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It Looks Like We Have Trust Issues

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One of the most important aspects in arranging any fund finance transaction is structuring the security package. As anyone that has ever looked at a complete structure chart for a fund financing transaction knows, even a "simple" private fund structure typically involves a number of different entity types (limited partnerships, limited liability companies, etc.) organized in several jurisdictions (Delaware, the Cayman Islands, Luxembourg, etc.). Depending upon the type of facility (*e.g.*, a subscription facility, a NAV facility or a hybrid facility), there may be collateral pledged to the lenders (or a security agent on their behalf) by one or more of these entities to secure the obligation to repay the facility.

For purposes of this article, we discuss the issues that arise in connection with perfecting a security interest by filing a UCC-1 financing statement (which is the most common method of perfecting security interests granted pursuant to NY law governed security agreements in fund finance transactions) with respect to an entity type that is somewhat less common in the fund finance space - trusts.

While a careful analysis of the specific circumstances of each debtor is critical to ensuring proper perfection when preparing and filing a financing statement, debtors that are trusts raise a particularly unique set of issues that may warrant enhanced scrutiny. In this article, we describe several questions and issues that commonly arise when dealing with a trust, and we explain how to address them.

To perfect a security interest, a financing statement must be filed in the correct *jurisdiction*, using the correct *name for the debtor*. As such, there are three fundamental aspects of determining how to properly prepare and file a financing statement: (1) determining who is the debtor, (2) identifying the correct jurisdiction for filing the financing statement, and (3) confirming the correct name of the debtor for the filing.

Under the UCC, the "debtor" is "a person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor."[1] As a general rule, under a common law trust the trustee is the person who holds title to the collateral, while under a statutory trust the trust itself holds title to the collateral. However, lenders should not rely on this kind of generalization, but should review the trust's organizational documents and applicable state law. To give an example of a potential pitfall, under Delaware law the statutory trust is deemed to hold title to all of the trust property, regardless of whether the trust's organizational document formally vests title in one or more trustees.[2]

Once the debtor has been identified the analysis turns to where is the correct jurisdiction for filing. The jurisdiction where a filing must be made is the jurisdiction where the debtor is "located" under Section 9-307 of the UCC[3]. The debtor's "location" can be determined pursuant to Section 9-307. This is usually a fairly straightforward analysis for fund finance transactions; however, trusts introduce some nuanced complexities. For example, if the debtor is determined to be a trustee that is an individual, then the lenders must determine the jurisdiction in which the trustee maintains a "principal residence"[4] (a term that the UCC itself does not define) for purposes of identifying the correct

filing jurisdiction. Accordingly, when a trustee maintains residences in multiple jurisdictions, it may be prudent to file in all of them.[5] In addition, lenders should consider how to address the possibility that the trustee will move or be replaced. In some cases it may be prudent to obtain a covenant from the borrower to inform the lenders of any such change.

After identifying the debtor and determining the proper place to file, the final step is to determine the correct name of the debtor to file against. The UCC has special rules to determine the name to file against when collateral is held in trust.[6] The first question is whether the trust is a "registered organization."[7] Typically, a statutory trust is a registered organization, while a common law trust is not, but as always this should be confirmed by the lenders. One significant exception to this general rule is that a statutory trust organized in a non-UCC jurisdiction, such as the Cayman Islands, can never be a registered organization.

If the trust is a registered organization, then the UCC1 should be filed against the trust's name as set out in its public organic record.[8] Apart from the foregoing, the financing statement should be filled out normally.

If the trust is not a registered organization, then the UCC1 financing statement should provide, as the name of the debtor, the name specified in the trust's organic record.[9] If no such name is specified, the financing statement should provide, as the debtor's name, the name of the trust's settlor or testator.[10]

In either case, the financing statement should also separately indicate that the collateral is held in a trust.[11] For many jurisdictions, there is a box on the form UCC1 that can be checked to indicate that the collateral is held in trust. If no such box is available, consult the filing instructions for that jurisdiction.

It is not always straightforward to determine whether a trust's organizational document provides a name for the trust. In the ideal scenario, the trust's constituent document will expressly provide the name of the trust. In other cases, the name may simply be at the top of the document, or it may be a defined term that is not otherwise stated to be the name of the trust. The UCC does not provide detailed guidance on this point, so in these cases lenders should consider whether to make additional filings against the trust's settlor (as would be required if the organizational document does not specify a name for the trust).

A few examples should help illustrate. Imagine that the lenders' collateral is held in a common law trust established by an individual for her children. The settlor and the beneficiaries all live in New York, the trust is governed by New York law, and all trust business is conducted at the trustee's office in New York City. As is typical with common law trusts, the trust property is vested in the trustee, who resides in New Jersey.

In this case the UCC1 must be filed in New Jersey, because the trustee is the debtor and the trustee's principal residence is in New Jersey. The UCC1 must specify, as the name of the debtor, the name of the trust as set out in the trust's organizational document, and the lenders should check the box to indicate that the collateral is held in trust.

By contrast, if the lenders' collateral is held in a statutory trust organized in Delaware, then the financing statement should be filed in Delaware, and the name specified as the name of the debtor should be the name of the statutory trust indicated on its public organic record.

From a deal management perspective, it is important to identify any of the above issues as early in the transaction as possible. Where the trustees are individuals, there may be necessary lead-time to obtain the required residence information to determine where to file. In addition to determining where to file, including whether filings in multiple jurisdictions are necessary or desirable, the lenders may discover that closing deliverables, including especially opinions of external counsel, may be required in jurisdictions that otherwise have no connection to the transaction, and engaging such counsel late in the transaction may cause delays. And because trusts are less common in fund financing transactions than other types of entities (such as limited partnerships or limited liability companies, and their local law equivalents), these issues may be unfamiliar even to seasoned fund finance professionals.

As the above examples show, the UCC's system for filing against collateral held in trust is not particularly difficult to apply once the principles are understood. However, there is no substitute for carefully evaluating who owns the collateral, where the debtor is located, whether the trust is a registered organization, and, if not, whether its organizational record specifies a name for the trust. The diligence required to determine the answers to these points, as well how the principles discussed in this article apply to a particular trust entity pledging collateral in a transaction, should be discussed with external counsel to ensure the lenders' security interest is properly perfected.

[1] UCC § 9-102(a)(28)(A).

[2] 12 Del. C. § 3805(f) (“legal title to the property of the statutory trust or any part thereof may be held in the name of any trustee of the statutory trust, in its capacity as such, with the same effect as if such property were held in the name of the statutory trust”).

[3] While the discussion herein is based upon the Uniform Commercial Code of New York, the other UCC jurisdictions that we commonly see in this space (DE and DC) are similar on the matters discussed herein, with the only substantive difference being that particular jurisdictions have their own UCC forms that take different approaches to indicating that collateral is held in trust (e.g. a check box vs. an addendum that can be attached).

[4] UCC § 9-307(b)(1).

[5] Note that while the trustee may technically be the debtor, as explained below the filing will not be made in the trustee’s name, and the trustee’s home address need not be included on the UCC1 financing statement. As such, the trustee need not be publicly identifiable, and there should be minimal privacy concerns in connection with such a filing.

[6] The logic behind these rules is that if the normal UCC rule were used, entities that commonly act as trustee would be the subject of multitudinous filings, rendering the filing/searching system effectively useless.

[7] UCC § 9-102(a)(71).

[8] UCC § 9-102(a)(68). An example of this would be a certificate of trust filed to establish a Delaware statutory trust.

[9] UCC § 9-503(a)(3)(A)(i). Examples of an organic record for a trust include a declaration of trust, a trust deed, or a trust agreement.

[10] UCC § 9-503(a)(3)(A)(ii).

[11] UCC § 9-503(a)(3)(B). Note that where the name of the settlor or testator is used as the name of the debtor, the financing statement must also provide “additional information sufficient to distinguish the trust from other trusts having one or more of the same settlors or the same testators.”