

Hong Kong Trustees' Ordinance Amendment Bill

Summary and Background to the New Provisions

With the joint effort of HKTA and STEP Hong Kong Branch over many years working with officials of the Financial Services & Treasury Bureau, the Amendment Bill to the Hong Kong Trustees' Ordinance was finally passed by Legislative Council on 17 July 2013 with the amendments taking effect on 1 November 2013. In order to familiarise industry practitioners and the public with the key changes to the Ordinance, the following summary is hereby presented with information taken also from various sources including the consultation papers/information papers prepared by the FSTB.

A. BACKGROUND & JUSTIFICATIONS

1. Enhancement of Hong Kong's Status as an International Asset Management Centre

Hong Kong is a major asset management centre in Asia. As at the end of 2011, the trust industry held assets of an estimated HK\$2,600 billion¹. In view of the recent trust law reforms by some major common law jurisdictions like the United Kingdom ("UK") and Singapore to facilitate trust administration and attract more trust businesses, it was imperative for Hong Kong to modernise its trust laws in these aspects.

2. Modernise Outdated Law

The trust law regime in Hong Kong is mainly based on the common law, supplemented principally by the Trustee Ordinance (Cap 29) ("TO") and the Perpetuities and Accumulations Ordinance (Cap 257) ("PAO"). These two ordinances have not been substantially reviewed or modified since their enactment in 1934 and 1970, respectively. Some of their provisions are outdated and cannot meet the needs of present-day trusts.

Following a review of the TO and PAO having regard to the various modernisation proposals put forward by the trust industry and the recent trust law reform of the UK and Singapore, and based on the general support for the proposed modernisation exercise during the first public consultation in 2009, the Administration conducted a second public consultation in 2012 on the detailed legislative proposals to amend the TO and the PAO. The amendments have taken into account feedback from the industry and other stakeholders. The major changes are elaborated below in section C.

3. Increase Hong Kong's Competitiveness

In this connection, the amendments seek to bolster the competitiveness of Hong Kong's trust services industry and attract settlors to set up trusts in Hong Kong, which will in turn enhance Hong Kong's status as an international asset management centre.

B. SCOPE OF THE BILL

The Bill modifies the common law position and updates existing legislation in certain specific aspects of our trust law regime, viz.

- to facilitate effective administration of trusts through enhancing trustees' default powers;
- to provide for appropriate checks and balances so that trustees will exercise the new powers properly;
- to provide for validity of certain trusts;
- to abolish the rule against perpetuities; and
- to change the rule against excessive accumulation of income.

The scope of the Bill does not cover the common law rules with respect to how a trust is constituted and when a person is to be regarded as a settlor, trustee, or beneficiary. There is no change to other aspects of trust law or legislation not specifically covered by the Bill.

C. KEY LEGISLATIVE CHANGES

1. Enhancing trustees' default powers

Trustees derive their powers to administer a trust mainly from the instrument creating the trust, the TO or any other enactment. As far as trustees' powers are concerned, the TO only provides the default position. The default powers conferred by the TO on trustees previously would only apply subject to the terms of the instruments creating the trust or any enactment. In view of the increasing complexity of present-day trusts, it was necessary to enhance the default powers of trustees under the TO so as to facilitate effective administration of trusts in case the trust instruments do not contain specific provisions.

Trustees' default powers are enhanced in the following aspects below.

1.1 Power to appoint agents, nominees and custodians

Due to the increasingly sophisticated and multifarious activities of present-day trusts, trusteeship may require different professional skills that trustees may not possess. Under the TO, trustees' default powers to appoint agents or custodians to manage the trust property were of limited applicability. To facilitate effective administration of trusts, trustees needed to be given a general power to appoint agents, nominees and custodians to perform their functions other than the more important ones specified in the law ("the non-delegable functions"). For trusts that are *not charitable* trusts, the non-delegable functions include the functions relating to the distribution of trust assets and the appointment of other trustees, etc. For *charitable* trusts, in view of the public nature of the needs that they meet, the

amendments provide for their trustees be given a default power to appoint agents to perform only those functions which relate to the investment of assets, raising of funds and implementing decisions of the trustees.

1.2 Power to Insure

Section 21 of TO limits the default power of trustees to insure as presently the insurance can only cover loss or damage by fire and typhoon. It is also unclear under the TO whether trustees may insure up to the market value or full replacement value of the property concerned. This is considered unduly restrictive in present-day circumstances. The amendments widen and clarify trustees' default power to insure by empowering them to insure the trust property against risk of loss or damage caused by any event and by removing restrictions on the amount of insurance that the trustees may take out.

2. Entitlement to Receive Remuneration

Under the common law, trustees are not permitted to receive remuneration unless they are authorised by the trust instruments or other circumstancesⁱⁱ and trustees acting in a business or profession are not permitted to receive remuneration in respect of services that are capable of being provided by lay trustees unless they are expressly allowed to do so. There are increasing concerns that the common law position may lead to trusts not being able to appoint trustees with professional knowledge even if the administration of the trusts so warrants; and this may undermine the interest of the beneficiaries and impact on the attractiveness of Hong Kong as an asset management centre. Some comparable common law jurisdictions have already amended their trust laws in this regard. Having regard to overseas experience and specific provisions in their legislation, it was necessary to introduce statutory provisions enabling trustees acting in a business or profession to receive remuneration under specific circumstances stipulated in law.

The amendments have the effect that, if the trust instrument has provided for remuneration, a trustee acting in a business or profession may, subject to inconsistent terms in the instrument, receive remuneration out of the trust funds in respect of services provided even if the services are capable of being provided by a lay trustee. Where the trust instrument is silent on remuneration, a trustee acting in a business or profession may receive reasonable remuneration out of the trust funds for the services provided.

There are provisions for checks and balances, including certain restrictions on the application of the provision on trustees of charitable trusts, given the public nature of the needs that they meet.

3. Scope of Authorised Investments

In the absence of express provisions in the trust instruments (note that settlors/trustees may exclude schedule 2 investment restrictions in their trust deeds), trustees may invest any trust funds in authorized investments specified in the Second Schedule to the TO. In response to suggestions for changes made by the trust industry and in consultation with relevant financial regulators, the amendments revise the conditions regarding investment in shares as follows:-

- (i) lower the market capitalisation of shares from HK\$10 billion to HK\$5 billion; and
- (ii) replace the current five-year dividend requirement by a dividend requirement in any three of the previous five years, and to accept dividends in forms other than cash for the purposes of satisfying the dividend requirement.

In the amendments, it is also expressly stipulated that the list of default authorized investments does not cover structured products, as defined in the Securities and Futures Ordinance (Cap 571), since they are considered risky financial products.

4. Statutory Duty of Care and other Checks and Balances

In parallel with the new default powers to trustees, there is a new default statutory duty of care for trustees and other checks and balances so that trustees will exercise their new powers properly. The amendments cover:

4.1 Statutory Duty of Care

Case law has established that, in the investment of trust funds, appointment of agents and administration of trust property, trustees owe beneficiaries a duty of care, and the English courts have further expressed the view that a higher standard should be owed by paid trustees or trustees acting in a professional capacity. Such duty of care under the general law can be excluded or modified by the trust instrument. The amendments provide for a clear statement of the standard of care to be expected of trustees. The standard is that a trustee must exercise such care and skill as is reasonable in the circumstances, having regard in particular to any special knowledge or experience that the trustee has or that is held out by the trustee as having; and if the trustee is acting in the course of a business or profession, having regard to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

Subject to the terms of the trust instruments, the statutory duty of care will apply to trustees when they are exercising the powers and duties in relation to making investments, appointment of agents, nominees and custodians, taking out insurance, etc. The default statutory duty of care, when it is applicable, will replace the existing common law duty of care which might otherwise have applied. As settlors should be given greater flexibility to reflect their intention in the trust instrument, and having considered overseas experience as well as existing common law position, the statutory duty of care provision is to be default in nature (i.e. the duty can be excluded or modified by the trust instrument) and should not be mandatory.

4.2 Statutory Control on Exemption Clause in Relation to Trustees Acting in Business or Profession

Under the common law, a trustees' exemption clause in the trust instrument can validly exempt trustees from liability of all breaches of trust except fraud. The FSTB noted the increasing use of wide exemption clauses by trustees and that in some cases, settlors may not be aware of the trustees' exemption clauses in the trust instruments nor be able to comprehend their purpose or effect. To better protect

beneficiaries in the event of a breach of trust, we propose to subject trustees' exemption clauses to statutory control if the clauses seek to exempt trustees from liability arising from *fraud, wilful misconduct and gross negligence*, i.e. the exemption clauses will be void in these cases. Given the mandatory nature of the provision, its application is confined to trustees who act in a business or profession and are remunerated.

The new statutory control on trustees' exemption clauses will apply to trusts whether created before or after the commencement of the Bill when enactedⁱⁱⁱ.

4.3 Checks and Balances in Relation to the Appointment of Agents, Nominees and Custodians

In connection with the wider powers for trustees to appoint agents, nominees and custodians, and in addition to the statutory duty of care, trustees should be required by law to give clear guidance to their agents who are delegated with asset management functions, i.e. functions relating to the investment of trust assets and the acquisition, disposal and management of trust property. Trustees will have a duty to review arrangements under which their agents, nominees and custodians act. There are also certain restrictions on the choice of nominees and custodians.

Regarding the existing power for a person who is an individual trustee to temporarily delegate the trusts, powers and discretions vested in the person as trustee, the amendments require that, if a trust has more than one trustee, a delegation should not result in having only one attorney or one trustee administering the trust, unless that attorney or trustee is a trust corporation. This will better reflect the settlor's intention of having more than one trustee to administer the trust.

5. Beneficiaries' Rights to Appoint and Retire Trustees

Under the common law, beneficiaries of full age and capacity and are absolutely entitled to the trust property may act together to terminate the trust through court proceedings. However, the process would normally be costly and time-consuming, and there may be cases where the beneficiaries may wish to replace a trustee without terminating the trust. The amendments therefore provide beneficiaries with the right to appoint and retire trustees by way of a court-free process.

6. Reserved Powers By Settlers

It is generally acceptable under the common law for a settlor to reserve to the settlor some (but not excessive) powers to control the trust property. Amendments to the TO now put it beyond doubt that a trust would not be invalidated because of the mere fact that the settlor has kept the power of investment or asset management functions.

In addition, provision has been made in the TO to provide that where an investment power or asset management function has been reserved by the settlor, a trustee who has acted in accordance with the exercise of the power is exempt from liability.

7. Abolition of The Rule Against Perpetuities (“RAP”) and The Rule Against Excessive Accumulations of Income (“REA”)

Under the common law, RAP dictates that the interest in trust properties must vest in the beneficiaries not later than 21 years after the termination of the life of a specified individual at the time of the creation of such interest, otherwise the interest may fail. The common law rules were modified by the PAO, which provides for an alternative fixed perpetuity period of 80 years and for the mitigation of strictness of the RAP. On the other hand, REA stipulates that settlors may choose one of the six statutory accumulation periods^{iv} for which the income of a trust may be accumulated. However, the rules are complex and do not meet present-day needs.

Having regard to overseas legislation, and possible implications on existing trusts, the new amendments abolish the RAP and REA with prospective effect for all new non-charitable trusts, and allow settlors to set up perpetual trusts in Hong Kong. However, certain restrictions on accumulations of income for new charitable trusts are retained so that the income will be applied for the intended charitable purposes.

8. Provision Against Forced Heirship Rules:

Forced heirship rules are mandatory rules typically found in some civil law jurisdictions to restrict the freedom of testators in determining how to pass their estate on their death. In essence, they require a particular portion of the estate be reserved for designated categories of heirs (e.g. spouse, children). If there is not enough left in the estate to satisfy the indefeasible portions of the aforesaid heirs, property in trusts set up by the testator during his or her lifetime may be clawed back to make up for the shortfall. The Financial Services and Treasury Bureau commissioned a consultancy study on the possibility of introducing provisions against forced heirship rules in Hong Kong. The study concluded that such a statutory change could help reassure potential settlors that their Hong Kong lifetime trusts will be protected from forced heirship rules. In response to requests by the trust industry and having considered the implications carefully, including the possibility to enhance Hong Kong’s attractiveness as a domicile for trusts, amendments have been made to introduce a statutory provision to the effect that foreign forced heirship rules will not affect the validity of a lifetime transfer of movable assets to a trust expressed to be governed by Hong Kong law.

ⁱ Note (1) According to a survey conducted by the Hong Kong Trustees’ Association in 2012.

ⁱⁱ Note (2) Apart from the trust instrument, authorisation for remuneration may also come from an order of the court, the beneficiaries, etc.

ⁱⁱⁱ Note (3) To allow trustees of existing trusts to prepare for the implementation of the statutory control on exemption clauses, the statutory control will take effect one year after the commencement of the Bill.

^{iv} Note (4) Under the law previously, the six accumulation periods are, subject to certain conditions:
(a) the life of the settlor; or
(b) a term of 21 years from the death of the settlor; or
(c) the duration of the minority of any person in being at the death of the settlor; or
(d) the duration of the minority only of any person who under the limitations of the instrument

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- directing the accumulations would, for the time being, if of full age, be entitled to the income directed to be accumulated; or
- (e) a term of 21 years from the date of the making of the disposition; or
 - (f) the duration of the minority of any person in being at the date of the making of the disposition.