

A Trust for Securities Trading : Public Notice of the Trust and Segregation of Trust Property

Hidero Mafune (The Sumitomo Trust and Banking)

In the administration of a trust in which the trustee manages active trading of investment securities, the trustee is required to engage in prudent and timely trading. Under the traditional construction of the Japanese trust law, however, two problems may arise as to how the securities held as trust property can be protected from the risk of trustee's bankruptcy.

1. Problems

(1) Public Notice of the Trust

Article 3(2) of the Trust Law provides that a trust cannot be asserted against third parties unless it is indicated (in a manner promulgated by law) on the instruments that they are trust assets. In practice, however, the trust contract of a commercial trust for active trading of investment securities explicitly provides that the trustee is not obliged to make this public notice. Where this public notice is not made, if a general creditor of the trustee attaches the securities or the trustee becomes bankrupt, can the beneficiary and others raise objection and assert the beneficial interest in the securities?

(2) Segregation of Trust Property

In the administration of a commercial trust, the trustee typically holds a large number of trust funds and a vast quantity of investment securities, some of which belong to the trust funds and others to the trustee's personal

account. And with the active management of these securities, they are continuously brought in and out of the office of the trustee. It is thus impractical for the trustee to hold these securities in a way that each trust fund is identified to hold specific securities. If the trustee holds all the trust securities segregated from his personal securities as a whole, is the "specification requirement" by trust law met so as for the beneficiary to raise objection to the attachment by a general creditor of the trustee or to recover the securities as trust property from the trustee's bankruptcy estate?

2. Reporter's View

(1) Article 3(2) should be construed narrowly: with respect to a trust for active trading of investment securities, general creditors (both in and outside the trustee's bankruptcy) are not "third parties" within the meaning of Article 3(2). The beneficiary therefore can assert the validity of the trust against these creditors. Proper balancing of the interests between the trust beneficiary and general creditors of the trustee, as well as practical consideration in the need of active trading of investment securities in a commercial trust of this type, warrants this view.

(2) Article 28 of the Trust Law liberalizes the general segregation rule with respect to money, and provides that for money as trust property, physical segregation is not required and segregation in accounting in the trustee's book is sufficient. This provision should be applied to a trust for active trading of investment securities. These securities are fungible assets and therefore of the nature similar to money. Also, requiring physical segregation would impede the very purpose of the trust: active trading of securities. In this situation, an argument should be made that the specification requirement is met on the ground that the trust property is specified as a whole, or that the "value" of the securities held in trust for each beneficiary is specified through accounting segregation.