

TRUST LAWS FOR THE 21ST CENTURY

*A Submission to the Financial Services Branch of the Financial Services and the Treasury
Bureau of the HKSAR Government on Trust Law Reform by the Joint Committee on Trust
Law Reform.*



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1. INTRODUCTION

- 1.1 The Joint Committee on Trust Law Reform (“JCTLR”) was recently established by the Hong Kong Trustees Association (“HKTA”) and the Hong Kong Branch of the Society of Trust & Estate Practitioners (“STEP”) with a view to urging the HKSAR Government to reform trust law in Hong Kong. The JCTLR carries on the work of SCOT (Steering Committee on Trust Law Reform) which gained a wide level of support from a range of professional and industry bodies for the idea of reforming Hong Kong’s trust law. Further details of the HKTA and STEP can be found on their respective websites www.hktrustees.com & www.step.org.
- 1.2 HKTA & STEP represent the commercial and private trustee industry in Hong Kong and also all the professionals (legal, accounting, etc.) who work in the industry in administering trusts and represent the rights of Hong Kong based beneficiaries of trusts of various kinds including trusts used as collective investment vehicles, private family trusts and charitable trusts.
- 1.3 The JCTLR has identified a genuine and pressing need to substantially modernize Hong Kong trust law. We need to stop the movement of both private and commercial trust business from Hong Kong to elsewhere (principally Singapore) and to capture our rightful share of the fast growing legitimate international trust business which is bypassing Hong Kong. A modern flexible and certain domestic trust law is key to these objectives.
- 1.4 It is for these reasons and on this basis that the JCTRL makes the following submissions for trust law reform in Hong Kong.

2. WHY HONG KONG NEEDS A THRIVING TRUST INDUSTRY

- 2.1 We already have a substantial trust business in Hong Kong providing the following benefits:
 - 2.1.1 Direct employment of trust officers, legal, accounting, compliance and support staff.
 - 2.1.2 Increased local asset management of trusts’ underlying assets due to proximity to markets etc.
 - 2.1.3 Increased use of the local legal profession for drafting and opinion work and in the area of trust dispute resolution.
 - 2.1.4 Increased tax revenues to the HKSAR from local profit and salary generation from the above activities.
 - 2.1.5 A broader more sophisticated financial services sector.

- 2.2 Evidence of these benefits is found in the results of a survey conducted by the HKTA and STEP in May 2006 in which it was revealed that:
- 2.2.1 approximately USD364 billion of assets was held and managed in private client and institutional trust (and similar) structures in 2004.
 - 2.2.2 total trust industry revenues were USD247 million for 2004.
 - 2.2.3 some 3000 people were directly and indirectly employed in the trust administration business in Hong Kong.

Annexed to this submission as Annexure I is a copy of that survey.

- 2.3 Hong Kong can remain the regional leader of the trust industry because:
- 2.3.1 we are the recognized leading regional financial centre industry in asset management, banking etc.
 - 2.3.2 we have a first class corruption-free judiciary committed to the Rule of Law.
 - 2.3.3 we have deep expertise in trust administration and in legal and accounting aspects of trusts.
 - 2.3.4 we are the natural gateway to the burgeoning private wealth being created in the Mainland and for foreign investment into the Mainland.

3. WHAT'S WRONG WITH OUR TRUST LAWS?

- 3.1 In essence, our trust laws are outdated especially compared to the competition, that is, other jurisdictions seeking to attract trust business. Our trust laws have not been substantially amended since their introduction in 1934.
- 3.2 In that time the dynamics of trusts for both international private family and commercial purposes have changed dramatically. Trusts are now undoubtedly the planning vehicle of choice for the families worldwide that have an increasingly international reach of investments and family members. Trusts protect family assets and provide a predictable means of passing family wealth from generation to generation. Trusts are now the favoured vehicle for charities principally because of the flexibility they offer as compared with companies. Trusts are also now a popular choice for collective investment schemes (CIS) including private equity vehicles in addition to mutual fund companies and limited partnerships. Trusts for a purpose are used extensively to hold assets in international asset securitization structures. In Hong Kong, trusts are the favoured MPF scheme structure and the prescribed REIT structure.
- 3.3 One of the most attractive features of the trust is its flexibility, especially in the international context. For example, many families and CIS now have trust

assets in the US and Australia, which are administered in Singapore, governed by the law of the Cayman Islands, for the benefit of beneficiaries resident all over the world.

- 3.4 The choice of governing law is very important. It regulates the obligations that trustees owe their beneficiaries and their powers, duties and liabilities with respect to administering the trust assets. It governs the rights beneficiaries have against trustees and how the courts might deal with challenges by beneficiaries. It governs how long a trust will last, what powers a person might legitimately reserve to themselves when establishing a trust, and what are the roles of the respective players.
- 3.5 When a person establishes a trust, he chooses both the governing law of a place and a place to administer the trust assets. They do not have to be the same place. If Hong Kong has a modern equitable and predictable trust law, people are more likely to choose Hong Kong governing law.
- 3.6 This, in itself, is good for Hong Kong even if the trust is administered elsewhere, both in terms of Hong Kong's reputation as an international financial centre and also for the legal profession. Local lawyers will draft the trust documents and advise on them and handle trust dispute resolution.
- 3.7 In addition, when professional trustees with global trust portfolios are looking for a place to administer their trusts, they are more likely to choose a place that has, in addition to all the other attributes listed in paragraph 2.3 above, the right governing law. This is because it makes good sense to administer trust assets in the same place as the governing law. Trust officers, lawyers and the courts (where disputes arise) are better off applying their own laws than a foreign law.
- 3.8 People like certainty in what can be a complex web of relationships and have, over the years, chosen to adopt the laws of places that have trust laws that offer comprehensive, predictable and equitable outcomes. A recent example of this is Singapore, which in 2004 modernized its outdated trust laws and is continuing its trust law reform programme. Before its reform, Singapore had fewer than 15 registered companies. It now has issued 31 trust licences to trust companies, including the biggest trust administration players globally, and has granted exemption to a further 30 entities carrying on trust business in Singapore. It is understood that there are further applications for trust licences currently being dealt with. The recent severe shortages in the trust administration and private banking labour market in Singapore and the recent rapid increase in membership of STEP Singapore branch is well known in the industry and testament to the significant inflow of trust and related business to Singapore.
- 3.9 Hong Kong's weak link is our trust laws. The sources of our trust law include:
 - 3.9.1 The rules of equity and the common law i.e. made by the courts.
 - 3.9.2 The Trustee Ordinance, Cap. 29.

- 3.9.3 Variation of Trusts Ordinance, Cap. 253.
 - 3.9.4 Probate and Administration Ordinance, Cap. 10.
 - 3.9.5 Perpetuities and Accumulations Ordinance, Cap. 257.
 - 3.9.6 Wills Ordinance, Cap. 30.
 - 3.9.7 Recognition of Trusts Ordinance, Cap. 76.
 - 3.9.8 Securities and Futures Ordinance; Cap 571 and all subsidiary legislation, codes of practice and guidelines issued pursuant thereto.
 - 3.9.9 Mandatory Provident Fund Schemes Ordinance, Cap 485, and all subsidiary legislation, codes of practice and guidelines issued pursuant thereto.
- 3.10 The rules of equity may be said to provide the largest single body of trust law in Hong Kong. This is because the Trustee Ordinance is supplemental to the rules of equity and only applicable where it is expressed to override the terms of written trust instruments. Attached as Annexure II is an extract from The Trident Practical Guide to International Trusts (4th Edition – May 2004), which provides a useful everyman’s guide to trust law in Hong Kong. In particular, this extract deals with most practical trust law issues, and more importantly, shows which areas are dealt with by the Trustee Ordinance and other local statutes and which are left to the rules of equity and the common law. An understanding of this is critical to the reform process urged by the submission.
- 3.11 It can be readily seen from the above that, perhaps except for MPF related funds or schemes and SFC authorized collective investment schemes, there is no comprehensive statutory approach to the way trusts are administered in Hong Kong nor to the duties and obligations of trustees or the rights of beneficiaries. There has been no comprehensive review of Hong Kong’s private trust law since the enactment of the Trustees Ordinance in 1934.
- 3.12 The JCTLR has retained Mr. Mark Lea a local trust lawyer with significant experience in advising other jurisdictions on the modernization of their trust law. Mr. Lea conducted extensive research on trust laws around the world. The JCTLR has used that research and the collective international experience of its members to identify world’s best practice. This research will be made available to interested parties at the appropriate time. For the purposes of addressing at this point the principal policy issue of the need for reform we summarize below the main areas of concern. Annexure III hereto provides further detail of the individual proposals and the reasoning behind them; including, where appropriate, instances where other jurisdictions have reformed their laws in these areas. Mauritius, Jersey, Guernsey, Bermuda, the British Virgin Islands, the Cayman Islands, Labuan, the Bahamas, the Isle of

Man and Singapore all now have trust laws that are more modern, predictable and equitable than Hong Kong's.

4. TOWARDS 21ST CENTURY TRUST LAWS

- 4.1 Set out below is a list of suggested areas where our trust law could be improved, especially viewed in comparison to other jurisdictions around the world.
- 4.1.1 Improvements in definitions.
 - 4.1.2 Provisions for the role of Protector.
 - 4.1.3 Provisions for the role of Enforcer.
 - 4.1.4 Provisions for the unlimited duration of Private Trusts.
 - 4.1.5 Provisions enabling income to be accumulated throughout the duration of a Trust.
 - 4.1.6 Definition of types of Trust and specific provision for Purpose Trusts and Charitable Trusts.
 - 4.1.7 Provisions for the essential validity of Trusts.
 - 4.1.8 Provisions for certain reserved powers to Settlers, Protectors and Enforcers without infringing the validity of Trusts.
 - 4.1.9 Provisions that ensure neither the creation of a Trust nor the transfer of assets to a Trust will be invalidated by either foreign rules of forced heirship or because the concept of a Trust is not admitted by a foreign law.
 - 4.1.10 Provisions to provide greater certainty of definition and choice of Governing Law.
 - 4.1.11 Modernization of Trustees' powers to provide for best practice:
 - provision for a statutory duty of care;
 - enhanced powers of investment, delegation, insurance and remuneration;
 - removal of limitations on the powers of maintenance and advancement; and
 - general review of Trustees' powers.
 - 4.1.12 Greater definition of Trustees' duties and liabilities and the extent of the validity of trustee liability exculpation clauses.
 - 4.1.13 Consolidation of the powers of the Court.

- 4.1.14 Revision and simplification of the provisions for the appointment and removal of trustees and for the appointment and removal of Protectors and Enforcers.
- 4.1.15 Better definition of the interests, rights and liabilities of Beneficiaries and particularly the rights of Beneficiaries to information.
- 4.1.16 Better definition of the rights of third parties concerning:
 - the right to asset protection; and
 - the avoidance of foreign rules of forced heirship.
- 4.1.17 Regulation of trust companies by way of a licensing regime to ensure that:
 - “fit and proper” person criteria are met,
 - regulation is complementary to rather than duplicating existing regulation by HKMA, SFC, etc.; and
 - industry-wide adoption of anti-money laundering regulations and standards.
- 4.2 Not only will these changes substantially improve our attractiveness to global professional trustees and their advisors as a trust law jurisdiction but they will improve the legal environment for local beneficiaries of Hong Kong law trusts.
- 4.3 These proposals, if adopted, will place Hong Kong at the forefront of global trust law jurisdictions. In particular, these changes will position Hong Kong ahead of Singapore’s trust law regime.

5. THE WAY FORWARD

- 5.1 We seek an initial meeting with relevant members of the Financial Services Branch of Financial Services and the Treasury Bureau to discuss in greater detail this submission and to answer any queries with respect to it. Assuming for the moment that the Branch broadly support the proposals, we would be very happy to be part of whatever working group thought appropriate to undertake wider consultation of these proposals and to provide, at the appropriate times, technical input on specific legislative proposals.

6. SUMMARY OF CONCLUSIONS & RECOMMENDATIONS

- 6.1 Hong Kong is clearly the leading international finance centre in Asia. The reasons for this are well known as are the economic benefits that flow from this. There is already a significant and mature trust administration business in Hong Kong but it is a fraction of what it could be as a proportion of the global trust administration business. Hong Kong cannot afford to be complacent. A major reason why Hong Kong is losing existing and potential trust business and has difficulty in attracting more trust administration business is that our statutory trust law is out-of-date and not in line with world’s best practice. This applies both to private trusts and commercial trusts.

- 6.2 Hong Kong's statutory trust law has not been the subject of comprehensive review or reform since its introduction in 1934.
- 6.3 Since then the legal environment for private trusts for wealthy international families and trusts as collective investment vehicles for cross-border investment has changed dramatically. During that period, many offshore and onshore financial centres have substantially modernized their statutory trust regimes to keep pace with these changes and in so doing have managed to attract (in some cases away from Hong Kong) trust administration business.
- 6.4 Trust administration business is more likely to be attracted to places offering modern predictable and equitable trust law regimes thus resulting in a benefit to those economies directly through that activity and indirectly through related services such as asset management, legal and accounting services and dispute resolution.]
- 6.5 Hong Kong urgently needs to modernize its trust laws to keep pace with the competition and more fully capitalize on its unique advantages over the competition. This is a matter both of genuine substance and perception especially as professional trustees survey the global legal environment and see modernization everywhere, in particular recently in Singapore, and see Hong Kong stuck, in this regard, in the 1930's.
- 6.6 What needs to be done is clear, and whilst substantial, (essentially a new comprehensive Trusts Ordinance) very achievable and uncontroversial. This reform should be undertaken without delay to maintain Hong Kong as the financial centre of choice by the local and international community for private trusts and investment schemes.

Hong Kong
3rd April 2007