

Trust: A Tool for Estate Planning

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One of the most common tools in estate planning is the use of a Trust, an arrangement under which one can place his assets for his or someone else's benefit (the beneficiary) under the control of a trustee.

The concept of Trust was introduced in the Philippines by the Americans and was formally incorporated in the New Civil Code of the Philippines in 1950. For many years, this concept has been mistaken and confused with the "trust certificate" which was actually an instrument issued by banks in the early 1970's and is more synonymous with a time deposit, or with a "trust receipt" which is an instrument being availed of by importers as a corollary to a letter of credit application and as a security to a credit accommodation. This confusion is unfortunate considering that Trust is probably the most versatile and effective transaction a person with property could enter into. While in the United States and some European countries, they have sophisticated and more advanced rules on Trust, it is unfortunate that in the Philippines, this tool in estate planning is still not very much recognized as to its varied uses and benefits.

Meaning of Trust

Trust is a legal instrument or device whereby a person called a Trustor delivers part or all of his properties to another person called Trustee who administer and manages the property/ies for the benefit of designated person/s called Beneficiaries. The term "person" may refer to an individual or natural person or a juridical person like a corporation.

It is a transaction usually composed of three parties (trustor, trustee and beneficiaries), each with his own obligations and rights, and involving properties and property interests to address various kinds of purposes. The most notable feature of Trust is grounded on the fact that the legal title to the property is in one person while the beneficial interest which is referred to as the "equitable title" is in another person. The legal right of ownership and control are in the trustee, subject to the duty of applying and using the property as directed by the trustor, while the right to enjoy the benefits from the property is in the beneficiary of the trust.

Under the New Civil Code, Trust may be implied or express. Implied trust is created by operation of law, as for example when a person acquires property by mistake, he is considered by the law as a trustee while he holds the same for the real owner of the property. Express trust is established by the mutual stipulation of the parties or of the trustor.

In this article, I will only discuss express trust which is the most commonly used in the trust business or industry.

I. Basic Elements of an Express Trust

A. Parties to the Trust

1. The *trustor or grantor* - the owner or the person giving the property in trust, who should have the legal capacity to effectively transfer property outright by gift, assignment,

exchange or sale. Thus, a person under a legal disability to sell or donate a property, such as a minor or a mentally disable person, could not be a trustor.

2. The *trustee* – the person or institution in whom the confidence is reposed as regards the management of a property for the benefit of another person. The trustee may either be a natural person or a corporation or an institution.
3. The *beneficiary/ “cestui que trust”* – the person who is to receive the benefits from the trust or for whose benefit the trust has been created and is sufficiently identified as such. The beneficiary may be the trustor himself or persons other than the trustor, as for example, the trustor’s children or a foundation like Tuloy sa Don Bosco Streetchildren Foundation in Alabang, Muntinlupa City.

B. Manifest intention to establish a trust.

The person creating the trust must expressly show that he is seriously intending to enter into a trust arrangement. Imperfect expression of intent may result in converting the arrangement into some other form of contract, management or probably a simple agency relationship.

C. Trust Property

The subject matter of the trust or the ‘*res*’ must be clearly identified. It is important that the property to be transferred in trust must be existing, lawful, definite and transferrable. Anything that has an economic value and which a person may own and to which he may own and to which he may transfer legal title, by gift or sale, is a property that may be conveyed in trust. Hence, a trust may be constituted on real estate, household effects, cash, stocks, bonds and other securities, livestock and growing crops, works of art, jewelry and other tangible things.

Trust property need not be a tangible thing; it may be comprised of a claim, such as a right of action for breach of contract or upon a promissory note. For example, a trust may exist in life insurance policies or the proceeds thereof, or may consist of patents, copyrights, goodwill, trademarks and trade secrets.

D. A lawful purpose

If the trust violates a law or it is against morals, public policy or public order, the trust will be void and of no effect. Hence, a trust will be void if it involves the commission of a criminal act by the trustee, or if the trustee encourages the neglect of parental duties, restrains marriage, religious freedom or the performance of public duties.

II. Trust terms must be sufficiently stated in the trust instrument.

The trust instrument must at least show the following:

1. The beneficiaries and the extent of their interest;
2. The subject matter of the trust or the trust property;
3. The purpose or purposes of the trust;
4. A recitation of the powers and duties of the trustee to facilitate the orderly administration of the trust and the fulfillment of the trustor’s desires.

III. Who can be an Institutional Trustee?

A bank, investment house or any corporation can be an institutional trustee, provided that it is duly authorized or licensed by the Monetary Board of the Bangko Sentral ng Pilipinas

to perform trust and fiduciary business. In the case of authorized banks or investment houses, the trust or fiduciary business is normally carried out through their Trust division, department, group, unit, section, or any other form of aggragation. In the case of trust companies or trust corporations, the entire company or corporation is involved in carrying out the trust or fiduciary business, precisely because the company is establish for this particular business.

IV. Why will you benefit more in appointing an Institutional Trustee?

1. *Financial Responsibility and Responsiveness* - To be responsible is to be able to meet financial obligations; to be responsive is to be ready and willing as well as able, to meet them as they are determined. The institutional trustee is financially responsible not only by its own capital and surplus but also by the reserves it is required to put up for its trust business. Unlike a natural person as trustee, an institutional trustee is more compelled to maintain its financial responsiveness otherwise it may forfeit the patronage of people seeking trust service.
2. *Government Supervision* -The institutional trustee is under constant and continuous government regulations, examination and supervision by various government entities, specifically the Bangko Sentral ng Pilipinas, to ensure that the institutional trustee manages the trust property in the best interest of the beneficiary thereof.
3. *Group Judgment/Objectivity* -In the administration of trust, problems may arise which may require the advice and judgment of persons who, although not specialists, have sound judgment and are not subject to personal biases as regards the trust accounts presented to them for their deliberation. The institutional trustee obtains the group judgment of its officers, its Trust Committee and its Board of Directors.
4. *Specialization* -In trust administration institutions, the management of a trust is the work, not of one, but of several specialists. Hence, there are specialists, for example, in the investment of trust funds; in the management of business; in bookkeeping and accounting; in tax work; in research, in documentation, etc.
5. *Continuity of Capacity* - In the trust institution, continuity of capacity is to be found in the succession of trust officers. Incapacity or unavailability of one trust officer handling the account does not disrupt the servicing of the account because in a normal corporate set up, a successor or replacement or substitute immediately takes over.
6. *Continuity of Existence* - The life of a corporation or institution is almost perpetual. Corporate life under the Corporation Code of the Philippines is fifty (50) years renewable every fifty (50) years. The trustor feels assured that the institutional trustee he chooses will continue to be in existence and be prepared to serve his needs as well as his beneficiaries of the second and even the third generation.

V. What can you expect of an Institutional Trustee?

1. Fidelity to the trustor's interest;
2. Compliance with trustor's instructions and with the terms of trustor's agreement with the trustee;
3. Full disclosure of the details of trustor's investments;
4. Separation of trustor's money from the business of the bank and from the money of its other clients, except in the case of Common Trust Funds where participants become proportionate owners of a pool of investments;
5. Execution of all investments at the best possible prices and at the least transaction costs;
6. Scrupulous care, safety and prudent management of trustor's assets;

7. Confidentiality about trustor's financial affairs.

VI. What are the services offered by an Institutional Trustee?

The institutional trustee offers its clients a wide array of trust and other fiduciary services. These services range from the very simple safekeeping to the more complicated management of estates or retirement funds. In all these instances, the financial institution as *trustee takes the side of the works in the interest of the client*. The client may be an *individual, a corporation or an institution*.

The various services offered by an institutional trustee may be classified under three (3) general categories as follows:

A. Fiduciary/Trusteeship

The institutional trustee acts as the fiduciary when it is appointed by the court and serves as the executor or administrator of the properties left by a deceased person, as guardian of the estate of a minor or an incapacitated person, and a trustee of a legally constituted trust.

When the institutional trustee serves as a trustee of a legally constituted trust, it acts as fiduciary in the fullest sense. As trustee, it holds the legal title (*the trust property is registered in the name of the trustee for and in behalf of the beneficiary*) over the trust property for the benefit of the beneficiary who is said to hold the equitable title. This means that, with respect to the entire world, except the beneficiary, the owner of the property is the trustee. However, unlike a true property owner, the trustee is not entitled to use the trust property for its own gain. Instead, it is supposed to manage the trust asset for the benefit or for the good of the beneficiary.

B. Advisory

Under this role, the institutional trustee makes financial recommendations to the client as in, for example, the proper timing for selling or buying stocks, or which investment outlets to go into for maximization of yields, or the prospects of foreign currency investment, or transfer of assets at the least tax cost, etc. In addition to the financial advice, the client gets access to the in-depth and comprehensive investment research and analysis available to the institutional trustee because of its resources and extensive network. Some smart owners of big owners of portfolios split their money among several investment advisory accounts with the different institutional trustees and, after comparing the financial recommendations of these financial advisors, make their investment decisions based on where the weight of well-informed opinion lies.

C. Agency

As an agent, the institutional trustee does not take legal title to the property under its agency. The institutional trustee acts in behalf of the client in a representative capacity.

Examples of these services are as follows:

1. *Safekeeping* – The property owner turns over his securities and other valuables to the institutional trustee as agent. The institutional trustee has no other duty than to keep them safely and in due time return them to the owner or deliver them upon the owner's order or instructions.

2. *Custodianship* - As custodian, the main duties of the institutional trustee are to safekeep, preserve the property and to perform ministerial acts with respect to the property as directed by the client, such as collecting and crediting interest and dividends, attending to calls, maturities and conversion of securities. Stocks and bonds are the usual subject matter of custodianship.
3. *Management of Assets* - The institutional trustee as managing agent, undertakes to perform on behalf of the client, managerial duties and responsibilities appropriate to the kind of assets comprising the agency account and in conformity with the terms of the agency. The managing agent performs all the usual duties of a custodian plus participation in the active management of the assets of the agency account. The assets remain in the name of the client but the management of the assets is largely placed in the good judgment of the institutional trustee. The client may grant the trustee the authority to exercise full discretion in the management of the assets. This gives the trustee maximum flexibility necessary to enable the trustee to react in a timely and efficient manner to changes in the financial market that could have significant effects on the client's investment portfolio. Some clients may opt to limit the discretion of the trustee by requiring that the investments be made in accordance with a set of guidelines established beforehand and reviewed from time to time jointly by the client and the trustee.
4. *Escrow* - The institutional trustee as escrow agent for two contracting party protects their individual interests by ensuring that the terms and conditions mutually agreed upon by these two parties in a separate contract, are fulfilled. As a disinterested party, the escrow agent holds in custody the properties delivered to it by each of the contracting parties. The escrow agent monitors the conditions upon the performance of which, or the event upon the occurrence of which, the escrow agent shall deliver specific assets to the party entitled to receive them in accordance with the agreement between the parties. This service is convenient for transactions such as buying/selling of assets on installment basis, or disposition of assets subject to mandate restrictions or clearances.
5. *Attorney-in Fact for Various Purposes* - The client grants the institutional trustee as agent the power and authority to perform one or more specific acts in behalf of the client. The client meanwhile avails himself of the services of the institutional trustee's personnel who are experienced, competent and skilled in the performance of the delegated set/s.

VII. How flexible is trust?

Trust is flexible such that it can be modified from time to time to suit changing situations and objectives. However, certain limitations are to be considered and observed namely:

1. *Irrevocable Living Trust* - No changes may be made which would alter the irrevocable natures of the trust; this applies also to an Irrevocable Life Insurance Trust where the insured has designated an irrevocable beneficiary of insurance proceeds.
2. *Revocable Living Trust* - The trustor can change its terms such as the beneficiary designation, how the fund will be invested, manner of disposition or distribution of the fund to the beneficiaries; he may even terminate the trust at any time he so wishes.
3. *Testamentary Trust* - The trustor can change its term anytime during the life of the trustor. The trust becomes operative and the terms of the trust become final only upon his death.
4. *Retirement/Pension Trust* - The trustor (the employer) cannot amend the terms of

the trust where such amendment would constitute the diversion of all or a part of the principal and/or income of the fund to purposes other than those specified in the Retirement/Pension Plan.

5. *Sinking Fund Management, Trust Indenture, Escrow Agency, Collateral and Similar Arrangements* - Amendments in the terms can be made only upon mutual consent of the trustor and the beneficiary.

In any trust arrangement, however, the trustor and, in some cases the beneficiary, can change the trustee at any time.

VIII. How safe is your money in the Trust Institution?

Although not an obligation of the trust institution and not insured with the Philippine Deposit Insurance Corporation, money placed with a reputable trust institution is just as safe, if not safer, than money in a savings or time deposit account with a bank. There are enough safeguards instituted through current government regulations and industry practice, namely:

1. *Capitalization Requirements/License*

Not every bank or investment house can engage in the business of trust and other fiduciary functions. Only those authorized by the Bangko Sentral ng Pilipinas (BSP) may do so. And the BSP has set very high standards and stringent measures for financial institutions that are engaged in trust business.

Under a circular issued by the Monetary Board, an applicant for a trust license must have a combined capital account of not less than P250 million. This means that the total of its unimpaired paid-in capital, earned surplus and undivided profits, excluding amounts it had set aside for income taxes as well as unbooked valuation reserves and other capital adjustments required by the BSP, must be at least P250 million. Hence, the trust business is limited to banks and investment houses who can show their capability to be financially responsive.

Sometime July 2015, the Monetary Board in order to spur the interest in the establishment of stand-alone trust corporations adjusted the minimum capitalization requirements. Previously, a trust corporation was required to put up a minimum paid-in capital of P300 million at inception. The new guidelines have reduced this to P100 million at inception, but is coupled with a five-year transition period within which the trust corporation should eventually increase its capital to P300 million. The lowering of the minimum capital requirements is not only intended for banks, but also for other market entrants who desire to engage in the trust business but find the previous P300 million requirement too restrictive.

2. *Reserves*

Before a trust institution with trust license can actually accept money in trust, it must also make an initial deposit of at least P500,000.00 with the Bangko Sentral ng Pilipinas, in the form of eligible government securities, as security for the trust institution's faithful performance of its trust duties. If, while doing business, the assets that a trust institution holds in trust exceeds P50 Million, the trust institution must place with the BSP additional government securities to maintain its deposit at the equivalent of at least 1.0% of total value of the trust assets it is managing. This deposit likewise serves as security that the trust institution will perform its duties well. At no time can the security deposit be less than P500,000.00. In

addition to the basic security deposit, the BSP requires liquidity reserves of varying rates for common trust funds and for certain types of trust and other fiduciary arrangements.

3. *“Prudent-Man” Rule*

Under this rule, the trust institution is required to “administer the funds or property under its custody with the skill, care, prudence and diligence necessary under the circumstances then prevailing that a prudent man, acting in like capacity and familiar with such matters, would exercise in the conduct of an enterprise of a like character and with similar aims.”

Investment Restrictions/Disclosure. The BSP regulations on trust spell out some of the specifics of the *Prudent-Man* rule in a set of investment rules that limit the placement of funds in safe outlets, such as in government securities like Treasury Bills, or in loans fully secured by a hold out on deposits with a bank, by real estate mortgage, or by a pledge of movable properties. Investment can be made outside this restricted list only if the transactions are fully disclosed to the clients and approved by the latter prior to execution. For practicality, many trust institutions disclose these deviations to the client before an account is opened and the client’s approval is embodied in the trust instrument itself.

Also the BSP regulations prohibit certain acts which, although not necessarily unsound, could unduly expose the trust funds to some risks. For example, unless the transaction is fully disclosed and is specifically authorized by the owner, money held in trust cannot be lent to a corporation that is owned at least 50% by the trust institution. Likewise, specific authorization is needed before the trust department of a financial institution could place funds in the same financial institution’s own money market desk. And when an investment, as for example, a long term-loan is transferred before maturity from one trust account to another, a specific client authorization is also required.

4. *Periodic Reports to Client/BSP*

Informative reports are required to be made by the trustee to the client and other parties who have legitimate interest in the trust. These reports must be given at least quarterly, and must consist of a balance sheet, an income statement, a schedule of earning assets and an investment activity report. With these reports, a client could closely monitor the movements of his account and take up with his account officer any misgivings he has on his trust account. The trustee likewise submits to the BSP periodic reports on the trustee’s trust business.

5. *Yearly Triple Audit*

The trust institution is required to submit itself to an annual triple audit: one by its own internal auditors, a second by the independent external auditors of the trust institution, and the third by the examiners of the Bangko Sentral ng Pilipinas. These audits, which have the common purpose of determining whether the trust business of the financial institution is being conducted in accordance with the law and regulations, serve as effective deterrents against unsound practices and fraudulent schemes.

6. *Earmarking/Separation of Accounts*

Trust assets are required to be kept separate and distinct from all other assets of the trust institution’s business; trust books and records are separate and independent from other books and records of the trust institution. The records of each trust account are separate from those of all other accounts and are adequately identified.

7. *Preference of Claims*

No assets held by the trust institution, as a trustee, shall be subject to any claims other than those of the parties (trustor/beneficiaries) interested in the specific trust accounts.

8. *Check-and -Balance Mechanism/Group Judgment*

No single person controls the entire process of administration of trust fund. The Board of Directors, the Trust Committee and the Trust Officer are all involved. Normally, transactions involving the trust account require dual signatories for implementation and trust assets are under the joint custody of at least two persons, one of whom shall be an officer of the trust institution, designated for that purpose by the Board of Directors.

9. *Reasonable Trust Fees*

The fees are based on the cost of services rendered and the responsibilities assumed; not based on the excess of the income derived from the investment of trust fund over a certain amount of percentage. Otherwise, the trustee will tend to be reckless in the investment of the trust fund just so it can get highest yield for the fund and eventually get a bigger fee.

10. *Reputation of the Trust Institution*

No respectable trust institution would want to have its name sullied by scandals and scams perpetrated by its own people. Every institution now operating would like, instead, to develop and maintain a reputation of prudent investment and efficient administration. A trust institution worthy of its name "*Trust*," will always make sure that the client's account is safe, that it achieves reasonable growth for the funds it manages and that its accounts yield adequate income for its clients.

In conclusion, I would like to state that contrary to the understanding of some people that trusts are only for the wealthy, this is not true. Anyone can utilize a trust in their estate plan as an instrument to distribute assets effectively and efficiently upon death or to put stipulations on assets gifted to children.