Lecture on Trust Law No.7 (on November 25, 2008)
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Deposit-type and Investment-type Trusts

1. Meaning of Business Trust

・Business trust "shall mean a trust which a trustee accepts as business, a concept against a nonbusiness trust, also known as a commercial trust. To accept as business shall mean to continuously and repeatedly accept with the purpose to earn a profit (or remuneration), i.e., a profit-making purpose. (*Terminological Dictionary of Trust Business Practice*, p.19)

・Trust Business Act lays down, "In this Act, a 'trust business' shall mean a business to conduct the acceptance of a trust." (Article 2, paragraph (1) of Trust Business Act)

・Sideline Act sets, "Banks and other financial institutions, despite the stipulations in other laws, under the license from the Prime Minister, may run the trust business provided in Article 2, paragraph (1) of Trust Business Act and the operations listed in the following." (Article 1 of Sideline Act)

2. Types of Business Trust

From ① to ④ below are sometimes called “commercial trusts.”

① Deposit type: loan trust, money trust (general kind), etc.

The structure of this trust is the one that is utilized to achieve the same kind of purpose as a banking activity (deposits and lending operations) in a traditional meaning within the structure of financial intermediation.

② Investment type: securities investment trust, performance-based-dividend type trust, individually-operated money in trust, specified fund trust、specified money in trust, pension trust, etc.

The structure of this trust is the one that is utilized to manage assets (monetary instances not negligible)

③ Conversion type: pecuniary claim trust for fluidization, property management and disposition trust, etc.

The structure of this trust is the one that is utilized to change the disposition of a subject or object of transaction. More specifically, in the eye of the law, it refers to a matter that has been characterized as a trust property gets converted to one that is characterized as a beneficiary right. (In many instances, a beneficiary right is to possess a higher degree of liquidity than a trust property.)

④ Enterprise type: land trust

The structure of this trust is the one that runs an enterprise by utilizing the structure of trust. It refers to that in which a certain kind of enterprise is conducted, that is not the management of property, but beyond it, or in a slightly different dimension, utilizing the structure of trust. →Trust of enterprise (trust of property having an enterprise disposition)

⑤ Business trust other than the above

The structure of these trusts are the ones established solely for the management and disposition of trust properties (sort of custody). In terms of patterns, there are the cases of a re-trust and joint-trust, based on which trust banks exclusively engaged in asset management conduct management/disposition of stocks and bonds.

3. Function of Trust

① Property-management function

・Function that enables to entrust the management/disposition of property to the third party (trustee) with a capacity of its preservation/management, and to enjoy its economic profit.

② Conversion function

・Function that enables to convert trust property to a variety of trust-beneficiary rights in accordance with trust objectives

・With the enforcement of Financial Instruments and Exchange Law, trust-beneficiary rights in general were views as stocks and bonds. (Art. 2, para. (2), item (i) of Financial Instruments and Exchange Law)

・Function to convert a cash flow yielded by trust property to a separate cash flow through the waterfall (stratification of the beneficiary right and structure of the preferred/subordinated), i.e., a cash-flow conversion function.

③ Bankruptcy remote function

・Function that enables to avoid an influence exerted at the time of the settlor's or trustee's bankruptcy, by isolating trust property from the settlor, and by managing trust property separately from the trustee's intrinsic property.

(a) Bankruptcy remoteness from trustee

・Due to the independence of trust property, a creditor of the trustee is not permitted to put into effect by legal process (Art. 23 of Trust Law), nor is incorporated into a bankrupt's estate of the trustee (Art.25 of Trust Law).

(b) Bankruptcy remoteness from settlor

・In fluidization of realty/pecuniary claim utilizing trust, the fund-raising is conducted as the guarantee, not the settlor's credit, but the value of the subject asset being the trust property. When the settlor bankrupts, assuming that the true sale is conducted, such a situation is evaded as one where the trust property gets placed under distraint by the settlor's creditor or receiver and such.

(c) Isolation from trust property's bankruptcy

・While the old Trust Law had not approved the capacity of bankruptcy of trust property, the law newly introduced the bankruptcy proceedings as for trust property. (Chapter 10-2 of Bankruptcy Law)

4. Loan Trust—Typical Product of Deposit-Type Commercial Trust

(1) Kind/structure

・Art.2 of Loan Trust Law

"In this law, a 'loan trust' shall mean a money trust in which, mainly by means of loan or bill discounting, a trustee jointly manages pecuniary that, based on a piece of trust agreement, said trustee has accepted with trust contracts which said trustee has concluded with a large number of settlors, where the beneficiary rights related to concerned trust contracts are expressed on the beneficiary certificates."

・A kind of a joint-investment designated money trust

(2) Characteristics

・Trust agreement—targeted at a large number of disconjugate settlors (beneficiaries)

・Joint management—to set up a management body

・Beneficiary certificate—Blank beneficiary certificate is securities stipulated in Subsection 1 (Art. 2, para. (1), item (xii) of Financial Instruments and Exchange Law)

・Contract for replacement of losses—Loan trust is a product of replacement of losses in rivalry with a term deposit, thus putting a risk on a trustee.

While Trust Business Act prohibits trust companies from replacement of losses and supplement of profits before/after the fact (Art. 24, para (1), item (iv) of Trust Business Act), Sideline Act approves, regarding trusts that meet the following requisite, to conclude the contracts on replacement of losses and such (Art. 6 of Sideline Act, Art. 37 of Ordinance for Enforcement of Sideline Act) based on the ground that banks running trust business as a sideline have solid financial foundations as deposits-managing financial institutions, inasmuch as they are set to be capitalized at ¥2 billion at minimum (Art. 5 of Banking Law, Art.3 of Order for Enforcement of Banking Law), and are under the capital adequacy requirement (Art.14-2 of Banking Law):

(a)Money trust whose investment method is not specified

(b)Trust contract other than the trust whose objective is to invest more than 50% of the total amount of trust property in assets of stocks and bonds/derivatives

・Competitive loan—As for competitive acts, the agreement for a joint-investment designated money trust lays down as follows:

"Art. 5, para. (1): Regarding transactions and other acts which our company can carry out as processing of trust operations based upon the authority as the trustee (hereinafter referred to as ‛competitive acts"), our company is set to be able to conduct in our company's banking accounts or by the calculation of our company's interested persons.

Art. 5, Para. (2): Regarding the act in the proceeding clause, our company is not to make a notice to the beneficiary stipulated in Art.32 , para. (3) of Trust Law."

・Statute of limitations—As pecuniary claim, beneficiary right is subject to extinctive prescription.

・Indirect financing—product competitive with a term deposit, with loan/bill discounting as the operational subjects, — product of a variable interest rate to specify projected returns every six months→fluctuating prime rate

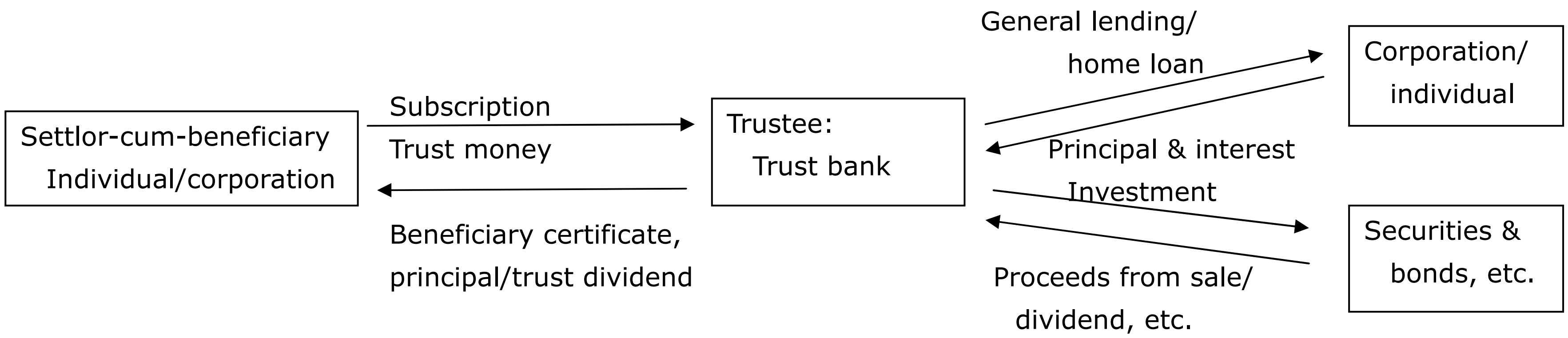
・With the practice of replacement of losses, special retainage is reserved.

・Nationwide balance at ¥50 trillion in 1993→¥1.2 trillion in 2008, flotation discontinued by all companies →From indirect financing to direct financing, termination of fluctuating prime rate

(3) Joint investment/joint-investment account (trust on trust)

・In loan trust, properties in trust having to do with trust contracts concluded in a stereotyped agreement with an unspecified large number of settlors (and concurrently beneficiaries) are jointly administered and invested. The trustee is obliged to administer by separating each trust property (Art. 31 of Trust Law), but if agreed in the trust deed, it is acknowledged to jointly administer and invest money entrusted by a large number of settlors.

<Management Structure of Loan Trust>

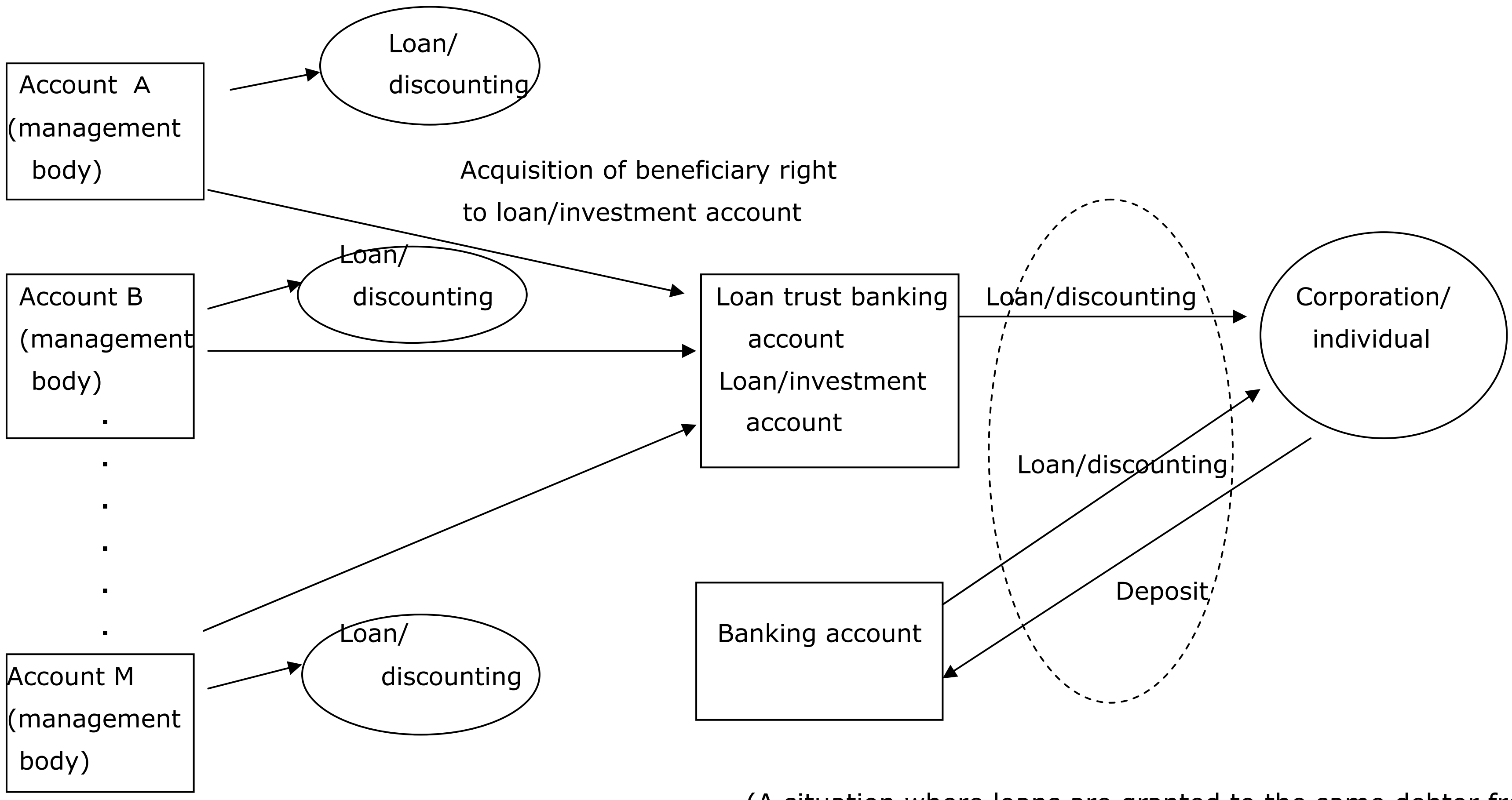


<Operating Structure of Loan Trust>

To set up a management body for every flotation term. A joint-investment account (loan-trust investment-fund account) has been installed so as to diversify and equalize operational risks of a management body.

Joint-investment account・・・trust on trust

(See the next page)



(A situation where loans are granted to the same debtor from both trust account and banking account is called "competitive lending.")

5. Securities Investment Trust—Typical Product of Investment-Type Commercial Trust

(1) Kind/structure

- Investment trust constitutes a structure that collects funds from a large number of persons and invests in financial assets and such.
- Investment trust is ruled by "the low concerning investment trusts and investment corporations" (the investment trust law).

<Grouping of Investment Trusts>

In addition to a sorting in terms of the securities investment trust (securities investment corporation) to invest mainly in securities and bonds, and the investment trust outside said securities investment trust, there is the following classification depending on an individual structure:

Investment trust (contract type)
- Settlor-directed-type investment trust
- Settlor-undirected-type investment trust

Investment corporation (company type)

- What a trust bank takes charge as a trust business is a settlor-directed-type investment trust (designated money trust, designated comprehensive trust).
- Art. 2, para. (1), item (i) of Investment Trust and Investment Corporation Act :

"The term a 'settlor-directed-type investment trust' as used in this Act shall mean a trust whose objective is to effectively manage the investment primarily in securities and bonds, reality and other assets that are required to be easily invested as provided for by Cabinet Order (hereinafter referred to as 'the designated assets'), based on a settlor's direction (including the direction of a party provided by said Order in case the whole or part of the authority pertaining to the direction is commissioned to a party provided by said Order), and which is established based on this Act, and further, is aimed at dividing its beneficiary right for multiple persons to acquire thereof."

- "Contract for a settlor-directed-type investment trust shall not be concluded unless a single financial-product dealer should be set as the settlor, and a single trust company as the trustee." (Art. 3 of Investment Trust and Investment Corporation Act the investment trust law)
- In securities investment trust, the settlor of a trust established based on one trust agreement is an investment trust commission company, and the trustee is a trust bank, where the settlor implements managerial directions to the trustee. The investor is positioned as the beneficiary of a trust to be established.
- An investment trust commission company bears to the beneficiary the duty of loyalty and care duty of good administration. And the working rules on acts of the investment trust commission company are stipulated in Financial Products Sales Law (Art. 42, Art. 42-2 of Financial Products Sales Law).

(2) Characteristics

- Beneficiary certificate—securities and bonds (Art. 1 of Financial Products Sales Law)
- Performance-based dividend—no replacement of losses
- Public announcement, separate administration of trust properties→ the administration by registering in transfer-account books of transfer institutions due to the computerization of stocks

(3) Investment-trust beneficiary certificate

Investment-trust beneficiary certificate is a certificate signifying an evenly-divided beneficiary right

investment trust is to collect money from a large number of persons by dividing one piece of beneficiary right, and although the method of collecting money from a large number of persons is the same, its structure is different from that of a joint management of a loan trust. →Ban on a similar investment deed

(4) Structure of contract-type investment trust

The most significant feature of a contract-type investment trust lies in its structure that a settlor manages the trust, that is, the leading role in the structure is played by an investment trust commission company.

・A settlor is to set up a trust with the money raised from investors, and implements investment directions to the trustee as to the management of the property in trust.

・Based upon a trust contract (trust agreement) concluded with the settlor, the trustee conducts administration/custody of the investment property .

In terms of the trust forms, there are an "others'-interest trust" and a "self-interest trust." Even with a self-interest trust, an investor becomes a later beneficiary with its acquisition of a beneficiary right.

・Client management is done by a sales company.

① Between the beneficiary and settlor

Roles of the settlor are to conclude a trust contract, direct on management of trust property, issue a beneficiary right, prepare data for disclosure, etc.

The settlor takes responsibility to the beneficiary for the management of the property.

As for its investment operation, the settlor is ruled by the investment trust law (structure of an investment trust, recorded items in an agreement, restrictions on the direction as to the investment in securities, right of a beneficiary, a management report, etc.) and Financial Instruments and Exchange Law (subject of the investment, restrictions on managerial directions→derivative, the duty of loyalty/care duty of good administration to a rightful claimant, prohibited acts→the ban on an act of conflicting interests/cross-transaction of investment properties〈Art. 42-2 of Investment Trust and Investment Corporation Act〉).

<Art. 42 of Financial Instruments and Exchange Law>—Special rule on the investment-management trade

Para. (1): The financial-products trader shall conduct an investment-management business loyally for the benefit of the rightful claimant.

Para. (2): The financial-products trader shall conduct an investment-management business with the care duty of good administration to the rightful claimant.

<Art. 21 of Investment Trust and Investment Corporation Act (responsibility of the investment trust commission company)>

An investment trust commission company (including the party provided by the Cabinet Order set forth in Art. 2, para. (1) who has been entrusted with the whole or part of the authority pertaining to the direction on investment by said investment trust commission company), when inflicted a loss to the beneficiary of an investment trust property who executes the direction on investment attributable to the company's negligence of the task, shall jointly take a responsibility of compensation for damage to said beneficiary.

② Between the settlor and trustee

Roles of the trustee are to conclude a trust contract, conduct administration/custody of the property in trust, calculate the property in trust, and certify the beneficiary right, etc.

The trustee takes responsibility to the consignor for the implementation of the investment order, and to the beneficiary for the administration/custody of the trust property.

The settlor/beneficiary and the trustee are the parties concerned, ruled by "Trust Law" and "Trust Business Act," and the trustee is responsible to the beneficiary for "duty of loyalty" and "care duty of good administration."

< Contract-type investment trust > — scheme for securities investment utilizing "trust"

Characteristics as the structure (group investment scheme)

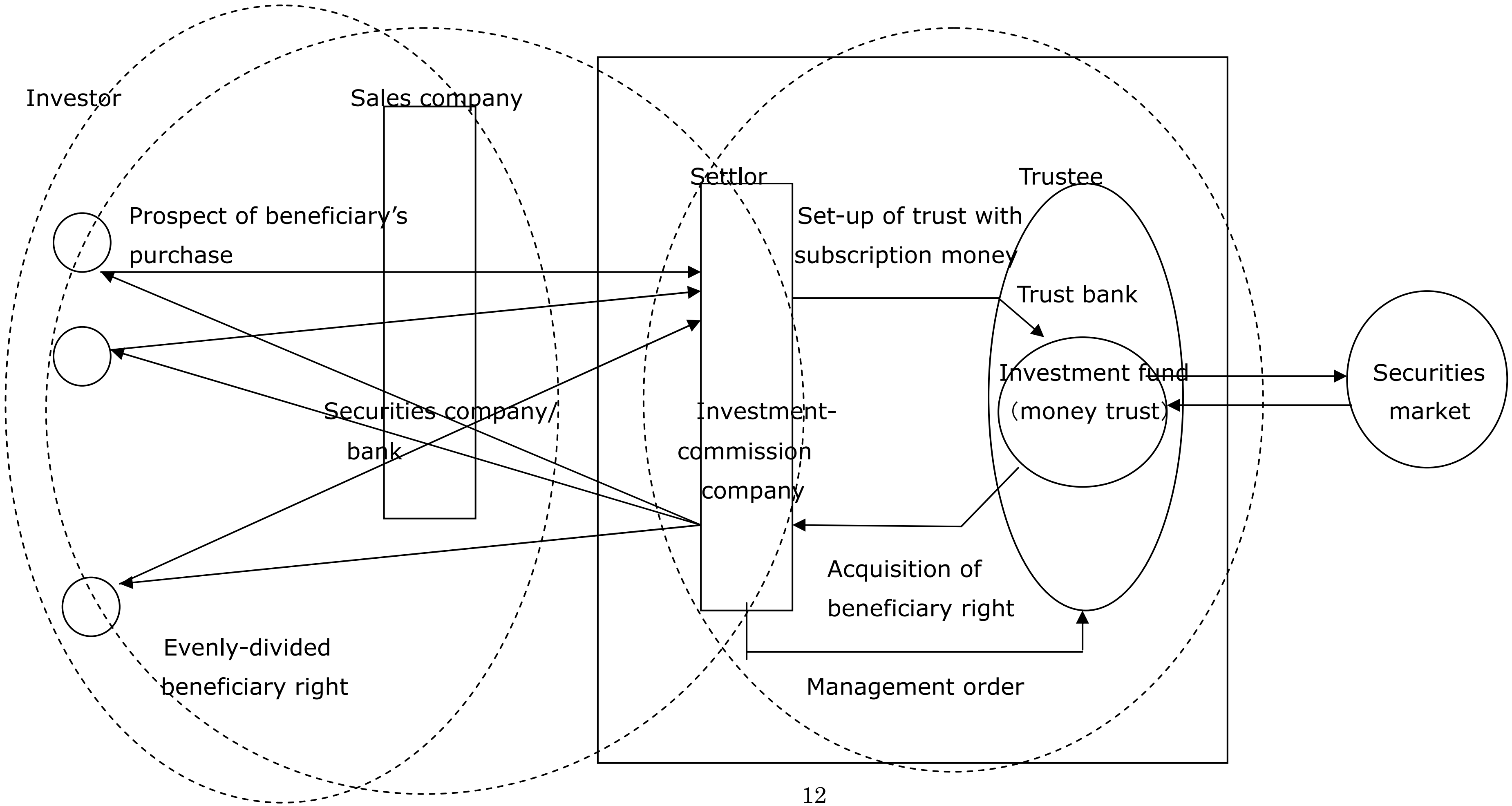
①Joint investment

②Diversified investment

③Management by specialists

Merits	Demerits
③ Diversified investment possible with small amount	①No guarantee of principal
④ Management by specialists possible	②Costly
⑤ Current] valuation amount daily available, easy to grasp asset values	③Limitations like a closed period

Dealing of subscription (financial-products trade)——Investment-management business — Receiving of trust (trust business)



Comparison Between Loan Trust and Securities Investment Trust (Settlor-directed-type investment trust)

	Loan Trust	**Securities Investment Trust (Settlor-directed-type investment trust)**
	(common product in trade dealt by trust banks)	(It's a fund designed for the securities investment formed by investment-trust commission companies, available in many kinds, each of which differs in subject of investment, investment policy, purchasing unit, sales target, redemption term, etc.)
Grounding laws	Loan Trust Law	Law Concerning Securities Investment Trust and Securities Investment Companies (Investment Trust and Investment Corporation Act)
Kind of trust	Loan trust (kind of a jointly-managed designated money trust).	Designated money trust/ designated comprehensive trust.
	A self-interest trust in which a client constitutes a settlor, and whose status is succeeded along with the transfer of the beneficiary right. The trust contracts concluded with a large number of settlors based on one piece of trust agreement, and the trust money gets jointly managed.	It's set up either in an others-interest trust form or in a self-interest trust form, positioning one investment trust commission company as a settlor, and one investment company as a beneficiary. It has multiple parties acquire the beneficiary right being divided evenly.
Beneficiary	Beneficiary certificate/beneficiary right (securities & bonds)	Beneficiary certificate (securities & bonds)
Subscription set-up	Subscription service periods are 6th-20th every month and from 21st to 5th next month, and with a trust money subscribed during these periods, one unit of joint management body gets composed for every flotation term.	Different by fund. There are cases with a certain limited subscription term and ones with a constant subscription, and are a public subscription and a private placement, and an open-end type allowing an additional issue and a unit-type in which an additional establishment is not possible.
Unit	Trust money in the unit of 10,000 Yen	Different by fund, starting with 1 Yen (MMF and such)
Trust period	2 years or longer (2 kinds in reality: 2 yrs and 5 yrs)	Different by fund; some with no period specified
Agreement	Loan trust agreement (to be approved by Prime Minister)	Securities investment trust agreement
Subject of investment	To be invested primarily in loan/bill discounting. Holding securities & bonds is possible as required reserves or depending on cash allowance.	To invest primarily in securities & bonds
Replacement of losses	Though performance-based dividend, a contract for replacement of losses can be put. If this contract is concluded, special retainage is supposed to be saved up out of loan trust's profits.	Performance-based dividend, and no contract for replacement of losses
Transfer	Free for a blank endorsement; possible to transfer with the trustee's consent in case of a full endorsement	Possible to transfer
Cancellation of contract before agreed term	Trustee can purchase the beneficiary certificate after one year since the set-up (to receive purchasing discount).	Different by fund; there's a closed-end type that restricts the cancellation of contract for a certain term since its set-up.
Treatment in taxation	Interest income	Interest income with an open-end bond investment trust, income from dividends with a securities investment trust