



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



S T E P

31 May 2010

Mr John Leung  
Deputy Secretary  
Financial Services and Treasury Bureau  
Queensway Government Offices  
15/F Queensway Government Offices  
66 Queensway,  
Hong Kong

By email: johnleung@cr.gov.hk  
and post

Dear John,

**Re: Response to FSTB on Trustee Ordinance Review Proposed Changes to Schedule 2**

I refer to our meeting on 6 January 2010 in regard to the finalization of changes to the Trustee Ordinance (TO). At that meeting the Joint Committee on Trust Law Reform undertook to review and make recommendations in regard to Schedule 2 of the TO. We apologise for the delay in reverting on this matter but have now set out our proposals hereunder.

**General Comments**

As you are aware, there has been quite some debate within our membership about whether trustees should be allowed to make use of any investment appropriate to achieve the investment objectives established for the trust or whether a schedule of investments is helpful, particularly for non professional trustees. Despite our conclusions in the Joint Committee submission our membership remains divided on the issue.

However, in line with our Joint Committee submission conclusions, we are of the view that if Schedule 2 is to be retained, it not only needs to be modernized but should also provide for more parameters around the investments. The thinking behind this is that professional trustees will opt out of schedule 2 and have wide powers of investment set out in their trust documents. Schedule 2, therefore, is only likely to be utilized by non professional trustees and we believe these trustees should not have an unfettered investment power unless the settlor expressly gives them one. Restricting, (albeit modernizing), the investment choices would therefore appear to be a more prudent approach.

**Proposed Changes**

Accordingly we have mapped out below our proposed amendments to the relevant sections in Schedule 2. We have contrasted this against the existing Schedule 2 provisions for your ease of reference.

**Trustee Ordinance**

**Schedule 2 – (Investment Policy for reference)**

Item No.	Existing Schedule 2	Proposed Amendments
1	<p>Share (paragraph 1(a))</p> <p>The shares are listed on a recognized stock market or specified stock exchange as these terms are defined in section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap 571) ("SFO")</p>	<p>We believe the list is too restrictive and should be expanded to enable fund managers to capitalize on a wider basis.</p> <p>We suggest the list be expanded to include exchanges which are members of the World Federation of Exchanges.</p> <p>For your ease of reference a copy is attached as Appendix 1 and the link for the list is:</p> <p><a href="http://www.world-exchanges.org/member-exchanges/member-exchanges">http://www.world-exchanges.org/member-exchanges/member-exchanges</a></p>
2.	<p>Share (paragraph 1(a))</p> <p>The market capitalization of the company issuing the shares is not less than HK\$10 billion.</p>	<p>The market capitalization requirement is too high and should be reduced to HK\$5 billion.</p>
3.	<p>Share (paragraph 1(a))</p> <p>The company has paid, in each of the 5 years immediately preceding the year in which the investment is made, a dividend wholly in cash</p>	<ul style="list-style-type: none"> <li>• The 5-year dividend requirement is too restrictive.</li> <li>• It should allow other methods by which investors can obtain yield, not simply cash yield.</li> <li>• It should not automatically rule out newly listed stocks on Heng Seng Index and Chinese H shares as they have proper procedures to vet large newly admitted shares.</li> </ul> <p>Consideration should also be given to other indicators such as the exchange list requirement i.e. the shares must be a listed on the World Federation of Exchanges.</p>

4.	<p><u>Debts/Debenture: Item 4, 5 &amp; 6</u></p>	<p>We believe the rating should be lowered so that the investment manager will have more flexibility.</p> <p>We propose the revised credit rating specified in the Table should be lowered but be consistent with the "debt class ratings" in the MPF Guidelines on Debt Securities<sup>1</sup> be adopted instead. We therefore propose:</p> <p>(a) To lower the rating to Baa2 (Moody) or BBB (S&amp;P)</p> <p>(b) To lower the rating to Prime 2 or A-2</p>
5.	<p>Debenture (paragraph 1(b))</p> <p>The security meets the credit rating as specified in the Table</p>	<p>The credit rating requirement is too restrictive.</p> <p>Please see our suggestions in point 4. above.</p>
6.	<p>Debt securities issued by the Government outside Hong Kong (paragraph 2(b))</p> <p>has to meet the credit rating specified in the Table</p> <p>(a) For long term debt-rating is A3 or A-</p> <p>(b) For short term debt-rating is Prime 1 or A-1</p>	<p>The credit rating requirement is once again too restrictive.</p> <p>Please see our suggestions in point 4. above.</p>
7.	<p>Debt securities (paragraph 2(c))</p> <p>Issued by any multilateral agency specified in Part 4 of Schedule 1 to the SFO</p>	<p>The list should be expanded to follow the MPF fund guidelines (see attached list Appendix 2 for your convenience)</p> <p>Please also see comments above in regard to credit ratings in point 4. above.</p>
8.	<p>Derivatives (paragraph 7)</p>	<p>We believe that derivatives should be used only for hedging purposes i.e. retain 7(a).</p> <p>We also believe that professional advice should be required in the use of derivatives so that trustees are fully informed about the nature of the hedging contracts they undertake and the associated risks i.e. retain 7(b).</p> <p>We have had discussions amongst our membership as to whether an overall restriction should apply to derivatives. If the hedging and professional advice restrictions are both in place, the nature of the investment portfolio should determine the</p>

		appropriate level of hedging derivatives. However, our membership still feels there should be an overall limit of not more than 15% for hedging derivatives.
9	Add hedge funds, private equity, commodities and structured products.	These investments may be appropriate to diversify portfolios or lower risk. However, we believe they should be restricted to 15-20% of the portfolio.
10	Add REITS	We believe that REITS are an appropriate investment choice and should be included.
11	Add insurance products	<p>We also believe that insurance based products may be appropriate. However, we proposed that the Insurer must meet certain credit standards.</p> <p>It would seem appropriate to adopt a test similar to that adopted for MPF products , whereby the Insurer must be an "approved local or overseas insurer (/bank/trust company)" in which the following minimum credit rating requirements (for short term debt obligation) are imposed:</p> <p>Fitch Ratings F1</p> <p>Rating &amp; Investment Information, Inc. a-1</p> <p>Moody's Investor Service, Inc. Prime-1</p> <p>Standard &amp; Poor's Corporation A-1</p>

#### Other Issues

Section 91 of the Trustee Ordinance ("TO") states that a trust company may invest moneys forming part of its own capital or reserve or accumulated profit in securities in which "private trustee may by law invest trust moneys". We know that in the case of private trustees investing trust assets, the investment powers set out in Schedule 2 of the TO are only in addition to those, often rather comprehensive, investment powers set out in the relevant trust instruments.

Section 91 of the TO relates to investing a trust company's own fund (in respect of which trust instruments are, arguably, not relevant). In setting out how a trust company may invest its own funds, Section 91, however, refers to what "private trustee may by law invest trust moneys" (in respect of which trust instruments would be most relevant). This gives rise to uncertainty when it comes to interpreting the meaning of section 91 and we now understand that some corporate trustees in fact take the view that, as trust instruments are not relevant to a trust company investing its own funds, Schedule 2 sets out exhaustively all of the investment powers of a trust company when it comes to investing its own funds. According to such a view, when it comes to trust company investing its own funds, Schedule 2 is not just a default set of powers but serves to strictly restrict what may be invested in.

The JCTLR disagrees with this view. We therefore request that section 91 be amended to clarify that Schedule 2 does not in any way restrict how a trust company may invest its own company funds.

The above comments have taken into account the views of our membership as well as those of the Hong Kong Investment Funds Association.

We look forward to a discussion with you on the above once you have had a chance to review them. In the meantime please do not hesitate to contact us if you have any queries.

Yours sincerely,



Carolyn Butler  
Joint Chairman  
Joint Committee Trust Law Reform  
Hong Kong Trustees' Association



Mary Ellen Hutton  
Committee Member  
Joint Committee Trust Law Reform  
Chairman, STEP Hong Kong

## **Appendix 1**

### **List of Recognised Exchange Companies (see Part I of Schedule 1 to the SFO)**

(a) the Stock Exchange of Hong Kong Limited; and

(b) Hong Kong Futures Exchange Limited

### **MPFO Approved Stock Exchanges Annex A to III.4 Version 3 – May 2003**

#### **LIST OF APPROVED STOCK EXCHANGES ESTABLISHED IN A PLACE OUTSIDE HONG KONG**

<b>Country</b>	<b>Name of Approved Stock Exchanges</b>
Australia	Australian Stock Exchange
Austria	Wiener Börse AG
Belgium	Euronext Brussels
Brazil	Sao Paulo Stock Exchange (BOVESPA)
Canada	Toronto Stock Exchange
China	Taiwan Stock Exchange
Denmark	Copenhagen Stock Exchange
Finland	Helsinki Exchanges
France	Euronext Paris
Germany	Deutsche Börse AG
Greece	Athens Stock Exchange
Ireland	Irish Stock Exchange
Israel	Tel-Aviv Stock Exchange
Italy	Italian Stock Exchange
Japan	Japanese Association of Securities Dealers Automated Quotations Osaka Securities Exchange Nagoya Stock Exchange Tokyo Stock Exchange

Korea	Korea Stock Exchange
Luxembourg	Luxembourg Stock Exchange
Malaysia	Kuala Lumpur Stock Exchange
Mexico	Mexican Stock Exchange
Netherlands	Euronext Amsterdam
New Zealand	New Zealand Stock Exchange
Norway	Oslo Børs
Portugal	Euronext Lisbon
Singapore	Singapore Exchange Securities Trading Limited
South Africa	JSE Securities Exchange South Africa
Spain	Madrid Stock Exchange
Sweden	Stockholmsbörsen
Switzerland	SWX Swiss Exchange
Thailand	Stock Exchange of Thailand
United Kingdom	London Stock Exchange
USA	American Stock Exchange
	NASDAQ (National Association of Securities Dealers Automated Quotations) Stock Market
	New York Stock Exchange
	Pacific Exchange
	Philadelphia Stock Exchange

## **Appendix 2 - MULTILATERAL INTERNATIONAL AGENCIES**

(Excerpt from the MPFA Guidelines III.1 on Debt Securities, version 8 – March 2008)

The following is a list of multilateral international agencies which satisfy the requirements of section 7(1)(d) of Schedule 1 to the Regulation at the time of the publication of these Guidelines:

- (a) African Development Bank;
- (b) Asian Development Bank;
- (c) Caribbean Development Bank;
- (d) Council of Europe Development Bank;
- (e) European Atomic Energy Community (EURATOM);
- (f) European Bank for Reconstruction and Development;
- (g) European Central Bank;
- (h) European Coal & Steel Community;
- (i) European Community;
- (j) European Company for the Financing of Railroad Rolling Stock (EUROFIMA);
- (k) European Investment Bank;
- (l) European Investment Fund;
- (m) Inter-American Development Bank;
- (n) International Bank for Reconstruction and Development (commonly known as the World Bank);
- (o) International Finance Corporation (an affiliate of the World Bank);
- (p) Islamic Development Bank; and
- (q) Nordic Investment Bank.