempt to harmonize the Swiss Regime with European legislation. Sprecher, T., *Die Revision des Schweizerischen Stiftungsrechts* (2006), p. 81.

⁶³ Final Title: Commencement and Implementing Provisions.

⁶⁴ www.bk.admin.ch/ch/f/as/2005/4555.pdf.

⁶⁵ Art. 3, al. (alinéa) 2, let. A, de l’ordonnance sur l’organisation de Département Fédéral de l’intérieur (Art. 3, Abs. 2. Bst. a, Organisationsverordnung vom 28. Juni 2000 für das Eidgenössische Departement des Innern (OV-EDI)) SR 172.212.1.

⁶⁶ <http://www.edi.admin.ch/esv/index.html>.

⁶⁷ <http://www.edi.admin.ch/esv/00465/00466/index.html?lang=fr>.

agency problem. The structural problems of a foundation's management do not relate directly to agency problems, but rather result from a lack of agents⁶⁸

B. The Swiss Foundation Code

Beyond the SCC and related federal and cantonal regulations, the philanthropic sector has formulated the Swiss Foundation Code in an effort of self-regulation.⁶⁹ Self-regulation by private parties can offer advantages over state compulsory regulation.⁷⁰ Perhaps the most obvious advantage that private-sector participants have over public authorities is specialized know-how and experience. This permits them to more easily spot the weaknesses in stewardship that need to be regulated. Nonetheless, self-imposed standards can have a downside if they are drafted by better equipped players in the philanthropic sector, such as large foundations. The imposition of sophisticated standards can cause small players to default without being culpable of any transgression *per se*, simply because they lack the means to fulfill the standards. It is therefore advisable to gather opinions from different members of the sector when fashioning self-regulation. Another point to consider concerns the relationship between the sector's regulatory body and the regulated parties. Parties within the sector are likely to have common interests. In this regard, problems related to capturing regulatory omissions may arise between the sector's players and *ad hoc* regulators, as happens between regulated parties and the public authority.⁷¹

In the case of the SFC, Swiss foundations (the Association of Swiss Grant-Making Foundations⁷²) commissioned a working group of experts in 2004. The aim was to prepare recommendations on the formation and management of Swiss foundations.⁷³ The first version appeared in 2005 under the heading Code of Best Practices, which was discussed and reviewed by members of Swiss foundations, the public authority, academia, organizations related to the philanthropic sector, and the private sector. The text was finally published under the name Swiss Foundation Code. It includes three main principles and 26 recommendations. The SFC is a

⁶⁸ Although certain voices suggest that foundations should adopt a "principal/agent" structure akin to the organization of a company. See the section Discussion in EFC, *Exploring Transparency and Accountability Regulation of Public-Benefit Foundations in Europe* (2011), p. 9.

⁶⁹ Other European countries also have a panoply of self-regulations involving transparency. See Breen, O., "Through the Looking Glass: European Perspectives on Non-Profit Vulnerability, Legitimacy and Regulation," *Brooklyn Journal of International Law*, vol. 36, no. 3 (2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1932653, p. 969.

⁷⁰ Brody, E., "The Legal Framework for Nonprofit Organizations," in *The Nonprofit Sector: A Research Handbook*, 2nd ed., Powell, W. W., & Steinberg, R. (eds.) (New Haven: Yale University Press, 2006), p. 257.

⁷¹ *Id.*

⁷² Grant-making foundations are those foundations that have the means either to develop their own projects or to finance the projects undertaken by other parties. These are foundations which, in their essence, can develop independently.

⁷³ Even though the foundations targeted by the SFC are the so-called "large" foundations, the introductory part of the Code includes the caveat that its recommendations should not be applied too rigorously in the case of smaller foundations, in order to prevent them from being overwhelmed by its provisions, and yet allow them to profit from the Code guidelines. See SFC, p. 13.

guideline for the activities of foundations formed in Switzerland.⁷⁴ It is not a management guide,⁷⁵ and its recommendations are not mandatory.⁷⁶

The SFC is divided into four chapters, which address the foundation's establishment,⁷⁷ leadership,⁷⁸ grant-making,⁷⁹ and finances.⁸⁰ The code sets forth "three General Principles, which must always be observed simultaneously by the management of any modern foundation. These principles relate to: (1) the Effective Implementation of the Foundation's Purpose; (2) Checks and Balances; and (3) Transparency."⁸¹ The first principle aims to ensure that a foundation's work is executed pursuant to its legal purpose. The second principle addresses the foundation's managerial structure. The third principle focuses on the relationship between the foundation and society in general.

C. The Swiss Legal System at Work

The rest of this article deals with the Swiss legal framework on foundations. It primarily deals with the provisions of applicable federal law, such as the Swiss Civil Code, and presents these in the context of regulated acts over the life of a foundation. Where relevant, the article notes the interplay between the recommendations of the SFC and the provisions of the SCC. A brief comment on the applicability of the principle of transparency closes the analysis of each piece of regulation.

1. Formation and Registration of Foundations

a. Swiss Civil Code

Article 80 of the SCC (on formation)⁸² lays down the basic principle that defines the foundation as being "established by the endowment of assets⁸³ for a particular purpose."⁸⁴ The act of allocating an endowment to a particular purpose and registering it in the commercial register gives the foundation its legal personality.⁸⁵ Article 81, para. 1, of the SCC stipulates that a foundation can be established by a public deed—*inter vivos*—or by a testamentary

⁷⁴ In its introductory section, the Code also contemplates the adjustment of its principles and recommendations applicable to foundations that are initially established under a foreign jurisdiction. See SFC, p. 13.

⁷⁵ See also SFC, p. 14.

⁷⁶ See SFC, pp. 14-15.

⁷⁷ Including Recommendations 1-3.

⁷⁸ Including Recommendations 4-15.

⁷⁹ Including Recommendations 16-19.

⁸⁰ Including Recommendations 20-26.

⁸¹ Swiss Foundation Code 2009, Foundation Governance, vol. 9 (Helbing Lichtenhahn Verlag).

⁸² Article 80 A. Foundation I. In General.

⁸³ In some countries, the law stipulates that the endowment must have a minimum threshold value. This is not the case of Switzerland, though in practice the Swiss authority requests a minimum amount before registration.

⁸⁴ In some European countries, the law requests that the purpose be published and expressly defined as being of a public-benefit. See EFC, *Exploring Transparency and Accountability Regulation of Public-Benefit Foundations in Europe* (2011). This level of precision is absent from the SCC.

⁸⁵ Thus, in Switzerland, registration functions as a state approval for grant-making foundations; whereas in other European countries, such as France, registration is not required. Alternatively, registration is achieved subject to judicial approval and not by state approval. See *id.*, pp. 12-13.

disposition.⁸⁶ A foundation can also be established by contract of inheritance (*pacte successoral*)⁸⁷ under the jurisprudence developed by the Swiss Federal Tribunal.⁸⁸ Article 81, para. 2, of the SCC stipulates that a foundation must be entered in the commercial register, pursuant to its charter, in accordance with any directions issued by the supervisory authority, and naming the members of the board of trustees. Finally, Article 81, para. 3, stipulates that the probate authority shall inform the commercial registrar of the creation of a foundation by testamentary disposition.⁸⁹ Upon subsequent notification of the supervisory authority, the registrar will exercise supervision.⁹⁰

b. Swiss Foundation Code

The first recommendation of the SFC concerns the examination of the founder's intent. In particular, the recommendation seeks (a) to ensure that the founder's intent corresponds to a societal need, and that that an independent foundation is an appropriate vehicle to deal with this need, taking into account its assets; (b) to determine whether the foundation is to have a permanent or limited existence, and, if permanent, to set up a framework for electing or replacing board members; and (c) to ensure a level of coherence in terms of the foundation's will, purpose, organization, and assets disposed.⁹¹

The second recommendation of the SFC deals with the legal domicile of the foundation. In principle, the recommendation states that the foundation should be established where its main grant-making activity takes place. However, geographic proximity is not the only concern; a foundation's domicile determines its legal framework and supervisory authority. In addition, the recommendation states that tax issues should be evaluated when setting the domicile of the foundation.⁹²

The third recommendation deals with the internal documents and bylaws of the foundation.⁹³ The purpose of the foundation should be stated in the charter. Ancillary rules concerning the work of the foundation, which need to be adaptable, can be established in other documents or guidelines. In cases where the purpose is broadly defined, the founder should add a

⁸⁶ The rules of formal testamentary disposition are governed by Article 498 A. Wills, I. Drawing up a will, 1. In general, Article 499 et seq. governs the requirements of testament established by public deed. The rules of hand-written testaments are governed by Article 505 (on Holographic will). Article 506 (on Oral will, dispositions) et seq. govern the rules on oral declarations of testamentary nature.

⁸⁷ The requirements for contracts of succession are set forth in Article 512 et seq. of the SCC. In order to be valid, the contract of succession must be vested with formal requirements of a will executed as a public deed and the intention of the parties must be declared before the public authority.

⁸⁸ Sprecher, T., *New Features in Swiss Foundation Law* (2006), p. 9.

⁸⁹ Art. 81.3 of the SCC.

⁹⁰ Sprecher, T. *New Features in Swiss Foundation Law* (2006).

⁹¹ See the Swiss Foundation Code 2009, with commentary. Sprecher, T., Egger, P., and Janssen, M., *Foundation Governance*, vol. 6., Helbing Lichtenhahn, Swiss Foundations (2009).

⁹² See *id.*

⁹³ As the law does not have provisions on the bylaws of the foundation, this recommendation is very useful for newly formed foundations.

mission statement to serve as a strategic guideline for the board, which can be periodically revised.⁹⁴

2. Challenges by Heirs or Creditors

Article 82 of the SCC⁹⁵ states that the foundation can be challenged by the heirs or creditors in the same way that a gift may be challenged.

3. Organization of Foundations

a. Swiss Civil Code

The charter stipulates the governing bodies of the foundation and its method of administration.⁹⁶ If the authority of the commercial register sees a lack of coherence between the way in which the foundation has been organized and its legal mandate, the authority will notify the pertinent supervisory authority of the foundation, which will need to redress these deficiencies.⁹⁷ The supervisory authority may set a deadline by which the foundation must establish its legal status, appoint an executive body (assuming this is vacant), or appoint an administrator (permanent or not) together with an assignment of competence. If the situation cannot be redressed and uncertainties persist regarding the feasibility of the foundation's organization, the foundation's assets can be donated to another institution that has a similar purpose.

This is to be done irrespective of whether the deed of the foundation authorizes it or not.⁹⁸ This provision constitutes a departure from the established Swiss legal regime on foundations, which did not give this power to the authority. Under such circumstances, the new regime even allows the authority to transfer the assets against the will of the founder and the members of the board, regardless what is stated in the deed.⁹⁹

b. Swiss Foundation Code

The second cluster of recommendations of the SCF deals with organizational issues. The last of the 12 recommendations stipulates that the foundation should share information on its principles, grant-making activities, and procedures with the public. The recommendation aims to inform the public about the purpose of the foundation, its structure, and its areas of activity. The SFC advises that foundations make their "goals, guidelines and procedures governing grant-making activities" accessible to the public via a website. The recommendation states that the foundation should share this information with its beneficiaries, the public authority, and the public in general.

Recommendation 4 provides rules for the functions of the board of trustees, which should be included in the foundation charter. The first recommendation states that the board should

⁹⁴ See the Swiss Foundation Code 2009, with commentary.

⁹⁵ SCC, Article 82 III., Challenge by founder's heirs or creditors.

⁹⁶ SCC, Article 83B, Organisation, I. In general.

⁹⁷ The foundation bears the cost of these diligences. Article 83d, IV, para. 3, of the SCC.

⁹⁸ SCC, Article 83d, IV. Organisational defects, point (2)

⁹⁹ Sprecher, T., *New Features in Swiss Foundation Law* (2006), pp. 9-10.

possess discretionary authority over its judgments and be free to hold independent opinions. Even if the founder is a member of the board, the other board members must remain autonomous. The board is entrusted with setting up the foundation's short-, medium-, and long-term strategies to achieve its purposes. Taking into account the foundation's charter, the board also has the power to periodically evaluate strategies of managers along with performances and policies of the foundation.

Recommendation 5 states that in the absence of stipulations in the foundation's charter, the board of trustees should draft procedures regarding the election of its members, their terms of office (two to five years per term), and rules governing their succession. Recommendation 6 deals with the number of members of the board of trustees (ideally five to seven). It suggests rules ensuring that foundation employees and board members receive adequate time to perform their functions and opportunities to benefit from training courses.

Recommendation 7 suggests rules on board members' remuneration, which ought to be commensurate with individual skill and experience, expended time, and performance. Although the recommendation indicates that board members will optimally perform their duties on a voluntary basis, it recognizes that members may require remuneration for their professional services. In this regard, the terms must be agreed in writing.

Recommendations 8, 9, and 10 deal respectively with the board's organization, the role of its chairperson, and the role of its committees. Meetings of the board should take place at least twice a year; they must be announced; decision-making procedures should be easy to comprehend; and minutes should be recorded. If necessary, the board should determine when to consult external experts. Recommendation 9 specifies the tasks entrusted to the chairperson *vis-à-vis* the board and the management of the foundation. The chairperson moderates board meetings and communicates timely information to board members so that they are appropriately informed before each meeting. The chairperson's duties, areas of competence, responsibilities, and term of office should be laid out in the foundation's regulations or guidelines. Recommendation 10 outlines cases where the board might decide to set up permanent or *ad hoc* committees for specific tasks, such as overseeing finance, investments, grant-making, human resources, and remuneration. The board must ensure that the external members of these committees are independent and in no way associated with the people they must evaluate. The board of trustees should lay down the committee's tasks in the foundation's regulations and guidelines.

Recommendation 11 deals with the rules governing potential conflicts of interest between a person's role as a foundation board member or management member and his or her other professional or personal activities. The board is charged with drafting the rules on this. As a matter of principle, any situation presenting a potential conflict of interest should be avoided. Should such a case occur, it must be disclosed to the board. It may also have to be disclosed in the annual report.

Recommendation 12 outlines the foundation's tasks regarding public communication. The foundation has a duty to provide its members, its beneficiaries, the government, the public, and the media with information concerning its purpose and structure, along with its grant-making policy, strategies, and activities. It should purvey this information using modern media channels, such as a website.

The function of management is addressed in Recommendation 13. The board of trustees should determine the skills, experience, duties, responsibilities, and compensation that its management should have and hire the management. Once hired, management should run the foundation's operations under the supervision of the board of trustees.

Recommendation 14 seeks to ensure that the auditing agency is not assigned any task other than what is required by statutory obligation. In particular, the board of trustees is cautioned against entrusting the auditing agency with the responsibility of managing foundation assets. The board must also make sure that the auditing agency or at least the head auditor is periodically replaced.

Recommendation 15 deals with the appointment of permanent or ad hoc advisors and consultants. When the board needs new skills or simply assistance, it can employ an external work force. The foundation's regulations or guidelines should state the task, areas of expertise, and responsibilities of such external workers. The rules on independence and remuneration of board members should apply equally to advisors, advisory committees, and other foundation bodies.

4. Recommendations on the Work of Grant-Making Foundations

a. Swiss Civil Code

The Swiss Civil Code is silent about the work undertaken by grant-making foundations in practice.

b. Swiss Foundation Code

SFC Recommendation 16 advises the board of trustees to document foundation policy in writing in order to serve as a reference framework. Grant-making and investment policies should be coordinated, and strategies should periodically be reevaluated in consideration of both society's needs and the activities of other private and public grant-making institutions. The board should set midterm goals as well as possibilities for collaboration.

Recommendation 17 addresses grant-making. In accordance with its investment strategies, the board of trustees should determine distributable foundation income and disburse available funds in a timely manner. A foundation should conduct grant-making activities in a professional, business-like fashion. There must be communication with other private and public institutions to operate efficiently and to avoid duplicate granting. There should be an optimal ratio between administrative costs and grant-making activities. The foundation should have established criteria to determine its efficiency.

Recommendation 18 advises that projects be evaluated and selected pursuant to the grant-making guidelines. The foundation should ensure that competent persons are in charge of such evaluation, and that it is done in an objective and timely manner. External committees or consultants may be used as well.

Recommendation 19 recommends that once a grant has been awarded, the foundation enter into a contract with the beneficiary for the duration of the project. The foundation should define the terms of the contract. A foundation can attach conditions to the funding and monitor the fulfillment of those conditions.

5. Recommendations on the Financial Management of Grant-Making Foundations

a. Swiss Civil Code

Article 83a (1) of the Swiss Civil Code on Foundations' Accounting obliges the board of trustees to maintain the foundation's accounts pursuant to the Code of Obligations on commercial accounting.

Article 83a (2) addresses the situation where a foundation conducts a commercial operation in order to pursue its objects. In such a case, the foundation is required to follow the provisions in the Code of Obligations¹⁰⁰ in respect to presenting public annual financial statements *mutatis mutandis*.¹⁰¹

The obligations to submit annual financial statements and to keep accounts apply even to foundations that have been exempted from the obligation to designate an external auditor.

b. Swiss Foundation Code

Whereas the Swiss Civil Code (SCC) and Swiss Code of Obligations (SCO) provide standard rules on accounting and auditing applicable to grant-making foundations, the SFC provides rules on financial management specifically drafted to deal with a grant-making foundation's daily activities. Recommendations 20 to 26 deal with finance.

Recommendation 20 entrusts the board of trustees with the duty to guard against improper funds—those derived from money-laundering, terrorism, corruption, or any other criminal activity. Such funds must not constitute either the original endowment or the income from foundation activities. The board should also ensure a sound balance between the cash flow of the foundation's assets and its grant-making activities.

Recommendation 21 deals with investments. The board of trustees should prepare an explicit policy covering the investment process. Then the foundation should follow this policy in determining the investment strategy, implementing the strategy, and overseeing the results.

Recommendation 22 states that the board should evaluate the foundation's "risk-carrying capacity." The foundation's assets should be invested pursuant to a strategy consistent with the foundation's purpose and its investment capacity, regardless of the personal preferences of the board.

Recommendation 23 stipulates that the board should use a competitive and open submission procedure to determine what entity will implement its investment strategy.

Recommendation 24 advises that the board of trustees systematically review investment results twice a year. Also, the investment strategy should be reviewed every two to three years. Results from the examination of investment returns and investment strategy should be recorded in writing.

Recommendation 25 deals with the foundation's investment plan. It advises that the board establish a plan for investing the foundation's assets efficiently. The components of the plan should be specified in the investment regulations. In addition, the plan should mandate that investment and oversight are strictly independent of one another. If the foundation holds stock,

¹⁰⁰ SCO, Arts. 957 to 962.

¹⁰¹ SCC, Article 83a II. Accounting

the investment regulation of the board of trustees should establish rules for exercising rights on stocks.

Recommendation 26 advises that the board of trustees administer the financial management of asset investment, budget planning, and the rendering of accounts. The annual financial reports should provide a complete, accurate, and transparent picture of the financial standing of the foundation. In addition, the board of trustees should generate a budget on the basis of its investment and disbursement plan. The foundation's board should use the annual budget as well as financial reports as tools for management and supervision.

6. Audit of Foundations¹⁰²

In principle, classic foundations must undergo a normal audit. Article 83b (1) of the Swiss Civil Code on Foundations' Auditors mandates that the board of trustees appoint external auditors.¹⁰³ However, this obligation can be waived by the supervisory authority. Article 83b (2) states that the Federal Council determines the conditions for such a waiver.¹⁰⁴

If there are no special provisions applicable to foundations, the rules of the Swiss Code of Obligations concerning external auditors of public limited companies are applicable *mutatis mutandis*.¹⁰⁵ If the foundation has the duty to carry out a limited audit, the supervisory authority can order a full audit in order to obtain a reliable financial assessment of the foundation's finances.¹⁰⁶ The external auditors must provide the supervisory authority with a copy of the audit report as well as all important communications it had with the foundation.¹⁰⁷

Thus, in principle, the law stipulates that foundations must have auditors, and this is understood as a fundamental rule of transparency that increases credibility and offers confidence to donors.¹⁰⁸ Nonetheless, the board of a foundation can request that the supervisory authority exempt it from the duty to designate an external auditor.¹⁰⁹ The supervisory authority can agree, subject to the fulfillment of conditions specified by the Swiss Federal Council and stipulated by Article 1 of the Ordinance on the Audit of Foundations. These are:

- The foundation has a balance sheet that amounts to less than CHF 200,000.-, in two successive business years (subpara. (a)), and
- The foundation refrains from raising capital either through public calls for donations or other contributions (subpara. (b)).

These conditions are cumulative. The first condition demands that a foundation seeking to obtain this waiver must have undergone an external audit for at least two years prior to application,

¹⁰² This part on Audit of Foundations is based on Sprecher, T., *New Features in Swiss Foundation Law* (2006), pp. 10 ff.

¹⁰³ SCC, Article 83b III. Auditors (1).

¹⁰⁴ SCC, Article 83b III. Auditors (2).

¹⁰⁵ SCC, Article 83b III. Auditors (3).

¹⁰⁶ SCC, Article 83b III. Auditors (4).

¹⁰⁷ SCC, Article 83c 2. Supervisory authority.

¹⁰⁸ Sprecher, T., *New Features in Swiss Foundation Law* (2006), p. 10.

¹⁰⁹ This request by the foundation's board implies that the exception is not granted *ex officio* by the supervisory authority.

which is thus a mandatory step in the case of newly formed foundations. The second condition implies that exemption can only be granted to foundations that are not seeking donations.¹¹⁰ Although this waiver is unlimited in duration, it may be revoked by the supervisory authority if the requisite conditions change or if an audit is necessary in order to make a reliable assessment of the financial situation of the foundation.¹¹¹

Since an auditor might be a legal entity, a foundation might act as auditor for another foundation. This act must be pursuant to the foundation's charter, and the requirements of independence must be satisfied "under the law governing audits."¹¹²

One of the innovations introduced by the law is the requirement that auditors be independent of the foundation. Sprecher points to four cases where independence can be questioned:¹¹³

- The persons commissioned to undertake the audit must not be members of another executive body of the foundation which is to be audited. If the auditors are members of an associated body, the obligations and responsibilities of the foundation executive bodies should be strictly divided from each other.
- Where the person commissioned to undertake the audit is an employee of the foundation, independence is jeopardized.
- In principle, cases where the persons in charge of the audit are also beneficiaries of the foundation's activities should be avoided.
- In principle, cases where the persons in charge of the audit have a close relationship with members of the foundation's executive bodies (e.g., family ties) should be avoided.

In view of the above issues, Article 2, para. 1, of the Ordinance on the Audit of Foundations instructs the foundation to engage a qualified auditor:

- if the foundation is raising funds and has received as gifts, donations or other contributions amounts exceeding 100,000 CHF in each of two successive business years; or
- if the foundation's finances exceed "any *two* of the following parameters" (subpara. *b*) during two successive business years:
 - 1) an overall balance sheet total of CHF 10 million, or
 - 2) a cash flow of CHF 20 million, or
 - 3) an annual average workforce of 50 full-time employees.

¹¹⁰ Sprecher, T., *New Features in Swiss Foundation Law* (2006).

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ *Id.*

7. Supervisory Authority and Oversight of Foundations

The Swiss Confederation itself, the Cantons, and within them, the Communes are entitled to supervise foundations. In principle, a foundation is supervised by the public authority to which it has been assigned. Nonetheless, the Swiss cantonal authorities can demand that a foundation supervised at communal level be supervised by the respective canton.¹¹⁴ This provision allows the cantonal public authority to supervise the activities of the foundation. The supervisory authority must make sure that the assets of the foundation are used for their declared purpose.¹¹⁵

8. On the Over-Indebtedness and Insolvency of Foundations

If a foundation is about to fall into insolvency or there are serious doubts about its financial capacity to meet its obligations, the board of trustees must draw up an interim balance sheet at liquidation values and submit this to the external auditors or, in the absence of external auditors, to the supervisory authority. If the external auditors identify such circumstances, they must notify the public authority directly. The supervisory authority must then command the board of trustees to take the necessary steps to redress the situation. If the board fails to do so, the supervisory authority will take these measures itself. As a last resort, the supervisory authority can take legal enforcement measures. The provisions of company law on commencement or deferral of compulsory dissolution apply to the foundation *mutatis mutandis*.¹¹⁶

The “revocation of the foundation as a matter of civil law” does not represent a financial restructuring measure. This might also not be possible if the foundation is over-indebted or if it runs counter to the will of creditors. Revocation is possible only if the legal enforcement process has been concluded and a surplus remains.¹¹⁷

A foundation may fall into bankruptcy. If financial restructuring is no longer feasible, the Swiss Debt Enforcement and Bankruptcy Law (DEBL) will apply to the foundation, *mutatis mutandis*, as it does in the case of corporate bankruptcy.

Finally, a foundation can issue a self-declaration of insolvency, pursuant to Article 39, para. 1, clause 12, of the DEBL.

9. Bookkeeping

Article 84b of the SCC¹¹⁸ sets the rules on bookkeeping for foundations. Foundations are subject to the duty to keep accounts, which is essential for auditing annual accounts as mandated by Article 83a, para. 3, of the SCC.¹¹⁹ The provisions on commercial bookkeeping of the Code of Obligations also apply here.¹²⁰

¹¹⁴ SCC, Art. 84 C. Supervision 1bis.

¹¹⁵ SCC, Art. 84 C. Supervision 2.

¹¹⁶ SCC, Art. 84 Cbis, 4, Measures in the event of overindebtedness and insolvency.

¹¹⁷ Sprecher, T., *New Features in Swiss Foundation Law* (2006), pp. 16-17.

¹¹⁸ SCC, Article 84b.

¹¹⁹ SCC, Article 83a II. Accounting.

¹²⁰ SCO, Arts. 957 et seq.

10. Changes in the Purpose of the Foundation

Under Swiss law, the purpose of a foundation can be changed by the federal or the cantonal authority pursuant to a proposal made by the overseeing authority or by the board of trustees of the foundation.¹²¹

11. Changes in the Foundation's Object at the Founder's Request

Traditionally, foundations have been conceived of as being institutions that pursue perennial objects. When establishing a foundation, founders devote a good deal of wealth to the pursuit of an object that they expect will survive them. This intent of the founder is the motivational force underlying the foundation's charter. The SCC recognizes the force of the founder's will in Article 86a, which introduces the right of the founder to amend the foundation's object by request, subject to the classical legal framework of foundations.

The request to change the purpose of a foundation can be made by the founder directly or by testamentary disposition. However, some conditions have to be fulfilled:

- At the time of setting up the foundation, the founder must have reserved the right to amend the purpose of the foundation.
- The request should be directed by the founder to the competent public authority. This request can be made directly or by testament. If the request is by testament, the authority disclosing the testament should inform the relevant authority of this request.
- This right to change the purpose of a foundation is personal. It cannot be passed to heirs or acquired by third parties. Therefore, if it is not exercised, it will end with the life of the founder.
- In the case of several founders, the request for change of purpose may only be exercised jointly by all the co-founders.
- In order to request the change, at least ten years must have elapsed since the creation of the foundation or the last change in the purpose of the foundation requested by the founder. This period of ten years ensures stability in the foundation's activities.
- If the founder is a legal entity, the right to change its purpose lasts for 20 years and is subsequently extinguished. This rule is aimed at preventing misuse of the right to change the foundation's purpose and abuse of the foundation as a legal entity.¹²²
- If the purpose of the foundation which is to be changed is of a public or charitable nature in the sense of Article 56, subpara. G, of the Direct Federal Tax Act,¹²³ the

¹²¹ A change in the purpose of the foundation might take place when the foundation's original object has changed to such a degree that it is necessary to redirect the foundation's purpose to the founder's original intention in a more coherent way. SCC, Art. 86 II. Amendment of objects, 1. Request by the supervisory authority or the board of trustees 75.

¹²² Sprecher, T., *New Features in Swiss Foundation Law* (2006), p. 20.

¹²³ DBG, Article 56, let. g, de la loi fédéral du 14 décembre 1990 sur l'impôt fédéral direct, Art. 56, Bst. g, Bundesgesetz vom 14. Dezember 1990 über die direkte Bundessteuer; Art. 56, lit. g, Federal Income Tax Statute of 14 December 1990; SR 642.11.

new object of the foundation must also be a “public or charitable object” under the terms of that law.¹²⁴

Whereas Article 86 assigns the federal authority the competence to amend the foundation’s purpose, Article 86a assigns the supervisory authority the task of ensuring that the request for the foundation’s change of purpose has been executed according to the requirements of the law. Once the supervisory authority has ascertained this to be the case, it must order the change of purpose and notify the Commercial Register Office. The authority, however, has no mandate to make subjective evaluations of the new purpose or to suggest alternative purposes.¹²⁵

12. Dissolution of the Foundation and Deletion from the Register

Article 88 gives the federal or cantonal authority the right to dissolve a foundation if its object has become unattainable and the foundation cannot be maintained by following the deed, or if the objects of the foundation become illegal or immoral.¹²⁶ Any interested party has the right to apply to the public authority for the dissolution of a foundation. Once this request has been granted, the commercial registrar must be informed so that the foundation can be deleted from the register.¹²⁷ Finally, courts have the power to terminate family or ecclesiastical foundations.¹²⁸

V. Concluding Remarks

This article has provided an account of the current Swiss legal regime applicable to foundations from a pro-transparency point of view. We began with a summary of the sector as it exists in Switzerland today. Our analysis focused on the legal provisions of the Swiss Civil Code and the Swiss Code of Obligations, together with the Swiss Foundation Code. We have also illustrated our analysis with functional aspects that are applicable to foundations beyond the borders of Switzerland. As a general conclusion, we hold that, in terms of the principles and practices related to transparency, the SFC provides a highly important self-regulation tool for Switzerland’s philanthropic sector.

We close with comments on the analyzed provisions:

[A] On formation of a foundation: A foundation can be established by an act *inter-vivos* or an *agreement as to succession*. An issue of transparency might arise if the heirs of the testator do not fulfill the will expressed in the testament. However, the SCC permits the formation of

¹²⁴ Sprecher points out that this was a highly disputed issue during the drafting of the law, as there were concerns that the new right to alter the purpose of a foundation could become a loophole for tax abuse and give the founder an opportunity to repatriate assets. On the other hand, this limitation is aimed at guaranteeing that the individuals who contributed to the foundation by donations or other instruments are reassured that their assets remain devoted to a “public or charitable” purpose, even if the new purpose is not the same as the original one. Sprecher, T., *New Features in Swiss Foundation Law* (2006), p. 21.

¹²⁵ SCC, Article 86b gives the right to the supervising authority—upon hearing the board of trustees—to provide ancillary modifications to the foundation charter, if these are demanded for objective purposes and do not affect third parties’ rights. These minor changes provided by the supervising authority aim to simplify the procedures for establishing a foundation. SCC, Art. 86b III. Minor amendments to the charter.

¹²⁶ SCC, Article 88 F. Dissolution and deletion from the register. Dissolution by the competent authority.

¹²⁷ SCC, Article 89 II. Right to apply for dissolution, deletion from the register.

¹²⁸ SCC, Article 88 F. Dissolution and deletion from the register. I. Dissolution by the competent authority.

foundations by testamentary disposition. This ruling reflects the institution's regard for individual freedom.

The SCC addresses this issue, albeit not in the section expressly dedicated to the regulation of foundations. So the duty of the heir to submit the will to the SCC¹²⁹ must be read in conjunction with the provisions on "Reading the will" of the SCC, Article 557.¹³⁰ The authority in charge of opening the testament must therefore notify the competent commercial register. The performance of this duty is the key to ensuring the fulfillment of the founder's will.

The more specific recommendations of the SFC address the functionality of the grant-making foundation. First, the recommendations suggest a kind of proportionality test to evaluate the feasibility of a foundation's achieving its objects given its means and organization. Recommendations 2 and 3 specify the level of coherence expected between the laws that are applied to foundations—including the tax regime—and the activities that foundations engage in. By anchoring the regulatory authority to the foundation's legal domicile, the SFC intends to discourage forum shopping. At the same time, however, given today's globalized economy, this provision should not limit foundations from operating across borders.

Recommendation 3 of the SFC outlines essential documents that a foundation should provide regarding its internal organization, which should remain valid for the first five years of the foundation's existence. Other documents include the foundation's constitution, its internal organization, and its mission statement. This material provides fundamental, *prima facie* evidence of the new foundation's objectives and principles.

The first three SFC recommendations relate to regulatory requirements for the formation of foundations: the founder's intent, the foundation's legal domicile and regulatory authority, and the founding documentation. Although none of these recommendations directly address transparency, they deal with issues that are central to it.

[B] On Article 82 of the SCC (Challenges by Heirs or Creditors): The SCC provision seeks to prevent foundations from being used as depositaries for assets diverted from their original legal destination by dishonest means: diluting assets entailed to a legal inheritance, or simulating a situation of insolvency by transferring assets to a foundation. Since these abuses do not directly concern to the functionality of foundations, the SFC does not refer to them specifically.

[C] On Article 83d of the SCC (IV. Organizational defects of foundations): The Swiss Civil Code provides the public authority with the power to intervene and directly restore situations where a foundation fails to organize itself pursuant to requirements of the authority. Under some circumstances the authority might even dispose of the foundation's assets, assigning them to another foundation of similar purpose. In theory, this is a way to ensure that foundations registered with the authority are internally structured pursuant to the law and supervisory regulations. But at the same time, such a disposition imposes a more compelling level of responsibility on the authority when assessing and endorsing any foundation in its registry. This provision does not concern issues of transparency *vis-à-vis* the public as such. However, it is not

¹²⁹ SCC, Article 556 (on Duty to submit the will) mandates that a will be submitted to the public authority; the public authority can afterwards release the estate to the statutory heirs on a provisional basis or designate an estate administrator.

¹³⁰ SCC, Art. 557 II. Reading the will.

detrimental either. Conversely, Recommendation 12 expressly addresses the issue of sharing information on a foundation's organization, activities, grant-making procedures, and purposes. This provision constitutes a plausible approach aimed at enhancing transparency between the foundation and the public, so that in conjunction with the ensemble of Recommendations 4 through 15 on Leadership, it provides for a level of transparency.

[D] With regard to the recommendations aimed at providing a framework of rules and conditions for the granting of funds, taking into account cost-analysis and the fact that foundations are not alone in the sector: Although these recommendations are directed more toward implementing a rational management of the foundation's funds than transparency as such, the fact that the SFC recommends that these policies be stipulated in writing provides grant-making applicants with a set of instructions drafted *ex ante*, which should help enhance grant permissions and at the same time reduce arbitrary refusals.

[E] On the finance of grant-making foundations: One of the responsibilities imposed on board members is the duty to check the origin of the assets introduced to the foundation. In general, the recommendations relating to this duty of care do not deal with issues of transparency directly. Nevertheless, they do provide foundations with principled guidelines that help the sector to function smoothly.

[F] On the accounting procedures of foundations: The Swiss Civil Code does not provide any rules specifying accounting procedures for foundations. This omission leaves numerous options open to the managers who are charged with fulfilling the foundation's purpose. The SCC regulations together with the rules and procedures for extending grants, as well as the SCF's general rules on finance, should help foundations offer a clearer picture of their activities. Recommendation 26 of the SFC constitutes a valued tool for achieving this.

[G] On auditing procedures for foundations: The authority has the power to exempt a foundation from the obligation to appoint external auditors. This potentially undermines the credibility of the authority in cases where the foundation becomes insolvent. In this sense, the Code's conditions might not always suffice to shield the authority from this risk. To address this risk, Sprecher presents a case where a group of foundations could create a foundation whose sole purpose would be to independently audit that group of grant-making foundations. Provided that the sector has sufficient resources for this purpose, the creation of an independent auditing foundation would promote transparency by giving specialists in the sector the opportunity to provide clear accounting procedures for foundations.

[H] On the supervisory authority and the oversight of foundations: Supervision should become more coherent throughout Switzerland. A highly confederated country, composed of 26 independent cantons, can only welcome such a provision. The SFC recommendations on the supervision of foundations therefore contribute to the sector's transparency.

[I] On insolvent or over-indebted foundations: None of the provisions concerns the transparency of grant-making foundations. At the same time, the fact that the law applies corporate rules on insolvency and bankruptcy to foundations shields the philanthropic sector from being hijacked by spurious financial maneuvers exercised by either local or foreign players.

[J] On bookkeeping: This legal aspect is not directly linked to transparency, but it is an instrumental item for achieving high standards in transparency.

[K] On changes in the foundation's purpose: In principle, the intervention of the public authority in providing clearance for a change in the foundation's purpose is likely to contribute favorably to transparency issues.

[L] On changes in the foundation's object at the founder's request: Whereas the SFC is markedly silent on this issue, SCC commentators suggest that the purpose should be defined as broadly as possible. However, the public authority has virtually no power to decide on the new purpose. Once the conditions required for changing the object have been met, the authority can do nothing in order to object. In this sense, the legislature clearly considers the legal requirements sufficient to ensure that the system is not abused. While this is possibly a disputable approach, the alternative would be to grant the public authority the right to designate a new purpose, which would conflict with the nature of the foundation as a legal, liberal institution. Moreover, if the authority does not have the right to determine the foundation's purpose at the moment of its registration, why should it acquire such a right later on?

[M] On the dissolution of foundations and deletion from the register: This provision also contributes to the transparency of this sector. It provides the public authority and interested parties with the right to request the liquidation of a foundation that has become estranged from its initial purpose over time due to changes in the purpose or the deed's restrictions.

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