STEP

HKTA
Hong Kong Trustees' Association Ltd
香港信託人公會

THE JOINT COMMITTEE ON TRUST LAW REFORM

Response to FSTB's Consultation Paper
on the Review of the Trustee Ordinance and Related Matters

The excellent Consultation Paper on proposed Trust Law reform for Hong Kong issued by FSTB reflects many of the detailed proposals put forward by the Joint Committee on Trust Law Reform ("JCTLR")*.

Whilst the responses to the questions posed in the Consultation Paper set out below ("the Responses") reflect the majority view of HKTA and STEP-HK, there were dissenting minority views expressed to JCTLR, both at an open forum ("the Forum") held to obtain views on proposed Responses (which representatives of FSTB attended) and expressed in writing to JCTLR.

The Responses set out the background and considerations put by JCTLR to HKTA and STEP-HK with regard to each question raised. With each Response, minority views are also recorded.

There is overall acceptance that the main purpose of the proposed reform is to help Hong Kong become the world's premier trust jurisdiction and thus attract quality trust business into Hong Kong with all the resulting advantages. The JCTLR consultation process has given rise to an interesting debate which has revealed the following broad principles:-

- Hong Kong should at least do more to reform its Trust Law than its main competitor, Singapore.
- Nevertheless, there is merit in simplicity. Too many options can confuse potential users of the jurisdiction who might therefore go elsewhere.
- However the virtue of simplicity has its own drawbacks. If Hong Kong does not, say, offer specific provisions validating trusts with reserved powers to a Settlor, then, where there is such a requirement, the work will, as now, go to, say, Cayman, Jersey or Singapore.
- The interests of Settlors and Trustees are paramount in considering the necessary attractions of change but these interests must be balanced with the legitimate interests of Beneficiaries if we are to have an attractive and robust jurisdiction.
- It will be easier and more efficacious to frame the changes in a new Trust Law rather than seek to amend the Trustees' Ordinance. The latter may provide a clumsy and difficult result.

Against the framework of these broad principles we present the following commentary and Responses.

** JCTLR – a joint committee of The Society of Trust & Estate Practitioners – (STEP) Hong Kong Branch and The Hong Kong Trustees' Association Ltd*

CHAPTER 2
TRUSTEES' DUTY OF CARE, POWERS AND REMUNERATION

A. Trustees' Duty and Standard of Care

Background and Considerations

2.1 It is proposed that a new statutory duty of care be adopted under which a trustee must "exercise such due care and skill as is reasonable in the circumstances" having regard in particular:
(a) To any special knowledge or experience that he has or holds himself out as having; and
(b) If a Trustee is acting in the course of a business or profession, 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.

2.2 The new statutory duty of care is proposed to apply when trustees are exercising their powers in matters such as:
(a) investing;
(b) acquiring land;
(c) appointing agents, nominees and custodians;
(d) compounding liabilities;
(e) insuring property;
(f) dealing with matters concerning reversionary interests and valuations
subject to any indication in the trust instrument that the new statutory duty of care is not meant to apply.

2.3 Whilst the statutory duty of care is expressed in broad terms i.e. "as is reasonable in the circumstances" its distinguishing feature from the common law duty is that it is clearly specified that professional Trustees and those holding themselves out as such have a higher duty of care than lay persons or volunteers. This incorporates the way the courts are moving to accommodate the increasing trend, in England and across the world, for modern trustees to be professionals rather than lay persons.

2.4 The powers subject to the duty of care listed above are uncontroversial. It will be possible in the trust instrument, to "contract out" of the statutory duty. The duty will be additional to and will not affect other fundamental common law duties of Trustees, nor will it affect whether or not to exercise a discretion but rather than the manner in which it must be exercised once the decision to exercise it has been taken.

2.5 The most controversial issue is the combined effect of the statutory duty of care with the Trustees' investment powers which is dealt with in the following section of this Response.

	Question 1	Answers to Question 1
2.6	(a) *Do you agree that a statutory duty of care for Trustees should be introduced, unless it is excluded by or inconsistent with the trust instrument?*	The majority agrees but see minority views below.
	(b) *If your answer to (a) is in the affirmative, do you agree that:*	
	(i) *the standard of care should be along the lines of the TA 2000 and the STA?*	Yes
	(ii) *the statutory duty of care should apply to the performance of those powers and duties set out in paragraph 2.14?*	Yes
	(iii) *the statutory duty of care should replace the existing common law duty of care which might otherwise have applied; and the statutory duty should be additional to, and not affect, the other fundamental common law duties of Trustees and the exercise of Trustees' discretion?*	Yes
	(c) *Further to (b), do you think that the statutory duty of care should apply in other circumstances (other than those mentioned in paragraph 2.14 above); and if so, which circumstances?*	No

Reasons:

2.7 Those who favour the answers set out above would say that a statutory duty of care, even though widely expressed as is proposed, adds certainty to the jurisdiction, which is good for Settlors, Trustees and Beneficiaries. Particularly important is the recognition that professional Trustees or those who hold themselves out as such have a higher standard of care than lays or volunteers. They would say that it is right to allow Settlors and Trustees to adopt a lesser standard than the statutory duty, or indeed, a higher standard. Where a lower standard is adopted (more later on this in the section dealing with exculpation clauses) it will be a clear departure from the statutory standard which would be the benchmark for professional Trustees in Hong Kong. Settlors and Trustees would need to have good reasons to adopt a lesser standard.

2.8 The powers and duties described in 2.14 of the Consultation Paper and, in particular the investing power, are the most important. A majority view is

that the statutory duty should replace the existing common law duty as to do otherwise would complicate rather than clarify matters. However, other strongly expressed views are set out in paragraphs 2.9 and 2.10. The majority may say that the duty should be additional to other fundamental common law duties of Trustees particularly in relation to the exercise of Trustees' discretion because the circumstances in which discretions may or may not be exercised is incalculable and it is unwise to attempt to codify all of them. These amendments would bring us into line with the United Kingdom and Singapore.

2.9 An alternative view, held by a minority, is that a statutory duty of care, which provides a higher standard for professional (paid) Trustees than lay Trustees, will not find favour with professional Trustees, who will simply not accept trusts with that standard. Such a standard is therefore not in the best interests of Hong Kong since it will detract from business.

2.10 The counter argument to that expressed in 2.9 above is that, for Settlors, such a standard is attractive. The Singapore experience is that most Trustees accept the higher statutory duty of care. To do otherwise hardly reflects well upon them. Some specifically use the fact that they do not contract out of the statutory duty as a marketing tool. Therefore the statutory duty of care is a good selling point for a jurisdiction.

B. <u>Trustees' General Power of Investment in Default of Express Provisions in the Trust Instrument</u>

2.11 The Consultation Paper provides a good background to this. Taken with the statutory duty of care proposed above, this means that a Trustee's duty of care of investing will vary according to whether the Trustees are professionals or not. This is how it should be. The old common law imposed upon Trustees the same duty of care in investments as a man of "ordinary prudence" had but qualified by the fact that they were investing other people's money. Trustees therefore had a responsibility to avoid hazardous investments even if they were authorized by the Trust. This test was set when most Trustees were lay Trustees. The standard reflected this, as did the statutory investment powers, which gave the "everyman Trustee" a bag of safe tricks to protect him and the Beneficiaries.

2.12 The 1960's saw, in England and elsewhere, more comprehensive inheritance and capital gain taxes together with a shift in wealth concentration from landed estates to more financial assets. This lead to a much wider use of discretionary trusts established both in, and outside, England and with it the much more common appointment of professional Trustees. At the same time a vastly more sophisticated and globalized financial world began to emerge.

2.13 Professional Trustees were inclined to seek wide investment powers in trust investments thus freeing themselves from statutory lists of appropriate investments. The courts, in recognizing this changing landscape, did two things. They have become increasingly less forgiving in applying the common law duty of care to Trustee conduct in investments and they came to expect Trustees with wide investment powers to adopt the modern portfolio theory to their investment portfolios, i.e. to diversify and to not look at individual investments in isolation but as part of an overall portfolio of investments. The prudent investor rule overlaid with the modern portfolio theory was deemed suitable for the sophisticated professional trustee with an unlimited bag of investment options at his disposal.

2.14 The principal issue here is whether a wide power of investment (i.e. not restricted to a list as is currently the default case in Hong Kong and as is proposed to be retained) goes hand in hand with a higher duty of care. Put another way, is there a problem with applying a more stringent test or standard of care to a trustee who has limited default investment powers such as in Schedule 2 of the TO? By imposing a higher standard where the choice of investments is restricted, is a Trustee required, unfairly, to construct a modern portfolio out of a limited and static list of investments?

2.15 For reasons discussed below we do not think this is problematic and we therefore support the proposal. However we recognize the legitimacy of the opposing views and the content of paragraphs 2.9 and 2.10 reflect these.

Question 2	Answers to Question 2
2.16 *(a) Do you agree that the Schedule 2 range of authorized investments should be retained? If your answer is no, please give reasons.*	Yes
(b) If you agree that Schedule 2 should be retained, please let us have your views on whether Schedule should be amended in respect of one or more authorized investments. For example, should any of the following qualification criteria for authorized investments (which are set out in Schedule 2 and explained in paragraphs 2.21 – 2.23 above) be amended:	
• *the minimum market capitalization of HK$10 million for companies;* • *the minimum 5 year dividend record for companies;* • *the definition and credit ratings for debentures;* • *the safeguards for permissible derivatives (for hedging purposes only, traded on a recognized or specified*	We will be happy to suggest the form and content of an amended

	stock or futures exchange, supported by specific written advice from a corporation licensed to give the advice with regard to suitability and potential risks and losses)?	schedule. We suggest that the Schedule be amended by regulation thus making it easier to amend.

Reasons:

2.17 We think that the range of authorized investments ought to be retained as a default position for the reasons expressed in the Consultation Paper i.e., that they present a safe harbor for situations where Settlors either deliberately choose to restrict the investment power of the Trustee or that becomes the default situation because it is not dealt with in the trust deed. Given the nature of the proposed statutory duty of care we do not see this as a problem. If a settlor wants to restrict a professional Trustee to the Schedule 2 range of authorized investments, the Trustee could, if he feels strongly, seek to contract out of, or at least qualify, his statutory duty of care via the trust deed. It is submitted that even if a professional Trustee did not alter the statutory duty of care in the deed, the definition is sufficiently flexible to take into account, in judging the conduct of a Trustee, the "circumstance" that the range of investments was restricted. The duty of care of a lay Trustee would in any event be less than that of a professional Trustee and a restricted list of authorized investments would again be a "circumstance" to be taken into account in judging the applicable standard of care.

2.18 A restricted default list reinforces the starting position that Trustees, by nature of their office, ought to be conservative in their choice of investments. However, this assumes that a Trustee is more likely to suffer fewer losses in the longer term if his investment choices are restricted to those within a carefully considered list.

2.19 Given recent events some will undoubtedly argue that the current list would not have, in fact, offered a safe harbour and thus such lists serve no good purpose at all.

2.20 Some feel that, even with the common law standard of care and bearing in mind what is said in paragraph 2.19, Settlors and their Beneficiaries have a "safe harbour" given to them without the need for Schedule 2.

C. Trustees' Power of Delegation

Background and Considerations

2.21 The Consultation Paper deals with these issues clearly. We regard them as relatively uncontroversial. We agree with the sentiment in the Consultation Paper that for the protection of beneficiaries, the power of delegation to a sole co-trustee under section 27(2) of the TO should be retained but subject to the overriding condition that if a trust has more than one trustee, a delegation made under section 27 should not result in having only one attorney or trustee administering the trust unless that attorney or trustee is a trust corporation.

Question 3	Answers to Question 3
2.22 *(a) Do you agree that the power of delegation under section 27 of the TO should be retained, subject to an amendment that if a Trust has more than 1 Trustee, the exercise of the power of delegation should not result in the Trust having only 1 attorney or 1 Trustee administering the Trust, unless that Trustee is a Trust Corporation?*	Yes
(b) Do you have any views regarding the different conditions upon which an individual Trustee may delegate his powers under section 27 of the TO and section 8(3) of the Enduring Powers of Attorney Ordinance (Cap. 501)? Do you agree that the latter should be repealed?	We think these issues should be dealt with separately as they address quite different circumstances of delegation.

Power to Employ Agents
Background and Considerations

2.23 The Consultation deals with these issues well. The UK and Singapore have provided Trustees with a general power of appointing agents but with a limitation on that power with respect to specific Trustee functions. Importantly, the UK TA 2000 attempts to guard against potential risks imposed by a general power of appointing agents by applying the statutory duty of care to that power, restricting the agent to appoint a substitute requiring agreements in writing in case of delegation of asset management functions, paying agents only reasonable remuneration and requiring Trustees to review the arrangements under which agents act and how those arrangements are being put into effect.

2.24 We do not see any material difference of this approach with respect to Charitable Trusts. It should be remembered that these are default powers and restrictions which can in the appropriate cases be dealt with, or contracted out of, in a carefully drawn instrument.

Question 4	Answers to Question 4
2.25 *(a) Do you agree that the TO should be amended to provide trustees with a general power of appointing agents along the lines of the TA 2000, subject to any express contrary intention in the trust instruments?*	Yes
(b) If your answer to (a) is in the affirmative, do you agree that the safeguards set out in the TA 2000 (as discussed in paragraph 2.41 above) are sufficient to protect the interests of the beneficiaries?	Yes
(c) What other safeguards (if any) would you suggest?	None
(d) If your answer to (a) is in the negative, do you agree that section 25(1) of the TO should be retained and that section 25(2) of the TO be standardised with the approach to section 25(1)?	Not applicable
(e) Do you agree that trustees of charitable trusts should be given wider powers to appoint agents along the lines of the TA 2000 (as discussed in paragraph 2.40 above); and if so, what safeguard would you suggest?	We think that Trustees of Charitable Trusts should be given the same powers to appoint agents along the lines of the TA 2000 as Trusts for non-charitable Beneficiaries and that the safeguards referred to in paragraph 2.20 are adequate for Charitable Trusts.

D. <u>Trustees' Power to Employ Nominees and Custodians</u>

Background and Considerations

2.26 We refer to paragraph 2.46 to 2.49 of the Consultation Paper. This is uncontroversial and for the reasons expressed in the Consultation Paper, we support the proposal.

Question 5	Answers to Question 5

2.27	*(a) Do you agree that the TO should be amended to provide Trustees with a general power to employ nominees and custodians along the lines of the TA 2000 and the STA, subject to any express contrary intention in the trust instruments?*	Yes
	(b) Do you agree that the safeguards set out in paragraph 2.48 are sufficient to protect the interests of the Beneficiaries?	Yes
	(c) What other safeguards (if any) would you suggest?	None

E. Trustees' Power to Insure

Background and Considerations

2.28 We refer to paragraphs 2.50 to 2.54 of the Consultation Paper. This is uncontroversial and we agree with the proposals in the Consultation Paper for the reasons set out therein. This is a long overdue technical deficiency in the law and we agree with the proposals to fix it.

	Question 6	Answers to Question 6
2.29	*Do you agree that section 21 of the TO should be amended to provide Trustees with wider powers to insure along the lines of the TA 2000 and the STA, subject to any express contrary intention in the trust instruments?*	Yes

F. Professional Trustees' Entitlement to Receive Remuneration

Background and Considerations

2.30 We refer to paragraphs 2.55 to 2.62 of the Consultation Paper. Given the preponderance of professional trusteeships of non-charitable inter vivos and testamentary trusts, we think that it is right to give professional Trustees a statutory right to remuneration along the lines of the provisions in England and Wales and in Singapore.

2.31 Clearly the position of professional Trustees of Charitable Trusts is more sensitive. We agree with the proposal for the reasons set out in clause 2.61 that default charging provisions in the TO should apply to professional trustees and we see no distinction between charitable and non-charitable trusts where, in Hong Kong at least, very many Trusts are administered, at

least on the investment side, by professional Trustees. This will also fit in with the Law Reform Commission's impending look at regulation of charities in Hong Kong from a prudential i.e. not purely a tax deductible basis.

Question 7	Answers to Question 7
2.32 *(a) Do you agree that the TO should be amended to provide for a statutory charging clause for professional Trustees of non-charitable trusts, subject to any express contrary intention in the trust instruments, along the lines of the TA 2000 and the STA?*	Yes
(b) Further to (a), if a trust instrument contains provisions entitling trustees to receive remuneration, do you agree that the TO should be amended to enable a professional Trustee of the Trust to charge for services that could be provided by lay Trustees?	Yes
(c) Do you think that professional Trustees acting for Charitable Trusts should be allowed to charge for their services in the absence of a charging provision in the relevant trust instrument; and if the answer is yes, what constraints (if any) should be impose?	Yes. We think there should be no distinction between professional Trustees of charitable or non-charitable trusts.
(d) Further to (c) above, if the trust instrument of a Charitable Trust contains provisions entitling Trustees to receive remuneration, do you think that the TO should be amended to enable a professional Trustee of the Charitable Trust to charge for services that could be provided by lay Trustees?	Yes. See above.

G. Others

2.33 We think that the default administrative powers in Parts II and III of the TO should be changed as per our earlier detailed submissions see in particular paras 8.38 to 8.61 thereof.

Question 8	Answers to Question 8

2.34	*Do you have any other suggestions in relation to the default administrative powers of Trustees provided in Parts II and III of the TO?*	See 2.33 above

CHAPTER 3
TRUSTEES' EXEMPTION CLAUSE

Background and Considerations

3.1 This is a complex legal issue. It also has complex policy ramifications for Settlors, Trustees and Beneficiaries and thus for Hong Kong in wanting to position itself as an attractive place to establish and administer Trusts. It therefore deserves a "back to basics" analysis.

3.2 The essential question is whether to regulate by statute the ability of Trustees to absolve themselves through the trust instrument or other trust documents from liability for behavior that would otherwise constitute a breach of trust.

3.3 The starting point must therefore be "what is a breach of trust?" and that is a failure by the Trustee to meet his duty of care to the Beneficiaries. This brings us back to Part A of Chapter 2. The next question is whether the common law adequately deals with the exemption clause issue and then, if not, how trustee's exemption clauses ought to be regulated by statute.

3.4 The proposal is to adopt a statutory duty of care for Trustees with respect to the exercise of certain powers functions or discretions (see paragraph 2.2 above). That statutory duty is to behave reasonably, in the circumstances, having regard, essentially, as to whether the Trustee is a professional (i.e. paid) or a lay person (i.e. a volunteer). The impact of this professional / lay Trustee dichotomy in given cases is, essentially, thrown back on the courts to determine what is reasonable and they have shown increasingly less lenience on professional than lay Trustees.

3.5 Of course, the statutory duty of care applies only to certain (the most critical) Trustee functions. The rest are left to the common law duty of care which is probably, in effect, not that much different given the courts' recent tendency to hold professionals to a higher duty than lay persons. And the proposal is to allow Settlors or Trustees to "contract out" of the statutory duty with respect to some or all of the covered functions, this leaves the common law standard to govern that trustee behavior.

Question 9	Answers to Question 9
3.6 *(a) Do you agree that trustee exemption clauses should be regulated statutorily and whether the regulation should apply to all Trustees or only professional Trustees who receive remuneration for their services?*	Professional Trustees who receive remuneration for their services should not have the benefit of exemption clauses except (a) where the Settlor has been

(b) If the answer to the first part of question (a) is yes, which of the following options do you prefer for regulating Trustee exemption clauses:	fully and properly and independently advised upon the nature and extent of exculpation; or
(i) prohibiting Trustee to exclude liability for breach of trust for dishonesty or intentional or reckless failure to exercise the degree of care and diligence that is to be reasonably expected of a Trustee along the lines of section 26 of the Mandatory Provident Fund Schemes Ordinance (Cap. 485); *(ii) prohibiting Trustee to exclude liability for breach of trust where he fails to show the degree of care and diligence required of him as Trustee along the lines of section 75B of the Companies Ordinance (Cap. 32);* *(iii) imposing procedural safeguards to ensure that the Settlor is aware of the Trustee exemption clause;* *(iv) subject Trustee exemption clauses to a reasonableness test similar to the one imposed under the Control of Exemption Clauses Ordinance (Cap. 71)?*	(b) where all the beneficiaries who are sui juris consent to a specific breach of trust provided however that under no circumstances will exculpation for fraud, willful default and gross negligence be permitted.
(c) Do you have additional or alternative options for regulating Trustee exemption clauses?	Yes, retain the existing provision to allow the court to relieve any trustee (professional or lay) from personal liability for a breach of trust.

Reasons:

3.7 Given the flexible nature of the statutory standard of care, that Trustees can opt out of it and its closeness, in any event, to the default common law standard one must wonder why it should be necessary, or in fact possible, for Trustees to 'get out of it" at all.

3.8 What is the point of setting a flexible statutory standard of behavior that can be opted out of in any event, only then to allow Trustees to further lower the bar on the acceptability of their conduct through a choice of words in the trust instrument? *Armitage v. Nurse* says that trustees can, through the trust

instrument, absolve themselves from all liability flowing from anything but fraud, willful misconduct or gross negligence. Even those who express concern at a strict liability on professional Trustees seem to agree that there should be no limitation on this decision.

3.9 How could a Trustee, calling himself a professional fiduciary in a position of high trust, be happy with such an undemanding standard; essentially not to be fraudulent or willful in misconduct but ok with engaging in misconduct and negligent behavior as long as is not grossly so? Other professionals would not, and often cannot under the law, adopt such meagre standards.

3.10 The fact is that the lower standards were expected of lay persons who were mostly the Trustees of yesteryear. This combined with the "contract out approach" to all but the "irreducible core of trust obligations" has created an opportunity to adopt inadequate standards and this should be addressed in our trust law reform. However, there may be circumstances where a Settlor is content to allow a Trustee to limit his liability fro breach of trust such as where the trust investments are particularly risky or the Trustees fees are well below market.

3.11 How is it possible to achieve the right balance of interests here? By saying that it is not possible for professional Trustees to exempt themselves from liability for breach of trust except in the terms suggested in our answer to Question 9 above and to retain the current discretion of the court to relieve trustees from breach of trust in special cases (s.60 TO).

3.12 Lay Trustees, who have a lesser standard in any event, should be thrown back on the common law regarding the enforceability of exculpation clauses i.e. Lord Millet's begrudging test of limiting the effect of such clauses to protection from only honest to goodness old-fashioned negligence.

3.13 Professional Trustees may well have a different view on this issue and some have expressed strong reservations. They have argued that risk is an important commercial issue and that it makes business sense to choose a law that allows them to reduce that risk as far as possible and that what is proposed here will mitigate against them using Hong Kong. This is particularly the case if Hong Kong ends up having a higher standard of care than other jurisdictions. They may argue that it is better to leave this matter to the Courts than to legislate for it. The Courts will judge Trustees on the basis of conduct and not performance and will be sympathetic to Trustees who act properly.

3.14 Another view is that Hong Kong is a leading financial centre and should promote high standards across the board to protect the interests of Beneficiaries and thus the jurisdiction's general reputation so that if

professional Trustees do not want to meet high international standards, they should not operate under Hong Kong law.

3.15 Our answer provides, we think, a sensible compromise which is that Settlors and Trustees may opt for limited exculpation in circumstances where the legal nature and effect of such exculpation are both fully explained to Settlors.

CHAPTER 4
BENEFICIARIES' RIGHT TO INFORMATION AND RIGHT TO REMOVE TRUSTEES

A. Beneficiaries' Rights to Information

Background and Considerations

4.1 This is a very unsatisfactory area of the law. A reading of paragraphs 4.1 through to 4.10 confirms this. Judicial pronouncement on this area has been widely varied to say the least. The English case of *Schmidt v. Rosewood Trust Ltd* essentially shifts the basis of beneficiaries' rights to information from the notion of a proprietary interest in trustee information as a species of property, to a more general idea that because such information can be critical in allowing beneficiaries to enforce trusts it goes to the heart of the validity question i.e. an unenforceable trust is no trust at all. This latter view has resulted in expanded discretionary court powers to decide who should get trust information and what that information should be.

4.2 There are those that argue that, given the state of the common law and the panolopy of circumstances that could determine not only the circumstances in which beneficiaries ought to be told that they are such, but the nature of the information to which they should then be entitled, no attempt should be made to codify this but to leave it to the supervisory powers of the court.

4.3 The problem with this is that it does not provide much certainty either to beneficiaries or trustees.

4.4 This should be subject of course to the terms of the trust deed except so far as rights of beneficiaries who have trust interests which are vested in possession.

4.5 In terms of the information that should be provided, again, this depends upon the nature of the trust interest. The deed itself can deal with this but the default position should be that any beneficiary (other than a mere object of a power) should be entitled upon request to copies of the trust deed and all ancillary documents. That beneficiary should also be entitled to all information concerning the state of the investment of the fund and the amount of income they are entitled to.

4.6 We think that a specific provision should be enacted which provides that, subject to the terms of the trust and to any order of the court, a Trustee should not be required to disclose his deliberations leading to the manner in which he exercised a discretion or performed a duty, or his reasons therefore (refer paragraph 12.31 of our detailed submission).

4.7 Whilst the majority of those who attended the Forum were in favour of guidelines, the details of them remain to be agreed (see paragraph 4.5 above).

A minority feel that no codification is best and that the Courts should be left to decide who shall receive what in any particular case applying the decision in *Schmidt v. Rosewood Trust Ltd*. Arguably, that goes against the trend in legislation of providing guidelines and therefore some certainty. Not to provide some guidelines could mean that Hong Kong foregoes an opportunity to provide an attractive item on its agenda. There are certainly those who are concerned not to overly protect Beneficiaries in terms of the guidelines or at all. Some point to specific difficulties, for example:-

(a) under pension schemes, whether the interest of an employee is vested or not, there may be questions as to entitlement; and

(b) there may be circumstances where it is not in the best interest of a Beneficiary to know. This could be so where there are divorce proceedings involving the Beneficiary.

4.8 It is also sensibly pointed out that Settlors may not wish Beneficiaries to be informed. Therefore the terms of the Trust Deed should be able to override the guidelines, enabling a Settlor to opt out of them. Whatever the position the Court should be able to exercise its power to provide as it sees fit in any particular circumstances.

4.9 Broadly there is agreement with the approach taken in the Consultation Paper in paragraph 4.10. Following on from discussion at the Forum, we accept the need for further discussion on the terms of any guidelines and we are happy to work with Government on this or any other matters arising. We answer the questions as follows:

Question 10	Answers to Question 10
4.10 *(a) Do you agree that the TO should provide certain basic rules regarding Beneficiaries' right to information?*	Yes
(b) If your answer to (a) is in the affirmative, do you prefer the first option (which is set out in paragraph 4.9) or the second option (which is set out in paragraph 4.10)?	We do not agree with either option but rather set out our preferred option below in answer (c).
(c) If you do not agree with those two options but still believe that the TO should provide for Beneficiaries' right to information, please set out what you believe the TO should provide, for example, what information should Trustees provide to Beneficiaries and what class of Beneficiaries (e.g.	The duty to inform a Beneficiary should be dependent upon the nature of his trust interest. If the Beneficiary has a trust interest which is vested in possession (which would normally necessarily require him to be of majority), he should be told of

	Beneficiaries with interests in possession (such as life tenants), Beneficiaries vested in interest only (such as reversionary or future entitlements) or Beneficiaries with right to be considered only (such as discretionary objects) should be entitled to information?	that fact and the nature of any contingency. If the Beneficiary is a mere object i.e. a member of a discretionary class so that he has no vested interest in possession contingent or otherwise, he should only be told that if he asks. Even so, such guidelines should be subject to the Terms of the Trust Deed to enable the Settlor to opt out of them. Whatever the position the court should be able to override the situation in exercising its jurisdiction under the decision in *Schmidt v. Rosewood Trust Ltd.* There should be transitional provisions which apply the new regime to Trusts coming into effect on or after the date of the passing of the new legislation.

B. <u>Beneficiaries' Rights to Remove Trustees</u>

Background and Considerations

4.11 This is well summarized in the Consultation Paper and provides a relatively easy means for Beneficiaries of a Trust who are dissatisfied with the Trustee to remove such a Trustee rather than relying on the rule in *Saunders v. Vautier* to bring the trust to an end.

	Question 11	Answers to Question 11
4.12	*Do you agree that the Beneficiaries of a Trust, who are of full age and capacity and are absolutely entitled to the trust property, should be empowered to remove a Trustee, along the lines of the TLATA of the UK?*	Yes

CHAPTER 5
PERPETUITIES AND ACCUMULATIONS OF INCOME

A. The Rule Against Perpetuities

Background and Considerations

5.1 The Consultation Paper clearly sets out the background and considerations, particularly in the interests of Hong Kong.

5.2 The Government provides two options. One is to abolish the Rules against Perpetuities ("RAP") without retrospective effect; the other is to provide a fixed perpetuity period. The Government is in favour of reforming RAP but is open minded upon which option should be adopted. The majority favour abolition of the rule. There was minority support for simplifying but retaining the rule and adopting a longer fixed maximum period such as 150 years.

5.3 There is no doubt that for the benefit of dynastic succession and for perpetual Purpose Trusts to properly serve business requirements, there is a need for perpetual trusts. Without them, business is and will be lost to other jurisdictions. The simplest option is to abolish the rule and this is what this discussion draft proposes in answer to Clause 6.5 below.

5.4 However, there is a further and more flexible option than those proposed worth consideration, namely:

- trusts are perpetual i.e. the rule be abolished;
- despite this, statutory provision be enacted that trusts can later be changed to continue for a fixed period; and
- if the continuity of a trust is initially or later confined to a fixed period, then the fixed period can, as per the terms of the trust deed, be shortened or extended or the trust can be made perpetual but all such actions can only be taken with the express consent in writing of the Settlor during his life but by no other person.

Question 12	Answers to Question 12
5.5 *(a) Do you agree that RAP should be abolished, without retrospective effect?*	Yes. We favour the flexible option set out in paragraph 5.4.
(b) If your answer to (a) is negative, do you agree that RAP should be modified by introducing one fixed perpetuity period, similar to that adopted by Singapore? How long do you think the new fixed perpetuity period should be (80 years, 100 years, 125	

years, 150 years or any other period)?

B. Rules Against Excessive Accumulations of Income

Background and Considerations

5.6 Once again the Consultation Paper sets out clearly the Background and Considerations.

5.7 The Government considers the Rule Against Excessive Accumulations of Income ("REA") to be archaic and proposes to abandon it. They are concerned as to whether Charitable Trusts should be able to accumulate income in perpetuity.

Question 13	Answers to Question 13
5.8 *(a) Do you agree that RAP should be abolished? Please give reasons.*	Yes. The rule is archaic, complicated, provides uncertainties, may frustrate the wishes of the Settlor and in modern times is unnecessary. Flexibility shall be provided by remitting accumulation of income throughout the life of a Trust or for any shorter period determined by the Trust Deed.
(b) If your answer to (a) is yes, will your answer be different if RAP is also abolished so that there will be no control over the period of accumulation?	No
(c) Do you think that REA should be retained in some form with regard to charitable trusts; and if so, how long should a charitable trust be allowed to accumulate its income?	We suggest that it is not a question of "how long" but rather "how much", we propose that trustees of Charitable Trust should be required to distribute not less than, say, 25% of net income annually, perhaps looked at over 10 year average. The balance they could then distribute or accumulate as they decide. This would ensure a reasonable benefit to charity compulsorily and prevent abuse

of the use of Charitable Trusts. The regulation of this should be addressed in the upcoming Law Reform Commission review of charitable trust regulation.

CHAPTER 6
FURTHER PROPOSALS ON PROMOTING
THE USE OF HONG KONG TRUST LAW

A. Protectors of Trusts

On these matters Government has an open mind and "would like to hear the views of all relevant stakeholders". We believe that the views determining these matters depend wholly on the benefit to Hong Kong.

Background and Considerations

6.1 The Consultation Paper correctly sees Protector as "watch dogs" for Beneficiaries. It also correctly sees that there is surprisingly little legislation on Protectors.

6.2 The office of Protector is a great comfort to Settlors and Beneficiaries who want a "check and balance" upon Trustees. Some say that Hong Kong would benefit from introducing legislation on the subject. Others fundamentally disagree that there should be legislation covering Protectors. Such legislation should cover:-

- who may be a Protector;
- the proactive and reactive powers which may be given to Protectors;
- appointment of Protectors;
- resignation and removal of Protectors;
- whether or not they maybe remunerated and receive re-imbursement of their expenses;
- whether or not they owe a fiduciary duty to the Beneficiaries;
- protection for them from being treated as Trustees and generally in terms of exculpation

6.3 If powers are given to Protectors at all, it is probably wise not to permit Protectors to have powers which are concerned with the distributions of income or capital. If the Settlor is Protector, then there can be a nominee arrangement (not a "sham") and if the Protector has too many powers he is in danger of being treated as a Trustee.

6.4 It may be appropriate to give Protectors default powers, subject to the terms of the Trust, extending to the following:-

- adding, removing and excluding Beneficiaries;
- appointing and removing Trustees;
- changing the proper law of the Trust and the forum of administration of the Trust; and
- directing investments and investment management.

6.5 This would be somewhat more conservative than, say, Dubai but sufficient and appropriate.

6.6 Whilst sympathizing with the needs of a Settlor with regard to the role and scope of powers of a Protector in any given circumstances, those who feel that legislation is attractive and follows a modern trend, may wonder why there is a problem with provisions such as those mentioned below in paragraph 6.9 and with limited default powers. In some cases elsewhere, the argument against legislation and default powers in particular has to some extent been based upon the probability that a Protector will have power to remove Trustees.

6.7 There is very little doubt that Protectors are fiduciaries. It therefore follows that they should be subject to the same standard of care as a Trustee acting in similar circumstances and having similar restrictions on their ability to rely on exculpation clauses.

6.8 The contrary view to what is said above is that all of this is up to the Settlor through the trust instrument and that the statute should not deal with this area at all. The argument against legislation is based upon the view that "Protector" to not a term of art needing definition. Further the role of the Protector and the powers given to the Protector can vary considerably from Trust to Trust. It is in any circumstances a matter for the Settlor to determine. Legislation, it is argued would muddy the water, make the situation more complex and make Hong Kong less attractive in this respect.

6.9 We think that Settlors and Trustees should be able to "opt in" to provisions concerning protectors for certainty but that these provisions not be default in nature; i.e. they do not apply unless specifically adopted. The terms of the Trust Deed should be paramount but that legislation should permit the inclusion in the Trust Deed of all or any of the following provisions:

(a) Who may be a Protector? The Settlor, any Beneficiary but not a Trustee. A Protector may be an individual or a corporation. In fact it can be any person who has good knowledge of either the settlor or the objects of his beneficence.
(b) The powers of a Protector (whether proactive or reactive).
(c) Who would appoint and remove Protectors? The Settlor could appoint and remove Protectors during his life and while he is not incapable. Protectors should be able to appoint Successor Protectors, Joint Protectors and Alternative Protectors revocably or irrevocably.
(d) Beneficiaries should have the same right to remove and appoint Protectors as they would Trustees.
(e) Protectors should be able to resign.
(f) Protectors could be remunerated and should be able to reclaim expenses.

(g) Protectors should be fiduciaries and owe a similar duty of care to Beneficiaries as a Trustee in similar circumstances and have similar restrictions on exculpation.

(h) Protectors should be liable to Beneficiaries similarly to Trustees but would not be treated as Trustees by reason of the exercise of their powers.

Question 14	Answers to Question 14
6.10 *Do you think that "protectors" should be statutorily defined in the TO and if so, how should the functions and duties of protectors be defined?*	We favour statutory guidelines as mentioned in paragraph 6.9.

B. Reserved Powers of Settlors and Validity of Trusts

Background and Considerations

6.11 Reserved powers to a Settlor and in a more limited way to a Protector (as mentioned previously) are essential for Hong Kong to take its position as a premier trust jurisdiction. Those who make Trusts, particularly in Asia, look for control. Without these provisions trust business is being, and will continue to be, lost.

6.12 The Consultation Paper contains a brief but useful discussion and remains open to the idea of following Singapore in introducing provisions to the effect that a trust will not be invalidated only because the settlor reserves to himself investment and asset management functions. The Consultation Paper rightly expresses concern "that allowing the settlor to reserve too many powers may lead to criticism that a trust established under Hong Kong law is in fact a sham".

6.13 The key issue is how to remove the common law uncertainties as to the impact on essential trust validity caused by reservation of powers to settlors without ending up with a statute that seeks to validate a legal arrangement with the barest resemblance to a classic trust and which other jurisdictions might view as a pure nominee arrangement, or at worst, a sham. This would tempt bad trust practice and possibly bring the jurisdiction into disrepute.

6.14 It is therefore a question of balance. There is bound to be disagreement about what reserved powers should be protected by statute. Our detailed submission made substantial reference to comparative legislation. We suggest that the law should provide that a Hong Kong law trust would be valid despite the inclusion or more limited powers to settlors (or protectors) as follows:

(a) To determine the law of which jurisdiction shall be the governing law of the trust;
(b) To change the forum of administration of the trust;
(c) To remove Trustees;
(d) To appoint new or additional Trustees;
(e) To remove any Beneficiary of the Trust and to declare that any person shall be excluded altogether from benefit under the Trust;
(f) To add any person as a Beneficiary of the Trust in addition to any existing Beneficiary of the Trust;
(g) To exercise the power of investment and of investment management;
(h) To release any of those powers.

6.15 The legislation would therefore not invite or exclude additional reserved powers. Apart from the certainty of validity with regard to the limited powers mentioned, it will be left to the court to decide any questions of validity or otherwise having regard to any wider reserved powers.

6.16 Those who voiced an opinion at the Forum on this topic were all in favour of the answers given below.

Question 15	Answers to Question 15
6.17 *(a) Do you agree that a statutory provision should be introduced to the effect that a Trust will not be invalidated by reason only of certain reserved powers of Settlors?*	Yes
(b) If the answer to (a) is yes, in your opinion, what kind of reserved powers of Settlors should not affect the validity of Trusts? Do you agree that we should permit the reservation of those powers stated in paragraph 6.15?	As per para 6.14 above

(a) <u>Governing Law of Trusts</u>

Background and Considerations

6.18 The background and considerations are clearly set out in the Consultation Paper.

6.19 In addition to providing for the choice of governing law, this is a good opportunity for providing, as in Dubai, for the migration of trusts into Hong Kong which will be more attractive to existing trusts as a result of this law reform.

6.20 The point is that properly incorporating Hague Convention concepts into domestic law will provide greater certainty of an issue central to the administration of a trust; its governing law.

Question 16	Answers to Question 16
6.21 *Do you agree that there is a need to codify the common law principles in relation to the governing law of trusts? If you do not agree, please explain the reasons.*	Yes. With the request that the provisions adopted by Dubai be used as a model for ours.

(b) Forced Heirship

Background and Considerations

6.22 These are clearly set out in the Consultation Paper. The broad objective is to strengthen the integrity of the trust law itself, and the jurisdiction of the courts have over it, by removing uncertainty created by conflicts of law principles as to when our courts should entertain claims made under foreign law. The provisions would make it clear that Hong Kong courts can ignore specified claims made against Hong Kong law trusts that may arise under foreign law.

6.23 Singapore and Dubai (amongst others) have recently amended their laws to ensure paramountcy of their local laws over the personal laws of claimants against the trust. As stated above, removal of such conflicts adds strength and certainty to a jurisdiction. Although the Consultation Paper rightly points out that many such claims arise only on death of a testator / settlor and therefore should not extend to challenge the validity of inter-vivos trusts, those foreign laws could change or contain "claw back" provisions which might expose Hong Kong trusts to attack.

6.24 We therefore propose adopting the Dubai model which refers to the unenforceability of lifetime claims and claims on death and which covers proprietary claims regarding divorce.

Question 17	Answers to Question 17
6.25 *(a) Do you agree that there should be statutory provisions to the effect that forced heirship rules will not affect the validity of trusts or the transfer of property into trusts that are governed by Hong Kong law?*	Yes and see below.
(b) If your answer to (a) is yes, should the provisions	The Dubai model for the

follow the Singapore model (i.e. section 90 of the STA), the BVI model (i.e. section 83A of the BVITO) or any other model? Please specify and explain.	reasons stated above.

(c) Non-Charitable Purpose Trusts and Enforcers

Background and Considerations

6.26 We agree that the definition of charity requires legislative widening. Dubai provides a good example of a modern legislative definition.

6.27 There are many valid uses of non-charitable Purpose Trusts. The Consultation Paper highlights some but there are many proper commercial uses (and uses that are strictly non-charitable but nonetheless laudable) making such trusts a useful tool in the armory of a jurisdiction's attraction for trusts. These have been substantially referred to in our earlier detailed submissions.

6.28 It is not the role of trust law to prevent the use of such trusts for tax evasion purposes. Hong Kong already has The Organized and Serious Crimes Ordinance to control this and is intending to strengthen its anti-money laundering regulations to meet OECD and FATAF requirements. Hong Kong is also intending to have at least 12 comprehensive DTAs and/or TIEAs to meet similar exchange of information requirements. It is these provisions which counter tax evasion, not trust law. It can be expected that professional trustees will act fully in accordance with the law and cooperate with law enforcement agencies.

6.29 The question of who enforces the enforcers is a fair one but it has never deterred the good operation of non-charitable Purpose Trusts in other jurisdictions. The use of a "designated person" as Trustee also assists.

6.30 If individuals can benefit in addition to purposes, then legislation can allow those individuals to enforce the trust as regards their interests.

6.31 A substantial majority of those who attended the Forum were in favour of the introduction of non-charitable Purpose Trusts.

Question 18	Answers to Question 18
6.32 *(a) Having balanced the reasons for and against, do you think that the law should be amended to allow the creation of non-charitable Purpose Trusts? Please give reasons.*	Yes. There is much more to be gained by having such Trusts than letting the work go elsewhere. We believe that in paragraph 7.24 we have dispelled

	the arguments against such Trusts.
(b) *Should any limitations and safeguards be imposed o the use of non-charitable Purpose Trusts and what should they be?*	Most trust jurisdictions provide generally in Trust Law for trusts which are invalid for illegality. Hong Kong should do this. Otherwise there is no need to mention trust law. Other law and regulations do and will prevent the illegal use of such trusts.
(c) *What measures should be introduced to facilitate the enforcement of non-charitable Purpose Trusts? For example, do you agree to provide for the role of "enforcers" in Hong Kong law?*	Yes, we would propose to provide for Enforcers. We suggest that Section 84A BVI TO be used as the primary source of reference but reference can also be made to the legislation in Dubai.
(d) *If you consider that the concept of "enforcers" should be introduced in Hong Kong, how should the role of "enforcers" be defined? Would you support the approach in Dubai, Cayman Islands or BVI?*	We propose that the approach set out in Section 84A BVI TO be adopted.

Bill Ahern
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STEP

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Co-Chair
HKTA

Hong Kong
23rd September 2009