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Panel on Financial Affairs
Meeting on 2 April 2012

Background brief on review of the trust law regime in Hong Kong

Purpose

This paper sets out background information on the review of the trust law regime in Hong Kong, and provides a summary of the views and concerns expressed by members when the subject was discussed at the meetings of the Panel on Financial Affairs ("FA Panel").

Background

Existing trust law regime

2. The trust law regime in Hong Kong is mainly based on the principles derived from rules of equity. They are supplemented by several pieces of legislation including the Trustee Ordinance (Cap. 29) ("TO") and the Perpetuities and Accumulations Ordinance (Cap. 257) ("PAO"). The TO was enacted in 1934, based on the Trustee Act 1925 of the United Kingdom ("UK"). Other than the range of authorized investments in its Schedule 2, the TO has not been substantially reviewed since its enactment. The PAO was enacted in 1970, based on UK's Perpetuities and Accumulations Act 1964, to amend the common law rules regarding perpetuities and accumulations of income. The PAO has not been reviewed since its enactment.

Review and consultation

3. In August 2007, the Joint Committee on Trust law Reform, which was formed by the Hong Kong Trustees' Association and the Society of Trust and Estate practitioners, submitted proposals to the Government, advocating a

comprehensive review of the trust law regime. The review of the provisions in the TO was included as a new initiative in the Policy Agenda of the 2007-08 Policy Address. The Administration started the review in early 2008 with the following aims:

- (a) to modernize the trust law to facilitate more effective trust administration;
- (b) to reform the TO for the protection of, and to offer guidance to settlors, trustees and beneficiaries by prudential default provisions;
- (c) to clarify issues and uncertainties in the existing law; and
- (d) to promote the wealth management business in Hong Kong.

4. As part of the review exercise, the Administration published a “Consultation Paper on Review of the Trustee Ordinance and Related Matters” on 22 June 2009 for a three-month public consultation on the proposals to reform the TO and other law relating to trusts. During the consultation period, the Administration organized a public consultation forum and attended several meetings and seminars to brief different stakeholder groups on the reform proposals and listen to their views. A total of 36 submissions were received. The Administration issued the consultation conclusions on 22 February 2010. According to the Administration, all the respondents indicated general support for most of the proposals and many respondents considered the review timely and necessary. The key reform proposals and issues in the consultation and the Administration’s conclusions are summarized in **Appendix I**.

Deliberations of the Panel

Meeting on 6 July 2009

5. On 6 July 2009, the FA Panel discussed the Administration's consultation proposals on the trust law reform. During the discussion, Panel members were mainly concerned about the protection of beneficiaries' interests in the trust law reform. A member pointed out that in the public consultation exercise, the interests of beneficiaries might not be equally represented as those of the trustees, because there was no particular organization representing the interests of the beneficiaries. The member requested the Administration to invite the Law Reform Commission ("LRC") to study the reform proposals to ensure protection of beneficiaries' interests. Another member suggested that the Administration should proactively invite views from professional bodies such as

the accounting and legal professions, and request them to provide views from the perspective of their clients who were beneficiaries of trusts.

6. The Administration advised that it had considered inviting LRC to study the reform proposals. This had not been pursued in the light of the advice of the Department of Justice ("DoJ") that Hong Kong could leverage the reform experience in overseas jurisdictions. Apart from the reform of the Trustee Act in UK, the Administration had also made reference to the reform experience/proposals of other jurisdictions. In view of members' concern, the Administration undertook to further discuss with DoJ to determine whether a study by LRC on safeguarding the interests of beneficiaries should be pursued.

7. Noting that the permissible investments contained in Schedule 2 to the TO included debentures, a member asked whether the Administration would review the definition of "debentures" to exclude high risk structured products. The Administration advised that the definition of "debenture" under Schedule 2 to the TO might be amended to narrow down the scope of permissible investments by excluding any structured products. Such amendment would tie in with any amendment to the definition of "debenture" under the Companies Ordinance rewrite exercise.

8. At the Panel's request, the Administration has provided supplementary information (**Appendix II**) on the comparison between the Administration's proposals to reform Hong Kong's trust law regime and the trust statutes of some common law and offshore jurisdictions.

Meeting on 1 March 2010

Development of wealth management business in Hong Kong

9. The Administration briefed the FA Panel on 1 March 2010 on the consultation conclusions and the way forward. Regarding members' concern on how the trust law reform would facilitate the development of wealth management business in Hong Kong, the Administration advised that many potential settlors did not create trusts in Hong Kong mainly because Hong Kong's trust law was outdated. The purpose of the proposed reform of Hong Kong's trust law regime was to keep it up with the trust law development in other comparable jurisdictions. Apart from the trust law reform, there were other initiatives to support the development of wealth management in Hong Kong such as the abolition of the estate duty.

Beneficiaries' rights to information

10. Noting that most respondents to the consultation were professional trustees, some members were concerned that the Administration had not given adequate attention to protecting the interests of beneficiaries. The members considered that the Administration should legislate to provide for the basic rules on disclosure by trustees of information to beneficiaries, and were disappointed to note that the Administration had decided not to legislate for the beneficiaries' rights to information for the time being. The Administration advised that there were diverse views on the issue and the relevant case law was still evolving. In view of the complexity of the subject matter, the Administration had requested LRC to consider conducting a further study on it.

Trustee's exemption clauses

11. The Administration proposed to subject trustee's exemption clauses to statutory control by following the Jersey approach which provided that nothing in the terms of a trust shall relieve, release or exonerate a trustee from the liability for breach of trust arising from the trustee's own fraud, wilful misconduct or gross negligence. A member pointed out that it was usually difficult for a plaintiff to prove whether an act constituted gross negligence, fraud or wilful misconduct, and queried why the Administration proposed that trustees were liable for breach of trust only when their conduct constituted gross negligence instead of ordinary negligence.

12. The Administration advised that the proposed statutory control would impose tighter control on the application of exemption clauses than that under the common law, because under the common law, the trustee was liable to breach of trust arising from the trustee's fraud only. The proposal also introduced a statutory duty of care on professional trustees. The member however opined that the common law duty of care was already in place and the proposed statutory control would not make any difference to the common law control on trustees. Instead, the Administration should eliminate the ambiguities about their duties and responsibilities defined in the existing legislation.

Costs afforded by beneficiaries

13. A member expressed concern about the high level of trustee fees including the hidden cost of creating a trust and the cost of the legal procedures required for beneficiaries to break a trust. The Administration advised that a default charging clause was proposed to give professional trustees a right to receive remuneration, subject to any contrary intention in trust instruments. It

was also proposed to legislate for beneficiaries' right to remove a trustee by a court-free route, provided that the specified requirements such as unanimous consent among the beneficiaries were met. These proposals should help reduce the cost of the legal procedures involved.

Roles of trustee and custodian

14. A member queried whether a company which acted as both a trustee and a custodian constituted a conflict of interest. The Administration advised that the trust law reform included a proposal to provide trustee with the power to employ custodians to perform certain designated functions. Under the reform proposals, the power of a trustee to appoint custodians would be governed by the statutory duty of care. The trustee was also required to review the performance of the custodians.

Non-charitable purpose trust

15. A member opined that non-charitable purpose trust had its functions in society. For example, a charitable trust could not support the development of a political party in Hong Kong. Despite that misuse of this type of trusts was found in other countries, the Administration should work out a statutory framework to allow the creation of this type of trusts for genuine lawful purposes. The Administration advised that non-charitable purpose trust was allowed in some offshore jurisdictions. The respondents' views on the proposal were diverse. Some respondents welcomed the proposal for commercial reasons while some considered that safeguards were necessary to enforce this kind of trusts to avoid conferring excessive rights to trustees. The Administration would need to further study the subject matter including identifying suitable legal safeguards, and would request LRC to consider conducting a study on the subject matter.

Recent development

16. The Administration will brief the FA Panel at the meeting on 2 April 2012 on the detailed legislative proposals on trust law reform.

Relevant papers

17. The relevant papers are available at the following links:

FA Panel meeting on 6 July 2009	Agenda Minutes (para. 37 to 45) Follow-up paper
FA Panel meeting on 1 March 2010	Agenda Minutes (para. 55 to 68)

Council Business Division 1
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**Summary of the key reform proposals and issues in the consultation and
the Administration's conclusions**

(Source: LC Paper No. CB(1)1213/09-10(03))

Proposals / Questions in the Consultation Paper	Administration's Conclusions
(a) Introduce a statutory duty of care for trustees	To introduce a statutory duty of care for trustees when they are exercising their powers in relation to investment, delegation, appointing nominees and custodians, and taking out insurance, etc.
(b) Retain the range of default "authorized investments" in the Second Schedule to the TO, subject to review from time to time to keep up with market needs and evolving market circumstances	To amend the Second Schedule to the TO to keep up with market needs, pending further study on the detailed amendments.
(c) Enhance the safeguard in temporary delegation of trustees' powers so that the number of trustees will not be reduced to one which is against the will of the settlor	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.
(d) Repeal section 8(3)(a) of the Enduring Powers of Attorney Ordinance (Cap. 501) in relation to the power of delegation to remove the overlapping with the TO	To repeal section 8(3)(a) of the Enduring Powers of Attorney Ordinance so that the power of delegation by an individual trustee is entirely governed by the TO.
(e) Whether trustee should be provided with a general power of appointing agents	To provide trustees with a general power of appointing agents with specified safeguards.

(f) Provide trustees with a general power to employ nominees and custodians with necessary safeguards	To provide trustees with a general power of employing nominees and custodians in relation to trust assets subject to specified safeguards.
(g) Empower trustees to insure any trust property against risks of loss or damage by any event and pay premiums out of the trust funds	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.
(h) Provide a default charging clause to enable the remuneration of professional trustees of trusts	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 trusts or non-charitable trusts.
(i) Improvement to the default administrative powers of trustees in Parts II and III of the TO	To amend sections 8, 11, 12 and 34 of the TO with a view to improving the administrative powers of trustees.
(j) Subject trustee exemption clauses seeking to exempt professional trustees who receive remuneration for their services to some statutory control	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.
(k) Provide some basic rules for beneficiaries' rights to disclosure by trustees of information, accounts and documents relating to the trust	Not to provide any basic rules governing beneficiaries' right to information. We will further study the subject keeping in view the evolution of the relevant law in other common law jurisdictions.
(l) Provide an alternative court-free route for beneficiaries, who are of full age and capacity and are absolutely entitled to the trust property, to remove a trustee	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.

(m) Abolish the rule against perpetuities altogether or introduce a fixed perpetuity period	To amend the Perpetuity and Accumulations Ordinance (Cap. 257) (“PAO”) by repealing the existing rule against perpetuity in respect of new trusts to be set up.
(n) Abolish the rule against excessive accumulations of income (with possible exception regarding charitable trusts)	To amend the PAO by repealing the rule 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.
(o) Whether the role of "protector" should be defined in law	Not to introduce legislation providing for the definition of protectors nor for their roles.
(p) Whether the law should provide that a settlor's reservation of powers does not invalidate a trust	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.
(q) Whether the common law principles on governing law of trust should be codified	Not to codify the common law principles on governing law of trusts and continue to rely on the current law.
(r) Whether the law should provide that the forced heirship rule does not invalidate a trust	To introduce legislation to the effect that forced heirship rule will not affect the validity of trusts by following the Singapore approach.
(s) Whether the creation of non-charitable purpose trust be allowed in the law	Due to the complexity and controversy of the issue on non-charitable purpose trusts , we need to study the issue in greater detail before taking a final view on the subject.

Comparison between the Administration’s Proposed Trust Law Reforms and the Trust Statutes of Selected Jurisdictions¹

	Hong Kong Existing Position²	Hong Kong Reform Proposals³	United Kingdom⁴	Singapore⁵	Cayman Islands⁶	British Virgin Islands⁷
Trustee’s duty of care	No general statutory duty of care	Introduce a general statutory duty of care	Statutory duty of care	Statutory duty of care	No general statutory duty of care	No general statutory duty of care
Trustees’ general power of investment in default of express provisions in the trust instrument	Limited to investments authorised in Schedule 2 to the TO	Retain the range of authorised investments in Schedule 2 to the TO, subject to modifications and periodic reviews	General power of investment by trustees	General power of investment by trustees	Power of investment limited to certain categories (but including securities in which trustees in England are allowed to invest)	General power of investment by trustees

¹ These jurisdictions are selected because:

- (a) our review proposals have made reference to the recent reforms in the UK and Singapore; and
- (b) the trust laws of Cayman Islands and British Virgin Islands are more commonly adopted as the governing law for trusts created in Hong Kong.

² Mainly with reference to the Trustee Ordinance (Chapter 29) (“TO”), the Perpetuities and Accumulations Ordinance (Chapter 257) and the Recognition of Trusts Ordinance (Chapter 76).

³ See Consultation Paper on the Review of the Trustee Ordinance and Related Matters (June 2009).

⁴ UK Trustee Act 1925, UK Trustee Act 2000, UK Trusts of Land and Appointment of Trustees Act 1996 and UK Perpetuities and Accumulations Bill.

⁵ Singapore Trustees Act (Chapter 337).

⁶ Cayman Islands Trusts Law (2007 Revision).

⁷ British Virgin Islands Trustee Ordinance 1961 (Chapter 303).

	Hong Kong Existing Position	Hong Kong Reform Proposals	United Kingdom	Singapore	Cayman Islands	British Virgin Islands
Trustee's Power to delegate to sole co-trustee	No delegation to sole co-trustee, except for trust corporation	Retain the restriction on delegation to sole co-trustee with augmented safeguards	No restriction on delegation to sole co-trustee	No restriction on delegation to sole co-trustee	No provisions on delegation	No restriction on delegation to sole co-trustee
Trustees' power to employ agents	General power of appointing agents except for fiduciary functions	Invite views on whether trustees should be given a general power of appointing agents even for some fiduciary functions ⁸	General power of appointing agents even for some fiduciary functions ⁹	General power of appointing agents even for some fiduciary functions ¹⁰	General power of appointing agents except for fiduciary functions	General power of appointing agents except for fiduciary functions
Trustees' power to employ nominees and custodians	No general power to employ nominees and custodians	Introduce a general power to employ nominees and custodians	General power to employ nominees and custodians	General power to employ nominees and custodians	No general power to employ nominees and custodians	No general power to employ nominees and custodians
Trustees' power to insure	Power to insure against loss or damage by fire and typhoon	Power to insure against loss or damage by any event	Power to insure against loss or damage by any event	Power to insure against loss or damage by any event	Power to insure against loss or damage by fire	Power to insure against loss or damage by fire

⁸ The proposed power/provision may not be applicable to charitable trusts subject to public views.

⁹ Power of appointing agents is different between non-charitable trusts and charitable trusts.

¹⁰ See footnote 9.

	Hong Kong Existing Position	Hong Kong Reform Proposals	United Kingdom	Singapore	Cayman Islands	British Virgin Islands
Professional trustees' entitlement to receive remuneration	No default charging provision for professional trustees	Introduce a default charging provision for professional trustees ¹¹	Default charging provision for professional trustees ¹²	Default charging provision for professional trustees	No default charging provision for professional trustees	No default charging provision for professional trustees
Trustees' exemption clauses	No control on trustee exemption clauses	Subject professional trustees' exemption clauses to control	No control on trustee exemption clauses	No control on trustee exemption clauses	No control on trustee exemption clauses	No control on trustee exemption clauses
Beneficiaries' right to information	No provision on beneficiaries' right to information	Provide in statute certain basic rules regarding beneficiaries' right to information	No provision on beneficiaries' right to information	No provision on beneficiaries' right to information	No provision on beneficiaries' right to information (save for (i) exempt trusts which require information to be provided to the Registrar of Trusts and (ii) Special Trusts ¹³ which may	No provision on beneficiaries' right to information (save for purpose trusts which require information to be provided to enforcers)

¹¹ See footnote 8.

¹² The default provision is not applicable to charitable trusts.

¹³ Those trusts, including non-charitable purpose trusts, permitted under Part VIII of the Cayman Islands Trusts Law (2007 Revision).

	Hong Kong Existing Position	Hong Kong Reform Proposals	United Kingdom	Singapore	Cayman Islands	British Virgin Islands
					require information to be provided as if the enforcer is a beneficiary)	
Removal of trustees by adult beneficiaries who are absolutely entitled	No express provision in the TO but court may order substitution of trustees	Provide an alternative court-free route for these beneficiaries to remove trustees	Provide an alternative court-free route for these beneficiaries to remove trustees	No express provision but court may order substitution of trustees	No express provision but court may order substitution of trustees	No express provision but court may order substitution of trustees
Rule against perpetuities	Allow settlor to set a perpetuity period not exceeding 80 years but not mandatory	Abolish the rule against perpetuities altogether OR Introduce a fixed perpetuity period	A bill has been introduced to replace the existing common law and statutory perpetuity periods with a single perpetuity period of 125 years.	A single perpetuity period of 100 years	The rule against perpetuity does not apply to the Special Trusts (for other trusts, a single perpetuity period of 150 years)	The rule against perpetuity does not apply to purpose trusts (for other trusts, settlor may set a perpetuity period not exceeding 100 years)
Rule against excessive accumulations of income	Choice among six statutory accumulation periods for which the income of a	Abolish the rule against excessive accumulations of income so that income can be	A bill has been introduced to abolish the rule against excessive accumulations of	Income can be accumulated for the duration of the trust	Income can be accumulated for the duration of the trust	Income can be accumulated for the duration of the trust

	Hong Kong Existing Position	Hong Kong Reform Proposals	United Kingdom	Singapore	Cayman Islands	British Virgin Islands
	trust may be accumulated	accumulated for the duration of the trust ¹⁴	income so that income can be accumulated for the duration of the trust ¹⁵			
Defining “protectors” of trust and their functions and duties	No definition of “protectors”	Invite views on whether “protectors” and their functions and duties be defined	No definition of “protectors”	No definition of “protectors”	No definition of “protectors” but has made reference to the term	Contain provisions on protectors
Reserved powers of settlors	No statutory provision	Invite views on whether to allow the settlor to reserve certain powers	No statutory provision	Settlor can reserve the power of investment or asset management functions	Wide range of powers can be reserved by settlors	Wide range of powers can be reserved by settlors
Governing law of trusts	Mainly governed by the Hague Convention on the Law Applicable to Trusts and on their Recognition (“Hague Convention”)	Propose maintaining the status quo	Mainly governed by the Hague Convention	Not signatory to the Hague Convention No specific provisions on governing law of trusts	The Hague Convention not applicable in Cayman Islands Have statutory provisions on the governing law of	Mainly governed by the Hague Convention

¹⁴ See footnote 8.

¹⁵ UK Perpetuities and Accumulations Bill retains a 21-year restriction on accumulation for charitable trusts.

	Hong Kong Existing Position	Hong Kong Reform Proposals	United Kingdom	Singapore	Cayman Islands	British Virgin Islands
					trusts	
Forced heirship	No statutory provisions to shore up the supremacy of Hong Kong trust laws over forced heirship rules	Invite views on whether to introduce statutory provisions to shore up the supremacy of Hong Kong trust laws over forced heirship rules	No statutory provisions to shore up the supremacy of its local trust laws over forced heirship rules	Statutory provisions to shore up the supremacy of its local trust laws over forced heirship rules	Statutory provisions to shore up the supremacy of its local trust laws over forced heirship rules	Statutory provisions to shore up the supremacy of its local trust laws over forced heirship rules
Non-charitable purpose trusts	Non-charitable purpose trusts generally void	Invite views on whether non-charitable purpose trusts should be allowed	Non-charitable purpose trusts generally void	Non-charitable purpose trusts generally void	Non-charitable purpose trusts are allowed	Non-charitable purpose trusts are allowed