Column

What is a trust?

A "trust" is a structure through which the property or assets of a person (the settlor) are entrusted to another person (the trustee) and managed, administered, or disposed in accordance with the settlor's wishes and objectives. In actual fact, trusts play a role in our lives in various shapes and forms. On this page, we take a closer look at trusts—a system that the SuMi TRUST Group, as a trustee, has continued to uphold and develop.

1. Purposes

Trusts are predominantly used for any of the following four purposes: (1) saving/growing assets; (2) preserving/utilizing assets; (3) connecting/transferring assets; or (4) putting assets to good use.

Saving/growing (asset formation and management)

There are trusts for managing money, securities, or real estate. Some trusts are also utilized by companies under the government's property accumulation savings scheme so that employees can build wealth.

Preserving/utilizing (asset administration and utilization)

There are trusts for safely administering the assets of the elderly or people with disabilities, for example. Some trusts are also utilized by companies in corporate pension plans for employees.

Connecting/transferring (asset inheritance)

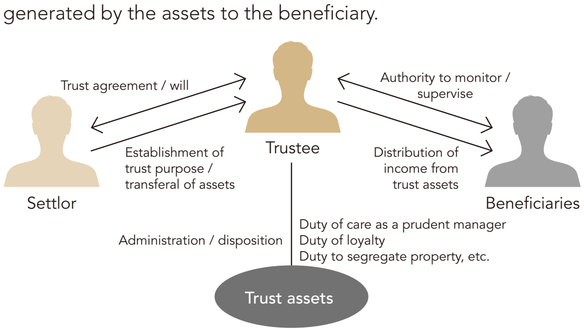
There are trusts that broadly provide assistance on paying education or marriage expenses. For example, school enrollment fees or the cost of lessons, as well as weddings and births, for one's children or grandchildren. There are also trusts for passing on assets to family members after one's death.

Putting assets to good use (social contribution)

There are trusts that put one's assets to good use for scholarships, environmental conservation, or research in academic fields. There are also trusts through which money is donated to non-profit organizations to support social contribution activities.

2. Mechanism

A trust comprises three parties: (1) the settlor who entrusts the assets; (2) the trustee who administers and manages the trust assets; and (3) the beneficiary who receives the benefits generated by the trust assets. More specifically, the purpose of the trust is established with the conclusion of a trust agreement between the settlor and the trustee. The assets are then handed over to the trustee, who distributes the assets along with any income generated by the assets to the beneficiary.



3. Trustee responsibilities

To earn the trust of the settlor and the beneficiary, various obligations are imposed on the trustee under Japan's Trust Act and Trust Business Act.

The typical obligations of a trustee are as follows.

Duty of care as a prudent manager
The trustee must exercise due care of a prudent manager when administering the trust.

Duty of loyalty
The trustee must faithfully administer the trust for the beneficiary.

Duty to segregate property
The trustee must administer property belonging to the trust assets separately from its own property (property owned by the trustee itself) and from property belonging to other trust assets.

Duty of fairness
Where a trust has multiple beneficiaries, the trustee must execute its duties fairly for all beneficiaries.

The origin of trusts

While there are numerous views on how trusts came about, one theory relates to the "use" system that emerged in medieval England around the time of the crusades (11–13th century). At that time, a large sum of taxes had to be paid to the king or lord if the child of a person died in battle was to inherit the land of the deceased. To avoid such a heavy tax burden, it was customary for a person to donate their land to the church after they had died, but this was subsequently prohibited by law, so to counter this, the "use of land" system was developed. Thus, land was transferred to a trustworthy person and the income generated from its use was donated to the church.

Later on, the use system was also utilized at the time of the crusades. The land and possessions of a knight fighting in the crusades in the Middle East were assigned to a trustworthy person to be managed on behalf of his family left behind in England, while the income generated was to be handed over to the family. If the knight returned home safely, his land and possessions would be duly returned.

The use system was built on a strong relationship of trust between two parties and in time developed into what we now know as a "trust."

Trust Q&A

Q In simplest terms, what is a trust?

A A trust is used to transfer your own assets to another person. While you are entrusting your assets, you are not lending them. You are transferring your ownership rights. The other person is called the trustee and not only can they lease your assets, they can also sell them.

Q So that means I'd no longer own those assets and the trustee can do whatever they want with them. Why on earth would I agree to that?

A You see, the trustee can't use the trust assets for themselves. They must only use them for the beneficiary. This is what's known as duty of loyalty.

Q I see. But in saying that the trust assets can only be used for the beneficiary, that could mean just about anything. Wouldn't the trustee have a hard time deciding on how the trust assets should be used?

A Exactly. Which is why the purpose of the trust is decided on beforehand. This way, the trustee uses the trust assets for the beneficiary in accordance with the purpose of the trust. In other words, it's a policy on how the trust assets are to be used.

Q I see. But if the trust assets now belong to the trustee, won't they be turned over to a creditor if the trustee goes bankrupt?

A Well, a function of trusts called "bankruptcy remoteness" means that the trust assets cannot be seized by the trustee's creditor even in the event of default. And of course, because the trust assets no longer belong to the settlor, they are impervious to bankruptcy on the part of the settlor. The same applies to bankruptcy of the beneficiary (although beneficiary rights can be seized).

Q But how does the trustee know which assets belong to themselves and which are the trust assets of the trust?

A The trustee has a duty to segregate property. They must properly manage the trust assets by separating them from other property. For assets like real estate that have a recording system, the trustee must make a record (known as a trust register) that basically shows what the trust assets are.

Q So, in what kind of situations can a trust be used?

A They have many uses, but particularly when assets are entrusted to a trust bank, many people expect their funds and assets to be managed and administered in a professional manner. The trustee of a trust has a duty of care as a prudent manager. That is, a duty to render attention sensibly as normally expected of a person undertaking such a task based on their capabilities and position. This means that even though the trust assets belong to the trustee, simply paying attention to them as their own assets is not good enough.

Q Interesting. So, even though the entrusted assets belong to the trustee, the trustee has numerous obligations to fulfil, which essentially guarantees that the trust assets will be used for the beneficiary of the trust.

Q By the way, could you go into a bit more detail about what it means to "utilize professional capabilities"?

A As an example, trust banks are investment management professionals. Not only do they manage assets for companies and individuals, they also manage pension fund contributions. They also jointly manage large sums of money entrusted from many clients.
On top of this, trust banks are also real estate professionals and they use their know-how to construct and manage buildings. In fact, a lot of capital is needed to erect a building and such funds need to be procured from somewhere, but this process happens to proceed more smoothly when a trust bank (the trustee) is the borrower. Even the paperwork for the municipal office can be handled solo because the trustee is also the owner, which is really convenient especially when there are multiple leaseholders.

Q I see. So the creditworthiness of the trustee can be put to good use and even legal matters can be simplified. Anything else?

A Another example would be the ability to create an investment product by liquidizing assets such as real estate, loan claims, or credit receivables. Using a trust, the assets become the beneficiary rights (credit obligations), but they can be broken up into smaller units and sold to investors. This is called multilayering and the beneficiary rights can also be separated into different types depending on the level of risk.

Q That's also called securitization. What else is there?

A Trusts can also be used in place of wills. You can decide in advance who will become the beneficiary of your trust after you have died. And you can even decide on the next beneficiary after them. Better still, you can also have the trust continue so that your children or grandchildren can receive regular payments, or you could have the trust continually donate money to a charity organization of your choosing.

Q Trusts really do have so many different functions and uses.

A Yes, they certainly do.
Professor Kazuo Shinomiya, a leading trust law scholar, wrote the following in his 1989 book *The Trust Act*: "...a trust can be created for any purpose unless it is an unlawful or impossible and as such there could be an infinite amount of them, but if there would be anything to limit their number, it would only be a lack of imagination on the part of lawyers and business people..." I think this statement really rings true.
Even as the times have changed, trust banks have continued to meet the needs of society by providing various trust products. For example, loan trusts supplied funds to Japan's industrial sector, pension trusts underpinned the adoption of the pension system, land trusts provided a means for the development of land to proceed without the need for real estate to be bought or sold at a time when land prices went through the roof during Japan's bubble economy, and liquidation trusts contributed to the diversification of corporate financing. Let's hope trust banks continue to make good use of trusts in imaginative and creative ways to meet the needs of society.