A Critical Review of the Trust in the Philippines: The Past, Present, and Future

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I. INTRODUCTION

The renowned authority on trust, Harvard Law Professor Austin Wakeman Scott, perfectly captured the trust's usefulness when he exclaimed: "the purposes for which trusts can be created are as unlimited as the imagination of lawyers."[1] The trust is a venerated instrument in the legal systems where it is accepted and utilized. Behind the simplicity of its fundamental legal construction lies trillions of dollars worth of industries, deals, and capital

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1. AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS 4 (1987-1991).

movement.[2] All throughout the world, through jurisdictions with varying legal traditions, the trust enables people to fine-tune their portfolio of assets efficiently, economically, and ingenuously.

The Anglo-American trust was introduced in the Philippine legal system sometime at the start of the 20th century. To an appreciable extent, the doctrinal concept of the Anglo-American trust has been infused into Philippine law and jurisprudence such that its name has become a part of ordinary parlance. The history and recognition notwithstanding, the trust is still only vaguely understood by local lawyers and laymen alike. The full depth and richness of the concept has remained egregiously untapped. And while the domestic capital market has grown increasingly receptive to its use, thanks to the soaring popularity (and notoriety) of newly-introduced investment vehicles, one wonders why the state of things remains as it is. Thus, this article starts with a question — *why is the trust, despite its popularity, still so unknown and, even worse, so misunderstood?*

The limitations of this article are principally borne out of the dearth of academic legal literature on the subject, only reinforcing our starting question. Nevertheless, by surveying past and present Philippine trust law and noting how the trust industry has developed, it is possible to come by a holistic analysis of the trust. This work adopts a multi-disciplinary approach in its analysis. Philippine trust law will be examined and evaluated not only by its legal parameters, but also by its philosophical, policy, and commercial underpinnings. This work will tackle important issues and questions, primarily: (1) whether or not the Philippines has an adequate trust legal system; (2) what the rising challenges and opportunities for the development and deployment of trusts in the country are; and (3) how the Philippine trust can be made more real and accessible to users desiring to avail of its benefits.

II. THE PHILIPPINE LEGAL SYSTEM

The Philippines has a presidential form of government similar to that of the United States. The Philippine government is divided into three main branches: the Executive, the Legislative, and the Judiciary. Unlike the United States, however, governance in the Philippines is through a unitary government and the political subdivisions of the Philippines are not

2. Interview with Prof. Robert H. Sitkoff (Apr. 29, 2007). In the United States alone, the value of commercial trusts is already estimated to be at the level of $10 trillion. "Federally-reporting trust institutions have over $1 trillion in noncommercial trust funds" while "2/3 of mutual funds (worth $10 trillion) are trusts." Asset securitization and federally mandated pension trusts likewise add trillions to the estimate.

independent federal states but are part of the national government. In this system, laws enacted by Congress generally govern all. The courts of justice operate within a singular hierarchy, with the Supreme Court having appellate jurisdiction over the Court of Appeals and the various lower courts.

The legal system of the Philippines is a hybrid of the civil and common law systems.[3] Laws are codified or enacted through ordinary statutes. The centerpiece of private law governing the whole gamut of personal status, property, and contracts, among many, is Republic Act No. 386, or the Civil Code of the Philippines, which was preceded by the Spanish Civil Code of 1889. Both codes are unmistakably products of Roman law influence. Even so, the half-century of American supervision has led to the substantial infusion of the common law tradition into the legal system.[4] Thus, the 1950 Civil Code, while largely patterned after the Spanish Code, is interspersed with provisions copied from the American legal system. These provisions are supplemented by common law principles as developed by American courts.[5]

III. THE TRUST UNDER PHILIPPINE LAW

The American trust first found its way to the Philippines after Spain ceded the latter to the United States upon the signing of the Treaty of Paris of 1898. After the turnover, the Spanish Code continued to govern for several years until it was replaced with the 1950 Civil Code. The Spanish Code contained no provisions on the Anglo-American concept of trust whatsoever. However, the legal institution of the trust was already in existence even before the effectivity of the 1950 Civil Code.[6]

3. The Philippines was under Spain from 1521-1899 and under the United States from 1899-1946, such history imbibing vast and lasting legal influences from both countries.

4. Vicente Abad Santos, *Trusts: A Fertile Field for Philippine Jurisprudence*, 25 PHIL. L.J. 521 (1950) [hereinafter Abad Santos].

5. *Id.* The Code Commission deemed the selection of rules from the Anglo-American law as:

> proper and advisable: (a) because of the element of American culture that has been incorporated into Filipino life during the nearly half a century of democratic apprenticeship under American auspices; (b) because in the foreseeable future, the economic relations between the two countries will continue; and (c) because the American and English courts have developed certain equitable rules that are not recognized in the present Civil Code.

6. *See*; De Leon v. Molo-Peckson, 6 SCRA 978 (1962). The Spanish Civil Code of 1889, being of a non-political nature, continued to be in force until it was superseded by the Civil Code of 1950 which remains in effect until today. *See*, RUBEN F. BALANE, THE SPANISH ANTECEDENTS OF THE PHILIPPINE CIVIL CODE 43 (1979).

A. *The Pre-1950 History of the Trust*

The first provision of trust law was inserted in 1901 when the Philippine Commission[7] enacted Act No. 190, or the Code of Civil Procedure. Chapter XXVII of Act No. 190 had actually been patterned after Massachusetts law and contained procedural rules for the Courts of First Instance in the exercise of jurisdiction over trusts and trustees. Some time thereafter, the same Commission enacted Act No. 496, the Land Registration Act, which "dealt with the registration of land held under trust."[8] In 1906, the Corporation Law provided "rules concerning the organization and operation of corporate trustees." Shortly thereafter, the Insolvency Law, a virtual copy of the Insolvency Act of California of 1895 and the U.S. Bankruptcy Act of 1898, was passed. The Insolvency Law included a provision requiring that the insolvent's inventory include property held in trust.[9]

The growth of the body of trust law was relatively slower during the succeeding years until it virtually stopped in 1939 after two developments: the approval of Commonwealth Act No. 434 which vested certain supervisory functions over trusts for charitable uses in the country's treasurer and the approval of the Internal Revenue Code, sections 56 to 62 of which provided for the taxation of trust income. Thereafter, until the effectivity of the 1950 Civil Code, the body of trust law remained substantially unaltered although "several statutory relocations" were introduced by new laws.[10]

As provisions on trusts were slowly amalgamated in the statute books, the Supreme Court of the Philippines provided parallel development of the trust through case law. The first cases under the new American-supervised regime essentially shunned the trust. In *Roman Catholic Bishop of Jaro v. De la Peña*,[11] the Supreme Court, in resolving a criminal charge against a priest

7. After the advent of American occupation, the Philippine Commission, a civil authority vested with administrative functions, was established. *See generally*, Government of the Philippine Islands v. Springer, 50 Phil. 259 (1927).

8. TRUST INSTITUTE FOUNDATION OF THE PHILIPPINES, A HANDBOOK OF TRUST OPERATIONS IN THE PHILIPPINES (unpaginated) (undated) [hereinafter TIFP].

9. *Id.*

10. *Id.*

11. Ramon Catholic Bishop of Jaro v. De la Peña, 14 Phil. 775 (1909), *cited in* TIFP, *supra* note 8. However, note that as early as 1906, three years before *Roman Catholic Bishop of Jaro*, the Supreme Court had actually started resolving

who diverted funds placed in his charge for the construction of a leper hospital, evaded the application of trust law by ruling that the English and American law on trust had "no exact counterpart in the Roman law and has none under Spanish law." The Court ruled that, in the Philippines, "liability is determined by those portions of the [Spanish] Civil Code which relate to obligations." This state of things was not meant to last as an American-dominated Supreme Court slowly injected bits and pieces of trust principles into the resolution of its cases.

From 1909 to 1923, trust principles were slowly painted in by the Supreme Court as it started to redefine the legal landscape. The big shift came in 1924 with the landmark case of *Government of the Philippine Islands v. Abadilla*,[12] where the Supreme Court authoritatively held that American trust precedents were "valid sources of applicable [trust] rules" since the trust of American and English equity jurisprudence was found to have been derived from Roman law and "based entirely on Civil Law principles."[13] This signified that the institution of trust, as understood and interpreted under American common law, was already a part of Philippine law.[14]

Contrary to the common belief held by Philippine lawyers, the institution of the trust was already in existence prior to the enactment of the 1950 Civil Code. Nonetheless, the law at that time suffered from a glaring inadequacy. Nowhere to be found were the rules on the mechanics of the trust, such as provisions on the creation, administration, and termination of a

case issues by utilizing principles of trust law. *See, e.g.*, Strong, *et al.* v. Gutierrez, 6 Phil. 680 (1906) (likening the duties of directors of a corporation to trustees and the nature of a stockholder as *cestui que trust* as to the properties of the corporation).

12. Government of the Philippine Islands v. Abadilla, 46 Phil. 642 (1924). *See,* Barretto v. Tuazon, 50 Phil. 888 (1927); Miguel v. Court of Appeals, 29 SCRA 760 (1969); Sumaoang v. Judge, 215 SCRA 136 (1992).

13. *See,* TIFP, *supra* note 8; Abad Santos, *supra* note 4, at 524. "It has been said that the trust has similarities with Roman law devices of *usufructus*, *usus*, *fideicommissum* and *bonorum possession* and that it was at one time believed that the trust had its origin in Roman law." *Id.* at 522. "While this view has been generally discredited, it would be a mistake to suppose that Roman law had no influence in the development of trusts or that the Roman law had no institutions similar to it."

14. Historical records tell us that until the Commonwealth of the Philippines in 1935, the majority of members of the Supreme Court were American lawyers. The American composition of the bench no doubt facilitated the acceptance of the trust and its American precedents into Philippine law.

trust, and the rights and duties of the parties to the trust relationship.[15] To determine if the law has developed such a framework, it is necessary to survey the system of Philippine trust law.

B. The 1950 Civil Code on Trusts

The main body of Philippine trust law is found in the 1950 Civil Code, where a few select provisions form what is to be the legal regime of the trust. Unlike the treatment of other concepts in Philippine law, there is conspicuously no statute which provides for the comprehensive details of a trust arrangement. For lack of a better description, the 1950 Civil Code merely dabbles in the topic of trust and comes up with a collection of a mere 18 articles — two as general provisions, four elucidating on the nature of express trusts, and the remaining articles providing for a non-exclusive enumeration of the kinds of implied trusts.[16]

Philippine law understands the general concept of a trust in the same way it is understood under the American common law. A trust is the "legal relationship between one person having an equitable ownership in property and another owning the legal title to such property," whereby the equitable owner is entitled to the performance of certain duties and the exercise of

15. *See,* TIFP, *supra* note 8. The fundamental legal framework of the trust that exists presently would not be established until the enactment of the 1950 Civil Code. Subsequent parts of this work discuss the glaring inadequacies of the 1950 Civil Code framework.

16. Abad Santos, *supra* note 4, at 526. Note, however, the sentiments of earlier commentators, among which was Mr. Justice Vicente Abad Santos who stated:

> [t]hat the framers of the code did not attempt to incorporate more articles on trusts was a wise move. Indeed if they had placed detailed provisions on trusts in the code it would have attained unnecessary length. The Restatement of the Law of Trusts which contains the more salient principles, doctrines and rules on the subject contains four hundred and sixty sections. In evolving our own law of trusts we can rely on the Restatement which has won wide, though by no means universal, acceptance in the United States. We can also draw from the rich and almost unlimited jurisprudence of both the United States and England on the subject.
>
> The author believes that nothing should have prevented the Code Commission from including a more definite framework on trusts.

certain powers by the legal owner for his benefit.[17] The parties in a trust arrangement are the trustor, the trustee, and the beneficiary.[18]

The 1950 Civil Code's classification of trusts, terse and truncated, happens to also be quite limited. It tells us that trusts are either express[19] — created by the intention of the trustor —, or implied, or comes into being by operation of law.[20] As to the time of its effectivity, trusts are classified into testamentary trusts or trusts *inter vivos* — the latter sometimes inaccurately equated to living trusts.[21] Trusts existing under the aegis of the Civil Code, or under any Philippine law, excepting tax law, do not possess separate juridical existence.

The 1950 Civil Code spends more time providing for guidelines on the creation of express trusts. It provides that "no particular words are required for the creation of such a trust, it being sufficient that a trust is clearly intended."[22] A trustee which declines his designation as such does not prevent the trust from gaining legal efficacy, unless the contrary appears on the instrument creating the trust.[23] The law nevertheless requires acceptance by the beneficiary but also goes on to state that if the trust "imposes no onerous condition upon such beneficiary, acceptance will be presumed there being no proof to the contrary."[24] These principles clearly originate from American trust law.

17. *See,* HECTOR S. DE LEON & HECTOR M. DE LEON, JR., COMMENTS AND CASES ON PARTNERSHIPS, AGENCY AND TRUSTS 652 (5d ed. 1999) [hereinafter DE LEON].

18. Act to Ordain and Institute the Civil Code of the Philippines [CIVIL CODE], Republic Act No. 386, art. 1440 (1950); *See,* DE LEON, *supra* note 17, at 655.

19. CIVIL CODE, art. 1444 ("No particular words are required for the creation of an express trust, it being sufficient that a trust is clearly intended."); *see,* Tuason de Perez v. Caluag, 96 Phil. 981; Julio v. Dalandan, 21 SCRA 543, 546 (1967).

20. *See,* CIVIL CODE, art. 1441 (Note: The definition of resulting and constructive trusts are provided for in the body in the next page.). DE LEON, *supra* note 17, at 658-59 (citing Sumaoang v. Judge, 215 SCRA 136 (1992)).

21. DE LEON, *supra* note 17, at 658. Note, however, that the BSP has given a particular definition of "living trusts" in BSP Circular No. 521, series of 2006. Technically, a living trust is a species of a trust *inter vivos* but one which has independently identifying characteristics of its own. It is discussed in Part 4.

22. CIVIL CODE, art. 1444.

23. *Id.* art. 1445. *See,* 5 ARTURO M. TOLENTINO, CIVIL CODE OF THE PHILIPPINES 676 (1995) (citing 1 SCOTT ON TRUST 539-40).

24. CIVIL CODE, art. 1446.

The 1950 Civil Code does not define implied trusts except by providing for non-exclusive examples of such trusts. Implied trusts can either be resulting trusts or constructive trusts. Jurisprudence tells us that a resulting trust is a trust that is "raised by implication of law and presumed to have been contemplated by the parties, the intention as to which is to be found in the nature of their transaction, but not expressed in the deed or instrument of conveyance."[25] Examples of resulting trusts are found in articles 1448 to 1455 of the Civil Code.[26] A constructive trust, on the other hand, is "a trust not created by any words, either expressly or impliedly evincing a direct intension to create a trust, but by the construction of equity in order to satisfy the demands of justice. It does not arise by agreement or intention, but by operation of law."[27] Once again, these concepts are wholesale adoptions from American common law.

Perhaps the most unique and interesting item in the cluster of provisions, and the one which is most significant to our understanding of the interplay of Philippine and American trust law, is article 1440 of the 1950 Civil Code, which states that "the principles of the general law of trusts, insofar as they are not in conflict with the Code, the Code of Commerce, the Rules of Court, and special laws are adopted into Philippine law."[28] This provision was intended by the Code Commission who drafted the 1950 Civil Code as a catch-all clause to provide a default regime of rules in the wake of the interstitial silence of the 1950 Civil Code trust provisions. This default regime would, in turn, be fostered by the equity jurisdiction inherent in all Philippine courts.[29] The Code Commission made it clear that it sought to

25. Salao v. Salao, 70 SCRA 65 (1976) (citing 89 C.J.S. 725).

26. *Id. See,* Padilla v. Court of Appeals, 53 SCRA 168, 179 (1973); Martinez v. Graño, 42 Phil. 35 (1926).

27. Salao v. Salao, 70 SCRA 65 (1976) (citing 89 C.J.S. 726-727).

28. *See,* CIVIL CODE, art. 1440. Recall that first inkling for this type of statutory ordering in the law of trust in the Philippines was the 1924 case of *Government of the Philippines v. Abadilla,* where the Supreme Court held: "[a]s the law of trusts has been much more frequently applied in England and in the United States than it has in Spain, we may draw freely upon American precedents in determining the effect of the testamentary trust here under consideration."

29. A prime example of the High Court's exercise of its equity jurisdiction with respect to this particular provision was in the resolution of *Roa, Jr. v. Court of Appeals,* 123 SCRA 3 (1983), where the Second Division of the Supreme Court held:

> [t]he above principle is not in conflict with the New Civil Code, Code of Commerce, Rules of Court and special laws. And since we are a court of law and of equity, the case at bar must be resolved on the general principles

engraft the core and penumbras of American trust law into the Philippine legal system by this statutory mechanism.[30]

C. The 1997 Rules of Civil Procedure

The Rules of Court promulgated by the Supreme Court provide a more workable system for appointing and obligating trustees. The provisions of rule 98 of the Rules of Court empower certain lower courts to appoint trustees when "necessary to carry into effect the provisions of a will or a written instrument."[31] The trust estate will vest on a trustee so appointed.[32] Among the responsibilities established by the rules is the requirement that the trustee post a bond before entering his duties;[33] make and return an inventory of trust property when required by the court; discharge his trust in accordance with law, the will, trust instrument, or court order; render a yearly accounting; and settle and deliver the estate at the expiration of the trust.[34] The trustee's compensation is fixed by the court which also has the power to remove the trustee upon petition or *motu proprio*.[35] It is unclear

of law on constructive trust which basically rest on equitable considerations in order to satisfy the demands of justice, morality, conscience and fair dealing and thus protect the innocent against fraud.

30. DE LEON, *supra* note 17, at 662 (citing the REPORT OF THE CODE COMMISSION 60 and Roa, Jr. v. Court of Appeals, 123 SCRA 3 (1983)). This article is meant to incorporate a large part of the American law on trusts and thereby the Philippine legal system will be amplified and will be rendered more suited to a just and equitable solution of many questions. *See,* CIVIL CODE, art. 1432. Notably, the Code Commissioners also employed this scheme for the doctrine of estoppel, closely wording the incorporation provision after its counterpart in trust.

31. 1997 RULES OF CIVIL PROCEDURE, rule 98, § 1. Interview with Prof. Robert H. Sitkoff (Apr. 29, 2007) ("There is a rule in American trust law that a trust will not fail for want of a trustee; a court will appoint a trustee if all the other elements of trust creation are met.").

32. 1997 RULES OF CIVIL PROCEDURE, rule 98, § 2.

33. *Id.* § 5. The trustee who neglects to file such bond shall be considered to have declined or refused the trust. *Cf.* General Banking Law of 2000, § 86 (2000) [hereinafter GBL of 2000] (providing that no bond or security shall be required to ensure faithful performance of duties when appointing a trust entity, as defined in the law, as trustee). This notwithstanding, a court may require a bond as security for funds or property confided to the trust entity.

34. *See,* 1997 RULES OF CIVIL PROCEDURE, rule 98, § 6 (a)-(d).

35. *See,* 1997 RULES OF CIVIL PROCEDURE, rule 98, § 8. The petition should be by the parties beneficially interested. The court shall give due notice to the trustee

how extensively these procedures are availed of when one considers that the trust arrangements of concern will normally indicate a trustee for the purpose of executing the trust.

D. Banking and Investment Laws

The regime of business and investment trusts are governed by a subset of banking laws which are highly regulatory in character. The *Bangko Sentral ng Pilipinas* (BSP) is the central monetary authority of the country.[36] Section 4 of Republic Act No. 8791, the General Banking Law of 2000 (GBL of 2000), gives the BSP the power to supervise the operations of and regulate trust entities. To give flesh to this mandate, section 79 of the GBL of 2000 states that only "stock corporations or persons duly authorized by the Monetary Board to engage in trust business shall act as a trustee or administer any trust or hold property in trust or on deposit."[37] It concludes the provision by stating that such a "corporation" shall be known as a trust entity.[38] The ramifications of this peculiar drafting will be discussed later.

State policy views the banking industry as imbued with public interest.[39] Accordingly, the GBL of 2000 and the Manual of Regulations for Non-Bank Financial Institutions (BSP Manual), an administrative regulation having the force and effect of law, provides a variety of safety valves on the conduct of the trust business. As a basic requirement, the trust entity is

and accord a hearing. The court may, upon due notice to interested parties, remove a trustee who is insane, unsuitable, or incapable of discharging his trust.

36. *See,* New Central Bank Act, Republic Act No. 7653, § 3 (1993). The BSP was created by Republic Act No. 7653, the New Central Bank Act. This Act gave the BSP regulatory powers over the operations of finance companies and non-bank financial institutions performing quasi-banking functions and institutions performing similar functions.

37. In characteristically broad strokes, "trust business" is defined by § 4403Q of the *Bangko Sentral ng Pilipinas'* Manual of Regulations for Non-Bank Financial Institutions [hereinafter BSP Manual] as referring to "any activity resulting from a trustor-trustee relationship involving the appointment of a trustee by a trustor for the holding, administration, and management of funds and/or properties of the trustor for the use, benefit or advantage of the trustor or others called beneficiaries."

38. Note too, that Presidential Decree No. 291, as amended, otherwise known as the Investment House Act, and Republic Act No. 5980, as amended, the Financing Company Act, authorize investment houses and financing companies, respectively, to act as trust entities subject to BSP regulation.

39. Development Bank of the Philippines v. Court of Appeals, 331 SCRA 267 (2000).

obliged to keep the trust business and all funds and properties received in such capacity separate and distinct from the general business or all other funds, properties, and assets.[40]

The trustee entity's principal aims are as follows: (a) preservation of the fund's purchasing power; (b) ensuring safety of principal; (c) promoting growth and stability; and (d) maintaining a certain level of liquidity for unforeseen continuing withdrawals.[41] A trust entity must therefore, in the pursuit of these objectives: (a) observe the standard of diligence that a prudent man would exercise in the conduct of an enterprise of a like character and with similar aims;[42] (b) comply with minimum paid-in capital requirements[43] as determined by the Monetary Board of the BSP which, when added to the surplus, must always be equivalent to the current level of the deposit requirement imposed;[44] (c) comply with a deposit requirement currently fixed at PhP500,000.00 in cash or approved securities;[45] and (d) comply with the reserve requirements for Peso-denominated managed funds and Trust and Other Fiduciary Accounts (TOFA).[46] Both sections 4404Q.1 and 4404Q.2 of the BSP Manual, aside from providing details of these requirements, impose other financial criteria for a trust entity, such as

40. GBL of 2000, § 87.

41. Jose K. Manguiat, Jr., *Trust Business in the Philippines: An Overview and the Pertinent Laws and Regulations Affecting the Same* 76-77, 28 ATENEO L.J. 68 (1983) [hereinafter Manguiat].

42. GBL of 2000, § 80.

43. § 4404Q.1 of the BSP Manual requires combined capital accounts of the trust entity to be not less than PhP250,000,000.00 or such amount as may be required by the Monetary Board or other regulatory agency.

44. *See,* GBL of 2000, §§ 81 & 84.

45. *See,* GBL of 2000, § 84 (requiring the maintenance of such minimum amounts). Meanwhile, § 4405Q.1 explains that the PhP500,000.00 is only the threshold minimum amount as such deposit must at least be equivalent to one percent of the book value of the total volume of trust, other fiduciary and investment management assets. § 34 of the GBL of 2000 also states that if the capital and surplus fall below said amount, the Monetary Board may limit or prohibit the distribution of net profits and may require that part or all of the net profits be used to increase the capital. The Monetary Board may also restrict or prohibit the acquisition of major assets and the making of new investments by the bank until the minimum required capital ratio has been restored.

46. BSP Manual, § 4405Q.5. Regular and liquidity reserves of 10% and 11%, respectively, of the fund are required. BSP Circular No. 491, series of 2005. § 4405Q.6 requires up to 40% of the reserve requirement to be deposited in the special deposit account of the BSP.

required rates for return on equity and net worth-to-risk assets ratio, liquidity floors, and ceilings on Directors, Officers, Shareholders, and Related Interest (DOSRI) loans. Also a measure of substantive protection is the exemption-from-claims feature found in the GBL of 2000. Philippine law exempts trust assets from claims other than those of the parties interested in the specific trusts.[47]

The law also dictates how trust operations are organized. BSP regulations require that trust and other fiduciary businesses of an institution be carried out through a trust department "organizationally, operationally, administratively, and functionally separate and distinct from the other departments and/or businesses of the institution."[48] As part of its manifold duties, a by-law created trust committee under oversight of the Board of Directors must be put in-charge of the trust department and must have power over the "acceptance and closing of trust and other fiduciary accounts and the investment, reinvestment, and disposition of trust funds or property."[49]

Aside from determining *who* may engage in the trust business, the BSP Manual also tells us *how* the trust business should be carried out. The BSP refines the definition of a trust relationship by enumerating specific arrangements that do not functionally give rise to a trust. Those beyond the ambit of a trust relationship include arrangements involving a "fixed rate or guaranty of interest, income, or return" in favor of the client or beneficiary;[50] and arrangements where risk or responsibility for losses is exclusively with the trustee even when such losses were not due to his failure to "exercise the skill, care, prudence, and diligence required by law."[51]

The GBL of 2000 provides that, "unless otherwise directed by the instrument creating the trust, the lending and investment of the funds or

47. GBL of 2000, § 92 ("Exemption of Trust Assets from Claims. No assets held by a trust entity in its capacity as trustee shall be subject to any claims other than those of the parties interested in the specific trusts.").

48. BSP Manual, § 4406Q.1 (a).

49. *Id.* § 4406Q.4 (b).

50. BSP Manual, § 4407Q (d). Essentially, the regulations provide that the nature of the trust is the absolute non-existence of a debtor-creditor relationship. *See,* BSP Manual, § 4407Q. Curiously, however, the same section states that for a trust to exist, the trustor (rather than a beneficiary) should be entitled to all the funds or properties and earnings less fees/commissions, losses and other charges. Whether or not this wording is a result of a misdraft is unknown.

51. BSP Manual, § 4407Q (e).

assets" shall be limited to those prescribed under law or regulation.[52] Regulations provide that, as a default, investments should be in evidence of indebtedness of the Philippines or of the BSP, indebtedness or obligations fully guaranteed by the government, or loans fully secured by deposits or deposit substitutes or specified security.[53] Conflict of interest rules provide that no trust entity shall "purchase or acquire property from, sell ... lend money or property to, or purchase debt instruments of, any of the departments, directors, officers, stockholders, or employees of the trust entity or ... related interests," unless specifically authorized by the trustor.[54] Failure to comply with these regulatory obligations lead the BSP to classify the trust entity as doing business in an "unsafe or unsound" manner and may result in administrative sanctions for the entity and/or its directors and officers, not precluding criminal sanctions for culpable individuals.[55]

These regulatory strictures for banks and trust entities seem to have been patterned after certain aspects of American state legislation. While regulation in a state like Delaware, for instance, is not as intrusive as the prevailing regime created by the BSP through its extensive rule-making powers, there are still comparable requirements for state trust entities — such as that state banks and trust companies register with the bank commissioner, that they submit quarterly reports, observe and maintain reserve requirements, and keep within the prescribed investment and loan limitations.[56] General regulation seems to be the trend in monitoring and supervising entities conducting the trust business.

52. GBL of 2000, § 88.

53. BSP Manual, § 4409Q.2.

54. *See,* GBL of 2000, § 80. For more detailed conflict rules, *see,* BSP Manual, § 4409Q.3.

55. *See,* BSP Manual, § 4408Q (in relation to Appendix Q-24). Appendix Q-24 provides a non-exclusive list of activities deemed unsafe or unsound, the breadth of which could certainly cover failure to cover the regulatory requirements. *See also,* BSP Manual, § 4408Q.9. Possible administrative sanctions to be imposed by the Monetary Board could include cease and desist orders, fines not to exceed PhP30,000 a day on a per transaction basis, suspension of lending or foreign exchange operations or ability to accept new deposit substitutes and/or trust accounts, suspension of responsible directors and officers, revocation of licenses, receivership and liquidation.

56. *See,* DEL. CODE, tit. 5, ch. 9, subch. 1 (on regulations governing the business of state banks and trust companies).

E. The National Internal Revenue Code

It should not come as a surprise that the taxation of trusts under Philippine law is also closely patterned after the American system, although on a more limited scale. Under Republic Act No. 8424, the National Internal Revenue Code of 1997 (NIRC), a tax is imposed on any kind of property held in trust.[57] Section 22 (A) of the NIRC defines a taxable person as an "individual, *trust,* estate, or corporation."[58] Trusts are considered by tax rules as separate taxpayers from the parties to the trust.[59]

The NIRC accords trusts as qualified pass-through taxation insofar as the trust entity itself is not taxed and it distributes its income to the beneficiaries. Since trusts are taxed as individuals, the undistributed trust income is taxed on the basis of a graduation of the tax base and in accordance with the schedule under section 24 (A) (1) (c) and not under section 27 (A) on taxes for corporations.[60]

The tax rules likewise tell us when a trust is to be ignored for tax purposes and its income considered as that of the settlor-grantor, as in the case of a revocable trust[61] and the income of the trust for the benefit of the

57. Completely identical to § 641 of the Internal Revenue Code of the United States, section 60 of the NIRC provides that such property in trust includes:

> (a) income accumulated in trust for the benefit of unborn or unascertained person or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust; (2) income which is to be distributed currently by the fiduciaries to the beneficiaries ... (4) income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

58. Act Amending the National Internal Revenue Code, as Amended, and for Other Purposes [NIRC], Republic Act No. 8424, § 22 (A) (1997) (emphasis supplied).

59. HECTOR S. DE LEON, THE NATIONAL INTERNAL REVENUE CODE ANNOTATED 406 (7d ed. 2000). *See also,* Commissioner of Internal Revenue v. Visayan Electric Company, 132 Phil. 203 (1968); Bureau of Internal Revenue Ruling No. 003-05, July 22, 2005.

60. For corporate tax rates, *see,* An Act Amending Sections 27, 28, 34, 106, 107, 108, 109, 110, 111, 112, 113, 114, 116, 117, 119, 121, 148, 151, 236, 237 and 288 of the National Internal Revenue Code of 1997, as Amended, and for Other Purposes [E-VAT LAW], Republic Act No. 9337 (2005). The law states that corporate income tax rate is increased from 32% to 35% of taxable corporate income starting November 2005. It is due to decrease to 30% of taxable corporate income after December 31, 2008. *See also,* BIR Revenue Regulation 14-2005, June 28, 2005 (for other changes).

61. NIRC, § 63 (1997).

grantor.[62] On the contrary, an irrevocable trust is generally considered as a separate taxpayer from the settlor-grantor.[63]

Taxed as an individual, the active and passive income of a trust is subjected to a variety of taxes including income tax levied on active income, capital gains tax for capital assets dispositions,[64] and percentage taxes.[65] Tax exemptions, based on the nature of the trust or the character of income, are also provided for. The income of an employee's trusts which forms part of a pension, stock bonus, or profit-sharing plan of an employer for the benefit of employees is exempted from taxation.[66] An exemption is also provided for the interest income of an irrevocable trust provided that such arises from long-term investments in common-trust funds, known also as CTFs, and

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested (1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or (2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income.

62. *Id.* § 64 provides that the following parts of the trust income shall form part of the taxable income of the grantor, *viz.*:

(A) [w]here any part of the income of a trust (1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be held or accumulated for future distribution to the grantor, or (2) may, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor, or (3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be applied to the payment of premiums upon policies of insurance on the life of the grantor.

63. Karen Boxx, *Gray's Ghost – A Conversation About the Onshore Trust*, 85 IOWA L. REV. 1200 (2000) [hereinafter Boxx].

If the grantor of a trust has relinquished sufficient control over the trust assets, then, under federal estate and gift tax principles, the transfer is a completed gift, subject to gift taxes, and the trust assets will not be included in the grantor's estate for estate tax purposes when the grantor dies. (The rule is similar to that of the United States.).

64. *See,* NIRC, § 27 (C) & (D).

65. *See,* NIRC, §§ 27 (B) & 127 (A).

66. *See,* NIRC, § 60 (B).

other investments evidenced by certificates approved by the BSP.[67] Long term investments are defined as those not less than five years.

Before closing this section, a cautionary note seems to be in order. That a substantial amount of the Philippine laws on trusts are patterned closely after American trust rules does not necessarily lead to the conclusion that the solutions found in the American legal system are readily drawn up as solutions to trust issues in the Philippines. Thus, the idiosyncratic set-up of Philippine trust law requires a unique approach.

IV. TRUST USAGE IN THE PHILIPPINES

Despite the lingering misimpression on the scarce use and negligibility of the trust in the Philippines, a dizzying variety of trust products are offered by all major Philippine banks. Newspapers and magazines are replete with articles of and advertisements offering new investment trust products. From the dawn of this decade, the Philippine trust industry has progressively and aggressively moved forward.

This comes as no surprise. The trust has been described as the "most versatile device known in law for dealing with property"[68] and it has been commented that "the purposes for which a trust can be created cannot be fully enumerated because the purposes are limited only by the imagination of lawyers and men of business."[69] It has also been said that in the realm of law and business, the trust device is used where "the relations to be established are too delicate or too novel for the devices of contract or incorporation."[70] Its governing rules are flexible, refreshingly pliant to varying needs and objectives. Hence, it is a distinct curiosity why the ubiquitous existence of

67. *See,* NIRC, §§ 24 (B) (1) & 25 (A) (2). Should the holder of the certificate pre-terminate the investment before the fifth year, a final tax shall be imposed on the entire income to the tenor of the following rates: four years to less than five years - 5%; three years to less than four years - 12%; and less than three years - 20%. NIRC, § 24 (B) (1). This exemption is not to be considered as attached to the trust itself, but rather applies to the income derived from the investment in such trust distributed to him. *See,* BIR Ruling No. 003-05, Feb. 16, 2005; BIR Ruling No. 030-2001, July 24, 2001.

68. Abad Santos, *supra* note 4, at 525.

69. *Id.* at 525 (citing 1 SCOTT ON TRUSTS 370-71). These conclusions will be fully fleshed out in the later discussions of this work through the discussion of the trust's features, flexibility, and adaptability in personal asset management and commercial concerns.

70. Abad Santos, *supra* note 4, at 526 (citing Nathan Isaacs, *Trusteeships in Modern Business*, 42 HARV. L. REV. 1048 (1929)).

the trust in the Philippines is overshadowed only by the lack of understanding of its nature.

A. The Nuts and Bolts

One inquiring into the realm of trusts should first know that trust legal rules are principally default rules. This signifies that, unless there is an explicit restriction, whether in the policy of the common law or in a specialized statute, the parties are free to structure their trust relationship according to the specificities of their objectives and intent.

Beyond the operation of the laws discussed in Part 3, a trust constituted in the Philippines will generally[71] be governed by American common law trust rules.[72] These rules are drawn from the American Law Institute's Second and Third Restatement of the Law of Trust and the Uniform Trust Code (UTC), all of which are notable attempts at codifying the common law on trust.[73] Nevertheless, it would be at the risk of oversimplification to say that modern American trust law is confined to what the common law rules tell us. In recent years, the law on statutory business trusts has experienced unprecedented growth. There may well be a growing dichotomy between the default rules applicable to donative private trusts and business trusts in general.[74] In recognition of this trend, allusion will

71. "Generally," since there may be other particularized provisions in Philippine law which may address, govern, or have a direct or indirect effect on trusts in a manner contrary to common law rules. In case of conflict, Philippine law will certainly govern.

72. *See,* CIVIL CODE, art. 1440. Nevertheless, the reference to the Restatements and the Uniform Trust Code as the "general law on trust" does not change the author's position that the category of "general law on trust," especially as it pertains to American trust law, is non-existent.

73. As last revised in 2005. The United States' Uniform Trust Code (2000) (UTC) was drafted by the National Commissioners on Uniform State Laws. Uniform Trust Code, Prefatory Note. "It is the first national codification of the law of trusts intended to provide the States with precise, comprehensive, and easily accessible guidance on trust law questions and to supply uniform rules for issues on which States diverge or on which the law is unclear or unknown." The Code incorporates or otherwise supersedes the Uniform Probate Code, article VII, the Uniform Prudent Investor Act (1994), the Uniform Trustee Powers Act (1964), and Uniform Trusts Act (1937).

74. Third Restatement specifically excludes from its coverage trusts as devices for conducting business and investment activities outside the express private- and charitable-trust context. Third Restatement, § 1 Comment (b). "The business trust is a business arrangement that is best dealt with in connection with business

sometimes be made to the latest draft of the uncompleted Uniform Statutory Trust Entity Act (USTEA)[75] when it is felt that this will enrich the discussion.[76] Nonetheless, the USTEA's inclusion is but to provide a theoretical counterpoint inasmuch as Philippine law has no analogous legislation providing for this subject matter.[77] When applicable, Philippine laws and jurisprudence relevant to the subject matter serve as appropriate reference points.

1. Creation of a Trust

A trust may be created in several ways. It may be created through: (a) a transfer of property by the trustor by will; (b) a transfer of property by the trustor *inter vivos*; (c) a declaration by the property owner that he holds such property as trustee; or (d) an exercise of a power of appointment to a person as trustee, in all of these instances for the benefit of one or more

associations; and most pooled investment vehicles are properly governed by laws applicable to investment companies and to the issuance and sale of securities."

75. Interview with Prof. Robert H. Sitkoff (Apr. 29, 2007). The Uniform Statutory Trust Entity Act (USTEA) is an unincorporated entity statute. The substantive provisions of the USTEA are taken from the Delaware Statutory Trust Act which is the dominant state business trust statute in the United States. USTEA, Prefatory Note. Over the years, comprehensive statutory trust regimes have been put into place in several states, notably Connecticut, Delaware, Maryland, New Hampshire, Nevada, South Dakota, Wyoming and Virginia. A statutory trust differs from a common law trust in several respects: a common law trust arises from private action without the involvement of a public official while a statutory trust normally requires filing with a governmental agency; the common law trust is not a juridical entity while the statutory trust is and may thus sue, be sued and transact over property in its name, among others. Interview with Prof. Robert H. Sitkoff (Apr. 29, 2007). The USTEA is expected to be finalized and promulgated to the states in 2008.

76. It should be emphasized that the USTEA does not reject the applicability of common law trust rules. § 105 of the USTEA provides that state trust laws are intended to fill in the gaps. To this extent, the Second and Third Restatements and the UTC will still find suppletory applicability. *See also,* USTEA, Prefatory Note ("most existing state business trust statutes do not prohibit use of the common law trust for a commercial purpose. Common law trusts, whether donative or commercial, remain subject to the principles of law and equity applicable to private and charitable trusts.").

77. The author believes that a very limited application for the purpose of this work's subpart is required given that Philippine law adopts the general law on trusts which — as will be threshed out in Part 5 — only alludes to the general body of common law and not specific and individually enacted state trust law.

beneficiaries.[78] Creation may also be through a promise or a "beneficiary designation that creates enforceable rights in a person who immediately or later holds those rights as trustee, or who pursuant to those rights later receives property as trustee, for one or more persons."[79] Trusts are also sometimes created by statute or, in some cases, by court decree.[80] The Third Restatement also goes to the extent of providing a list of what a trust is not.[81]

Under common law, a trust is not created as a separate and independent juridical entity — it has no personality of its own and must operate through the trustee through which the trust conducts its purposes and business and holds its properties. Statutory business trusts are created differently.[82]

78. *See,* Third Restatement, § 10; *see also,* UTC, § 401 (specifying virtually identical modes of trust creation). Under the methods specified for creating a trust in the section, "a trust is not created until it receives property." "The property interest necessary to fund and create a trust need not be substantial ... the property interest need not be transferred contemporaneously with the signing of the trust instrument." UTC, § 401 Comment. These rules are supported by Philippine jurisprudence. Thus, a trust is present where "the owner of the property declares that he holds it as trustee for others, even though he does not have possession of the trust property or the instrument creating the trust, provided another person exists as the beneficiary." Commissioner of Internal Revenue v. Visayan Electric Company, 132 Phil. 203 (1968) (citing Morsman v. Comm. of Internal Revenue, 90 F. 2d 18 (1937)).

79. Third Restatement, § 10.

80. *See generally,* 1997 Rules of Civil Procedure, rule 98. Upon strict analysis, the court does not create the trust arrangement but merely appoints a trustee to implement the trust intended explicitly or implicitly by the will or the written instrument.

81. Third Restatement, § 5.

The following are not trusts: (a) successive legal estates; (b) decedents' estates; (c) guardianships and conservatorships; (d) receiverships and bankruptcy trusteeships; (e) durable powers of attorney and other agencies; (f) bailments and leases; (g) corporations, partnerships, and other business associations; (h) conditions and equitable charges; (i) contracts to convey or certain contracts for the benefit of third parties; (j) assignments or partial assignments of choses in action; (k) relationships of debtors to creditors; (*l*) mortgages, deeds of trust, pledges, liens, and other security arrangements.

82. *See,* USTEA, § 201. On the contrary, statutory business trusts thus constituted are juridical entities and are created by the filing of a governing instrument filed with a designated government authority, owing their creation to an enabling statute.

The Third Restatement provides that a written document is not necessary to create an "enforceable *inter vivos* trust, whether by declaration, by transfer to another as trustee, or by contract."[83] Thus, an *inter vivos* trust may be created in writing or orally[84] — with the caveat that one should undertake the formalities in the creation of a trust with a mind to other statutes which may impose stricter rules, for instance, the Statute of Frauds.[85] A testamentary trust which is created through a valid will is required to be in writing to comport with the required formal solemnities.

There is no need for "notice to or acceptance by" any beneficiary or trustee for the creation of a trust.[86] The Third Restatement also tells us that a trust does not fail just because "no trustee is designated or because the designated trustee declines, is unable, or ceases to act, unless the trust's creation or continuation depends on a specific person serving as trustee."[87] Furthermore, no consideration is required for the creation of a trust[88] and subject to the general rule against illegality, the trust property, known as the trust *res,* may be in any type of property.[89]

As to its purpose, a trust may either be private or charitable, giving a settlor wide discretion. Nevertheless, a trust and its terms must always be for the benefit of its beneficiaries.[90] A trust is founded on equity and the trust's

83. Third Restatement, § 20.

84. UTC, § 407 likewise allows the creation of an oral trust but states that its terms may be established only by clear and convincing evidence.

85. Interview with Prof. Robert H. Sitkoff (Apr. 29, 2007).

86. Third Restatement, § 14. Article 1446 of the Civil Code which requires the acceptance of a beneficiary is not contrary to the Restatements as the lack of a prior acceptance does not prevent the trust from coming into existence. But a disclaimer of the beneficiary of her designation as such works to eliminate the interest retroactively. *See,* Third Restatement, § 14 Comment C (1). In fact it has been held that in a voluntary trust the assent of the beneficiary is not necessary to render it valid because as a general rule acceptance by the beneficiary is presumed. CIVIL CODE, art. 1446; Cristobal v. Gomez, 50 Phil. 810 (1927).

87. Third Restatement, § 31.

88. *Id.* § 15. Third Restatement, § 15 Comment (a) states that "the owner of property can create a trust of the property by will or by declaration or transfer *inter vivos*, whether or not consideration is received for doing so."

89. Third Restatement, § 40; *id.* § 41. However, "an expectation or hope of receiving property in the future, or an interest that has not come into existence or has ceased to exist, cannot be held in trust."

90. UTC, § 404.

purposes and provisions cannot be contrary to law or public policy.[91] Under Philippine law, they likewise cannot be contrary to morals, good customs, or public order.[92] Laws on fraudulent transfers or preferences will also apply to protect creditors from transfers which are intended to defraud them.[93] Transfers to a trust are limited further by the 1950 Civil Code rules on compulsory or forced heirs and the requirement for the delivery of their legitimes.[94] A private trust or a provision therein, may also be or become unenforceable because of impossibility or indefiniteness.[95]

Another thing to be remembered on the creation of certain trusts is the observance of applicable statutory requirements. For instance, business or commercial trusts which are under the ambit of the GBL of 2000, or

91. *See,* Third Restatement, § 29. *See generally,* Deluao v. Casteel, 26 SCRA 415 (1968).

92. CIVIL CODE, art. 1306.

93. *See, e.g.*, § 70 of the Act No. 1956, as amended, the Insolvency Law:

> If any debtor, being insolvent, or in contemplation of insolvency, within thirty days before the filling of a petition by or against him, with a view to giving a preference to any creditor or person having claim against him or whom is under any liability for him ... *makes any payment, pledge, mortgage, assignment, transfer, sale, or conveyance of any part of his property ... and that such attachment, sequestration, seizure, payment, pledge, mortgage, conveyance, transfer, sale or assignment is made with a view to prevent his property from coming to his assignee in insolvency, or to prevent the same from being distributed ratably among his creditors, or defeat the object of, or in any way hinder, impede or delay the operation of or to evade any of the provisions of this Act, such attachment, sequestration, seizure, payment, pledge, mortgage, transfer, sale, assignment or conveyance is void* ... (emphasis supplied).

Khe Hong Cheng v. Court of Appeals, 355 SCRA 701 (2001). The rescissory action of *accion pauliana* can also be brought for transfer in fraud of creditors. The requisites for the action are:

> 1) That the plaintiff asking for rescission has a credit prior to, the alienation, although demandable later; 2) That the debtor has made a subsequent contract conveying a patrimonial benefit to a third person; 3) That the creditor has no other legal remedy to satisfy his claim, but would benefit by rescission of the conveyance to the third person; 4) That the act being impugned is fraudulent; 5) That the third person who received the property conveyed, if by onerous title, has been an accomplice in the fraud.

94. *See,* CIVIL CODE, art. 842 ("One who has compulsory heirs may dispose of his estate provided he does not contravene the provisions of this Code with regard to the legitime of said heirs.").

95. Third Restatement, § 30; *Id.* §§ 28, Comment (a) & 67 (*cy pres*) (for charitable trusts).

specifically prescribed for in the BSP Manual, are laden with specific regulatory requirements. Trusts for charitable purposes require registration with the Insurance Commissioner while trusts of pre-need companies require registration with the Securities and Exchange Commission (SEC). This notwithstanding, most other trusts have no regulator and parties are free to establish the trust within the privity of their relationship and in accord with their intentions.

2. Parties to a Trust

As already mentioned earlier, the basic parties to the trust are the trustor (the settlor), the trustee (the fiduciary), and the beneficiaries.[96] A trust may have more than one trustee, such as where there are co-trustees, and multiple beneficiaries. Nothing prohibits the trustor from being a trustee or a beneficiary. The trustee may also be a beneficiary but if the "entire beneficial interest in trust property passes to the trustee, the trust terminates and the trustee holds the property free of trust."[97] By implication, if the same person plays all three roles alone, no trust is created.[98]

A trustee may be an individual or a corporation. A partnership, unincorporated association, or other entity may also be a trustee if it has "capacity to take and hold property for its own purposes."[99] A trust will be created only if the trustee has duties to perform.[100]

96. Third Restatement, § 64, Reporter's Notes. In some cases, one might also have a trust protector. The protector may be one of the beneficiaries or one of several trustees, but often is neither but rather a trusted advisor or friend of the settlor, or a series of such third parties. Protectors are granted authority ranging from extensive power to a narrowly defined power to change trustees or the situs of administration. Protectors with broader authority are likely to be granted powers to terminate trusts and to clarify or modify trust terms for such purposes as qualifying for or accomplishing specific tax or non-tax objectives, improving administration or otherwise promoting the settlor's general purposes or the beneficiaries' best interests, or adding or eliminating beneficiaries or rearranging their rights.

97. Third Restatement, § 69 Comment (a); *id.* Comment (c). "A trust does not terminate merely because one of several beneficiaries becomes one of several trustees or the sole trustee, or because the sole beneficiary becomes one of several trustees, or because the several beneficiaries become the co-trustees."

98. Boxx, *supra* note 63, at 1198. The exception would be if such a trust were created in a jurisdiction with a statute authorizing self-settled trusts.

99. Third Restatement, § 33.

100. *See,* UTC, § 402 Comment. Trustee duties are usually active, but a validating duty may also be passive, implying only that the trustee has an obligation not to

As a general rule, capacity to take and hold legal title to the intended trust property is required in order for one to qualify as a beneficiary.[101] The beneficiary must also be "ascertainable or become ascertainable" within the period and terms of the rule against perpetuities.[102] The Third Restatement also provides that, except when there is a valid restriction on transfer, a beneficiary of a trust can "transfer his or her beneficial interest during life to the same extent as a similar legal interest"[103] and that such transfer may be to "another beneficiary, to the trustee, or to a third person to the extent that person has capacity to be a trust beneficiary."[104]

3. Powers and Duties of the Trustee

The trustee, being the fiduciary in the trust relation, has manifold responsibilities. The trustee has the duty of loyalty — he must administer the

interfere with the beneficiary's enjoyment of the trust property. Such passive trusts are valid under the UTC.

101. Third Restatement, § 43.

102. *Id.* § 44. *See also,* UTC, § 401.

The Rule against Perpetuities is a restriction on the remote vesting of interests, in trust or otherwise ... the fundamental policy assumption of the Rule is that vested interests are not objectionable, but contingent interests are .... A remainder is vested if (1) it is given to a presently ascertained person and (2) it is not subject to a condition precedent (other than the termination of the preceding estates). A remainder is contingent if (1) it is not given to a presently ascertained person or (2) it is subject to a condition precedent.

JESSE DUKEMINIER, STANLEY M. JOHANSON, JAMES LINDGREN & ROBERT H. SITKOFF, WILLS, TRUSTS, AND ESTATES 674-675 (7d ed. 2005) [hereinafter DUKEMINIER].

The Rule against Perpetuities limits the time during which property can be made subject to contingent interests to "lives in being plus 21 years .... The Rule is said to have two basic purposes: (1) to keep property marketable and available for productive development in accordance with market demands; and (2) to limit 'dead hand' control over the property which prevents the current owners from using the property to respond to present needs."

Id. But see, Jesse Dukeminier & James E. Krier, *The Rise of the Perpetual Trust,* 50 UCLA L. REV. 1303 (2003) ("At least seventeen jurisdictions in the United States have enacted statutes abolishing the Rule in the case of perpetual (or near-perpetual) trusts.").

103. Third Restatement, § 51.

104. *Id.* § 51 Comment (b).

trust "solely in the interest of the beneficiaries."[105] There is also a duty of fairness on the part of the trustee and it is incumbent upon him to communicate to the beneficiary "all material facts the trustee knows or should know as to the transaction involved."[106] The trustee also has the duty of impartiality that requires him to deal with all beneficiaries of his trust according to that standard.[107] This rule applies whether the interests of the beneficiaries are concurrent or successive.[108]

The trustee shall exercise a discretionary power given to him by the instrument creating the trust in "good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries."[109] He is under a duty to administer the trust with the "care and skill that a man of ordinary prudence would exercise in dealing with his own property."[110] Nevertheless, this duty of ordinary prudence is modified when it comes to the trustee's investment discretion. One of the most articulated duties of the trustee is that of "prudent investment."[111] The Third Restatement informs

105. Second Restatement, § 170 (1); *id.* Comment (a).

A trustee is in a fiduciary relation to the beneficiary and as to matters within the scope of the relation he is under a duty not to profit at the expense of the beneficiary and not to enter into competition with him without his consent, unless authorized to do so by the terms of the trust or by a proper court.

106. *Id.* § 170 (2).

107. *Id.* § 183; UTC, § 803 Comment.

The differing beneficial interests for which the trustee must act impartially include those of the current beneficiaries versus those of beneficiaries holding interests in the remainder and among those currently eligible to receive distributions. In fulfilling the duty to act impartially, the trustee should be particularly sensitive to allocation of receipts and disbursements between income and principal and should consider, in an appropriate case, a reallocation of income to the principal account and vice versa, if allowable under local law.

108. Second Restatement, § 183 Comment (a). However, this may be modified by a trust instrument which allows it. The court will make sure that the power is not abused.

109. UTC, § 814.

110. Second Restatement, § 174. If the trustee procured his appointment by "representing that he has greater skill than that of a man of ordinary prudence, he is under a duty to exercise such skill."

111. Third Restatement, § 227 (a), Comment (a). The prudent investor rule stated in this section is "an extension and clarification of the traditional, so-called

us that the standard requires the "exercise of reasonable care, skill, and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as a part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust."[112] A duty to diversify the investments of the trust, unless such is imprudent, is also imposed on the trustee.[113] The main precept is that trustees should "craft a diversified portfolio in light of its balance of overall (rather than investment-specific) risk and potential return."[114]

Generally speaking, the trustee must personally perform the responsibilities of his trusteeship. He may, however, delegate it to others if a prudent person would likewise do so. This duty of prudence applies to the selection of the agent, establishing the scope and terms of delegation, and ensuring the supervision thereof.[115]

For his administrative duties, the trustee must (1) keep and render accounts;[116] (2) furnish the beneficiary complete and accurate information on the nature and amount of the trust property upon request;[117] (3) use reasonable care and skill to preserve the property;[118] (4) keep the trust

"prudent man rule" originally articulated by the Massachusetts Supreme Judicial Court and now followed by most states."

112. *Id.* § 227 (a).

113. *Id.* § 227 (b). However, "the prudent investor rule is profoundly protective of trustees who have followed common investment-industry standards."

114. Robert Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 653 (2003-2004) [hereinafter Sitkoff, *Agency Costs*]; *see also*, John H. Langbein, *The Uniform Prudent Investor Act and the Future of Trust Investment Law*, 81 IOWA L. REV. 641 (1996); Max Schazenbach & Robert Sitkoff, *Did Reform of Prudent Trust Investment Law Change Trust Portfolio Allocation?*, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=868761 (last accessed July 15, 2007). The trend is toward increasing liberality in the grant of power to a trustee. "Traditional questions about whether a trustee possesses particular powers will be replaced by recognition that, absent contrary trust provision or statute, a trustee has all the powers of other property owners, but with a duty of prudent exercise and compliance with other fiduciary standards." *See,* Edward C. Halbach, Jr., *Uniform Acts, Restatements, and Trends in American Trust Law at Century's End*, 88 CAL. L. REV. 1920 (2000) [hereinafter Halbach].

115. *See,* UTC, § 807 (a); *id.* § 807 (c). "A trustee who complies with the duties in delegation shall not be liable to the beneficiaries or to the trust for an action of the agent to whom the function was delegated."

116. Second Restatement, § 172.

117. *Id.*

118. *Id.* § 176.

property separate from his individual property and from other property not subject to the trust and see to it that the trust property is properly designated as such;[119] (5) keep the property productive;[120] (6) enforce and defend actions;[121] and (7) pay the beneficiaries the net income of the trust property at reasonable intervals.[122] Upon termination of a trust, the UTC requires the trustee to "distribute the trust property in a manner consistent with the terms or purposes of the trust."[123]

For the performance of these duties and his services, a trustee is entitled to "reasonable compensation out of the trust estate ... unless the terms of the trust provide otherwise or the trustee agrees to forgo compensation."[124] The trustee will also be entitled to "indemnity out of the trust estate for expenses properly incurred in the administration of the trust."[125]

4. Liability of Trustee

Trust law has specific rules on trustee liability. Beneficiaries have a personal claim against a trustee for breach of trust.[126] A trustee who deals with trust

119. *Id.* § 179.

120. *Id.* § 181. This is qualified by the Prudent Investor Rule of Third Restatement, § 277.

121. *Id.* §§ 177 & 178.

122. Second Restatement, § 182.

123. UTC, § 412 (c).

124. Third Restatement, § 38; *id.* Comment (a). "The trustee's experience, skill, and facilities, however, are factors in determining the reasonableness of compensation. Also, a family relationship or friendship may be relevant to the parties' expectations (and therefore intentions) concerning compensation." UTC, § 708.

The trustee is entitled to be compensated as specified if the terms of the trust specifies the level of compensation, but the court may allow more or less compensation if the duties of the trustee are substantially different from those contemplated when the trust was created or the compensation specified would be unreasonably low or high.

125. Third Restatement, § 38.

126. John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 639 (1995) [hereinafter Langbein, *Contractarian Basis*].

Under the liability regime of trust law, the trustee places its substantial capital at risk in the event that the trustee misperforms its duties. This exposure of the trustee's capital effectively ensures the beneficiary against many potential harms and creates a further incentive for the trustee to perform the trust deal faithfully.

property in breach of trust is liable for the greater value of what it would take to "restore the value of the trust property and trust distributions to what they would have been had the breach not occurred" or a disgorgement of the "profits to the trust even if the trustee paid fair value for the property."[127] Even in the absence of a breach, "a trustee is accountable to an affected beneficiary for any profit made by the trustee arising from the administration of the trust" and is not liable to a beneficiary for "a loss or depreciation in the value of trust property or for not having made a profit."[128]

Despite these liability rules, a trustee will not be liable for breach of trust for "acting in reasonable reliance on the terms of the trust."[129] The beneficiaries' personal claims also have "no higher priority than the claim of the other creditors of the trustee."[130] The trustee's own personal creditors, other than the trust beneficiaries, are limited in recourse to the trustee in his personal capacity and, as such, will not be able to reach the trust property. Even if the trustee wrongfully disposes of the trust property, "the beneficiary will be able to recover the trust property unless it has come to the hands of a bona fide purchaser for value."[131] If the trust property is disposed of by the trustee and with such proceeds new property is bought, the beneficiaries will have recourse to such property to enforce the trustee's liability for the breach of trust.[132] Note that trust property is not subject to personal obligations of the trustee, even if the trustee becomes insolvent or bankrupt.[133]

5. Removal and Resignation of the Trustee

A trustee who has accepted the trust can resign "in accordance with the terms of the trust, with the consent of all beneficiaries, or upon terms approved by a proper court,"[134] and in the latter case, the Third Restatement provides that a court may act on the petition of "any beneficiary, co-trustee, or other interested party, or on its own motion."[135]

127. UTC, § 1002. *See also,* Langbein, *Contractarian Basis*, *supra* note 126, at 656.

128. UTC, § 1003.

129. *Id.* § 1006.

130. DUKEMINIER, *supra* note 102, at 493.

131. *Id.*

132. *Id.*

133. UTC, § 507.

134. Third Restatement, § 36.

135. *Id.* § 37 Comment (d). "The trustee is entitled to due process, with notice and an opportunity to be heard, although the court may suspend a trustee's powers (including, if necessary, by appointing a temporary trustee) pending a removal hearing."

The trustee is also allowed to resign by giving a 30-day notice to all interested parties.[136]

The rules are somewhat different as to the removal of the trustee. A trustee may be removed "in accordance with the terms of the trust" or "for cause by a proper court."[137] Unless authorized by the instrument constituting the trust or given the power to modify or terminate the trust, the beneficiaries will not be allowed to remove the trustee except for cause.[138] Another ground is when the court determines that "the value of the trust property is insufficient to justify the cost of administration."[139]

6. Termination or Modification of Trusts

A trust is terminated in whole or in part upon "the expiration of a period or the happening of an event, as provided by the terms of the trust."[140] When there is no such provision in the terms of the trust, the trust will terminate when its purpose is accomplished.[141] Termination is also brought about

136. DUKEMINIER, *supra* note 102, at 491. "At common law, once a person accepts the office of the trust, the person can be released from liability only with the consent of the beneficiaries of by a court order. However, § 705 of the UTC modifies this rule to allow for resignation by the trustee with 30 days notice to all interested parties."

137. Third Restatement, § 37 Comment (e) provides a non-exhaustive enumeration of several possible grounds for a court to remove a trustee:

> [l]ack of capacity to administer the trust; unfitness, whether due to insolvency, diminution of physical vigor or mental acuity, substance abuse, want of skill, or the inability to understand fiduciary standards and duties; acquisition of a conflicting interest; refusal or inability to give bond, if bond is required; repeated or flagrant failure or delay in providing proper information or accountings to beneficiaries; the commission of a crime, particularly one involving dishonesty; gross or continued inadequacies in matters of investment; changes in the place of trust administration, location of beneficiaries, or other developments causing serious geographic inconvenience to the beneficiaries or to the administration of the trust; unwarranted preference to the interests of one or more beneficiaries; a pattern of indifference toward some or all of the beneficiaries; or unreasonable or corrupt failure to cooperate with a co-trustee.

138. *Id.* Comment (b).

139. UTC, § 414 (b).

140. Third Restatement, § 61.

141. *Id.*

when the purposes of the trust have become "unlawful, contrary to public policy, or impossible to achieve."[142] A trust may also be subject to rescission and reformation.[143] Statutory business trusts, on the other hand, are terminated by administrative dissolution[144] or dissolution by agreement of all trustees and beneficial owners.[145]

Even when the trust is constituted, the settlor may sometimes retain the power to revoke or modify the trust.[146] Aside from the settlor, the trustee or beneficiaries will have the power to terminate the trust or to change its terms as granted by the terms of the trust.[147]

Without such terms in the trust, modern trust law allows the court to modify the terms of a trust in a manner that is not contrary to the settlor's probable intention in order to achieve the settlor's tax objectives.[148] The court may also modify an administrative or distributive provision of a trust, or direct or permit the trustee to deviate from an administrative or distributive provision, if this will further the purposes of the trust and such

142. UTC, § 410 (a).

143. Third Restatement, § 62.

> Where no consideration is involved in the creation of a trust, it can be rescinded or reformed upon the same grounds, such as fraud, duress, undue influence, or mistake, as those upon which a gratuitous transfer of property not in trust can be rescinded or reformed. Where consideration is involved in the creation of a trust, the rules governing transfers for value and contracts are applicable.

Id. Comment (a). Reformation is generally available when "the terms of a trust fail to reflect the donor's original, particularized intention. The mistaken terms are then reformed to conform to this specific intent." *See,* UTC, § 416.

144. *See,* USTEA, § 208.

145. *See,* USTEA, § 611 (a).

146. Third Restatement, § 63 (1); Halbach, *supra* note 114, at 1898.

> Under the common law of trusts the settlor has no power to revoke or amend an *inter vivos* trust except as authority to do so is reserved in the terms of the trust. The beginnings of a legislative trend — which can be expected to grow — is the enactment of statutory rules in a couple of states (like the long-standing California statute) declaring essentially that '[u]nless the terms of a trust expressly provide that the trust is irrevocable, the settlor may revoke or modify the trust.' This UTC proposal has drawn surprising support.

147. Third Restatement, § 64 (1).

148. UTC, § 416.

circumstances were not anticipated by the settlor.[149] And so, if a trustee "knows or should know of circumstances that justify such judicial action," he has a duty to petition the court for such a purpose.[150] Administrative terms are also subject to modification if they are "impracticable or wasteful or impair the trust's administration."[151] The Third Restatement also allows a third party to be granted "power with respect to termination or modification of the trust" according to such corresponding terms in the trust.[152]

B. Kinds of Trusts in the Philippines

With certain limitations, one can generally establish in the Philippines any kind of trust that one can find in the United States, provided it is not for an illegal purpose.[153] While this is true as a general proposition, there are peculiarities under Philippine law which either add to or subtract from the feasibility of using a particular trust in the jurisdiction.

The following list of the various trust instruments, devices, and arrangements used in the Philippines against the various provisions of Philippine law relating to such trusts does not purport to be a comprehensive one. Its purpose is to give one an idea of how trust devices are being deployed for personal asset management, commercial transactions, and industry regulation, to name some of the purposes. Species of trust erroneously thought to be as such or thought to be applicable in the Philippines are also discussed hereunder.

1. Private Trusts

Fundamentally, a trust is an asset management device. Under common law, the trust was specifically devised and contemplated for use in connection with gratuitous transfers. Property owners, desirous of an efficient asset or

149. Third Restatement, § 66 (1); *id.* Comment (a).

> This 'equitable deviation' doctrine does not require changed circumstances. It is sufficient that the settlor was unaware of the circumstances in establishing the terms of the trust. It is not necessary that the situation be so serious as to constitute an "emergency" or to jeopardize the accomplishment of the trust purposes. The objective is to give effect to what the settlor's intent probably would have been had the circumstances in question been anticipated.

150. *Id.* § 66 (2).

151. UTC, § 412 (b); *id.* Comment. This is a specific application of the requirement that "a trust and its terms be for the benefit of the beneficiaries."

152. Third Restatement, § 64 (2). *See, supra* note 96 (on trust protector).

153. Interview with Atty. Reynaldo Geronimo (Mar. 5, 2007).

estate management regime whereby they could bestow their assets to others, found in the trust the necessary adaptability and flexibility they required. Unfortunately, the Philippine experience has not been to this effect.[154]

The private trust is distinctively marked by its separation of "the benefits of ownership from the burdens thereof."[155] For instance, through the simple use of a trust managed by a pre-selected trustee, parents can dedicate the benefits arising from their assets to their children-beneficiaries.[156] The private trust also provides for other equally compelling advantages such as the avoidance of probate,[157] the segregation of property from the settlor's mass of assets to lower the settlor's gross estate, and professional management of trust assets by an individual or entity governed by fiduciary duties. The following discussion elucidate on these principles:

Living Trusts. A living trust is a kind of *inter vivos* trust which retains for the settlor the right to the income of the trust for life with the remainder to pass on to specified beneficiaries upon his death.[158] In the Philippines, the

154. The features of adaptability and flexibility have largely been lost to a great number of Philippine lawyers. Donative transfers in the context of an estate plan are typically structured through tax free stock-for-asset exchanges to controlled corporations under § 40 (C) (2) (c) of the NIRC which provides for the non-recognition of gains or losses if "property is transferred to a corporation by a person in exchange for stock or unit of participation in ... a corporation ... as a result of such exchange said person, alone or together with others, not exceeding four (4) persons, gains control of said corporation."

155. Sitkoff, *Agency Costs*, *supra* note 114, at 623.

156. Edsel Velasco, *Regulating Survivorship Agreements and Other Will Substitutes*, 49 ATENEO L.J. 1087, 1088 (2005). This arrangement "would also allow the trustee much more flexibility in managing those assets than a court appointed guardian would have."

157. *Id.* at 1080-81. Trusts which allow the settlor to partition his assets while avoiding probate are sometimes referred to as "will substitutes." Will substitutes enable the settlor to accomplish four important objectives: (a) to simplify the disposition of the decedent's estate by allowing him or her to avoid the formalities of will execution; (b) to enable beneficiaries to avoid the delays and costs of probate; (c) to protect the assets from creditor claims; and (d) to avoid delays in beneficiaries' receipt of title and possession of the property.

158. *Id.* at 1088. "A living trust, however, does not necessarily eliminate the need for a will and probate unless every asset the trustor owned is transferred to the trustee prior to death." Reynaldo Geronimo, *Separating the Goats from the Sheep*, Manila Standard Today, Feb. 8, 2006, *available at* http://www.thetrustguru.com/ MSToday/mstoday020806.htm (last accessed July 14, 2007). When a trust is structured the other way around, one may have a "reversionary trust."

BSP has prescribed regulatory guidelines for living trusts in furtherance of its campaign to effectively screen financial products created to circumvent the reserve requirements imposed on deposit arrangements.[159] Under BSP Circular No. 521, series of 2006, a living trust is created by a "written agreement"[160] whereby "the settlor conveys property or a sum of money to be managed by the trustee, for the benefit of the trustor and third persons or third persons alone." While the circular comports with the functional definition of a living trust, it limits flexibility by decreeing that the trustor cannot create a trust with herself as the sole beneficiary.[161] The BSP-prescribed living trust may be designed to be revocable or irrevocable.

The regulatory hand of the BSP is further revealed in the Circular's prescribed minimum criteria for the creation of a living trust, which include: a minimum of PhP100,000 as trust *res* with a required minimum balance of PhP500,000 in the living trust account to allow investment of the *res* in something other than a deposit, and a minimum effectivity period of not less than six months.[162] Violation of the Circular may subject the bank to administrative sanctions under section 37 of the New Central Bank Act. The

A trustor may want to set up a trust for the support and medical expenses of his elderly parents after whose deaths the property goes back to him automatically .... In living trusts, the trustor is referred to as the 'life tenant' and his successor beneficiaries as the 'residuary.' In the reversionary trust, the trustor is the 'residuary' and his parents are the 'life tenants.'

159. Des Ferriols, *BSP Notes Unusual Increase in Living Trust Accounts of Banks*, The Philippine Star, Apr. 4, 2005, *available at* http://www.rbap.org/article/articleview/2461/1/20/ (last accessed July 14, 2007). This was most probably in response to the unusual increase in the living trust accounts of banks following the phase-out of common trust funds into the newly-regulated unit investment trust fund (UITF). The BSP felt that banks might have shifted to other lightly regulated trust accounts as an alternative.

160. The circular specifically requires that the written agreement indicate: (1) the purpose or intention of the trust; (2) the nature and value of the property or sum of money that comprise the trust; (3) the trustee's investment powers; (4) the name(s) of the beneficiaries; and (5) the terms and conditions under which the income and/or principal of the trust is to be paid or to be disposed of during the lifetime and ultimately, upon the death of the trustor or upon the occurrence of a specified event.

161. BSP Circular No 521, s. of 2006, ¶ 1.

162. *Id.* ¶ 2 (2). Violation of this rule is charged with a penalty: "the termination of the living trust agreement, for any cause, within the minimum holding period shall render the trustor ineligible from opening a new living trust account within a period of one year from termination date."

effect of these rules is to convert what is essentially a common law trust concept into something which is more of a business trust.

Spendthrift Trusts. The spendthrift trust is a common law trust that restrains voluntary and involuntary alienation of any or all of the beneficiaries' interests. The effect of such a trust is that a beneficial interest may not be "transferable by the beneficiary" or "subject to the claims of the beneficiary's creditors."[163] The rules apply to the beneficiary's interests in principal as well as in income, and also to possessory interests under trusts.[164] A spendthrift trust may or may not be laden with a forfeiture provision in case of breach of the restriction.[165]

The spendthrift trust protects a beneficiary from his own improvidence — he cannot "anticipate his interest and his creditors cannot reach it."[166] The Third Restatement emphasized that spendthrift protection is not necessarily limited to beneficiaries who are "legally incompetent or who, as a practical matter, lack the ability to manage their finances in a responsible manner."[167] It also provides for exceptions on spendthrift protection such that the interest of a beneficiary can be reached by a claim for the "support of a child, spouse, or former spouse," or for "services or supplies provided for necessities or for the protection of the beneficiaries' interest in the trust."[168] In the absence of spendthrift recognition, settlors who wish to guard the trust's assets from an insolvent beneficiary's creditors may use a discretionary trust. With a discretionary trust, payments from the income of the trust are within the trustee's discretion and "neither the beneficiary nor her creditors have a right to a payout."[169] Spendthrift and discretionary trusts may be validly set up in the Philippines.

163. Third Restatement, § 58 (1). "Spendthrift restraints are not permitted under English law and have been rejected by a few American cases." A vast majority of decisions in the United States, however, have validated the spendthrift trust. *Id.* Comment (a). "A number of states have enacted legislation codifying the law of spendthrift trusts. A few statutes contain significant departures from the rules stated ... such as by allowing restraints on income but not principal interests or otherwise limiting the extent of the protection allowed (*e.g.*, to the beneficiary's support)."

164. *Id.* Comment (a).

165. *Id.*

166. Abad Santos, *supra* note 4, at 526.

167. Third Restatement, § 58 Comment (a).

168. *Id.* § 59.

169. Sitkoff, *Agency Costs*, *supra* note 114, at 676. *See also*, Second Restatement, § 155.

Asset Protection Trust. The fundamental basis of an asset protection trust are the same restrictions placed by a spendthrift trust on the alienation of the equitable interest of a beneficiary with the difference that such beneficial interest, rather than being given to a third party, is retained by the settlor.[170] Asset protection trusts, in jurisdictions which have validated such a legal instrument,[171] has enabled settlors to escape the reach of their creditors by simply placing their assets in a trust, constituting themselves as beneficiary, and inserting a spendthrift provision. An asset protection trust is prohibited by the Restatements and the common law, thus presenting the strong probability that such a trust would be invalid if set up in the Philippines.[172]

2. Business Trusts[173]

The business trust commends itself to planners of commercial transactions because of its chief attributes. Its advantages include: (a) the possibility of

170. Third Restatement, § 58 (2).

171. Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L. J. 382 (2005). Both Alaska and Delaware have validated the APT. Other states which have adopted some form of APT legislation include Nevada (1999), Rhode Island (1999), Oklahoma (2004), Utah (2004), and South Dakota (2005), bringing the state count to at least seven.

172. Boxx, *supra* note 63, at 1203. "U.S. courts have accepted the spendthrift trust as a valid means of protecting a gift to someone who may face creditor difficulties, but that acceptance has never been extended to permit a person to place his own assets beyond the reach of creditors, while still retaining use of those assets."

173. Steven L. Schwarcz, *Commercial Trusts as Business Organizations: Unraveling the Mystery*, 58 BUS. LAW 562 (2003) [hereinafter Schwarcz]. One should start with the awareness that the underlying philosophy of business trusts is different from that of a gratuitous trust.

> The most obvious difference is that the settlor in a gratuitous trust receives no compensation for the conveyance whereas the settlor in a commercial trust always receives payment for the assets conveyed to the trust. One therefore can view a commercial trust as a trust in which there is a bargained-for exchange rather than a gift. A more subtle difference is that the settlor in a gratuitous trust may or may not retain a residual interest in the trust assets, whereas the settlor in a commercial trust almost always retains a residual interest in trust assets that remain once the business transaction is concluded.

conduit-type taxation to avoids income taxes at the entity level;[174] (b) the automatic imposition of default fiduciary rules requiring the trustee to exercise power in the best interest of the trust beneficiaries and prohibiting self-dealing transactions;[175] (c) the flexibility in designing governance structures and in providing for the rights of the different classes of beneficial interests without the corresponding restrictions encountered with the corporate form;[176] and (d) the protection of beneficial interests in the event of trustee insolvency.[177] It is widely believed that the commercial use of the

174. John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 YALE L.J. 180 (1997) [hereinafter Langbein, *Life of the Trust*]. *Id.* at 180-81.

> The corporation as a juridical entity has attracted entity-level taxation [of income tax] ... resulting in double taxation when the corporation's shareholders are taxed again on income they derive from corporate distributions. Because we treat the trustee's ownership of trust property as merely nominal, with real ownership remaining in the beneficiary, we have tended to tax trust proceeds at the beneficiary level only.
>
> Note, however, that this observation might not be as critical in the Philippines absent tax laws which specifically exempt a trust from income tax on the entity level.

175. *Id.* at 182. The two great principles of trust fiduciary law are loyalty and prudence.

> Loyalty requires the trustee to administer the trust solely in the interest of the beneficiaries ... the duty of prudent administration imposes a reasonableness norm that places the trustee under a duty to the beneficiary in administering the trust to exercise such care and skill as a man of ordinary prudence would exercise in dealing with his own property.

176. *Id.* at 184. For instance, the trust can be drafted to dispense with routine shareholder meetings reducing "the costs of proxy solicitation and other meeting-related expenses that are mandated under corporation codes." Classes of trust shares can be easily created and extinguished allowing a trust to create an unlimited number of shares. On the other hand, corporate law limits a company to the maximum number of shares authorized in the corporation's certificate of incorporation. "Increasing that number [of shares] puts ... shareholders to the expense of soliciting and obtaining share approvals." Also a factor is the absence of state corporate franchise and filing fees. In juxtaposition, consider the business trusts which are regulated by the BSP which require onerous financial and operating conditions on trust entities. How these restrictions affect the inherent advantages of using the trust is an excellent area of inquiry.

177. *Id.* at 179; *Id.* (citing Second Restatement, § 12). "Trust rules tell us that even when a trustee becomes insolvent, the beneficiary retains his interest in the

trust has already surpassed the use of the instrument for gratuitous asset transfers.[178]

Statutory Business Trust. There are no statutory business trusts (SBT) in the Philippines in the manner SBTs are understood in the United States.[179] The SBT, juxtaposed to the common law business trust, is an unincorporated entity possessing a separate juridical personality under law. SBTs are the epitome of the "entitization of the common law trust."[180] Modern business trust law provides trusts with the mantle of limited liability, perpetual existence, and greater flexibility with emphasis on the freedom of contract and fewer mandatory rules. The modern SBT has been described as a "blank slate that offers wide latitude for the customization of the entity to fit the exigencies of individual transactions with the comfort of statutory confirmation that those customized terms will be enforceable."[181] There is currently no law in the Philippines that comes close to providing features of SBT legislation and it is unclear whether one may expect such a development in the near future.

Deeds of Trust. Deeds of trust are "transfers of legal title to property from the settlor to the trustee for the purpose of placing the legal title with the trustee as security for the performance of loan obligations."[182] The instrument is denominated a trust since property is held by the trustee for the beneficiaries under the instrument. However, the "differences between a deed of trust and a traditional trust suggest that the former is a trust only in form and not in substance" as the transfer of legal title is "conditional" for the return of the property is required of the trustee when the loan is repaid.[183] This could be nothing more than a functional equivalent of a security device for the granting of collateral.[184] In spite of this analysis, article

> subject matter of the trust and is entitled to retain such against the general creditors of the trustee."

178. DUKEMINIER, *supra* note 102, at 497 ("Pension funds hold over $10 trillion; mutual funds hold over $7 trillion; and there is at least $1 trillion in asset securitization trusts."). In comparison, the aggregate wealth held in donative trusts is estimated at $1 trillion.

179. Robert H. Sitkoff, *Trust as "Uncorporation,"* 1 U. ILL. L. REV 35-36 (2005). In the United States, 29 states have general business trust legislation.

180. Robert H. Sitkoff, *The Rise of the Statutory Business Trust* 2 (unpublished manuscript) (on file with author) [hereinafter Sitkoff, *Rise of the Business Trust*].

181. *Id.* at 2-3.

182. Schwarcz, *supra* note 173, at 570.

183. *Id.*

184. *Id.* at 571.

1454 of the 1950 Civil Code clearly provides that "an absolute conveyance of property made in order to secure the performance of an obligation of the grantor toward the grantee establishes a trust by virtue of law." Therefore, a deed of trust under Philippine law is a trust both in name and juridical concept.

Common and Unit Investment Trust Funds. The common trust fund (CTF) is an open-ended fund which is essentially a collective investment vehicle, functioning "similarly as a mutual fund, which pools the investments of small investors into a larger fund under professional management."[185] Gains and losses are shared by the investors according to the proportion of their participations in the fund.[186] To align the operation of pooled funds under trust entity management with "international best practices" and to "ensure differentiation of such funds from bank deposits and other direct liabilities of financial institutions," the BSP issued its Circular No. 447, dated 3 September 2004, prescribing rules and regulations for the creation, administration and investment of Unit Investment Trust Funds (UITFs).[187] The UITF is simply another descriptive name for what is essentially a CTF by nature.[188]

185. Office of Supervisory Policy Development, Supervision and Examination Sector, *Status Report on the Philippine Financial System, First Semester* 2005 13-14, *available at* http://www.bsp.gov.ph/downloads/Publications/2005/Status_1sem2005.pdf?id=249 (last accessed July 15, 2007) [hereinafter BSP Report]. Interestingly, there is a different set of rules referring to the fund management activities of trust entities. A careful reading of the BSP Manual indicates that the provisions on Investment Management activities, while grouped together with trust activities, are actually non-trust in character. Investment management activities under § 4403Q (c) of the BSP Manual are defined as arrangements by which the institution, as the investment manager, binds itself to handle or manage investible funds or any investment portfolio in a representative capacity which does not create or result in a trusteeship.

186. *Id.*

187. The UITF is intended to be an improved version of the CTF. Nevertheless, the BSP has imposed certain requirements and incentives which make the CTF regime differentiable from a UITF regime.

188. *See,* BSP Manual, § U4410Q.1 ("The term Unit Investment Trust Funds is synonymous to CTFs."). As of June 2005, a total of 12 universal/commercial banks reported UITFs amounting to PhP31.4 billion, representing 12.1% of total CTFs/UITFs of PhP258.8 billion. As of Oct. 11, 2005, 71 UITF applications have been approved with 25 applications pending. BSP Report, *supra* note 185, at 14.

BSP Circular No. 447 defines the UITF as a type of "open-ended pooled trust fund denominated in pesos or any acceptable currency, operated and administered by a trust entity ... made available by participation"[189] and evidenced by a "Participating Trust Agreement" and an instrument called a "Confirmation of Participation."[190] Under the scheme, the trustee is given exclusive management and control of each UIT Fund under its administration, and the sole right at any time to "sell, convert, reinvest, exchange, transfer, or otherwise change or dispose of the assets comprising the fund."[191] The fund is administered by the trustee in accordance with the trust agreement, referred to in the circular as the "plan".[192]

The Circular requires the trustee to disclose UITF investments to investors and to provide a list of prospective and outstanding investment outlets for the review of all UITF clients.[193] While such a list exists to limit the investments which may be made by the UITF trustee, the range of allowable investments is extensive as investments in bank deposits, a variety of securities, marketable instruments, loans, and other BSP allowed tradable investments are permitted[194] in the investment mix as long as these have an

189. BSP Report, *supra* note 186, at 14. "Total assets and accountabilities of each fund is accounted using pooled-fund accounting method." BSP Manual, § U4410Q.5 (a). "Participations of clients shall be pooled and invested as one account. Investments in a UITF are determined under a unitized net asset value per unit (NAVpu) valuation methodology ...." BSP Manual, § U4410Q.5 (c) & (d).

190. BSP Manual, § U4410Q.7 (b) (2).

191. *Id.* § U4410Q.3.

192. Among the things the plan requires to be stated are: the manner in which the fund is to be operated with a statement of the fund's investment objectives, policies, and limitations; the investment powers of the trustee with respect to the fund including the character and kind of investments which may be purchased; the terms and conditions governing the admission or redemption of units of participation in the fund; the basis upon which the fund may be terminated; and the amount of fees, commission, and other charges. *Id.* § U4410Q.6.

193. *Id.* § U4410Q.7.

194. *Id.* § U4410Q.9. Investments shall be limited to bank deposits; securities issued by or guaranteed by the Philippine government, or the BSP; tradable securities issued by the government of a foreign country or any supranational entity; exchange-listed securities, marketable instruments traded in an organized exchange; loans traded in an organized market; and other tradable investments outlets the BSP may allow. The UIT Fund may also avail itself of financial derivatives instruments solely for the purpose of hedging risk exposures of the existing investments of the UITF.

active market which allows for transparent pricing. This being the case, UITFs may not extend traditional loans or invest the trust *res* in real estate and other illiquid investments.[195] It is also provided that the prescribed limit as to the combined exposure of the UITF to any entity and its related parties shall not exceed 15% of the market value of such UITF.[196]

The Circular subjects the trust entity, through their managers, to a host of duties for the protection of investors, such as to inform clients of "general investment policy and the applicable risk profiles" and "to publish, at least on a weekly basis, material information for the guidance of investors."[197] The Circular also establishes other measures of protection — UITFs are to be "audited annually by an independent auditor acceptable to the BSP and the results of the external audit are to be made available to participants and investors."[198] For the independent valuation of the asset pool, investments in securities by UITFs need to be "deposited for safekeeping with BSP-accredited third party custodians tasked with performing independent marking-to-market of such securities."[199]

Classified by the BSP as a true investment product, the UITF is not subject to regulations applicable to deposits and trust funds (*i.e.* CTFs) in general. Unlike the CTF, UITFs are not subject to liquidity and reserve requirements and are further excluded from the restrictions of the Single Borrower's Limit and the DOSRI transaction ceilings.[200]

Mutual Funds. There is increasing investor preference for shares in pooled investment vehicles where "investment professionals select and manage the fund's assets according to guidelines that define the fund's investment objectives."[201] Contrary to a common misperception, mutual funds in the Philippines are not and currently cannot be in the form of a trust. While a substantial number of mutual funds in the United States are in

195. BSP Report, *supra* note 185, at 13.

196. *Id.*; BSP Manual, § U4410Q.14.

197. BSP Report, *supra* note 186, at 13. The information must include, among other things, the name of the fund and its general classification; the fund's NAV per unit; and the moving return on investment (ROI) on a year-to-date and year-on-year basis.

198. *Id.* at 14.

199. *Id.*

200. BSP Manual, § 4410Q.14.

201. Langbein, *Life of the Trust*, *supra* note 174, at 170.

the form of unit investment trusts,[202] mutual funds in the Philippines are stock corporations selling shares to investors.[203] Nevertheless, the current bill for the proposed Revised Investment Company Act (Revised ICA) presents the possibility that mutual funds in the Philippines could be organized as trusts in the future as section 13 of the Bill empowers the SEC, as the agency with regulatory jurisdiction over all Philippine mutual funds, to prescribe a different mutual fund structure and/or capitalization by regulation.[204]

Mortgage Trust Indenture. A trust indenture is one of the primary instruments in most bond issuances. While the Philippines has no special law similar to the United States' Trust Indenture Act of 1939 which requires most debt security issues to utilize the "services of a corporate fiduciary to act as trustee for the bondholders or other obliges,"[205] such a conceptual structure is similarly applicable and observed in the Philippines in practice.

202. *See*, Langbein, *Life of the Trust*, *supra* note 174, at 171. § 4 (a) of the Investment Company Act of 1940 defines "Unit investment trust" as an "investment company which is organized under a trust indenture, contract of custodianship or agency, or similar instrument, does not have a board of directors, and issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities."

203. *See,* Implementing Rules of the Investment Company Act, rule 35-1 (b) (1) [hereinafter ICA Rules]. The rules require the stock corporation to have a minimum subscribed and paid-in capital of PhP50,000,000.00. ICA Rules, rule 35-1 (b) (1) (A). Securities and Exchange Commission, *The Non-Bank Financial Sector Development Plan: Blueprint for Growth and Expanded Contributions to the Philippine Economy (2004-2010)*, at 43, *available at* http://www.sec.gov.ph/notices/draft/nbfs20july2004.pdf (last accessed July 14, 2007) [hereinafter SEC Report] ("[A] comprehensive reform of the Investment Company Act was sent to Congress in 1999 together with the Securities Regulation Code; however, only the last was enacted into law. This omission has perpetuated the outmoded (1960) legal framework of (sic) the mutual funds.").

204. The current differentiation of a common trust fund from a mutual fund is substantially eroded away in the Revised ICA. Section 4 (b) (2) of the bill provides that the following shall not be an investment company under the Act: "Any bank engaged in the conduct of its ordinary business, or any common trust fund administered by a bank for collective investment of funds contributed by the bank in a fiduciary capacity." Thus, it is arguable that as long as the funds are not contributed by the bank, *i.e.*, contributed by investors, common trust funds can be mutual funds.

205. Langbein, *Life of the Trust*, *supra* note 174, at 173 ("The Federal Financial Institution Examination Council estimates that of year-end 1994 corporate trust department served as indenture trustees for just over $3 trillion in debt.").

Under a mortgage trust indenture, a trustee is called to hold properties for a syndicate of creditors and/or investors as collateral until the loan of the debtor is extinguished. In a trust indenture, however, unless the transaction documents give the mortgage trustee additional powers and duties, *i.e.* as an intercreditor agent, such trustee would possess less responsibilities than it otherwise would in a conventional private trust. The trustee under a corporate indenture normally has no "possession, or right to possession, of the mortgaged property until after a default occurs"[206] and has "no control over the business of the obligor" nor, except under peculiar circumstances, "any voice in the management of its affairs." The trustee acquires actual possession of the trust assets only "in the event that the issuer breaches the covenants of the loan agreement ... [t]he indenture regime imposes ... a species of contingent or standby trusteeship."[207] Nevertheless, the attractiveness of the trust indenture arrangement is its ability to have a "sophisticated financial intermediary — the trust company acting on behalf of numerous and dispersed bondholders in the event that a loan transaction does not work out ...."[208] Collective action issues are thus overcome.

Asset Securitization Trust. The trust is used extensively in structured finance transactions. An asset securitization trust enables creditors to refinance debt as well as rights to insurance policies, among others.[209] An originator owning financial assets may transfer these assets via true sale to a special purpose entity (SPE) which, in turn, sells participating interests in the SPE to investors. Securitization is thought to lower the cost of credit as it "separates the particular assets into a trust that is distinct from the rest of the

206. *Id.* (citing ROBERT I. LANDAU, CORPORATE TRUST: ADMINISTRATION AND MANAGEMENT 25 (4d ed. 1992)). Footnote 54 states:

> [t]he essential function of [such] a trustee is the administration of the security provisions of a contract between the issuing corporation and the holders of the indenture securities. If the issue is secured in any way, the trustee holds and deals with the security .... [For example, i]f the security for the bond issue is personal property, such as equipment, the trustee will normally 'perfect' its security interest in the property by filing a financing statement pursuant to the Commercial Code of the applicable state .... [A]s administrator of the contract, the trustee has the responsibility of making sure that the covenants and other indenture provisions are performed in the agreed manner .... [I]n the event of default the trustee has a primary responsibility for enforcing the remedial provisions of the contract.

207. Langbein, *Life of the Trust*, *supra* note 174, at 174.

208. *Id.*

209. *Id.* at 172.

liabilities" of the asset originator.[210] Asset securitization trusts are also deemed "bankruptcy remote."[211]

In the Philippines, Republic Act No. 9267, the Securitization Act of 2004, provides for the creation of SPEs either as special purpose corporations (SPC) or special purpose trusts (SPT).[212] An SPE constituted as an SPT is required to be a trust administered by a duly licensed trust entity but need no longer register with the SEC.[213] The SPT shall have the power to accept the sale or transfer of assets; issue and offer asset-backed securities for sale to investors; undertake on its own or through contracts with any person activities as contained in the approved securitization plan; create any indebtedness or encumbrances; and pay out or invest its funds.[214] The rules provide that an entity duly authorized to perform trust functions may be the trustee of more than one SPT.[215] Though not a corporation, the SPT can be dissolved in a way akin to the dissolution of a corporation. Thus, holders of at least two-thirds of the total amount of the asset-backed securities outstanding may resolve to dissolve the SPT.[216]

Employee trusts. In an employee trust, the employer, employees, or both, contribute to a trust fund for the purpose of "distributing to such employees or their beneficiaries, the corpus and income accumulated by the trust in

210. *Id.* at 173.

> Because these assets are specialized to a single recurrent class, they are easier for outside investors and rating agencies to evaluate than is the bank's general portfolio of assets. These assets are commonly less risky than the bank as a whole, for reasons that include the high quality and fixed duration of most of the securitized credits, as well as the various credit-enhancing guarantees from the originator or other contractual parties.

211. *See,* Langbein, *Life of the Trust*, *supra* note 174, at 173. The investor in the asset securitization trust is no longer a lender to the originator who is exposed to default risk in cases where the originator became insolvent. With asset securitization, the former lender becomes an "owner of a beneficial interest in a distinct pool of trust assets" unaffected by financial troubles of the asset originator.

212. *See,* Securitization Act of 2004, § 3 (l).

213. *Id.* § 5. However, § 9 provides that when the SPE is an SPT, endorsement by the BSP of the securitization plan shall be required before its approval by the Commission.

214. *See,* Securitization Act of 2004, § 10.

215. Implementing Rules of Securitization Act of 2004, art. II, rule 5 (c) (i).

216. Securitization Act of 2004, § 15 (b). Approval of both the BSP and the SEC must have been obtained for dissolution to be effective.

accordance with the plan."[217] Section 60 (B) of the NIRC provides a tax exemption for employee trusts[218] established under Republic Act No. 4917 and qualified as a reasonable private benefit plan under the regulations of the Bureau of Internal Revenue (BIR).[219] Before availing of the benefits, the employer must submit a copy of the plan and the trust agreement covering the plan for prior determination by the BIR of its eligibility,[220] and the BIR must see that the employee's trust form part of a "pension, stock bonus or profit-sharing plan of an employer for the benefit of some or all of his employees;" that "contributions are required to be made to the trust by such employer, or employees, or both for the purpose of distributing to such employees the earnings and principal of the fund in accordance with the plan;" and that it is "impossible under the trust instrument for any part of the trust corpus or income to be used for, or diverted to, purposes other than for the exclusive benefit of the employees prior to the satisfaction of all liabilities to the employees."[221]

Tax regulations also provide for guidelines on the investment powers of the trustee. While no specific limitations are provided under the law, administrative tax regulations state that the exemption of the trust income may be denied if the trust: (a) lends any part of its income or corpus without adequate security and a reasonable rate of interest; (b) pays any compensation

217. BIR Ruling No. 051-2000, Oct. 30, 2000.

218. *See,* BIR Ruling 001-88, Jan. 7, 1988. The parties to the employees' trust which qualify as a reasonable private retirement trust plan are: the trustor-employer, the trustee of the fund who must be independent from the employer-trustor and the beneficiary or employee-members.

219. Section 2 of BIR Revenue Regulation 1-68, Mar. 25, 1968 (provides for the requisites of a reasonable plan). Generally, a reasonable plan: (a) must be a definite written program setting forth all provisions essential for qualification; (b) must be permanent and continuing; (c) must cover at least 70% of all officials and employees; (d) one where the employer, or officials and employees, or both, shall contribute to a trust fund; (e) one where the corpus or income of the trust fund is at no time used for any purpose other than for the exclusive benefit of officials and employees; (f) must be non-discriminatory in contributions or benefits; (g) must provide for non-forfeitable rights; (h) must expressly provide that forfeitures arising from severance of employment, death or for any other reason, must not be applied to increase the benefits any employee would otherwise receive under the plan; and (i) must be administered by a trust.

220. *Id.* § 6.

221. NIRC, § 60 (B) ("[A]ny amount actually distributed to any employee or distributee shall be taxable to him in the year in which so distributed to the extent that it exceeds the amount contributed by such employee or distribute.").

in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered; (c) makes any part of its services available on a preferential basis; (d) makes any substantial purchase of securities or any other property for more than adequate consideration; (e) sells any substantial part of its securities or other property for less than an adequate consideration; or (f) engages in any other transaction which results in a substantial diversion of its income or corpus.[222]

Private Equity and Retirement Account. Another trust-like instrument is on the legislative horizon. As of this writing, the Personal Equity and Retirement Account Act of 2005 (PERA Bill) is undergoing final deliberations in the Philippine Senate. The PERA Bill encourages the establishment of voluntary individual retirement accounts with the benefit of favorable tax treatment in order to encourage private savings for retirement.[223]

A contributor establishes and makes deposits in his personal equity and retirement account (PERA Account). While an administrator is responsible for overseeing the PERA Account,[224] there must be a separate and independently operating custodian that shall hold all funds and securities comprising the PERA investment.[225] The deliberations of the Senate appear

222. *See,* BIR Revenue Regulation 1-68, § 5.

223. *See generally,* Henry Hansmann & Ugo Mattei, *Trust Law in the United States. A Basic Study of Its Special Contribution*, 46 AM. J. COMP. L. SUPP. 147 (1998) [hereinafter Hansmann].

> In the United States, the typical pension fund is a pool of assets that is accumulated as a reserve with which to pay the pensions of the employees at a given firm, and that is both funded and managed by the corporation whose employees are covered by the fund. ... The Employee Retirement Income Security Act of 1974 requires that pension fund assets be held in trust form.

224. PERA Bill, § 3 (a). Under the PERA Bill, the administrator's duties, while substantial, fall short of being a trustee. Its duties shall include: reporting on contributions made to the account, computing the values of investments, educating the Contributor, enforcing contributions and withdrawal limits, collecting appropriate taxes and penalties for the government, issuing BIR Income Tax Credit Certificates to the Contributor, consolidating reports on all investments, income, expenses and withdrawals on the account and ensuring that PERA contributions are invested in accordance with the prudential guidelines set by the Regulatory Authorities.

225. *See,* PERA Bill, 3 (c). The Custodian is also required to report to the Contributor and the concerned Regulatory Authority at regular intervals all financial transactions and all documents in its custody under a PERA account.

to treat the custodian as a true trustee,[226] even if, technically speaking, the arrangement does not appear to be a true and full trust arrangement since the trustee will not have real powers of management over the trust corpus and the contributor will remain in control of his contributions. The duties of the trustee under the trust will be minimal at best and the trust could be what is known as a "passive" or "dry" trust, which fails as a trust according to the Third Restatement.[227] Furthermore, the contributor is to retain both "legal and beneficial" ownership of funds placed in the PERA Account including "all the earnings of such funds."[228] It remains to be seen how the PERA Bill will be finally drafted.

Real Estate Investment Trust (REIT). The REIT is another trust which has experienced soaring popularity worldwide. It is fundamentally a vehicle for investments in real estate. It is an innovation insofar as its features make it possible to raise money efficiently through the public markets. The public trading of REIT securities gives this form of investment in real estate "much more liquidity than has historically been available to real estate investors."[229]

The REIT's history in the United States is well known. In 1960, the United States Congress, utilizing the structure of the Massachusetts business

226. *See,* Philippine Senate, *Spot report on the public hearing conducted by the Committee on banks, financial institutions and Currencies, the Personal Equity and Retirement Account or PERA (SBN 1343, 1747, and 1821) and the Lending Companies Act (SBN 1103, 1180, and 1762),* at 4, Jan. 14, 2005 [hereinafter Senate Report].

> Upon query of Senator Enrile on who retains the legal title over the fund after it has been waived by the contributor-beneficiary, Assistant Governor de Zuñiga explained that since this is a trust arrangement the legal title is awarded to the administrator or trustee, although there are certain provisions in the PERA which maintains that while it is a trust fund, the contributor or trustor retains control of his investments.
>
> Senator Angara stressed that a provision be included in the PERA Bill, stating the obligations and liabilities of the trustee to safeguard the interest of the contributor-beneficiary from losses incurred by investments made by his administrator.
>
> Mr. Andaya of the Bankers Association of the Philippines (BAP) recommended the following proposals. First, the number of trustees or fund managers should not be limited to promote competitive fees and second, the PERA Bill must include provisions relating to the selection of a trustee and the forming of an infrastructure defining the roles of the trustee, fund manager and custodian.

227. DUKEMINIER, *supra* note 102, at 491.

228. *See,* PERA Bill, § 3 (f).

229. Kathleen Smalley, *Real Estate Transactions* 9.3 (unpublished manuscript) (on file with author) (2006) [hereinafter Smalley].

trust, introduced a "new taxing scheme designed to permit public participation in the passive ownership of real estate."[230] Despite the name given to this highly popular investment vehicle, REITs are not necessarily trusts,[231] and a REIT is more precisely defined as a type of "tax status."[232] Hence, a REIT in the United States can be a business trust, a corporation, or an unincorporated association that elects to be taxed as a REIT and that qualifies under the relevant tests provided by the Internal Revenue Code.[233] Under § 856 of the Internal Revenue Code, such a qualifying REIT receives a deduction for income distributed to its shareholders.[234] Therefore, the

230. *Id.*

231. Sitkoff, *Rise of the Business Trust, supra* note 180, at 13. A study of the REIT filings with the United States SEC from 1998 to 2005 shows that nearly all publicly-traded REITs are organized as Maryland corporations.

232. *Id.* at 13.

233. *See,* INTERNAL REVENUE CODE, § 856 (a).

234. Smalley, *supra* note 229, at 9.5. To qualify as a REIT under the Internal Revenue Code, a REIT must pass several tests. It must:

> (a) be managed by one or more trustees or directors, § 856 (a) (1); (b) have ownership evidenced by transferable shares or certificates of beneficial interest, § 856 (a) (2); (c) have beneficial ownership held by 100 or more persons (after the first taxable year in which the entity elects to be taxed as a REIT), § 856 (a) (5), § 856 (h) (2); and (d) not have more than 50% of its stock owned by 5 or fewer individuals during the last half of its taxable year, § 856 (a) (6), § 856 (h) (1).
>
> *Id.* at 9.6.
>
> There are two income tests: (a) the 95% test whereby "at least 95% of the REIT's gross income must be derived from sources such as rents on real property, gains on sale of real property ... interest on and proceeds of debt secured by real property, and other forms of passive investment income ... § 856 (c) (2);" and (b) the 75% test whereby "at least 75% of the REIT's gross income must qualify" — income qualifying for the 75% test includes the real estate-related items that qualify for the 95% test but the REIT cannot rely on the dividends and interest that count toward the 95% test. *Id.* There are also two asset tests: (a) a 75% test whereby "at the end of each quarter, the REIT's assets must be at least 75% by value in real estate, cash or certain cash equivalents, and government securities, § 856 (c) (4) (A);" and (b) the 25% test where "at the end of each quarter, no more than 25% by value of the REIT's assets can be held in securities other than government securities, § 856 (c) (4) (B)."

United States REIT is not subject to the multi-level taxes imposed on most entity earnings, *i.e.* entity-level tax and tax on distributions to investors.[235]

While there is currently no statute which will allow a Philippine entity to elect REIT status for tax purposes, it has been submitted that a REIT specifically formed for the purpose of investing in construction projects could be created and as such enjoy the same pass-through taxation which a REIT in the United States can. The benefit of pass-through taxation would apply if the REIT is constituted as to be classified as a "joint venture or consortium formed for the purpose of undertaking construction projects"[236] which will be taxed as a partnership under Philippine law and receive pass-through treatment rather than as a corporation which must pay an entity-level income tax.[237] While this scheme may detract from the underlying policy of the United States REIT — that the REIT is a vehicle for passive investments in real estate — this strategy presents a practical solution and allows the fund-raising concept of the REIT to be used in the Philippines without major amendments to the tax laws.

Pre-Need Company Trust. Pre-need plans pertain to contracts which provide for the "performance of future services or the payment of future monetary considerations at the time of actual need, for which planholders pay in cash or installment at stated prices."[238] Pre-need companies are plan issuers authorized under section 16 of Republic Act No. 8799, the Securities Regulation Code, to sell or offer for sale to the public pre-need plans under the guidelines of SEC rules and regulations.[239] As of 2001, sales of pre-need plans had already amounted to PhP20.8 billion per annum.[240]

To ensure payment of benefits, a specified portion of the sales collections of pre-need companies are required to be placed in a trust fund.[241] Pre-need companies must deposit 51% of total amounts collected to the trust fund

235. *Id.* at 9.3. The REIT is not a pass-through entity *per se.* "If it incurs a net loss, its owners do not report a net loss on their tax returns."

236. *See,* NIRC, § 22 (B).

237. Reynaldo Geronimo, *REIT: Another financial product for the OFW,* Manila Standard Today, Apr. 19, 2006, *available at* http://www.thetrustguru.com/MSToday/mstoday041906.htm (last accessed July 14, 2007).

238. Emilio B. Aquino, *Private Pension Schemes in the Philippines: Regulatory Practices* 3, *available at* http://www.oecd.org/dataoecd/51/34/2763673.pdf (last accessed July 14, 2007) [hereinafter Aquino].

239. *Id.* at 3.

240. *Id.* at 4.

241. *Id.* at 5.

which will be maintained by BSP-registered trust entities.[242] At the end of 2001, the pension trust fund equities administered by various trustees amounted to PhP13.3 billion.[243] By June 2003, the trust fund portfolios of all pre-need companies already amounted to some PhP60.6 billion.[244]

The SEC is currently in the process of issuing a new Memorandum Circular which provides for guidelines on the management of the trust fund of pre-need corporations. The draft contains salient points on trust operations of the trustee: the trust agreement must be submitted by the pre-need corporation for SEC approval;[245] investment limits and/or criteria for the deployment of the trust fund[246] and a prescribed investment mix are imposed;[247] certain investments incompatible with the guidelines are

242. SEC Guidelines on the Management of the Trust Fund of Pre-Need Companies § 3, *available at* http://www.sec.gov.ph/index.htm?notices/index (last accessed July 14, 2007) [hereinafter SEC Proposed Guidelines]. The trust fund must be established independently from the company with a trust company, trust department of a bank or an investment house that is authorized by the BSP to perform trust and other fiduciary functions.

243. Aquino, *supra* note 238, at 6.

244. SEC Report, *supra* note 203.

245. *See,* SEC Proposed Guidelines, *supra* note 242, § 4 (citing New Rules on the Registration and Sale of Pre-Need Plans, rule 17.1).

246. Section 6.1 of the SEC Proposed Guidelines provide that all investments of the Trust Fund shall be limited to: (a) fixed income instruments such as Government securities and other evidence of indebtedness issued by the government; (b) loans, bonds or other evidence of indebtedness issued by government owned and controlled corporations and guaranteed by the Philippine government; (c) savings or time deposits (peso or foreign currency denominated) maintained with a commercial or universal Bank with a satisfactory examination rating; (d) commercial papers duly registered with the commission with an investment grade credit rating; (e) certain specified loans to private corporations; (f) private or corporate bonds of corporations duly registered with the SEC with a current credit rating of at least "a" by an accredited Philippine rating agency.

247. Total investment in Government securities may not be less than 10% of the trust fund equity. The maximum exposure to fixed income investments in items (c) to (f) of § 6.1 of the SEC Proposed Guidelines, shall not exceed 20% of the total Trust fund equity while the exposure to each issue shall not exceed 50% of the allocated amount. The same section also states that the amount to be allocated for equities shall not exceed 25% of the total trust fund equity while the investment in any particular issue shall not exceed 10% of the allocated amount.

required to be divested;[248] a liquidity reserve fund is established;[249] and trustees are required to submit monthly reports on the trust fund financial condition.[250] SEC personnel are also authorized by the guidelines to conduct audits of trust entities managing pre-need trust funds.[251]

3. Charitable Trusts

Title 2 of the Insurance Code provides for the recognition of charitable trusts[252] in the Philippines. Charitable trusts are trusts created for the "relief of poverty, the advancement of education or religion, promotion of health, governmental or municipal purposes, or other purposes the achievement of which is beneficial to the community."[253] The common law rule is that a trust that "states a general charitable purpose does not fail even if the settlor had neglected to specify a particular charitable purpose or an organization which is to receive distributions as a court has the power to specify particular

248. SEC Proposed Guidelines, *supra* note 242, § 6.3 (requires divestment of the following within three (3) years from the passage of the guidelines: (a) unlisted shares of stock; (b) excess from the prescribed limit of the investment portfolio allocation (c) non-income generating real estate investments, and (d) other instruments not allowed by the circular).

249. *See,* SEC Proposed Guidelines, *supra* note 242, § 8 (citing New Rules on the Registration and Sale of Pre-Need Plans, rule 18.1) ("No less than10% of the net value of the trust fund assets per type of plan shall be set aside as a liquidity reserve to cover the benefits due to the planholder.").

250. Aquino, *supra* note 238, at 8; *see,* SEC Proposed Guidelines, *supra* note 243, § 9 (2) (requiring the trustee to make a report to the pre-need company and the SEC within 10 days after each month).

251. *Id.* at 7.

252. Charitable trusts according to art. 410 of the Insurance Code include:

> [a]ll the real or personal properties or funds ... given to or received by any person, corporation, association, foundation, or entity, except the National Government, its instrumentalities or political subdivisions, for charitable, benevolent, educational, pious, religious, or other uses for the benefit of the public at large or a particular portion thereof or for the benefit of an indefinite number of persons.

253. UTC, § 405; Second Restatement, § 291 Comment (c). A charitable trust can be created for two or more of the purposes stated.

> If the purposes to which the property is by the terms of the trust to be devoted are charitable purposes, the motive of the settlor in creating the trust is immaterial. Thus, even if the motive of the testator in disposing of his property is to spite his heirs, the trust is none the less a charitable trust if the purposes are charitable.

charitable purposes or recipients" or "delegate to the trustee the framing of an appropriate scheme to this effect."[254] Moreover, a trust which fails to state a general charitable purpose "does not fail upon failure of the particular means specified in the terms of the trust," and the court must instead apply the trust property in a manner consistent with the settlor's charitable purposes to the extent they can be ascertained.[255] Charitable trusts must also be legal and not contrary to public policy.[256] Enforcement of the trust may be through a suit instituted by the settlor.[257]

Under Philippine law, all trustees for charitable trusts are required to obtain a certificate of registration from the Insurance Commissioner[258] and section 411 of the Insurance Code precludes the National Government, its instrumentalities, and political subdivisions from serving as the trustee. Given the brevity of title 2, the Insurance Code provides a catch-all provision stating that all provisions in the Insurance Code governing mutual benefit associations, *i.e.* articles 390 to 409, and other such provisions as "practicable and necessary," are applicable.[259] While the reference to "all provisions ...

254. UTC, § 405 Comment; Second Restatement, § 396. "A charitable trust is also valid, although by the terms of the trust the trustee is authorized to apply the trust property to any charitable purpose which he may select." Government v. Abadilla, 46 Phil. 642 (1924). "It is not necessary to the creation of a trust that the *cestui que trust* be named or even be in existence at the time of its creation, and this is especially so in regard to charitable trusts."

255. *See,* UTC, § 413(a).

256. UTC, § 405 Comment; *see also,* CIVIL CODE, art. 1306 (on the general prohibitions aside from illegality and contrariness to public policy).

257. UTC, § 405. This is contrary to the rule laid down in § 391 of Second Restatement which provides that enforcement of a charitable trust can be done by a suit brought by the attorney general (the State) or any other public officer, or by a co-trustee, or by a person who has a special interest in the enforcement of the charitable trust, but not by persons who have no special interest or by the settlor or his heirs, personal representatives or next of kin.

258. INSURANCE CODE, § 413; Procedure in the Licensing of Trust for Charitable Uses, Letter from Insurance Commissioner Evangeline Escobillo (Mar. 31, 2007). To obtain the certificate of registration, a prospective trustee is subject to several licensing and actuarial requirements such as a deposit in the amount of PhP10,000.00 in government securities as guaranty fund, submission of fidelity bonds of accountable officers, pre-licensing examination, actuarial projections prepared and signed by a duly accredited actuary showing probable income and outgo, reserve requirements, and enumeration of actuarial assumptions and bases.

259. *Id.*; Letter from Insurance Commissioner Evangeline Escobillo (Mar. 31, 2007). The number of charitable trusts in the country has been historically limited.

governing mutual benefit associations" may be an instance of overbreadth since not all of these provisions may be applied to the charitable trust without denigrating its fundamental nature, some of the provisions do present specialized rules for charitable trusts and trustees and must be taken particular note of.[260]

V. CHALLENGES AND OPPORTUNITIES

While there is perhaps some esoteric merit in analogizing the challenges and opportunities faced by the Philippine trust with that of the trust in the United States, a contextualized critique is needed to accurately assess how the Philippine trust is situated. Indeed, a century of legal and business accretion, or perhaps the lack thereof, has made the Philippine situation unique by its own.

A. Developing a Philippine Trust Law System

The heading could have been written to be more accurate. It is not that the Philippines needs to develop a system of trust law — this work has shown that one exists today — it is coming up with the right system of trust law that is called for.

1. Identifying the Impediments

More than a decade has passed since 1903 when the first Philippine case dealing with trust law principles was promulgated by the Supreme Court.[261] Despite the span of time that has elapsed, despite the proximity of fundamental Philippine trust law with the great body of American trust law, and despite the increasing globalization of commerce, the growth of Philippine trust has been slow, erratic, and for lack of a better adjective — interstitial. Add to this the fact that the trust, while known by the average Filipino, can hardly be claimed to be as popular, as understood, as accepted,

Moreover, the number of new charitable trusts per annum is on the decline. In 2006, there were seven new charitable trusts registered with the Insurance Commission compared to the 26 new charitable trusts registered in 1997.

260. *See, e.g.*, INSURANCE CODE, § 398 (investment powers), § 400 (reportorial requirements), § 401 (exemption of distribution from attachment, garnishment or other process) & § 409 (fines and penalties for violation of requirements).

261. The case is *Martinez v. Martinez*, 1 Phil. 647 (1903). In this case which dealt with the ownership of a steamer and coastal vessel, the Philippine Supreme Court held that: "[t]he fact that a vessel registered in the name of one party was purchased with funds of another does not give the latter either a legal or an equitable title to the vessel, nor does it raise a resulting trust in his favor."

or as widely-used as its juristic and juridical alternatives in asset partitioning and conveyancing (*i.e.* sale, agency, donation, etc.) and organizational law (*i.e.* partnership or corporation).

No Comprehensive Trust Law System. The first impediment is revealed via a critique on systems design — an observation on how current Philippine trust law works on a macro-level and an examination of its philosophical underpinnings. One major factor perceived to be the cause of the slow stalactiting of the trust legal system is the lack of a general body of trust law that is comprehensive and accessible and which represents a practicable framework.

The framework must be comprehensive. Determinate rules governing the trust relationship must be established in codified form. The rules to be supplied should include detailed guidelines on the creation of the trust, the kinds and different natures of trusts, the capacity of the parties to enter into the trust relationship, the duties and powers of the trustee, the entitlements of the beneficiaries, trustee liability, and trust termination, just to name a few. Such a system is in stark comparison to the current state of trust law found in the 1950 Civil Code which provides an unjustifiably incomplete summary of the general nature of the trust, its creation and types, and which leaves the so-called general law on trust to fill in the gray areas. To realize how this aids the process of assimilating the trust as a legal institution into Philippine legal culture, one need only see how influential trust treatises and works have been to the development and maturity of American trust law. The American Law Institute's Restatements of the law of Trust and George Bogert's seminal works collectively served as handbooks for several generations of American lawyers.[262] Because of these works, a systematic presentation of trust law was made available which was authoritative at the same time as it was comprehensive.

It is pointed out that works like the Restatements are mere studied attempts to consolidate the ever-evolving common law on trusts. Thus, any issue of trust law is best solved by first referring to state court decisions for a

262. *See,* Thurman W. Arnold, *The Law of Trusts and Trustees by George Gleason Bogert*, 36 COLUM. L. REV. 689 (1936).

> Therefore what the *Restatement* has actually done is to bolster our faith that such things as the law of trusts are on a firm, rational and logical basis. It has lined up the bench and bar in a great and very necessary protective association against the attacks of judicial realists. Its published results are a ceremony and a way of thinking rather than a textbook .... The ceremony was successful in setting the symbols of trusts on a firmer foundation than before.

determination of the status of the common law rules prevailing within a state, and only then by turning to the Restatements as secondary reference point.[263] Several points also show that works like the Restatement and the UTC cannot be taken as conclusive proof of the "general law of trust" in and by themselves alone.

First, works like the Restatements and the UTC do not have the force and effect of a codified statute. The Restatements are a collection of principles that serve as guidelines to the legal profession while the UTC is in the nature of a model law which may or may not be adopted by a state in its jurisdiction. Even in the case of the adoption by a state, such state may still choose to augment, supplement, or revise some of the UTC's provisions. Second, the Restatements and the UTC only purport to represent the rules that most of the states accept and thus, by necessary implication, other states might have a different view on a particular trust issue. The fact that the variations among the state may be no more than insignificant at one point does not negate the potential variability inherent in the system. Finally, the process of drafting works like the Restatements and UTC have taken a considerable time and they may likewise take a long time to amend or supplement. The Second Restatement came into use in 1959 while the amendments for the Third Restatement had been started as early as the 1980s but has yet to be completed to this date. This is a likely indication that there will inevitably come a time when the Restatements or similar works will fail to accurately embody what the common law of trust is at a particular point in time. The whole point of this analysis is to show that the body of the common law on trust is essentially an evolving one[264] and pegging the operation of a set of rules on its basis can be difficult.

Article 1440 of the 1950 Civil Code provision on the incorporation of the American common law on trust is a good point to start an analysis. What "general law of trust" does it speak about? *Government v. Abadilla* held that American trust law precedents were valid sources of trust principles in the Philippines, but the same case clearly made reference to both American and

263. Austin W. Scott, *Trusts in the United States*, 31 J. OF COMP. LEGIS. & INT'L L. 12 (1949) [hereinafter Scott, *Trust in the U.S.*].

The so-called Restatement of the Law of Trusts was first issued in 1935. Its purpose was to state the principles and rules of the law of Trusts prevailing generally in the States, without regard to particular deviations in particular States. The Restatement does not have the authority of a statute or the authority of judicial decisions.

264. It should also be pointed out that the Restatements 2d and 3d are not wholly in point. The UTC also is marked by deviations from some of the rules contained in the Restatements.

English equity jurisprudence, not American jurisprudence alone. The independent development of the American and English trust law over the course of the century has caused these two systems to be punctuated by various differences.[265] Thus, it is a plausible reading that, when the 1950 Civil Code refers to the general law of trusts, it could actually be referring to the collective understanding of trust law in virtually all trust jurisdictions, that is, if there is such a coherent collectivity in the first place. For the sake of simplicity, but without conceding the correctness of the position, we might assume that it is American common law which solely applies to the exclusion of other systems which we might otherwise classify as part of the general law of trusts. The defect in this approach is the fact that there simply is no all-encompassing and definitive "general law of trust" in the United States the compendium of which, according to the Code Commission, should serve as the loci in locating a definitive set of trust rules for the Philippines.[266] Indeed, American trust law is essentially state law and while there are doctrinal overlaps signifying collective agreement in certain areas of trust law, there is no collective agreement on all trust principles. As shown earlier, the closest one can get to such an agreement would be the Restatements or the UTC but even this has been shown to be not absolutely true. For practicality's sake, therefore, one might have to end up accepting the Restatements or the UTC as the frames of reference in determining a comprehensive system of trust rules even if such an approach clearly does not comport to the literal dictate of article 1440. This only shows that article 1440 was a poor exercise in legislative drafting and that its practical result is the circular impossibility of the Philippine trust system. That the Code Commissioners did this with the rationale that "American and English courts have developed certain equitable rules that are not recognized in the present Civil Code" is no excuse for neglecting to provide a more definite system of trust law in the 1950 Civil Code. Up to now, no comprehensive trust code has been enacted.

265. *See*, Scott, *Trust in the U.S.*, *supra* note 263, at 11 (on the differences of the developments in English and American trust law); *see also*, MAURIZIO LUPOI, TRUSTS: A COMPARATIVE STUDY 277 (2000).

266. *Cf.* Interview with Robert H. Sitkoff (Apr. 29, 2007) ("There are general, core principles that pertain in all states. And in trust law in particular, because so many states have so few cases, the Restatements, treatises, and uniform laws have had profound influence."). Nevertheless, even as these collective principles may constitute what may be loosely referred to as the "general law of trust," it is believed that employing such a framework of rules mainly by reference does not forebode stability for Philippine trust law given the peculiarities of the Philippines' legal system.

The system of trust law must also be accessible. Accessibility is important since it is the most efficient way a system of legal rules can permeate into the legal culture. On the other hand, lack of accessibility, as has been the case in the Philippines, can stymie growth of the law. Until the advent of the internet, Philippine lawyers virtually had no efficient way to access and therefore make sense of the complex and conflicting rules of trusts, or even simply keep abreast with the development of the "general law of trust." Without this access to jurisprudential developments, such general law of trust was effectively inutile as the common law on trusts was to be found therein. While Philippine lawyers could have brought in American consultants to "guide" them on American law, this seems to be an impractical approach. Aside from the very irony of bringing in a foreign consultant to tell Philippine lawyers what their law should be, one subscribing to this approach would surely be wary of the transaction costs this course would entail. Even with the ease of information gathering and communications today, the inertia of inaction has weighed heavily against the development of trust law in the Philippines.

The institution of the trust is invariably affected by past industry behavior and environmental, cultural, political, and economic factors.[267] These must be taken into account in drafting any compilation of trust law for the Philippines to ensure the harmonization of the use of the trust instrument with other prineiples in the legal system. This will be in stark contrast with the past piecemeal developments where the growth of the law was unstructured and haphazard, such that specific and specialized areas in trust law were developed without particular regard to the effect on the entire trust system. This unstructured development and the lack of comprehensiveness and accessibility of the trust legal system lead to the problem of legal uncertainty.

Shadows of Legal Uncertainty. The shadow of legal uncertainty in Philippine trust law is all too palpable. Within the statute books, we see various examples of juristic concepts but superficially similar to the trust categorized, utilized, and referred to as trusts, inviting the application of trust rules, when such concepts are juristically distinct from the trust and should be governed by different rules under local law.[268] This is the problem of mischaracterization which is bound to happen when a comprehensive system of trust law is absent.

267. Manguiat, *supra* note 41, at 76.

268. Abad Santos, *supra* note 4, at 522. "The trust should not be confused with other relationships containing a fiduciary element, such as deposit, agency, guardianship, executorship, or administratorship."

Worst, without the comprehensive system, one cannot depend on the automatic application of default rules to the trust relationship — even as this is heralded as one of the chief benefits of the trust regime. Indeed, the trust form is a superior form because of the whole array of default rules called upon the establishment of the trust.[269] Parties resorting to a trust agreement are assured in the fact that the lack of detail contained in the trust instrument will not prevent the trust rules on fiduciary duties, trustee liability, and powers and entitlements from entering the four corners of the instrument. Trust rules also govern the ordering of the relationship between the parties to a trust and third parties with whom they deal.[270] Thus, the settlor and the trustee need only record the extent to which their deal deviates from the default governance regime whenever they use the trust arrangement.[271] This default regime benefits the trustor and beneficiaries as it lowers transaction and agency costs and provides a veneer of stability to the legal relationship and makes its effects predictable.

If the trust is underused in the Philippines, one should not blame local lawyers for not sticking out their clients on a limb on the basis of an untested legal concept. A lawyer who reads an article on trust law might be impressed with the attributes of a trust; he might believe in the article when it tells him that the trust can serve as a versatile and alternative medium in situations traditionally monopolized by other legal forms. A good lawyer, however, must be aware of what particular consequences a feature of the transaction vehicle brings to the deal, and thus, should opt to go with something tried and tested such as a corporation as the deal entity — he is reassured by the maturity of the body of corporate law in the country.

What of trusts contained in special laws or regulations such as the BSP Manual? These rules are codifications in themselves and the way these regulations are drafted shows that they seek to provide a workable system to govern the particular trust product regulated. This lessens the unease of uncertainty but, nonetheless, emphasizes the need for a system of

269. Hansmann, *supra* note 223, at 135. Notice that:

> the utility of the trust as a legal institution turns on the efficiency of having this set of standard terms, which in turn requires, in general (1) the standard terms must be efficient in themselves, which is roughly to say that they are the terms that the parties would agree to it they could bargain costlessly between themselves; (2) the transaction costs of negotiating at least some of those standard terms would be significantly higher if the parties could employ only the basic law of contract, property, and agency.

270. *Id.* at 147.

271. Sitkoff, *Agency Costs*, *supra* note 114, at 630.

comprehensive trust rules as even these special laws and regulations hardly cover enough of the multi-faceted aspects of a trust relationship.

It must also be remembered that while the legal system of the Philippines is a hybrid of civil law and common law, many Philippine educated lawyers are still geared towards a civil law bias, one that gives emphasis to the contents of codifications. Most certainly, a Philippine lawyer is one who will give importance to judicial precedent from the Supreme Court as *stare decisis* is a widely-observed principle. Nonetheless, a lawyer trained in the Philippines will probably have a different outlook on the legal system from an American lawyer. An American lawyer (and judge) is bound to slice-and-dice decisions, to sift through subtle differences in fact scenarios, to derive the common law and oft times creating sub-rules within rules. A Philippine lawyer, on the other hand, will tend to look at the fact scenario, arrive at the appropriate legal rule by induction and then go back via deduction in application of the rule. Nothing should be taken to imply that one of these systems is inferior — both have their independent merits — but it should underscore the observation that the machinery of Philippine law is more principle- and code-based. Codified law has the effect of establishing certainty while the opposite is inevitably produced by the lack thereof.

It also needs to be pointed out that article 1440 subordinated the general law of trusts to the provisions of the 1950 Civil Code and other special laws. Peculiarly, the general law of trusts is even subordinate to the Rules of Court which is only an administrative issuance of the Supreme Court. This is tantamount to saying that the law occupies a lower rung in the hierarchy against an administrative regulation. The practical effect of this is that an administrative body may easily issue rules to provide a codified trust regime to solve the Philippines' lack of a comprehensive trust law system. Though Trust law will have the ability to develop and adjust faster than common law or congressional enactments, the very ease by which such regulations are put into place is the scheme's very downfall. Various governmental agencies are authorized to issue administrative regulations, but which governmental agency should have the authority to issue trust regulations? If more than one is authorized to issue, what happens when an issuance conflicts with another issuance given out by a co-equal agency? The result seems to be more legal uncertainty. The speed by which administrative regulations may be drafted and passed also means an ever-shifting body of trust rules, an event which leads to the same uncertain results. Finally, the fact that the study and deliberations accompanying administrative regulations are usually less in severity compared to the deliberations for statutes could mean that poorly thought-out policy could be developed to the detriment of trust users.

It is not hard to see just how the general law of trust is nebulously applicable to the Philippines and how article 1440 effectively doomed trust law by reason of its insertion into the 1950 Civil Code. A prime example would be the legal categorization of a trust. While the Third Restatement amply provides a list of relationships which are not trusts, there are pockets of uncertainties which have encouraged legal scholars to argue that some trusts may be much more akin to certain other legal forms than previously believed. Take the argument of John H. Langbein on the contractarian underpinnings of the trust which he persuasively argues is founded on the contractual deal. According to him, the trust is a deal, a bargain about how trust assets are to be managed and distributed and, as such, is functionally indistinguishable from the modern third-party beneficiary contract.[272] Thus, while it may be argued that American trust law is too developed to accept the proposition that a trust is a contract, Philippine trust law is too undeveloped to be able to deny the same.

What is the effect of trusts being considered as contracts under Philippine law?[273] Simply put, the effect will be that the entire regime of obligations and contracts under the 1950 Civil Code will be held applicable to the trust and, by virtue of article 1440, trust rules will be subordinated to all the provisions of this regime which are in any way contrary.

Trust creation and its formal requisites are the first to be affected. To illustrate, a contract will require valid consideration which a trust for gratuitous transfer will not have. Alternatively, the trust could be deemed a donation burdened with a charge or condition.[274] In this case, the formal rules on donations will apply and a settlor will not be able to create a trust orally if the trust corpus is more than PhP5,000.00.[275] Beyond this, since the

272. Langbein, *supra* note 126, at 627.

273. *Id.* at 628. Frederic Maitland, a great scholar of the common law, believed that the trust was a bargain, "an obligation in point of fact a contract thought not usually so called." *Id.* at 644-45. Even though the trust arises upon the transfer of the property to the trustee, the trust: "originates in an agreement ... The Chancellor begins to enforce a personal right, a *jus in personam*, not a real right, a *jus in rem* — he begins to enforce a right which in truth is a contractual right, a right created by promise."

274. Pierre Lepaulle, *Civil Law Substitutes for Trust*, 36 YALE L.J. 1136 (1927). "Though the idea of a personal benefit comes to mind when one speaks of a donee or legatee, it is perfectly possible, from a legal point of view, to impose on a legatee or donee such a charge or condition, or to deprive him of all real benefits."

275. *See,* CIVIL CODE, art. 758. *Cf.* Cristobal v. Gomez, 50 Phil. 810 (1927)

trust can be compared functionally to a third-party beneficiary contract, a so-called stipulation *pour autrui*, acceptance of the beneficiary must be express and communicated and cannot be left to a presumption contrary to the rule provided by the general law of trust.[276] If the ceding of equitable title to the beneficiary is considered a usufruct under property law, a collection of different rules will apply.[277]

Furthermore, a settlor would not be able to take the position of trustee concurrently insofar as a merger would result which, under the 1950 Civil Code, will result in the extinguishment of the obligation.[278] The standards of fiduciary duty might also be different inasmuch as contract law generally requires the conduct of a good father of the family compared to the developed duty of prudence from the common law of trusts. It might also be unclear whether Philippine contract law will allow a contract for the benefit of a third party (*i.e.* the beneficiaries of the trust) when such third party, while ascertainable, are yet to be born or conceived. For testamentary trusts, it could be argued that the principle of fideicommisary substitution applies and, therefore, its limitations need to be observed in derogation of general trust principles.[279] On the trustee's power to delegate under the prudent

A trust constituted between two contracting parties for the benefit of a third person is not subject to the rules governing donations of real property. The beneficiary of a trust may demand performance of the obligation without having formally accepted the benefit of the trust in a public document, upon mere acquiescence in the formation of the trust and acceptance.

276. *See,* CIVIL CODE, arts. 1311 & 1446.

277. *See,* CIVIL CODE, arts. 562-612. Note, *Common Law Trusts in Civil Law Courts*, 67 HARV. L. REV. 1031 (1954) [hereinafter Note, *Common Law Trusts*]. "The holder of a usufructuary right, like the life beneficiary of a trust, may enjoy the property during his life without being allowed to endanger it, but the extent of his enjoyment will depend on his own management and not on that of another."

278. *Cf.* Langbein, *supra* note 126, at 627 (for the proposition that while some trusts can be contracts, some are not).

The contractarian account, presupposing a separate trustee, does not embrace the declaration of trust, which is a mode of trust creation that allows the transferor of property simply to declare himself or herself trustee for the transferee. This two-party trust lacks the separate trustee. The settlor cannot contract with himself or herself, and accordingly, we see that the trust can arise without contract.

279. *See,* CIVIL CODE, art. 785.

Fideicomissary substitutions by virtue of which the heir is charged to preserve and transmit to a third person the whole or part of the inheritance

investor rule in Third Restatement, the trustee who properly delegates and who would otherwise be free from liability for the acts of the substitute could be held liable under agency principles if he was not specifically authorized in the trust instrument.[280] These are but basic illustrations of how uncertainty is engendered by potential interpretative conflicts.

The compound effect of these views is to disfavor the trust form utterly against the alternatives. For asset dispositions, depending on how extensively legal and equitable title are to be ceded, one might look towards the straightforward and much more understood devices under the 1950 Civil Code such as a contract of sale, agency, donation, or mortgage. For an organizational form, instead of a trust, a transaction planner might prefer a partnership or a corporation even when more restrictions abound with these juridical forms.

Path Dependence and Network Externalities. Preceding discussions have shown us that the manner in which the 1950 Civil Code provisions on trust were drafted has contributed largely to the current deplorable state of the Philippine trust in general. The results of the lack of comprehensive trust rules and the resulting legal uncertainty form a vicious cycle. Aside from asking why corporations are vastly favored over trusts, one also wonders why lawyers and bank groups have not lobbied hard for laws which enable the increased use of the flexible trust.

Lack of access, understanding, and pervading uncertainty was one explanation proffered earlier. Another explanation borrowed from economic literature involves the concept of network externalities.[281] Applying the

shall be valid and effective, provided they do not go beyond the second degree, or that they are made in favor of persons living at the time of the death of the testator.

Note, *Common Law Trusts*, *supra* note 277. Like the trust:

the *fideicommissum* limited the transferee's right of alienability and gave the beneficiary of the charge a power to enforce his rights against the owner, but it differed in that the heir could repudiate the will and upset the testator's plan, while a trust will not fail for want of a trustee.

280. Halbach, *supra* note 114, at 1910. § 9 (c) of the Uniform Prudent Investor the Act expressly provides that a trustee who complies with the requirements of proper delegation "is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated." *But see,* CIVIL CODE, art. 1892 ("The agent may appoint a substitute if the principal has not prohibited him from doing so; but he shall be responsible for the acts of the substitute: (1) when he was not given the power to appoint one ....").

281. Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CAL. L. REV. 481 (1988). "Economic scholarship has recently focused

theory, local Philippine lawyers opt not to lobby Congress for the adoption of trust rules because other legal alternatives have so far dominated the legal culture, such that it will create more value for them to ask for improvements to forms which already populate the status quo. It is also plausible, if not likely, that lobbying efforts of banks have been redirected to other more traditional or understood areas as forays into new financial products or arrangements will need to pass through the bank's lawyers first. And so, a self-perpetuating prophecy is set into motion.

2. Recommendations

In light of the extensive discussion on the impediments to trust development in the Philippines, several recommendations are presented. First, a comprehensive body of trust rules must be codified for the guidance of the legal profession and the business community. Codification will give the trust regime much needed stability and allow planners to perceive such regime as one imbued by predictability of outcome. The compilation will serve as ready and accessible reference points for users, particularly judges and lawyers, in evaluating trust relationships and will lead to the steady outgrowth of Philippine trust law as trust doctrines are used more and more in documents, transactions, and litigation. This will also allow Philippine trust law to grow organically and independently of the American model.

Second, programs to promote trust awareness within the Philippines should be supported. The growth of Philippine trust law does not only start with the law profession but must be met with grassroots growth, specifically among the users. At present, trust industry bodies, in cooperation with the BSP, have been active in such undertakings. The Trust Officer's Association of the Philippines (TOAP), and its educational arm, the Trust Institute Foundation of the Philippines (TIFP), have been conducting information campaigns and training seminars on trusts. Under the auspices of the BSP, a series of Trust Consciousness Weeks have been declared to enhance the knowledge and acceptance of the trust instrument by the general public.

a great deal of attention on the phenomenon of network externalities, or network effects: markers in which the value that consumers place on a good increases as others use the good." *Id.* at 488-89.

Telephones and fax machines are classic examples of actual network goods; owning the only telephone or fax machine in the world would be of little benefit because it could not be used to communicate with anyone. The value of the telephone or fax machine one has already purchased increases with each additional purchaser, so long as all machines operate on the same standards and the network infrastructure is capable of processing all member communications reliably.

B. Refining Regulatory Control and Jurisdiction

1. The Burden of Regulation

An issue bearing on the availability and feasibility of trust arrangements in the Philippines is the detail, coverage, and extent of regulation trust arrangements are subjected to. In the Philippines, the system of trust regulation is severely polarized. On one hand, traditional trust instruments and relationships are virtually ungoverned due to a lack of observable legal standards for trust arrangements. On the other hand, a number of trust instruments and products have become subject to broad and encompassing regulation by the BSP as it implements its mandate of ensuring the safe and sound conduct of trust business. Such regulation comes at a price as each regulatory nuance imposed sacrifices a large measure of the flexibility of the trust.

To understand how important design flexibility is, one must understand that the trust form's adherents have greatly valued its innate flexibility to conform to a user's objectives. A trust is used to bypass restrictions which burden other legal forms and alternatives, say a corporation. It allows a user to tailor-fit the deal to his desire such as by allowing infinite levels of participating classes with different rights, allowing varying standards to govern the trustee's powers of investment and measure of risk-tolerance, and imposing inexpensive, practical, and automatic safeguards against otherwise unabated agency costs. It awards users with administrative and design flexibility.

These beneficial attributes of the trust are severely downgraded by administrative regulations, which not only sweep too broadly, but also over-provide in details. While there is no argument that the BSP has the right to do this under the police power of the state, there are some points which should be raised with respect to the BSP's rule-making tendency:

First, the phrase "rule-making tendency" is used as it describes how the BSP seems to believe that each trust product that has enjoyed more than modest success must be regulated. Lest it be understood, the underlying premise is in fact laudable. The BSP is wary of deposit arrangements masquerading as products without complying with reserve and other requirements.[282] Rather than coming up each time with a new regulation to

282. Reynaldo Geronimo, *Dialog Bears Good Fruit*, MANILA STANDARD TODAY, Dec. 27, 2006, *available at* http://www.thetrustguru.com/MSToday/mstoday122706.htm (last accessed July 14, 2007) [hereinafter Geronimo, *Dialog Bears Good Fruit*].

cover a developing trust industry, the BSP will do better by subscribing to a principle-based approach to the regulations on deposit arrangements so that bad tissue are incised rather than healthy ones. Regulations should provide a general model which goes beyond formal categorizations of instrument-type and it should spare the Lilliputian details in favor of standard-setting guidelines which serve to separate deposit arrangements from differently regulated financial instruments.[283] To this end, the BSP could issue a list of what would make an arrangement, regardless of what it is actually or legally called, subject to reserves and treated like debt.[284] Though it may be difficult, the task can be accomplished and a set of standards which provide for the minimum characteristics of a deposit arrangement to separate it from the rest will work.

Second, a review of existing regulations will show that some regulations are too broad or too detailed. The scales may ultimately tilt more toward the egregious results than the limited improvements introduced. Take, for instance, living trusts which are regulated by a BSP circular. The circular's definition of the living trust is in accord with the concept of a living trust at common law. Nevertheless, because of the broad definition of the circular, it is arguable that the BSP regulation on living trusts will have to be complied with in any and all occasions a living trust arrangement is entered into by and between a settlor and the trust department of a bank or trust company.[285] This may seem beneficial since definite parameters now exist to govern the creation and mechanics of such a trust, however, it also means

There was a need to draw a line between the two classes of relationships with banks with a trust license since deposits are a bank's actual liabilities duly accounted for in its balance sheet (hence, 'on books') while trust accounts are contingent accounts which do not go into the computation of the bank's resources and obligations, (hence, 'off-books'). From this main distinction flows a whole set of different regulations.

283. *Cf.* BSP Manual, §§ 4211Q-4211Q.3 (on Deposit Substitute Operations). § 4211Q provides: "Only the following types of instruments may be issued by NBQBs as evidence of deposit substitute liabilities: (a) Promissory notes; (b) Repurchase agreements; and (c) Certificates of assignment/participation with recourse."

284. *See,* Reynaldo Geronimo, *The Third Man in the Trust Ring,* MANILA STANDARD TODAY, Feb. 15, 2006, *available at* http://www.thetrustguru.com/MSToday/mstoday021506.htm (last accessed July 14, 2007).

285. Geronimo, *Dialog Bears Good Fruit, supra* note 282. "This regulation will cover trusts established by individuals intended for their private benefit, including those of the trustor's family. Falling under this category would be trusts created as part of an estate plan, trusts for wealth management, trusts for asset protection, and, generally, trusts for family maintenance and support."

that all living trusts falling into the category must unfailingly comply with the specific mechanics prescribed by the BSP.[286] Since the circular has the force and effect of law, it will take precedence over any common law trust doctrine or statute to the contrary.[287] The effect is that a settlor wishing to have a living trust in the Philippines is *ipso facto* required to have a BSP-prescribed living trust to the exclusion of any other form of living trust. Such a living trust will have to comply with the specified minimum amount in trust assets and effectivity period, otherwise, the bank or trust company will be subjected to onerous reserve requirements imposed for deposit arrangements. This tends to destroy any inherent flexibility existing in the trust form and further, gives the public the general impression that living trusts are restrictive instruments by nature. In the absence of a general framework of trust rules, the BSP may feel that it is left with no other choice but to issue the regulations in the way they are currently drafted.

The entry barriers to the trust industry have also invariably influenced the growth of the trust business and the use of the trust, in general. For many lawyers and businesses, governmental regulations act by imposing high barriers to entry to the trust business. The Philippines is not alone in its regulation of the trust business. Several American states, a prime example of which is Delaware,[288] impose a regulatory regime on entities engaged in the conduct of the trust business. Both the BSP and Delaware impose registration prerequisites, reserve requirements, loan and investment limitations, and mandatory reportorial processes, among other things.

The problem for the Philippine case is the fact that section 79 of the GBL of 2000, the qualifying provision for trust entities, is hardly a model of clarity. While the general understanding is that the cluster of provisions dealing with trust operations in the GBL of 2000 apply almost exclusively to banks and trust companies, it has far reaching effects on trusts and trustees in general. Certainly, one may read the provision to the conclusion that any person wishing to act as a trustee or who wishes to administer or hold property in trust for a beneficiary must be first authorized by the Monetary Board as a condition *sine qua non.* Such is the strict and literal meaning of section 79. Carried to its illogical result, any trustee in the Philippines who has not been granted BSP authorization is doing so illegally and is subject to the penalties under law.

286. BSP Circular No. 521 on living trusts this imposes amount thresholds and holding periods among the many requirements.

287. *See,* CIVIL CODE, art. 1440.

288. *See,* DEL. CODE, tit. 5, subch. I, §§ 901-03.

The practice today is that personal trustees serving a trust will often not require compensation to avoid being categorized as being engaged in the trust business. Based on what the law clearly says, a trustee may not perform trust duties even if he is doing it for free if he has not been so authorized by the Monetary Board. The definition of "trust business" as contained in the BSP Manual is no help either as it does not in any way limit its applicability to professional trusteeship services.[289] Even assuming that this reading is erroneous, it should be pointed out that section 79 refers only to authorized stock corporations as "trust entities" to the implied exclusion of natural persons or other entities under law. Is one to infer from this that the whole regime of rules in the GBL of 2000 and the BSP do not apply to non-corporate trustees? Are there any independent rules for non-corporate trustees in the first place? Has the Monetary Board ever granted a non-corporate trustee such an authorization?[290]

Finally, there are the burgeoning operational and financial requirements for trust departments of banks and trust companies. Unlike the Delaware Code, Philippine banking laws and regulations require large deposits, maintenance of liquidity floors, and required levels for return on equity as well as the maintenance of net worth-to-risk assets ratios. These requirements are imposed equally on a bank and a trust company. The requirements to enter into the trust business may therefore have become too high except for the big and established players. Whether this is a policy which should be perpetuated is a complex question which should be studied carefully.

2. Regulatory Competition

Regulatory competition in this section is meant to describe the ongoing debate as to which governmental body should have the rightful competence and jurisdiction to regulate trusts and oversee the trust industry. At present, the general conduct of trusts by trust entities is under the direct supervision of the BSP. Charitable trusts, however, fall under the jurisdiction of the

289. *See,* BSP Manual, § 4403Q (on the definition of "trust business," *viz.*: "Any activity resulting from a trustor-trustee relationship involving the appointment of a trustee by a trustor for the holding, administration, and management of funds and/or properties of the trustor for the use, benefit or advantage of the trustor or others called beneficiaries.").

290. Interview with *Bangko Sentral ng Pilipinas*, Trust Examination Department (Apr. 24, 2007). Preliminary responses of the BSP's Trust Examination Department indicate that no regulatory distinction is made with respect to corporate vis-à-vis personal trustees. It does not appear that a natural person has ever been accredited by the Monetary Board for the conduct of trust business.

Insurance Commissioner while the SEC exercises concurrent jurisdiction with the BSP over the trust funds of pre-need companies.[291] There is also the prospect of judicial supervision when a trustee is appointed by the court or when the trustee seeks judicial instruction as allowed under the common law.

To what extent may concurrent jurisdiction safely exist? The general issues which one should expect to arise include the effect of conflicting regulations over trust arrangements under concurrent governance. Not only will this exacerbate the lack of flexibility associated with the traditional regulation of trusts, it will also erode public confidence in the predictability of the effects of the trust form. It will also make it difficult to monitor the trust industry as a whole and assess its effects on the economy as inter-agency cooperation has not been particularly promising in the past. Suffice it to say that there is a growing sentiment that a consolidation of governance under one agency is operationally desirable and in keeping with global best practices. When and how this will occur, or fail to occur, is to be seen in the future.

3. Recommendations

There is a compelling need to restudy and refine the regulation of the trust business. An approach emphasizing principle-based standards is appropriate to make sure that regulations do not sweep too broadly as to include instruments which are governed by an independent set of rules and that they are not overly-detailed as to quash the innate flexibility and malleability of the trust form. Policies which unjustifiably impose high and restrictive barriers to entry to the trust industry should also be reviewed periodically to ensure that they produce a best-fit with the presently prevailing policy of the state. Furthermore, certain laws and regulations need to be clarified so that categories of trustees can be differentiated and appropriate regulations applied to the proper category.

VI. CONCLUSION

The trust celebrates its 104th birthday this year marked from the moment it first appeared in the Philippine legal system. Given its ability to replicate almost all trust arrangements under the American common law, the trust in the Philippines has the unsurprising promise of duplicating the transactional feats it has accomplished in jurisdictions which have astutely learned to

291. While some trust instruments are securities under Republic Act No. 8799, the Securities Regulation Code, § 9.1 (e) of the law provides that securities issued by a bank except its own shares of stock are exempt securities.

capitalize on the instrument's strengths and features. Its wide applicability and flexibility has made it a valuable tool in the modern world. Greater use of the trust in the Philippines will bring vast benefits to businesses, government, the non-profit sector, and individuals seeking a suitable alternative in the private ordering of their affairs. Industry groups, hand-in-hand with government, acknowledge the value of the trust and are increasingly turning to it to accomplish objectives for which other legal forms were traditionally utilized. Thus, while the growth of the Philippine trust has once been marked with stubborn stagnancy, it is believed that the requisite groundwork is being paved for the long-awaited and much-deserved renaissance of this legal institution.

Is the Philippines ready for the trust? Not surprisingly, the findings of this work verified the suspicion that much work has yet to be done. On the theoretical level, existing trust laws and regulations seem to have covered the major holes in the legal fabric of the trust. There is a fundamental framework for the recognition of trust in the jurisdiction. There are banking laws and regulations for trusts administered by financial institutions. There is a credible and workable taxing system for trust arrangements. An enormous body of American common law on trusts is expected to fill in whatever gaps are left. Philippine jurisprudence has also reinforced the concept of the trust into the Philippine lawyer's vocabulary and has pronounced certain trust doctrines which are now part of the legal system. And yet, there remains a fundamental incoherence in Philippine trust law.

The incoherence is brought by the absence of a comprehensive system of trust law in the Philippines and exacerbated by the invisible clash of the incorporation provision of the 1950 Civil Code and the general body of common law from which the missing parts of Philippine trust law are supposed to be derived. It is a model which has failed to meet expectations but one which can be fixed.

A comprehensive system of trust law is made possible by enacting a trust code which is not only complete and accessible, but is also drafted so that it reflects the unique legal and business realities in the Philippines. Such a law will enable legal practitioners to appreciate the full concept of the trust and it will encourage them to view the trust for what it really is — a unique legal institution with unique rules that are distinctly differentiable from other concepts found under Philippine law. The elucidation of these rules will allow trust users to understand how a trust truly operates and what different trusts can and cannot do. It will tell trustees what their powers and duties are and inform beneficiaries of what they are entitled to expect. Creditors and third-parties to the trust will likewise be enlightened by a set of rules which details their respective rights against the trustee and the trust. And, it will

help regulatory agencies streamline the contents of their trust rules so that regulation that is imposed is only to the extent necessary, allowing the use of the trust for the legitimate purposes the common law commended it to. As a result, overhanging legal uncertainty will dissipate and, in its place will be a set of rules which will allow users to plan ahead and accurately predict the legal consequences of a trust arrangement. These heretofore unrealized benefits will also have the effect of increasing trust usage by banks and the business sector in general and will help them realize the trust's potential as an attractive investment medium which will contribute to the deepening of domestic capital markets.

Finally, and most importantly, such a development will provide an unmistakable signal to the public that a once obscure part of the law is now being appropriately brought to fore in cognizance of its growing significance in a progressively evolving trust jurisdiction.