



# the TRUST GURU

*Let's choose executors and talk of wills  
And yet not so... Richard II, Act III, Scene 2*

## **Trust regulatory *aggiornamieto* leading to *perestroika* and *glasnost*.**

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We are in the middle of the Lenten season; hence, it is perhaps permissible to use a bit of Church lexicon: there is some form of *aggiornamieto* going on in the trust regulatory environment. The focus of is shifting away from the then Central Bank's obsession to reacting to market practices to the current Bangko Sentral's strategy of strengthening the market structures and practitioners. The result is wider investment and other choices for the trust client.

I had the privilege of being in the thick of things when the first paradigm shift in the trust business in the Philippines occurred. The pioneering efforts of Jobo Fernandez's Far East Bank and Trust Company laid bare the existence of a rich deposit of opportunities in the bosom of what was theretofore an activity presided over by lawyers bored to death managing real estate of absentee or lazy landlords. Banks suddenly realized that the trust device was a useful, in fact more potent, tool in generating funds to meet the demands of their clients, the loan-hungry as well as the capital-needy.

The then legal superiority of trust over deposits and similar banking products became very obvious: trusts were more flexible and therefore easily contoured to the needs of users and wants of funders; more tax-favored because the rules were imported from the US tax code that had a long history of favoring the wealthy class; and, most of all, less regulated by the Central Bank that seemed clueless on how to handle its activities. There was only one stumbling block. The rich fund owners were just as ignorant as the rest of the market of what a trust was.

The way the trust industry hurdled the obstacle was to simply make the trust relation look not only very much like a deposit, i.e. safe and easily withdrawable, but with a better twist, i.e. yielding higher interest. Thus was born an oxymoron called “Trust Deposit Certificate” and its numerous progeny, some of them, I must say, truly moronic.

The response of the Central Bank was vintage bureaucracy. In summary, (with apologies to the tired duck) what looked like a deposit, acted like a deposit, and earned like a deposit, was treated like a deposit. The most striking example of this stance is Section X407 of the Manual of Regulations for Banks which classifies as “non-trust” those instruments and relations that, among other things, are, in essence, issued as medium of confirming placements, where there is a fixed rate or guaranteed interest, where the risk is borne by the trustee, etc.

As a consequence, in the same way that, as the great historian Fr. Horacio told us in Freshman College, the history of landlocked states in Eastern Europe is a story of their struggle to have access to the sea and the foreign policy of the United Kingdom with respect to continental Europe is an account of how the Brits played one power against another so that none could threaten to cross the English Channel, the developments in trust regulations constituted a narrative of the constant game of catch-up that the Central Bank the regulator played with the trust departments the regulated.

The unsavory result is a slew of ad hoc regulations which make no sense in the light of the nature of trusts. Examples are prohibitions against borrowing against the trust res (motivated by regulatory intent to prevent tax arbitrage) and the importation into trust lending regulations the rules of bank lending, e.g. the single borrower’s limit. The imposition of reserves on common trust funds during the term of Governor Gabby Singson also belongs to that genre of market castigating regulations.

But lately a second paradigm shift has started to occur. The beginnings are to be found also in the area of collective investment of trust funds. Circular No. 447, issued during the watch of Governor Paeng Buenaventura, removed the requirement of putting up reserves on UITFs, implying the view that they really are not deposits. And most recently, there is the insistence, in Circular 593 issued by the Monetary Board under the leadership of Governor Say Tetangco early this year, on greater and more disclosures to the UITF investor as well as, very significant, the express

requirement of a suitability process to determine whether a definite UITF investment is suited to the profile of the client.

The greater interest of the regulator is now obviously to promote the maturity of the trust clientele and intensity the fiduciary involvement of the trustee. The trustor is made more aware through strong and in-your-face disclosures to the client before the trust relationship is established to ensure that the client is walking into the arrangement with eyes very wide open and mind capable of clear thinking. At the same time, the trustee is, even prior to the start of the relationship, considered already as a fiduciary who, independently of the likes and dislikes of the client, must determine whether what the particular trust relation being offered is or is not really good for the client and his family.

The inevitable result of this second paradigm shift in trust regulations is an unprecedented expansion in available investment and other choices for the trust client. His breadth of vision will capture a larger variety of suitable investment choices and the length of his sight will see farther into the investment world yonder.

For that salutary result to be achieved, however, the trust industry would need, to convince its members to institute some form of *perestroika* and *glasnost*, its brand of restructuring and openness. But, we can leave those profane activities after Easter.