

**For discussion
on 21 April 2009**

**LEGISLATIVE COUNCIL
PANEL ON DEVELOPMENT AND
PANEL ON ADMINISTRATION OF JUSTICE AND LEGAL SERVICES**

**JOINT SUBCOMMITTEE ON
AMENDMENTS TO LAND TITLES ORDINANCE**

Risks and Liabilities

PURPOSE

This paper sets out the risks and liabilities to public funds arising from the conversion mechanism as provided for under the Land Titles Ordinance (Cap. 585) (LTO) enacted in 2004 and compares these with the position under the alternative mechanism proposed by the Administration as outlined in the paper for the Panel for Development on 19 December 2008 (Paper No. CB(1)396/08-09(06)) (the Panel Paper).

BACKGROUND

2. This paper has been prepared in response to the request made by the Joint Subcommittee on Amendments to LTO at its meeting on 19 March 2009 for the Administration to “explain the risks and liabilities to public funds and the Land Registry that the Administration envisages the conversion system currently provided for under the LTO would entail and to explain how the proposed modifications to the conversion system would be able to address and manage such risks and how the various other parties would be affected”.

2004 LTO CONVERSION MECHANISM

3. Under the enacted LTO, on a date 12 years after the commencement of the LTO, all land defined as “LRO land” (i.e. land under the Land Registration Ordinance (Cap. 128) (LRO)) under section 1 of Schedule 1 to the LTO will be deemed to be registered land under the LTO. Exceptions are allowed only where an instrument (such as assignment, mortgage, etc) submitted for registration before the conversion day has not completed registration by that date or the land is the subject of a registered caution against conversion which still subsists. There is no other basis for the Land Registrar to delay or withhold conversion of any LRO land envisaged under the “deeming” mechanism.

4. On conversion, the person registered as owner will be vested with “the same legal estate or equitable interest and rights” as if the land had been transferred to him and he had been registered as the owner under section 25 of the LTO. The deeming of the LRO land as registered land under the LTO will not however affect the validity or enforceability of any unregistered interest that affected the land immediately before the conversion and was enforceable against the land. Any such unregistered interest will only cease to be enforceable against the land after the first sale to a purchaser for valuable consideration after conversion.

5. Under section 84 of the LTO, subject to certain qualifications, any person suffering loss by reason of an entry in or an entry omitted from the Title Register due to fraud that affects ownership or due to mistake or omission of the Land Registrar or public officers assisting him, is entitled to be indemnified by the Government in respect of that loss.

Risks under 2004 enacted mechanism

6. The first risk arises from the fact that the registers of LRO land are deemed to form part of the Title Register kept under the LTO on the conversion date automatically and under the LTO the Title Register is conclusive evidence of title. This is very different from the position under the LRO where the Land Registry is simply a registry of documents. There is no assurance from the Government as to the completeness or the validity of the documents registered. The LRO registers may contain mistakes or omissions which cause persons subsequently dealing with a property under the LTO to suffer loss. It is not feasible to carry out an investigation of every title prior to conversion that would be able to uncover and rectify any existing mistakes and omissions. A number of problematic cases have been found through computer screening and past notifications but there is no practical means under the enacted LTO available to the Land Registrar to ensure resolution of these cases prior to conversion or to hold them back from conversion pending a resolution. Nor can assurance be given that these are the only problematic cases. In other words, we are left uncertain as to the full range of possible mistakes and omissions, and are not able to deal with certain problems we do know about.

7. The second risk is about the resilience of the Land Registry Trading Fund and the Indemnity Fund. The extent of the losses due to mistakes and omissions of the Land Registrar or public officers assisting him that have to be indemnified may exceed the financial resources available to the Land Registry Trading Fund. The trading fund operates on the basis of fee income received for the services that it provides. On the commencement of title registration, in

addition to fee income there will be a levy on registration of transfers. The levy will be calculated to provide income sufficient to build up an indemnity fund to meet liabilities arising due to fraud cases that affect ownership. Indemnity for mistakes or omissions other than fraud will be paid through the indemnity fund but met from the general revenue of the trading fund. Before the conversion date, a very small proportion of properties will be involved in dealings under the LTO. In the first couple of years after commencement there will be a negligible number of dealings in new land. By the 12th year after commencement it is estimated that around 15% of dealings may be new land. This means that the amount of levy collected prior to conversion and the ability to set aside revenue to defray conversion risks for fraud cases before the conversion date will be correspondingly small. There is no basis for increasing fees under the LRO to offset the liabilities that might arise under the LTO from cases involving mistakes and omissions. Immediately after conversion, however, the Land Registry will be expected to meet whatever liabilities are realised. If these liabilities cannot be met out of recurrent income, the trading fund will have to borrow money to cover the indemnities. Charges on the public will have to be raised to repay the loans.

8. The third risk arises from the exclusion of liability under the LTO for pre-conversion matters. Section 84(4)(b) and (c) of the enacted LTO seeks to limit liability by excluding payment of indemnity for fraud, mistakes or omissions that occurred before the date of conversion. The consequences that might arise from this for particular individuals may lead to litigation outside the LTO. This would impose costs on the litigants, including the Land Registry.

9. The fourth risk also arises from the effect of section 84(4). The exclusion of liability may reduce the confidence that owners and purchasers can place in the Title Register, leading to pressure to investigate the chain of title behind the Title Register or to seek other forms of insurance. The cost of this to individuals may be substantial (it may be comparable to the cost of upgrading with title checking under the proposed modified mechanism). This would undermine the efficiency and security for conveyancing that the legislation aims to introduce. This is a separate issue to the problem with trust in the Title Register created by the mandatory rectification rule as set out in paragraph 14 of the Panel Paper and paragraph 23 of the Consultation Paper attached as Annex A to the Panel Paper.

MODIFIED CONVERSION MECHANISM

10. The modified conversion mechanism set out in the consultation paper has the following features relevant to risk management –

- (a) All LRO land is brought under the LTO at an early date to automatically become “converted land” three years after commencement of the Ordinance. Fee and levy income would begin to accrue from all registered dealings, instead of being limited to the small proportion of transactions represented by new land;
- (b) After conversion, indemnity would be given for loss arising from post-conversion fraud affecting ownership, or from mistakes or omissions occurring after conversion. There would be no warranty or liability in respect of pre-conversion matters;
- (c) Before full indemnity would be given, a title would have to be upgraded. Upgrading would be triggered by an application by the owner. The Land Registry would be able to decide whether or not to approve upgrading. The decision would be subject to an appeal mechanism; and
- (d) After upgrading, indemnity would be limited only by the cap to be applied in cases of fraud affecting ownership and would apply to pre-conversion cases with fraud affecting ownership, mistakes and omissions.

How modified mechanism addresses risks under 2004 enacted mechanism

11. Under the modified mechanism, the risk of there being significant mistakes or omissions in the Title Register that would have arisen from automatic conversion may be greatly reduced by the scrutiny that can be given to titles at the point of application for upgrading. The uncertainty that the Land Registry will face over possible liabilities will therefore be greatly reduced. The early commencement of the full revenue stream from title registration before the full range of liabilities is taken up will also increase the resilience of the Indemnity Fund and Land Registry Trading Fund and increase assurance that any liabilities that may arise can be settled without the need for new financing arrangements.

12. Since upgrading would only be granted after application, the exclusion of liabilities for pre-conversion matters can be removed. This would avoid the risk of litigation over such liabilities and the risk of undermining confidence in the Title Register after upgrading.

Other implications of the modified mechanism

13. It is recognised that the modified mechanism would reduce the risk of financial problems for the Land Registry Trading Fund – which if realised would impose costs on the public through increased fees and charges – with a cost to owners for upgrading. This cost would depend on the manner in which the scrutiny of title were to be carried out. The simpler the scrutiny, the lower the cost to owners but the higher the risk that the Land Registry would have to assume, a risk that would be reflected in fees and charges.

14. Under the modified mechanism there would also be uncertainty as to when most properties would be brought fully under the title registration system and hence there would be a period with two registration systems running in parallel. There would be a risk that a large number of applications might be made within a short period of time, straining resources in the Land Registry, causing delays and leaving owners uncertain until the application had been processed. On the other hand, there would be a risk that owners would choose not to make applications for upgrading.

COMPARISON OF THE TWO APPROACHES TO CONVERSION

15. The table at Annex summarises the difference between the two mechanisms in managing the risks in conversion and provides further details on how the two mechanisms will affect different stakeholders.

ADVICE SOUGHT

16. Members are invited to note the content of this paper and comment on our proposals.

**Development Bureau
April 2009**

Comparison Table

	“Daylight” Mechanism under LTO enacted in 2004	Modified Mechanism
Risk of conversion of LRO registers which may contain mistakes or omissions without title investigation.	No practical means to reduce risk.	Investigation before upgrading can reduce risk.
Risk of liabilities exceeding financial capacity of Land Registry Trading Fund	Significant risk in the early years after conversion as liabilities may arise on conversion but main revenues from title registration do not begin until conversion. There is no means to build up any contingency reserve in advance of the conversion date.	Reduced risk because full liabilities are not taken up until after upgrading (during which there is opportunity to screen out risks). Before this the full revenue from title registration will be available, allowing contingency funds to be built up that can defray liabilities incurred on upgrading.
Risk of litigation over liability for mistakes or omissions outside the LTO	Yes	Not after upgrading but risk may remain prior to upgrading.
Risk of loss of confidence in Title Register	General risk as no purchaser can be certain whether they may not suffer an unindemnified loss.	No general risk after upgrading.
Risks from uncertainty over timetable for full upgrading and effects of not upgrading particular cases	No	Yes

	“Daylight” Mechanism under LTO enacted in 2004	Modified Mechanism
Risk of delay and difficulty for property market if applications for upgrading are not processed quickly	No	Yes
Implications for Land Registry	<p>Simpler legislation.</p> <p>Difficulty with problematic registers and with conversion of caveats (these may be addressed with specific amendments).</p> <p>Uncertain financial risks on conversion.</p> <p>Little capacity to create adequate reserve to meet liabilities.</p>	<p>More complex legislation.</p> <p>No particular problem with problematic registers or caveats.</p> <p>Need to develop information technology system to deal with conversion of existing land immediately rather than after seven or eight years (concentrating investment costs).</p> <p>Able to build up reserve against liabilities before upgrading.</p>
Implications for owners	<p>Risk of large increases in fees and levy if significant liabilities are realised.</p> <p>Uncertainty about security of ownership.</p>	<p>Less risk of large increases in fees and levy to meet liabilities for indemnity.</p> <p>Added cost of application for upgrading.</p> <p>Uncertainty about result of application for upgrading.</p>

	“Daylight” Mechanism under LTO enacted in 2004	Modified Mechanism
	No indemnity for cases involving pre-conversion fraud affecting ownership, mistake or omission.	Some protection from indemnity for post-conversion matters after conversion and before upgrading. Better protection after upgrading. Indemnity will extend to cover pre-conversion fraud affecting ownership, mistake or omission.
Implications for solicitors	Client may require investigation behind the Title Register to guard against unindemnified loss. Possible liability if client’s ownership is displaced due to pre-conversion fraud affecting ownership. Curative effect on technical defects of title after conversion.	Greater complexity in title investigation in respect of dealing with property between conversion and upgrading. Uncertainty over implications of a refusal to grant upgrading. Curative effect on technical defects of title after upgrading.
Implications for financial institutions	General uncertainty over security of owners after conversion.	Uncertainty over security of owners prior to upgrading. Better protection after upgrading. Indemnity will extend to cover pre-conversion fraud affecting ownership, mistake or omission.

	“Daylight” Mechanism under LTO enacted in 2004	Modified Mechanism
<p>Implications for purchasers</p>	<p>Likely to have no redress (except against fraudster) if ownership is lost due to pre-conversion fraud.</p> <p>Difficulty with investigation of pre-conversion title where vendor is not obliged to provide pre-conversion documents.</p>	<p>Likely to have no redress prior to upgrading (except against fraudster) if ownership is lost due to pre-conversion fraud.</p> <p>Uncertainty about subsisting interests prior to upgrading.</p> <p>Less difficulty with investigation of pre-conversion title as prior to upgrading, vendor is obliged to provide purchaser with pre-conversion documents within root of title.</p> <p>Better protection after upgrading. Indemnity will extend to cover pre-conversion fraud affecting ownership, mistake or omission.</p>
<p>Implications for holders of pre-conversion unregistrable interests</p>	<p>Validity of interests not affected prior to conversion.</p> <p>Mechanism for registration of caveats or cautions against conversion prior to conversion to protect interests.</p>	<p>Validity of interests not affected prior to upgrading.</p> <p>Mechanism for registration of warning notes prior to upgrading to protect interests.</p>