The history, development and challenges of the trust laws in Japan

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1. The history of trusts

Trusts, as a subject of the modern legal system, were introduced to Japan in the latter half of the Meiji era. At that time, Japan was undergoing rapid development as an industrial nation and was importing a wide variety of systems and technologies from the United States and advanced nations in Europe. One of those systems was the trust, which was widely employed in the United States and contributed much to its industrial development. In Japan, however, trusts more often took the form of secured debenture trusts, rather than the investment trusts more commonly used in the United States. As a result, Japan enacted its Secured Debenture Trust Law in 1905, before it enacted its Trust Law.

Before the Trust Law was a part of Japan's general law, the meaning of the word 'trust' was unclear. As research conducted by the Ministry of Finance prior to the enactment of the Trust Business Law revealed, so-called 'trust businesses' performed a wide range of functions, including real estate brokering, money lending, stock trading and legal representation. The trust system and trust services, as currently defined, did not come into existence until the enactment of the Trust Law and the Trust Business Law (the two trust laws) in 1922. This point will be examined in the following pages in considerable detail.

The beginning of the Taisho era (1912 to 1926) saw a trust boom fed by strong economic growth; and the novel term 'trust', which came to Japan from Europe and the United States, appears to have been particularly attractive. All manner of businesses – including real estate brokering, money lending at usurious rates and investment services – were pursued under company names that included the word 'trust'. Indeed, in 1921, there were no fewer than 514 trust operators and 487 trust companies, many of which were apparently engaged in activities that had no relationship at all to the legal definition of 'trust', despite their use of the word in their names. Misappropriation of the trust concept was rampant.

In response to the chaotic state into which the trust industry had descended, the Ministry of Finance took steps to regulate the sector. The ministry set goals which included stopping malicious operators, clarifying the concept of trust operations and taking measures that would protect and foster the development of a sound trust industry. To achieve these goals, the ministry undertook to draft legislation that would become the Trust Business Law.

At that time, however, there was no clear legal definition of the concept of trusts that should be subject to regulation. The work of the ministry therefore had to begin with the creation of a basic law that would accomplish tasks such as establishing a clear legal definition of the trust concept in general and describing what would constitute a basic trust scheme under the law. To this end, the Ministry of Finance enlisted the assistance of the Ministry of Justice; working together, the two began the process of simultaneously creating a law addressing trusts in general, which would become the Trust Law; and industry regulations, which would take the form of the

Trust Business Law. The two ministries divided the work, with the Ministry of Justice taking charge of work on the Trust Law and the Ministry of Finance doing the same for the Trust Business Law.

The bills that emerged from the two ministries were debated in the Legislative Council in 1920 and were finally passed as the Trust Law (Law 62/1922) and the Trust Business Law (Law 65/1922). The laws took effect simultaneously in 1923. The achievements of Dr Torajiro Ikeda are particularly noteworthy as regards the creation of the Trust Law. Ikeda was born in the western Japanese prefecture of Saga in 1879. After serving in various capacities, including Civil Affairs Bureau chief at the Ministry of Justice, he was appointed as a Supreme Court justice in 1928 and then named chief justice in 1936. He died in 1939.

There are a few key points to note about the Trust Law and the Trust Business Law. The first is that they were intentionally created as an integral set of laws. The fact that both were promulgated (21 April 1922) and enacted (1 January 1923) on the same days is a clear indication of this. A second, more important point is that the Trust Business Law, which was expected to address trusts from various perspectives, was the focus of legislative attention. The process of creating the two trust laws makes this clear. The Trust Law – which, as a general law, was expected to set out basic legal points as regards trusts – was relegated to playing a complementary role to the Trust Business Law. In other words, Japan's first genuine trust laws were the result of a government body (the Ministry of Finance), under pressure to regulate the industry, finally taking the initiative to do so. Furthermore, one could say that the fundamental objective, rather than the protection of individuals needing trust services, was tight regulation of trust service providers. The conditions in Japan were thus very different from the conditions in the United Kingdom and the United States – nations which saw the spontaneous development of trusts in response to the needs of individuals. At any rate, the creation of Japan's trust laws as regulations for trust service providers would long cast a shadow over the trust.

Any consideration of the current state of Japan's trust laws, and the conditions with regard to trust administration in particular, must supplement coverage of the Trust Law and Trust Business Law with a discussion of another law that regulates the activities of trustees: the Law Regarding the Concurrent Operation of Trusts by Financial Institutions, more widely known as the Concurrent Operation Law.

This law, which was originally passed in 1943 as the Law Regarding the Simultaneous Performance of Deposit and Trust Operations by Ordinary Banks, was intended to stabilise the operations of trust companies through mergers with banks. (The law was later renamed the Law Regarding the Concurrent Operation of Trusts by Ordinary Banks in connection with the comprehensive revision of the Banking Law in 1981, and took on its current name with the 1992 financial system reform acts that created the Concurrent Operation Law.) Despite that,

however, it would gradually come to function, in essence, as the 'trust bank law'.

Behind this development was the fact that the Trust Business Law – a basic law governing business – was not functioning at all. By way of explanation, trust companies suffered tremendously from the rampant inflation that developed in the wake of World War II, and all converted to trust banks offering both banking and trust services in 1948. That left no more trust companies engaged only in trust services; and to this very day there are still no companies performing trust services with licences based on the Trust Business Law, which is essentially no longer enforced. All of Japan's present-day trust banks obtained their licences based on the Concurrent Operation Law, which is also the law under which they perform trust services. Therefore, although the Concurrent Operation Law was originally created simply as a measure for licensing the operations of banks that would also perform trust services, it is now the administrative core of trust law in Japan.

Japan's trust laws are characterised (particularly at the administrative level) by circumstances inherent to that country – namely, the Concurrent Operation Law constitutes the core of trust law administration. More specifically, trustees are trust banks offering both regular bank accounts and trust accounts; and the trust system has been, and continues to be, significantly influenced by banking. These facts should be kept in mind when considering problems in the operation and interpretation of the trust system.

2. Stages in the development of trusts in Japan

Since the passage of the two trust laws, trusts operated by non-trust banks (family trusts) have not come to be as widely used as the agency system. Trusts operated by trust banks, on the other hand, have developed to suit the investment climate in Japan, and overall trust assets totalled ¥1,202 trillion as of March 31 2019.

The legal basis for Japan's trust system is directly descended from the trust systems of the United Kingdom and United States. But were there no trust concepts or trust-like schemes in Japan prior to the development of its modern trust laws in the late 19th and early 20th centuries? To answer this question, one need only look to the example provided by Kukai's establishment of the *Shugeishuchiin* School in 828. Kukai was a Buddhist monk and *Shugeishuchiin* was a school he established using his followers' donations of land and other resources. These resources could not be donated directly to Kukai, so they were transferred instead to a third party that received them on behalf of Kukai. Another example of an early trust-like scheme is the Nobunaga Trust, set up by Oda Nobunaga (a major feudal leader in 16th century Japan). Under this scheme, fields inside and outside the ancient capital of Kyoto were assessed for a rice tax, to be entrusted to the various towns within Kyoto. The towns that received the rice would then loan it out, collect interest in the form of rice and pay the interest to the emperor.

The purpose of this system was to support the imperial household. There was also the Akita *Kannon-ko* system, established in 1829. This was a type of public welfare trust system in which merchants and others would contribute money to the Akita fiefdom, which would then purchase land, rent out the land and distribute the proceeds to those suffering from famine or other problems. There is a plethora of other pertinent examples, such as the family succession and head of household systems. It was possible, then, to establish trust-like structures in Japan even before the development of the modern trust laws. (The concepts and basic underpinnings of trust law were known in Japan prior to the development of its modern trust law.)

In other words, Japanese society had a need for trusts, so uses and schemes were created to meet that need. Looking in particular at Kukai's establishment of his *Shugeishuchiin* School in 828, an analysis of the document describing the purpose of the school reveals what some believe is, in some sense, the creation of the world's first trust.

Despite that, however, one might also say that Japan's ancient and indigenous trust concept disappeared before it could become the basis for a modern trust system. The author personally believes that the direct cause of the disappearance of indigenous trust concepts in Japan may have been the 1898 enactment of the Civil Code, which included the principle of absolute property rights. The introduction of this principle, which was found in continental law and was in fundamental contradiction to Japan's indigenous trust system, may very well have signalled the gradual decline of the latter.

The remarkable development of operating trusts in modern-day Japan can be seen to have occurred in three distinct phases.

The first phase began with the enactment of the two trust laws and lasted until about 1950. During this period, trusts mainly accepted large amounts (at least ¥500 in then-current yen) of capital from individual and institutional investors and invested, either independently or jointly, in loans and public bonds in the hope of earning returns greater than deposit interest. From an economic perspective, therefore, trusts were similar to today's large floating-rate deposits. Principal guarantees and interest supplements were permitted under the Trust Business Law and were used to promote investment in and the development of trusts.

During the second phase of trust development, which began with the 1952 enactment of the Loan Trust Law, a great democratisation of trusts took place.

The Loan Trust Law made money trusts into a regular financial product and provided a basis for developing a new customer segment. Furthermore, under Japanese tax law, trust income received the same tax treatment as deposited funds. This meant that it was tax free, which resulted in the democratisation of trusts. In fact, at one time, it was estimated that approximately 7 million households throughout the nation had invested in trusts. Funds were managed jointly, mainly by investing in long-term loans; and principal guarantees – which were not offered in

other countries – were available. Money trusts therefore perfectly suited the conditions with regard to asset forms and financing schemes in Japan, and became widely popular. Money trusts attracted more investors in Japan than in the United States, became a favourable long-term investment option and fuelled the development of the trust industry.

Of the various functions that trusts can perform, it was the financing function that flourished. Trust services blossomed as a source of long-term financing and the second phase of trust development was very fruitful in this sense.

The second phase also saw efforts to develop the asset management function of trusts; but, with individuals and corporations still working to accumulate assets, the market was extremely small and no significant results were realised. Nevertheless, company pension, charitable and other types of trusts combining financing and asset management functions were created and developed during this period.

The third phase of trust development began in the first half of the 1980s and is still in progress. Though not much time has passed since the beginning of this phase, it has been characterised by the rapid development of trust types that were previously regarded as having little chance to take hold in Japan. Because of this, Japan is said to have entered a truly golden era for trusts.

Land trusts, securities trusts and asset liquidation trusts are prime examples of trusts that have rapidly gained popularity during the third phase of development. The trust industry has wanted to employ these trust schemes since the enactment of the Trust Business Law; and the accumulation of personal and corporate assets, together with deregulation and other factors, not only made them possible, but drove their adoption. Land trusts are the leading example of business trusts; securities trusts are the leading example of managing trusts; and asset liquidation trusts are the leading example of convertible trusts. All three, together with loan and pension trusts – the traditional mainstays of trust banking operations – are expected to form the core of future trust banking operations. These types of trusts are becoming increasingly popular because factors such as an ageing population, increased nuclearisation of families and diversification of assets are driving the desire to enlist the asset management expertise of trust banks and insulate assets from the risk of bankruptcy. One could say that trusts in Japan have finally come into full bloom as a system utilised for assets and purposes of all types, just as in the United States.

Looking back on the rapid development of Japan's trust system and laws, one gets a picture of the special nature of trusts in Japan. The first decisive factor in determining this nature was the requirement that all trustees be trust banks (trust companies during the first phase of development). Next, it cannot be ignored that, rather than the asset management functions peculiar to trusts, it is the financial functions of trust banks used by group trusts (particularly

loan trusts) that have been the primary mode of implementing trust schemes. Compared to the development of trust systems and laws in the United Kingdom and the United States, and bearing in mind that trusts are asset management schemes, the development of the trust system and laws in Japan appears to have been somewhat unbalanced. The emphasis on asset management through trusts, which began to emerge at the end of the second phase of development, is the direction in which trusts should develop.

Moving forward, the issues that must be dealt with are internationalisation and the creation of new legislation.

To begin with, there is growing pressure to internationalise Japan's trust system and laws. The 15th session of the Hague Conference on Private International Law, convened in 1984, adopted the Convention on the Law Applicable to Trusts and on Their Recognition as a measure to promote international trust harmonisation. Japan will eventually have to decide whether to adopt this convention. Furthermore, in 1999 trust researchers announced the creation of the Principles of European Trust Law, which may well become the foundation for unifying trust law within the European Union. The establishment of a unified trust law in the European Union has therefore become a very real possibility. Amid various pressures and developments regarding the internationalisation of trust law, Japan must be careful to take the right course for its own trust laws.

The modernisation of Japan's trust laws, which are now about 80 years old, is also a key issue. It is very unlikely that anybody would disagree with the assertion that Japan's trust laws are in need of revision and some potential revisions are addressed at the end of this chapter. Without going into further detail here, any trust law revisions will have consequences beyond the country's borders. This is because South Korea, Taiwan and China, which passed trust legislation in April 2001, have all based their trust laws on the trust laws of Japan.

3. An outline of Japan's revised trust law

3.1 Events leading up to the enactment of the new Trust Law

For more than 80 years after its enactment in 1922, no substantial amendments were made to Japan's Trust Law. The law was somewhat regulatory in nature, reflecting the upsurge and poor management of small trust companies that was prevalent in the 1920s, and was created mainly with civil affairs such as the management of individuals' assets in mind.

However, the trust system grew to centre mainly on the commercial trust activities of trust banks, such as loan and pension trusts, particularly after the end of World War II. In recent years, demand for investment and finance schemes in the commercial trust sector has grown, while an increasingly aged society has led to the area of civil affairs experiencing a rise in

expectations about family trusts, the aims of which are asset management and inheritance transfers.

Against this background, the government started to consider the review and modernisation of the Trust Law, and in September 2004 the minister of justice consulted with the Legislative Council of the Ministry of Justice on a review of the law. The council established a sub-committee on the trust law and proceeded with its deliberations. The results of these deliberations were decided upon by the Legislative Council in the form of the Outlines on Revision of the Trust Law in February 2006 and relayed to the minister of justice. In March 2006 a draft trust law and supplementary bill based on the outlines was submitted to the 164th ordinary session of the Diet, and after continued deliberation they came into law at the 165th extraordinary Diet session in December 2006.

3.2 Main points in outline

The main changes introduced by the revised Trust law are as follows:

- rationalisation of the details of trustees' obligations under appropriate conditions:
- rationalisation of provisions concerning the duty of loyalty;
- rationalisation of provisions concerning the duty not to delegate;
- development of rules to improve the effectiveness and mobility of beneficiaries' execution of rights;
- rationalisation of methods for making decisions in trusts in which there are multiple beneficiaries;
- creation of a trust supervisor and beneficiary proxy system;
- development of rules relating to the creation and maintenance of account ledgers;
- creation of rights to file injunctions against trustees' actions;
- development of systems to respond to a variety of formats for using trusts;
- creation of a system for the merger and break-up of trusts; and
- creation of beneficiary security-issuing trusts, limited liability trusts and personal trusts.

4. Impact of the Trust Law in practice

As previously mentioned, trusts can be used to manage the assets of the elderly or disabled. It is arguably important to enable trusts to respond to varied individual needs; trusts are ordinarily individual matters and their use should centre on personal trusts. However, as of now, in Japan the focus of the trust business has been on collective trusts – a situation which makes it difficult to claim that personal trusts have developed sufficiently. Given Japan's ageing society, it is desirable that the trust business evolves to encompass personal trusts. To this end, it is necessary

not only to promote awareness of the trust banks that carry out trust business, but also to launch a debate as to the best way to regulate the supervisory authorities.

Although trusts are a system for managing assets, they are not a system for personal affairs; there is therefore a risk that that using trusts may cause the personal welfare aspect of asset management to be neglected. It is difficult in personal trusts to distinguish between asset management and personal affairs; but such a distinction is unnecessary. For example, the purpose of a special donation trust is to contribute to the stable life of the beneficiary, who is a person with special disabilities. However, this is not purely a matter of asset management; it is also a matter of personal affairs. It is unnecessary for the trustee to take direct responsibility for the care of the beneficiary; but because personal welfare matters are inevitably linked with the management of the trust assets, a forward-looking stance is essential for the future popularisation of personal trusts. At the very least, it should be entirely possible (eg, through coordination with adult guardianships under civil law) to position trusts within the support system that is provided for all aspects of the lives of the elderly people who are the beneficiaries.

Japan is one of the first nations in the world to face the challenges of a super-aging society. Senior generations in Japan are being asked to embrace new ways of living that enable them to enjoy a long, vibrant life while continuing to live in the regions they call home and stay connected with society after retirement. The role of finance to manage personal wealth is extremely important for building an economic system that supports new lifestyles. It is no exaggeration to say many feel trust banks, in particular, are a category of financial institution that most effectively performs a diverse range of functions. Sumitomo Mitsui (SuMi) Trust Group sees addressing the problems of an aging society as a source of business opportunities and is working actively to offer solutions for them. The Group has donated the Trust Chair to my university and I am the Chairholder, which is why I use here the examples of the Group.

SuMi Trust Bank has a range of wealth management services for clients with dementia and can develop solutions for individual needs. Here I would like to explain five examples.

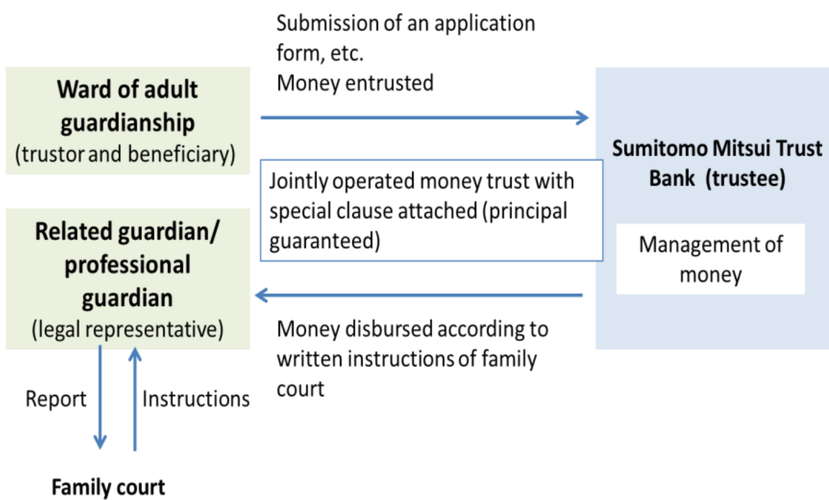
The first example: Safety Support Trust™ (Money Trust)

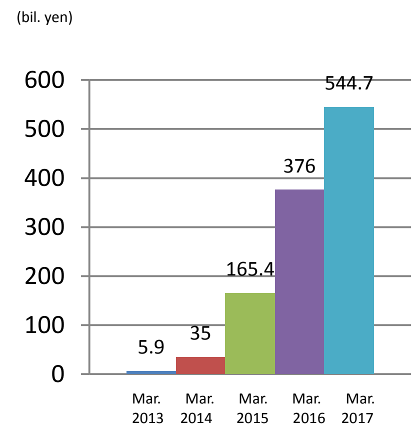
As for the money trusts, the settlor him/herself (self benefit trust) or another person (third-party benefit trust) can be named as the trust beneficiary. In this way, trust assets are disbursed according to the client's wishes, to him/herself, family members, charities, or any other bodies. For example, there are clients who have set up self-benefit trusts at SuMi Trust Bank who are planning to move into a nursing home for the elderly but have nobody they can trust to manage and conserve their wealth and are worried about what would happen if they were to develop dementia later in life. In such cases, SuMi Trust Bank is obliged to pay without fail monthly

residence fees on their behalf.

The second example: The Legal Guardianship Supporting System Trust™

The Legal Guardianship Supporting System Trust™ is a trust designed to protect the assets of the ward and contribute to the stability of his or her living into the future. The money placed in trust is paid out as a specified sum paid regularly to the ward, under a special provision established in accordance with a written instruction of the family court.

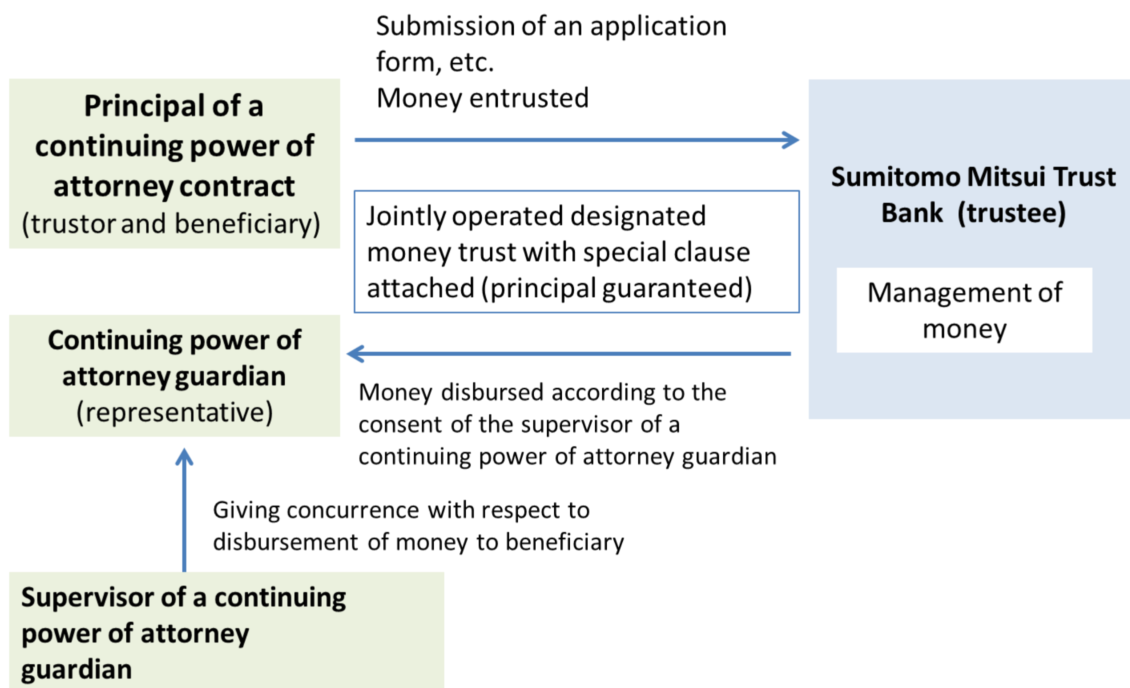




The third example: Continuing Power of Attorney-Associated Discretionary Trust™

The Continuing Power of Attorney-Associated Discretionary Trust™ is a trust which aims to back up the continuing power of attorney system from the view point of managing the principal's properties. After the continuing power of attorney contract comes into effect, the consent of the supervisor of continuing power of attorney guardian is required for payment from the deposited money trust, so we can safely and reliably protect property. Also, you can receive funds necessary for your daily life on a regular basis, so you can reduce the burden of property management carried by a continuing power of attorney guardian. This is the most recommended scheme.

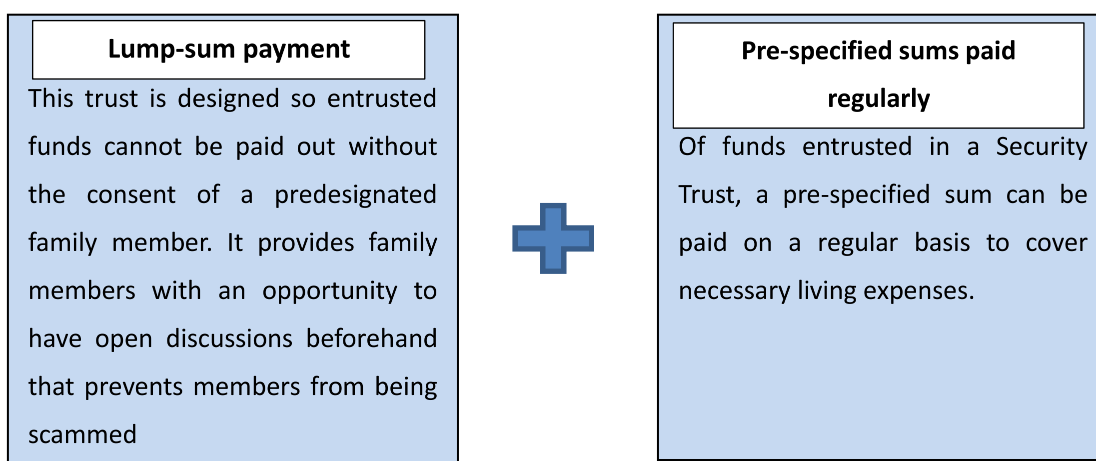
After the appointment of the supervisor of a continuing power of attorney guardian



The fourth example: Security Trust™

In view of the growth of financial crime, SuMi Trust Bank commenced offering a Security Trust™, a new product for protecting client assets, in September 2015. This product is structured so pre-designated a co-signer (a relative as far removed as the third degree of kinship, etc.) must consent to a request by the contracting party for a payment from deposited funds before the payout can be executed. For everyday living expenses, the contracting party can withdraw up to 200,000 yen per month periodically even without the consent of the co-signer.

Sufficient funds to cover daily living expenses can be paid while the client and their family members look after the client's assets



The fifth example: Qualified Educational Fund Gibing Trust™

An exemption from the gift tax has been created for lump-sum donations to cover tuition funds, allowing grandparents to make a tax-free lump-sum donation to grandchildren, etc. aged under 30, to help with tuition fees and other educational costs.

Funds deposited with SuMi Trust Bank as tuition funds for a grandchild, etc. via this product are paid out as tuition funds by SuMi Trust Bank when a request for payment is received from the grandchild, etc. If payment is made to a school or other educational institution, an exemption from gift tax will be provided, up to a maximum of 15 million yen per grandchild, etc.

These five types of trust represent a significant contribution to the development of personal trust in Japan and their future direction merits close attention.

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