Review of the Trustee Ordinance and related matters

Consultation Conclusions

BACKGROUND

On 22 June 2009, the Financial Services and the Treasury Bureau ("FSTB") launched a public consultation on the review of the Trustee Ordinance ("TO") and related matters. The consultation paper on the proposals ("Consultation Paper") was circulated to relevant professional bodies and practitioners, the Joint Committee on Trust Law Reform, trust services providers, chambers of commerce, financial services regulators, major charitable organizations and academics. It has also been posted on the FSTB's website.

2. During the consultation period, we organised a consultation forum to seek public views on 29 July 2009. We had also attended several meetings/forums of other interested organisations to brief the participants on the proposals and listen to their views. A list of the forums and meetings we attended is at Appendix I.

OUTCOME OF CONSULTATION

3. The consultation ended on 21 September 2009. A total of 36 submissions from 38 deputations were received and their views are reflected in this document. A list of the respondents is at Appendix II. A compendium of the responses is also available at the FSTB's website.[1]

General Comments

4. We have considered the respondents' views. All the respondents indicated general support for most of the proposals. Many respondents considered the review is timely and necessary, and that the proposals to modernize the trust law would be able to achieve the stated objectives of strengthening the competitiveness and attractiveness of our trust service

[1] Available at http://www.fstb.gov.hk/fsb.

industry. A modern trust law will attract more settlors to create trust in, or use the trust service of, Hong Kong and in turn would bring in earnings and employment opportunities. Nevertheless, some of respondents expressed their reservation or objection on a few relatively controversial proposals.

5. Some ideas that were proposed by respondents fall outside the purview of the current review. These include -

(a) there should be in place a registration and regulation scheme for professional trustees and trust companies[2], or a mandatory licensing regime for trust companies; and
(b) the reform should include taxation aspects and consider clarifying how trustees and trusts are being taxed under the existing tax regime.

We will forward the comments to the relevant bureau/departments for their consideration.

6. The respondents' comments and our responses are summarised below.

Trustee's duties and powers

(a) Trustee's statutory duty of care (Question 1)

7. We proposed to introduce in the TO a new statutory duty of care for trustees under which a trustee must exercise such care and skill as is reasonable in the circumstances, having regard to any special knowledge or experience that the trustee has or holds himself out as having; and if the trustee is acting in the course of 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.

[2] Currently, the registration regime for trust companies is a voluntary one. Nevertheless, trust companies are subject to certain control if they engage in certain investment activities or products and the existing system works well. In response to the FATF's recommendation that trust service providers should be subject to some anti-money laundering obligations, the Government will separately consider the issue concerning the regulating regime for trust service providers.

8. The proposed statutory duty of care should apply to trustees when they are exercising those powers in relation to investment, delegation to agents, appointing nominees and custodians, taking out insurance and dealing with matters concerning reversionary interests and valuation, subject to any indication in the trust instrument that the statutory duty is not meant to apply.

9. The statutory duty of care will replace the existing common law duty of care which might otherwise have applied. The statutory standard should be in addition to, and not affect, the other fundamental common law duties of trustees and the exercise of trustees' discretion.

Respondents' views

10. An overwhelming majority of the respondents supported the proposal to introduce a trustee's statutory duty of care, with the standard expected, along the lines of the UKTA.[3] The duty of care as enshrined in the law would make it more certain and accessible.

11. Some respondents, however, considered that the statutory duty of care should be mandatory while others proposed that the statutory duty should apply by default unless it is excluded by or inconsistent with the trust instruments. Where the statutory duty of care is excluded, the common law duty of care applies.

12. The dissenting minorities held the view that the common law duty of care or in short, the rule of a "prudent man of business" is well established and is best for Hong Kong. In the practice of UK, the statutory duty is often excluded or modified by the trust instruments. Some respondents opined that trustees should adhere to a higher standard of care than that of the common law standard, and the duty to comply with this standard should not be contracted out. Also, a higher standard of care should be imposed on professional trustees than lay trustees.

13. As regards the circumstances in which the statutory duty of care should apply, almost all respondents agreed to the circumstances proposed.

[3] The Trustee Act 2000 of the United Kingdom.

A couple of respondents opined that the statutory duty of care should apply to the exercise and performance of all of the trustee's powers and duties, and that certain core duties which are so fundamental that they should not be capable of being excluded. Core duties were those powers and duties mentioned in paragraph 8 above, together with the power to agree on the remuneration of agents, nominees and custodians. Two respondents suggested not extending the statutory duty of care to the technical powers in sections 16 and 24 of the TO.

Our response

14. We will introduce the necessary amendments to provide for the statutory duty of care as proposed. The distinguishing feature of the statutory duty of care from the common law duty of care is that, the former clearly recognises that professional trustees have a higher duty of care than lay trustees or volunteers. The proposed amendment will not take retrospective effect so that any trust created or trust instrument executed before the legislative amendment will remain unaffected.

15. Having regard to the views expressed by respondents as to whether the statutory duty should be optional and can be contracted out, we are of the view that the general default legal framework provided by the TO for the operation of trusts in Hong Kong should be maintained, and the optional nature will allow settlors and trustees greater flexibility to agree on the standard of care required of a trustee, and even to impose a higher standard than the legal requirement. While the statutory duty of care is perceived as a benchmark for trustees, settlors and trustees should be permitted to agree on a different standard. In any event, contracting out the statutory duty does not derogate any trustee from the common law duty of care, which applies and offers protection to the beneficiaries' interest.

16. We intend to provide for a statutory duty of care when trustees are exercising the more important powers in relation to the areas as originally proposed. It will be too onerous to impose statutory duty of care on all of the trustee's duties as such duties are many and may vary from case to case.

(b) Trustee's power of investment *(Question 2)*

17. We proposed to retain the list of authorized investments specified in the Second Schedule to the TO, and the trustee's power of investment is subject to the statutory duty of care. We also invited views on whether the Schedule should be amended and which area requires amendments.

Respondents' views

18. The vast majority of the respondents supported the proposal to retain the Second Schedule for the reasons given in the consultation paper. Since this is a default power, wider investment powers can be provided by a settlor in the trust instrument or authorized by the court. Most respondents agreed that adopting the Schedule would better protect beneficiaries against exposure to undue risk, and a statutory list is a helpful guide to lay trustees or settlors when investment power is not dealt with in the trust instrument. They suggested that the Second Schedule should be reviewed periodically with input from independent professionals for keeping it and the specified qualification criteria up to date and relevant.

19. A number of respondents agreed that the proposed statutory duty of care should apply to trustees in the exercise of their investment powers. The circumstances that the range of investments is restricted in the Second Schedule will be taken into account in judging the applicable standard of care.

20. Some respondents proposed to amend the Second Schedule in the following manners -

(a) in respect of investment in shares, to (i) lower the minimum market capitalization to HK$1 billion or 5 billion as a bigger company does not necessarily mean more secured; and (ii) relax the requirement for the minimum 5 years dividend record as the requirement is not realistic, and there could be valid reasons for a company not to declare dividends temporarily;
(b) to include any collective investment scheme, unit trust or mutual fund which is authorized by the relevant authority in other reputable and equivalent jurisdictions;

(c) to introduce some guidelines on divestment where after an investment decision had been made, the investment is no longer able to meet the qualification criteria; and
(d) to review the definition of derivatives, as derivatives are so sophisticated that their inherent risks are not fully understood and translated.

21. Those opposed the proposal considered that the list of authorized investment in the Second Schedule is too prescriptive, conservative and narrow and would not have offered a safe harbour. A more general power of investment should be given to trustees just like that of the UK and Singapore trust law.

Our response

22. We will retain a list of authorized investments in the Second Schedule in view of the overwhelming support for keeping it. The Schedule is a default arrangement and can be displaced by more general powers of investment expressly provided in a trust instrument. We will review the list of authorized investments in the light of the comments mentioned in paragraph 20 above and further consult the financial regulators and market practitioners on the details. Upon completion of the review, the amendments to the Second Schedule can be implemented either by an order to be made by the Financial Secretary[4] or be incorporated into an amendment Bill, depending on the timing.

(c) ***Trustee's power of delegation*** *(Question 3)*

23. We proposed to retain the power of delegation under section 27 of the TO subject to the overriding condition that if a trust has more than one trustee, the exercise of the power of delegation should not result in the trust having only one attorney or one trustee administering the trust, unless that trustee is a trust corporation. The delegation is subject to the statutory duty of care.

[4] See section 4(3) of the TO.

24. We also proposed to repeal section 8(3)(a) of Enduring Powers of Attorney Ordinance (Cap. 501) ("EPAO") so that the power of delegation by individual trustee is entirely governed by the TO.

Respondents' views

25. There was a general consensus in support of both proposals. The power of delegation provided in the TO applies by default only if the trust instrument is silent in this aspect. The statutory delegation should not preclude or limit any express power of delegation contained in the trust instrument. A few respondents found the UK approach more attractive as delegation to a single trustee is permitted.

26. Almost all agreed that the overlapping provision in the EPAO should be repealed to remove the inconsistency with section 27 of the TO. A minority preferred to retain the enduring power of attorney under the EPAO as it would endure beyond the mental incapacity of the donor. However, others thought that this approach is undesirable because the incapable trustee is not in a position to exercise any supervision over the attorney whom he appointed. A respondent (the Law Society of Hong Kong) pointed out that section 8 of the EPAO is inherently defective in respect of delegated power to act in relation to the trustee/donor's property and financial affairs.

Our response

27. We will amend section 27 of the TO and section 8(3)(a) of the EPAO along the lines of the proposal.

(d) Trustee's power to employ agents *(Question 4)*

28. We proposed that trustees be provided with a general power of appointing agents along the lines of the UKTA, subject to any contrary intention expressed in the trust instruments. The proposed power is subject to a number of safeguards, such as applying the statutory duty of care to the power of appointing agents, no delegation of functions on the distribution of trust assets and, in the case of delegating the asset

management functions, requiring an agreement in writing and a policy statement to give guidance as to how the functions are to be exercised.

29. We proposed to delete the power of delegation under section 25(2) of the TO in relation to properties outside Hong Kong.

30. We proposed to give trustees of charitable trusts wider powers to appoint agents along the lines of the UKTA, so that the functions of generating income to finance the trust's charitable purpose can be carried out by the agents. Again, the delegation is subject to various safeguards, such as applying the statutory duty of care to the power of appointing agents and no sub-delegation can be made.

Respondents' views

31. Almost all the respondents supported the proposals. It is a common practice that trustees would delegate their investment functions to agents like professional investors or qualified asset managers to manage the trust assets. Nevertheless, the statutory power of appointing agents could be excluded or modified in the trust instrument. Further, the law should make clear that the proposed safeguards would only apply when power is delegated under the legislation rather than a trust instrument. A couple of respondents, however, considered that the power should be subject to duty of care that could not be contracted out by a trust instrument. Moreover, agents should not be given any power to vary the class, or definition, of beneficiaries of a trust.

32. The contrary view was that it is not necessary to provide trustees with wide power to appoint agents as it may derogate from the fiduciary responsibility reposed by the settlors in the trust. Some thought that there is no material difference between delegation to trustees of charitable trusts and those of non-charitable trusts.

33. A great majority supported the proposal to standardize section 25(2) with the approach in section 25(1) in view of the advance in communication technology which makes it unnecessary for trustees to delegate fiduciary responsibilities to overseas agents.

34. Nearly all respondents agreed that there is a need to give trustees of charitable trusts, especially those sizeable ones, wider power to appoint agents to effectively carry out the charitable purposes. Some went further to suggest that qualified custodians and investment managers should be appointed for charitable trusts of substantial size. While the respondents had no objection to the safeguards proposed, one of them expressed that a new Charities Ordinance is needed to clarify and consolidate the law relating to Hong Kong charitable trusts and their operation.

Our response

35. In view of the majority support for the proposals outlined in paragraphs 28 to 30 above, we will include them in the legislative amendments.

(e) Trustee's power to employ nominees and custodians *(Question 5)*

36. We proposed to provide trustees with a general power to employ nominees and custodians in relation to such of the trust assets as they determine, along the lines of the UKTA and STA,[5] but subject to any contrary intention in the trust instrument.

37. The proposed power is subject to various safeguards, such as applying the statutory duty of care to the exercise of power to employ nominees and custodians, restricting the choice of nominees and custodians to persons carrying on business which consists of acting as a nominee or custodian, and requiring review of these arrangements.

Respondents' views

38. A strong majority of respondents supported the proposal to give wider power to trustees to employ nominees and custodians for achieving effective administration of the trust. The proposals reflect the current practice whereby shares are normally held in Hong Kong through nominees and the scrips of various funds are held by custodians. Some respondents considered that a professionally drafted trust instrument will address the

[5] The Trustee Act of Singapore.

issue. One respondent shared the experience that certain foreign countries restrict export of share certificate out of these countries, and hence a local nominee or custodian must be appointed for the investment there. Other respondents were concerned that the duty of care should not be contracted out by the terms of a trust instrument.

Our response

39. We will amend the TO providing trustees with a general power to employ nominees and custodians as proposed. Again, the default nature of the TO should be preserved to allow settlors flexibility in deciding the extent of power to be given to trustees in this respect.

(f) Trustee's power to insure (Question 6)

40. We proposed to give trustees wider powers to insure any trust property against risks of loss or damage by any event and pay the premiums out of the trust funds, subject to any express contrary intention in the trust instrument. The statutory duty of care applies to the exercise of the power to insure, whether conferred by the TO or otherwise.

Respondents' views

41. All respondents welcomed the proposal as it will afford greater protection to the trust properties. A few respondents opined that the power to insure should be mandatory and that the professional trustees should pay their professional indemnity insurance out of the administration fee.[6]

[6] The Law Society has proposed to provide for trustees' wider power to insure, so that a trustee may have an insurable interest in the life of a settlor and the trustee is able to take out an insurance policy for the benefit of the beneficiaries of the trust. The proposal is intended to address an issue arising from a U.S. District Court case that applied the Maryland law. We take the view that it is not necessary to change the law to cater for this issue, as in practice, a settlor may take out an insurance policy on his own life and then assign it to the trust. There is also no similar provision in the trust laws in other common law jurisdictions that provide for the trustee's insurable interest.

Our response

42. We will amend section 21 of the TO for giving effect to the proposal at paragraph 40. Whether professional indemnity insurance for professional trustees should be paid out of the administration fee, we take the view that it is a contractual matter to be negotiated between settlors and trustees. In any case, the legal provision can be overridden by any contrary intention in the trust instrument.

(g) Professional Trustee's entitlement to receive remuneration *(Question 7)*

43. We proposed that the TO should be amended to provide for a statutory charging clause for professional trustees along the lines of the UKTA and STA, subject to any contrary intention expressed in the trust instrument. There are different provisions for trustees of non-charitable trusts and trustees of charitable trusts.

44. For non-charitable trusts, if the trust instrument contains a provision entitling trustees to receive remuneration, trustees acting in the professional capacity or trust corporations are entitled to receive remuneration under the trust instrument, even if they are services which are capable of being provided by lay trustees. However, if no charging provision is contained in the trust instrument or any legislation, a trustee acting in a professional capacity (provided that he is not the sole trustee and each other trustee has agreed that he may be remunerated) or a trust corporation is entitled to receive reasonable remuneration out of the trust funds for its service, even if they are services which are capable of being provided by lay trustees.

45. For charitable trusts, if the trust instrument contains a provision entitling trustees to receive remuneration for their services, a trustee acting in the professional capacity (provided that he is not the sole trustee and the majority of the other trustees agreed that he could so charge) or a trust corporation could charge for services which are capable of being provided by lay trustees. However, in the absence of a charging provision in the trust instrument of a charitable trust, we asked whether professional trustees should be allowed to charge a reasonable amount for their service.

Respondents' views

46. While a majority of respondents agreed to provide for a statutory charging clause for professional trustees as proposed, some minority considered that the arrangement is unnecessary and the matter should be deferred to the court or provided for in the trust instrument.

47. For those in support of the proposal, they thought that no distinction should be drawn between charitable trusts and non-charitable trusts in terms of the remuneration policy. As regards trusts involving substantial assets, it is vital that professional trustees are engaged for the administration and management of the trust property, their service should be paid and expenses be reimbursed. There is an even stronger argument for charging fees for charitable trusts where professional services, including accounting and auditing, are required. The beneficiaries should be informed of the charging clause and the charge should be reasonable.

48. Some respondents pointed out that a default charging provision in the TO would be useful, particularly, in case of a will trust in which a trust company has been nominated to act as trustee and executor of the estate of a testator but a charging clause has been omitted from the will. The trust company cannot charge for its service other than by application to the court. Another case is on the retirement of a lay trustee (where no charging clause has been made in his favour) and replacement by a professional trustee. The trustees in both cases can then rely on the statutory provision to charge for their service. Having said that, statutory charging provisions should in no way affect or limit the express charging clauses in a trust instrument.

49. Two respondents were concerned that, where there are more than two trustees, the remuneration of a trustee (other than a trust corporation) would require the collective scrutiny by way of a written agreement of the other co-trustees.

Our response

50. We will provide in the TO statutory charging clauses along the lines of the UKTA and STA as set out in paragraphs 43 to 45 above. For charitable trusts, when a trust instrument contains no charging provision,

we suggest that a trust corporation or a trustee acting in a professional capacity is allowed to charge a reasonable amount for their service, provided that he is not the sole trustee and each other trustee has agreed that he may be remunerated. We consider it desirable to include in the legislation collective scrutiny of the trustee's remuneration as referred to in paragraph 49 and adopted by the UKTA[7]. The rationale behind the UKTA is that, trustees collectively should have power to authorize one (or more) of their trustees to charge for his professional services to the trust. The trustees will need to determine in each case whether it is appropriate to allow any one of them to be remunerated. The trustees need to consider all the circumstances of the case, including whether a settlor has conferred any benefit on a trustee, whether a trustee is the most appropriate person to provide the service to the trust, and whether allowing to charge is to the advantage of the trust.

(h) Default administrative powers of trustees in Parts II and III of the TO *(Question 8)*

51. We asked whether there are other suggestions in relation to the default administrative powers of trustees in Parts II and III of the TO.

Respondents' views

52. A number of respondents had proposed amendments to improve sections 8, 11, 12 and 34 of the TO.

53. Section 8(2) of the TO should be amended to conform to section 18(1) of the UKTA, to make it clear that if trustees retain or invest in bearer securities, they must appoint a custodian for the securities, unless the trust instrument or any enactment permits the trustees to retain the securities without appointing a custodian. Section 8(4) should also be amended so that the sum payable in respect of the deposit and collection of bearer securities will be paid out of the trust funds generally, rather than the income of the trust property given that some trust property may not be income producing.

[7] See sections 28(3) and 29(2) of the UKTA.

54. Under section 11(5), where a right to subscribe for securities is offered to a trustee, the trustee may exercise the right and apply capital money in payment of the consideration. It was proposed to revise section 11(5) to allow the payment to be made out of the trust funds generally so that income, in addition to capital money, can be applied in payment. Similarly, section 12(2) should be revised so that income, in addition to capital money, can be used to pay up calls on shares. Such payment arrangement will be fairer amongst the beneficiaries.

55. A couple of respondents suggested removing the current restrictions in section 34(1) that governs the power of advancement in order to give greater flexibility to the trustees. The current restrictions include limiting the money advanced not to exceed one-half of the vested interest, the money paid should be brought into account and the advancement is without prejudice to any prior life interest. In practice, such restrictions are usually excluded in the trust instruments or wills.

Our response

56. We have considered these proposals and will include them in the legislative amendments.

Statutory control on trustee's exemption clauses *(Question 9)*

57. We proposed to subject certain trustee exemption clauses to statutory control if the clauses seek to exempt professional trustees, who are remunerated for their services, from liability. However, similar control does not apply to lay trustees and professional trustees who provide their service free of charge.

58. We have asked the views of the respondents which of the following proposed options for effecting statutory control will be more appropriate:

(a) option (i) - prohibiting trustees 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);

(b) option (ii) - prohibiting trustees to exclude liability for breach of trust where he fails to show the degree of care and diligence required of him as a trustee along the lines of section 75B of the Companies Ordinance (Cap. 32);
(c) option (iii) - imposing procedural safeguards to ensure that the settlor is aware of the trustee exemption clauses;
(d) option (iv) - subject trustee exemption clauses to a reasonableness test similar to the one imposed under the Control of Exemption Clauses Ordinance (Cap. 71).

Respondents' views

59. A substantial majority of the respondents supported the proposal to regulate trustee exemption clauses. They opined that since trustees owe beneficiaries a duty of care, the court will have high expectation of trustees and tend to hold professionals to a higher duty than lay persons. Furthermore, Hong Kong is a leading financial centre and should promote high standards across the board to protect the beneficiaries and the reputation of Hong Kong. If trustees of Mandatory Provident Fund ("MPF") schemes are statutorily regulated, and trustees are required to carry insurance for fraud, there is no reason why professional trustees should be exempted from liability for breach of trust. While trustee exemption clauses may be included in a trust instrument, it is currently the market practice for professional trustees to limit liability to fraud, wilful default and gross negligence. Under no circumstances will exculpation for fraud, wilful default and gross negligence be permitted.

60. Most of the respondents who supported the proposal preferred the statutory regulation of exemption clauses to apply to professional trustees who charge for their services, but not to lay trustees or trustees who are already regulated under other legislation. Nevertheless, the existing discretion of the court to relieve trustees from personal liability for a breach of trust under special circumstances should be retained (see section 60 of the TO). In addition to regulation by statute, some respondents suggested to promulgate a code of practice in relation to the inclusion of exemption clauses in a trust instrument.

61. A few dissenting views held that statutory control is not necessary as there is no evidence of abuse of exemption clauses. Parties should be free to contract and agree the scope of the trustee's exemption in the trust instruments. The non-statutory approach of the UK is preferred. It is currently the market practice for professional trustees to limit liability to gross negligence, fraud and wilful default. They considered that the current market practice and the common law limitation together have achieved a balance between the interests of settlors, trustees and beneficiaries.

62. Amongst those who supported the proposals, their views on which option to adopt were divided. Slightly more respondents preferred option (i), but some pointed out that this option is unique to the pension trust under a retirement scheme, and its effect is not clear as it has not been considered by the court before. Some respondents rejected option (iv) because the reasonableness test is uncertain. Several trust service practitioners proposed the provision adopted by Jersey[8] and Guernsey as an alternative. The Jersey's approach has been discussed in paragraph 3.6 of the Consultation Paper.

Our response

63. We will provide in the TO statutory control of trustees' exemption clauses to be relied upon by professional trustees who receive remuneration for their services. There is some strength in the arguments in favour of option (i). Nevertheless, it has some imperfections as pointed out by respondents in paragraph 62. We consider the respondents' proposal for adopting the statutory provision of Jersey and Guernsey acceptable because it has imposed a tighter control on the use of exemption clauses as compared with that of the common law, is applicable to trusts in general and seeks to codify the prevailing market practice of the professional trustees. The statutory control will promote certainty and transparency, and hence offers more protection to beneficiaries.

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[8] Section 30(10) of the Trusts (Jersey) Law 1984 provides that "Nothing in the terms of a trust shall relieve, release or exonerate a trustee from liability for breach of trust arising from the trustee's own fraud, wilful misconduct or gross negligence.".
Section 39(7) of the Trusts (Guernsey) Law 2007 provides that "The terms of a trust may not (a) relieve a trustee from liability for a breach of trust arising from his own fraud, wilful misconduct or gross negligence, or (b) grant him any indemnity against the trust property in respect of any such liability.".

Beneficiaries' rights to information *(Questions 10)*

64. We proposed to provide in the TO some basic rules for the disclosure of information to beneficiaries so as to give a clearer guideline about what information beneficiaries can obtain. The court may, however, override such guidelines.

65. We have proposed two options. The first one is to follow clause 8 of the draft Trustee Act of the British Columbia which proposes to impose an additional duty on trustees, over and above the common law duty, to provide information to beneficiaries who are vested in possession or who make a request for information. The type of information to be disclosed mainly concerns the trustee's assets and liabilities. The second option is that trustees should on request be required to inform beneficiaries (whatever their status) of their interests in the trust. In both options, the duty does not apply in specified exceptional circumstances and is subject to any express contrary intention in the trust instrument.

Respondents' views

66. The views of the respondents were divided. For those who found the proposal attractive do so because the decision in *Schmidt v Rosewood Trust Ltd.*[9] is unsatisfactory, and there is a need for clarity by providing guidelines in the law as to who is entitled to receive what kind of information. Amongst these respondents, the extent of disclosure of information varied. Both proposed options were more or less popular. Respondents had also suggested other options. The general view is that, beneficiaries with interest vested in possession should be informed of the existence of a trust and their interest in it. If a beneficiary is a mere object, he will on request, be provided with information. Protectors should also be entitled to some trust information. The statutory guideline will be subject to the terms of the trust instrument and the court's inherent jurisdiction to decide otherwise. In any event, settlors' wish letters should not be disclosed, nor the reasons for which a trustee has exercised his power.

[9] [2003] 2 A.C. 709.

67. Those who rejected the proposal considered that the law is in a state of flux in this area, and the landscape has changed dramatically both on the nature of the right to trust information and the scope of that right. The Government should adopt a cautious approach not to codify pre-maturely all the common law principles in this area. A fine balance should be maintained between the beneficiaries' right to information, the trustees' accountability and the settlors' right of privacy. In practice, some trusts will be better administered if beneficiaries are aware of the trust arrangement, other trusts will create undesired consequences if disclosure to beneficiaries are mandated. These respondents preferred the right to information to be provided in the trust instruments or decided by the court on a case by case basis. In any event, the existing common law contains sufficient flexibility to enable the courts to cater for the facts of individual trusts. It would not be fruitful to define the sort of information which, by default, trustees are obliged to provide to beneficiaries.

Our response

68. As views were divided, and the subject is complex and warrants further study, we decide not to legislate for the beneficiaries' rights to information for the time being. The current law will remain unchanged.[10] We shall further study the subject and keep in view the evolution of the common law and overseas statutes before coming to a more definite proposal.

Beneficiaries' right to remove trustees *(Question 11)*

69. We proposed to provide beneficiaries with the right to remove trustees by way of a court-free process following the UK approach.[11] All the beneficiaries who are of full age and legal capacity and (taken together) are absolutely entitled to the trust property may, in writing, direct a trustee to retire from the trust and appoint a new trustee. The new power does

[10] The Legislative Council Panel on Financial Affairs ("LegCo Panel") has considered that the subject review is highly technical, especially in the area on the beneficiary's rights, and requested the Administration to consider inviting the Law Reform Commission ("LRC") to conduct further study on the subject matter, and recommend possible reform proposals for the Administration's consideration. We have referred the subject matter to the LRC for study as requested by the LegCo Panel, and is awaiting their reply.

[11] See sections 19 and 20 of the Trusts of Land and Appointment of Trustee Act 1996.

not affect the inherent jurisdiction of the court to remove a trustee at the instance of a beneficiary.

Respondents' views

70. A large number of respondents supported the proposal as it provides a relatively easy means for beneficiaries of a trust, who are dissatisfied with a trustee, to remove the trustee and appoint a new trustee without the need to terminate the trust. Nevertheless, the statutory right of removal should not override the express terms of a trust instrument that reflected the wishes of a settlor.

71. However, other respondents emphasized that the existing route for beneficiaries to remove trustees is reasonably adequate and beneficiaries can abuse the proposed power if the power is given. One respondent opined that a protector should be given the power to remove trustees.

Our response

72. We will amend the TO so that a trustee (including a trustee who is incapable by reason of mental disorder) may be removed from his office by the directions of all the beneficiaries, who taken together, are absolutely entitled to the trust property and all are of full age and legal capacity, so long as the trust instrument does not nominate any person to appoint new trustees.

The rule against perpetuities *(Question 12)*

73. We asked whether the rule against perpetuities ("RAP") should be abolished without retrospective effect, or the rule should be modified by introducing one fixed perpetuity period.[12]

Respondents' views

74. A majority of the respondents supported reforming the RAP by abolishing the rule without retrospective effect, because the rule is archaic,

[12] Under the UK Perpetuities and Accumulations Act 2009 ("UKPAA") (which received Royal Assent on 12 November 2009), the RAP is simplified by introducing a fixed period of 125 years.

overly complex, difficult to apply and can frustrate the intention of settlors. Those who advocated for non-charitable purpose trusts to serve business requirements said that there is a need for perpetual trusts. A number of respondents preferred to replace the common law perpetuity period with a fixed perpetuity period ranging from 50 years, 80 years, 100 years, and 125 years to 150 years.

75. A few respondents counter-proposed a more flexible option for consideration. If the RAP is abolished, a settlor will be free to subsequently set a fixed period in the trust instrument, which period will be subject to extension or abridgement by the settlor during his life time. The legislative amendment will not have retrospective effect but provisions should allow settlors to re-settle the existing trusts by extending the permitted period without offending the RAP.

Our response

76. In the light of the majority's views, we will amend the Perpetuities and Accumulations Ordinance ("PAO") by repealing the RAP in respect of new trusts to be set up.

The rule against excessive accumulations of income *(Question 13)*

77. We asked whether the rule against excessive accumulations of income ("REA") should be abolished, or whether the rule should be retained in some form with respect to charitable trusts, and if so, how long should a charitable trust[13] be allowed to accumulate its income.

Respondents' views

78. The proposal to abolish or revise the REA was welcomed by all respondents, not only because the REA is archaic and complicated, but also it can frustrate the wishes of settlors to accumulate incomes. The proposed period fixed for the REA can be the same as that for the RAP for consistency. Since trusts have been used as lawful vehicles for tax

[13] Under the UK Perpetuities and Accumulations Act 2009 (which received Royal Assent on 12 November 2009), the REA is abolished except that for a charitable trust, the accumulation period is limited to 21 years.

planning arrangements, and one of the arrangements is to accumulate income, the abolition of the REA will likely attract more trusts to be settled in Hong Kong.

79. Regarding charitable trusts, while some respondents concurred that income can be accumulated for a period up to 21 years, it is important to ensure that the income will be applied for its intended charitable purposes within the fixed period. Others suggested that charitable trusts should be required to distribute a certain proportion or percentage of the net income annually.

Our response

80. We will amend the PAO by repealing the REA except for charitable trusts. The amendment will not operate retrospectively. Trustees of charitable trusts should be allowed to accumulate income up to 21 years following the UK approach.

Further proposals on promoting the use of Hong Kong trust law

(a) Protectors of trusts *(Question 14)*

81. We asked whether there is a need to introduce and statutorily define "protector" in the TO and, if so, how should the functions and duties of protectors be defined.

Respondents' views

82. The views were divided, with slightly more respondents opposed the proposal than those in favour of it. For respondents who supported the introduction of "protector" in the legislation, they laid emphasis that protectors are watchdogs for beneficiaries and provide a check-and-balance on trustees. Opt-in provisions can be designed so that they do not apply unless specifically adopted by the trust instruments. These provisions could cover who may be protectors, their appointment and removal, their remuneration, duty of care and liability to the beneficiaries, etc.

83. For those who queried the need to legislatively provide for protectors, they argued that the role of a protector varies from case to case, and it will be better for settlors to define the roles and functions of protectors in the trust instrument to reflect their wishes. There was also concern that protectors can abuse their position by exerting undue influence on trustees to undertake risky investments. The observations raised in paragraphs 6.9 and 6.10 of the consultation paper are valid concerns and need to be addressed. Further, if the statute will include settlors' reserved power (for example, power to remove a trustee), then some of the rationale for having a protector will fall away.

Our response

84. While there is some support for the introduction in the legislation the definition and roles of a protector, there is pertinent concern that a protector may instruct trustees to act fraudulently or embark on high risk investment. We note that the Trustee Act of the UK and Singapore do not introduce the role of protector in their legislation. We consider that it is not a ripe time to legislate for protectors and the choice may well be left to the settlors to be determined in the trust instruments.

(b) Reserved powers of settlors and validity of trusts *(Question 15)*

85. We asked whether 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, and what kind of powers should be reserved.

Respondents' views

86. A majority of the respondents supported enacting a provision making clear that a limited reservation of settlors' power will not invalidate a trust, because such a provision will promote certainty and pre-empt litigation. A few respondents who opposed the proposal considered that there will be alternatives for settlors to maintain control of a trust, such as, by sitting as directors of a limited company that acts as a trustee of the trust.

87. There was little consensus as to what kind of powers is to be reserved. Some preferred to mirror the conservative model of Singapore by

restricting the reserved powers to investment or asset management. Others went further to reserve the powers to appoint and remove trustees and beneficiaries, or even further to determine the governing law of a trust. Several respondents reminded us of the danger of reserving too much of the settlors' powers may lead to challenge by the court and tax authorities that the trust is in fact a sham.

88. A few respondents were in favour of giving exemption to trustees. That is, where a power has been reserved or granted by the settlor, a trustee who has acted in accordance with the exercise of the power is not acting in breach of trust.

Our response

89. We will provide in the law that (a) a limited reservation of settlors' powers does not invalidate a trust along the lines of the Singapore Trustee Act and that (b) a trustee should be exempted from liability for acting in accordance with the powers that a settlor has reserved.

(c) Governing law of trusts *(Question 16)*

90. We asked whether there is a need to codify the common law principles in relation to the governing law of trusts.

Respondents' views

91. A great majority agreed that there was no need to codify the common law principles in relation to the governing law of trusts because the Hague Convention as enshrined in the Recognition of Trusts Ordinance (Cap. 76) provides clear guidelines and has been working well. The current law is clear and should be retained. In practice, the trust instruments prepared by professional trustees will usually contain an express choice of governing law.

Our response

92. We will not codify the common law principles in relation to the governing law of trusts and shall continue to rely on the current law which is certain and working well.

(d) Forced heirship (Question 17)

93. We asked whether 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 the Hong Kong law. We also asked what model the provisions should follow.

Respondents' views

94. A small majority considered that the integrity of trust law will be strengthened if there is a provision making it clear that Hong Kong court can ignore specified claims made against Hong Kong trusts that may arise under foreign law. Other respondents considered that the question can arise not only in the context of forced heirship, but also as a result of divorce, insolvency or other proceedings in another jurisdiction.

95. Some respondents preferred to have legislation confirming the validity of a trust which will not be affected by the forced heirship rules, and clarifying the powers of the court that it is not obliged to recognize foreign ancillary relief orders which purport to cover assets owned by Hong Kong trusts, and that only Hong Kong court can vary a trust set up under the laws of Hong Kong. The Singapore, Dubai[14], BVI, Jersey[15] or Guernsey models were quoted as reference. A slightly more respondents preferred the Singapore model.

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[14] Under section 16 of the Dubai Trust Law 2007, an heirship right conferred by foreign law in relation to the property of a living person shall not be recognized as:
(a) affecting the ownership of immovable property in the Dubai International Financial Centre (DIFC) and movable property wherever it is situated for the purposes of Article 14(2)(a) and (b) or for any other purpose; or
(b) constituting an obligation or liability for any purpose.

[15] See articles 9, 9(2) and 9(4) of the Trusts (Jersey) Law 1984.

Our response

96. We will introduce legislation to the effect that forced heirship rule will not affect the validity of trusts by following the Singapore approach.

(e) Non-charitable purpose trusts and enforcers *(Question 18)*

97. In response to the trust practitioners' request, we asked whether the law should be amended to allow the creation of non-charitable purpose trusts, and should any limitations and safeguards be imposed on the use of this kind of trusts. What measures should be introduced to enforce non-charitable purpose trusts, including whether to provide for "enforcers" and their roles.

Respondents' views

98. The views were diverse. Some respondents[16] welcomed the statutory creation of non-charitable purpose trusts for commercial purposes, for holding company shares or for other benevolent purposes which are not strictly charitable. They argued that such structure, when made available, will attract trust business to Hong Kong. The concern of using purpose trusts for illegal or tax evasion purposes can be addressed as there are in place anti-money laundering legislation and other control measures. The law can provide for enforcers (being professionals such as lawyers or accountants) to facilitate the enforcement of non-charitable purpose trusts. There are suggestions for various legal safeguards, such as the purposes of the trust must be lawful and reasonable, the trustees must be Hong Kong residents and the trust must be subject to periodic review. The Dubai model was quoted as a reference.

99. On the other hand, some vehemently opposed to the proposal.[17] Their arguments include –

[16] These respondents include trust service providers and practitioners, the Law Society of Hong Kong, law firms and ACCA.

[17] They include the Association of Banks, certain banks and professional bodies for accountants.

(a) The reputation of jurisdictions like the Cayman Islands[18] is adversely affected because non-charitable purpose trusts have been used to facilitate off-balance sheet structuring.
(b) There is a question of enforcement due to uncertainty of object, and the effectiveness of enforcement is yet to be tested.
(c) The introduction of "enforcer" and the possible abuse of unlimited and broad scope of purpose trusts are legitimate concerns and have to be addressed.
(d) The combined effect of the abolition of the RAP and the introduction of purpose trusts without ascertainable beneficiaries will have far reaching implications. For example, it may be difficult to stop a trustee and an enforcer from committing conspiracy to defraud trust assets.

Our response

100. The proposal to amend the law allowing the creation of non-charitable purpose trusts is a fundamental change to the trust law in the common law jurisdictions. While allowing the creation of such trusts may serve some useful commercial purposes, there are concerns over difficulties in the control and enforcement of the trusts and trust properties and dilution or weakening of beneficiaries' right under the trust as there will be no ascertainable beneficiary to enforce it. Given the divided views and the complexities of the issues involved, it would be prudent to study the issues in greater detail and keep in view the evolution of the relevant law in other common law jurisdictions before taking a final view on the subject. In any case, this would have to be considered as a separate legislative reform project as it goes beyond amending the TO.

CONCLUSIONS

101. In summary, the following proposals should be adopted-

[18] The Cayman Islands was governed by the Special Trusts (Alternative Regime) Law-STAR. This law is much more ambitious and sophisticated. It extends to "purpose" and "persons", so that persons who benefit do not have an enforcement right unless they are expressly given by appointment as an enforcer.

(a) To introduce a statutory duty of care for trustees when they are exercising their powers in relation to investment, delegation, appointing nominees and taking out insurance, etc *(Question 1)*;

(b) To amend the Second Schedule to the TO and the authorized investments it contains to keep up with market needs, pending further study on the detailed amendments *(Question 2)*;

(c) To retain the trustee's power of delegation under section 27 of the TO with amendments, so that there should be at least one attorney and one trustee or alternatively a trust corporation administering the trust *(Question 3)*;

(d) To provide trustees with a general power of appointing agents with specified safeguards *(Question 4)*;

(e) To provide trustees with a general power of employing nominees and custodians in relation to trust assets subject to specified safeguards *(Question 5)*;

(f) To amend section 21 of the TO, giving trustees wider powers to insure any trust property against risks of loss or damage by any event, and pay the premium out of the trust funds *(Question 6)*;

(g) To provide for a statutory charging clause for professional trustees or trust corporations to enable them to receive remuneration for their services under different circumstances, whether they are acting for charitable trust or non-charitable trusts *(Question 7)*;

(h) To amend sections 8, 11, 12 and 34 of the TO with a view to improving the administrative powers of trustees *(Question 8)*;

(i) To subject certain trustee exemption clauses to statutory control if the clauses seek to exempt professional trustees, who are remunerated for their service, from liability for breach of trust due to fraud, wilful misconduct or gross negligence *(Question 9)*;

(j) Not to provide any basic rules governing beneficiaries' right to information, and will further study the subject keeping in view the evolution of the relevant law in other common law jurisdictions *(Question 10)*;

(k) To legislate for beneficiaries' right to remove a trustee (including a trustee who is incapable by reason of mental disorder) if the beneficiaries are all of full age and legal capacity and are absolutely entitled to the trust property *(Question 11)*;

(l) To amend the Perpetuity and Accumulations Ordinance (Cap. 257) ("PAO") by repealing the existing rules against perpetuity in respect of new trusts to be set up *(Question 12);*

(m) To amend the PAO by repealing the rules against excessive accumulations of income in respect of new trusts to be set up, except that charitable trusts will be allowed to accumulate its income up to 21 years *(Question 13);*

(n) Not to introduce legislation providing for the definition of protectors nor for their roles *(Question 14);*

(o) To provide in the law that a reservation of settlors' powers to investment or asset management does not invalidate a trust and that a trustee should be exempted from liability for acting in accordance with the powers that a settlor has reserved *(Question 15);*

(p) Not to codify the common law principle of the governing law of trusts and continue to rely on the current law *(Question 16);*

(q) To introduce legislation to the effect that forced heirship rule will not affect the validity of trusts by following the Singapore approach *(Question 17); and*

(r) Due to the complexity and controversy of the issue, need to study the issues on non-charitable purpose trusts in greater detail before taking a final view on the subject *(Questions 18).*

WAY FORWARD

102. The Administration will incorporate the legislative proposals into a Bill, with a view to introducing it into the LegCo in the 2010-11 legislative year.

Financial Services and the Treasury Bureau
February 2010

Appendix I

List of Forums and Meetings Attended

Date	Organising Parties	Nature	No. of Participants from connected sectors
29 July 2009	Financial Services and the Treasury Bureau	Forum	106 participants – including trust service providers, banking staff, insurance service providers, academics, lawyers, accountants, civil servants and members of the HKTA and STEP Hong Kong Ltd
12 September 2009	Democratic Alliance for the Betterment of Hong Kong ("DAB")	Seminar	73 participants – including members of the DAB, lawyers, accountants and businessmen
15 September 2009	HK Trustees' Association Ltd ("HKTA") and STEP Hong Kong Ltd	Forum	70 participants – including members of the HKTA and STEP Hong Kong Ltd., banking staff, trust service providers, lawyers and accountants
17 September 2009	The Association of Chartered Certified Accountants Hong Kong	Seminar	204 participants – including members of the ACCA, accountants, banking staff, trust service providers, insurance service providers, wealth planning managers, academics and NGOs staff

Appendix II

Respondents

1. Asiaciti Trust Hong Kong Limited
2. Baker & McKenzie
3. Bank of Communications Trustee Limited
4. Bank of New York Mellon
5. Butterfield Private Office (HK) Limited
6. Consumer Council
7. David Gunson
8. Deutsche Bank
9. GFC Trustees (Hong Kong) Limited
10. Hong Kong Institute of Certified Public Accountants
11. International Tax Planning Association
12. James J Bertram
13. Joint Committee on Trust Law Reform
14. Law Debenture Trust (Asia) Limited
15 Linklaters, Hong Kong (on behalf of Bank of New York Mellon, Deutsche Bank and The Hongkong and Shanghai Banking Corporation Limited)
16. Michael Shane Kelly
17. Nicholas Pirie
18. ONC Lawyers, Hong Kong China
19. Po Leung Kuk
20. The Arab Chamber of Commerce & Industry

21. The Association of Chartered Certified Accountants, Hong Kong

22. The British Chamber of Commerce in Hong Kong

23. The Chinese Manufacturers' Association of Hong Kong

24. The Hong Kong Association of Banks

25. The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies

26. The Hong Kong Federation of Insurers

27. The Hongkong and Shanghai Banking Corporation Limited

28. The Hong Kong Society of Financial Analysts

29. The Institute of Accountants in Management

30. The Law Society of Hong Kong

31. Withers, Hong Kong

32. The Hong Kong Bar Association

33. Four respondents have requested their names not to be disclosed