

Trusts : What the Structured Finance Legal Practice Expects

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The Trust Law is expected to be significantly revised next year for the first time since its enactment over 80 years ago. On July 15, 2005, the Ministry of Justice issued, for public comment, a preliminary outline of the proposed revision of the Trust Law (*shintaku-ho kaisei youkou shi-an*) as part of its preparation to submit the reform bill to the Diet.

Recently, trusts have been increasingly used as vehicles in securitization and other structured finance transactions in Japan. This article sets out some of the essential elements contained in the preliminary outline that I, as a legal practitioner, would like to see included in the revised Trust Law to help facilitate the use of trusts in structured finance transactions.

In a structured finance transaction primarily backed by a pool of assets, the transaction should be structured to be bankruptcy remote from the originator. The preliminary outline proposes including three features in the revised Trust Law which would assist in creating bankruptcy remote structures:

- (1) Even where the sole beneficiary becomes insolvent, courts will only be able to terminate the trust in limited circumstances.
- (2) The preliminary outline proposes to clarify and elaborate the rules regarding fraudulent conveyances in connection with the creation of trusts. According to the proposal made in the preliminary outline, a trust generally will not be voided where a purchaser of the beneficial interest in the trust is not aware of the fraudulent conveyance at the time of the purchase, provided

that at such time, the beneficiary was not grossly negligent.

- (3) Waivers and transfers of the originator's statutory rights with respect to a trust will be valid at the time of the originator's sale of the beneficial interest.

According to the preliminary outline, however, the revision is likely to be silent as to how and to what extent a trust agreement will be subject to the statutory powers of the bankruptcy trustee, in bankruptcy proceedings of the originator, to terminate an executory contract to which the originator is a party. This issue will be left to the court's interpretation of the Bankruptcy Law.

The costs and risks involved and protections and returns intended in a structured finance transaction should be allocated among the parties in accordance with their agreement in a flexible manner. The preliminary outline proposes including two features in the revised Trust Law which would provide greater flexibility in structuring transactions:

- (1) Parties to a trust agreement may define the scope of a trustee's duties, including the duty of due care, the duty of loyalty, the duty not to delegate, the duty to segregate trust assets and the duty to report to beneficiaries.
- (2) Certain statutory put options may be granted to beneficiaries requiring the trustee to redeem their beneficial interests at a fair price in the event a significant amendment is made to the trust and the beneficiaries incur damages as a result.

Although the ability of the parties to determine a trustee's duties under the revised Trust Law could have a profound effect on structured finance transactions, unless the Trust Business Law is harmonized in conjunction with the Trust Law, trustees will still be bound by certain mandatory restrictions. In addition, in relation to the proposed put options, it would be preferable that they not be mandatory, or at least, be limited in scope.