

An Outline of a Fiduciary's Obligations in the Management of Securities

With Emphasis on the Duty to Exercise
Reasonable Care in Management

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1. *Introduction*

A trust bank, when entrusted with securities of which it is to act as trustee, is charged with the duty to exercise care in the management of those securities. As a starting point, I would like to focus on pension funds management, an area in which the application of the standard of care remains especially unclear. The following elements figure prominently in relevant legal thought.

2. *Modern Investment Theory*

Among the topics most frequently examined by modern investment theorists are risk-return trade-off, the efficient market theory, and the basic concept of fund management.

3. *Japanese Law*

Fiduciaries are required, by Article 20 of the Trust Law, to exercise care in the management of securities. The standard of care is defined as the care of a "good manager" (Japanese Trust Law, Article 20). Due to the subjective nature of the term "good manager," Japanese legal theorists are in agreement that this standard of care must be applied on a case-by-case basis. An outline of the primary elements comprising this standard of care will follow.

4. *American Law*

Until recently, modern investment theory considered *Harvard v. Amory* Mass. (9 Pick.) 446, 461 (1830) the clear precedent in this area. But recently courts have begun to apply an increasingly strict standard of care to their evaluations

of whether a defendant fiduciary has practiced speculative management. From this increased rigidity has arisen a recent wave of criticism by investment theorists. In certain areas, the applicable standard of reasonable care has been defined by legislation. Examples include ERISA's (Employee Retirement Income Security Act's) redefinition of the prudent man rule or the adoption by UMIFA (Uniform Management of Institutional Fund Act) of the business judgment rule. When we refer to American law, we ought also take into account ERISA's and UMIFA's two evaluations of the applicable standard of care.

5. *Conclusion*

The duty to exercise, throughout the investment process, reasonable care in the management of securities has four primary components. These are listed here in order of their relative importance. The fiduciary is charged with a duty: 1) To form investment policies only after conducting a thorough inquiry into the client's purposes, limitations and objectives; 2) To attempt to anticipate influences on the investment market by various strengths and weaknesses in such areas as economy, society, government, industry and securities issues; 3) To select and purchase those securities issues which are expected to offer optimal benefits to the client's portfolio; and 4) To monitor and respond to shifts in investment trends and the investment market. The business judgment rule, as defined by American case law, can provide an objective basis for evaluating whether a fiduciary has complied with the duty to exercise care in securities management. I would like to suggest that Japan, in order to clarify the standard of a "good manager," should incorporate into its standard the concept of the business judgment rule, as the U.S. did with the enactment of UMIFA, although some modification of the rule would be required, as applications appropriate to the Japanese and American legal systems would of necessity differ in some respects.