

**For information
on 2 April 2012**

**The Legislative Council
Panel on Financial Affairs**

Consultation on the Detailed Legislative Proposals on Trust Law Reform

PURPOSE

This paper informs Members of the legislative proposals to reform Hong Kong's trust law.

BACKGROUND

2. The current trust law regime in Hong Kong is largely based on the principles derived from rules of equity supplemented by several pieces of legislation. The Trustee Ordinance (Cap. 29) ("TO") was enacted in 1934 to, inter alia, supplement and modify the common law rules relating to trustees, including the appointment and discharge of trustees, powers and duties of trustees, and the investment of trust funds. Besides, the Perpetuities and Accumulations Ordinance (Cap. 257) ("PAO") was enacted in 1970 to modify the common law rules against perpetuities and against excessive accumulations of income.

3. Both TO and PAO have not been substantially reviewed and amended since their enactment. Some of their provisions, especially those regarding the powers and duties of trustees, are outdated and cannot meet the need of modern-day trusts. By comparison, some major common law jurisdictions like the United Kingdom ("UK") and Singapore have recently reviewed and reformed their trust laws to facilitate trust administration and attract more trust businesses. The trust industry in Hong Kong, represented by the Joint Committee on Trust Law Reform, submitted a detailed proposal to the Government in August 2007 advocating a comprehensive review of our trust law regime.

4. The Government agrees that there is a need to review our trust law. Drawing reference from other comparable common law jurisdictions (e.g. UK and Singapore), we formulated a set of proposed changes to TO and PAO. In June 2009 we launched a three-month public consultation on the proposed changes. We issued the consultation conclusions in February 2010 and briefed the Legislative Council's Panel on Financial Affairs in March 2010. In short, all the respondents indicated general support for most of the proposals and many respondents considered the review timely and necessary.

CONSULTATION ON DETAILED LEGISLATIVE PROPOSALS

5. Based on the consultation conclusions, we have prepared draft provisions to amend TO and PAO to reform our trust law. In preparing these draft provisions, our guiding principle is to strike a reasonable balance between allowing trustees to administer trusts with sufficient powers and flexibilities and protecting the interests of beneficiaries with adequate safeguards. On 22 March 2012 we launched a two-month public consultation on the draft provisions. Copies of the consultation document have been sent to Members of the Legislative Council. The draft provisions can be grouped under three broad categories –

- (a) clarification of trustees' duties and powers;
- (b) better protection of beneficiaries' interests; and
- (c) modernisation of trust law.

They are further discussed in the ensuing paragraphs.

Clarification of Trustees' Duties and Powers

Statutory Duty of Care

6. Under the common law, trustees owe beneficiaries a duty of care. We propose to introduce a new statutory duty of care for trustees. This seeks to provide a clear and accessible statement on the standard of care expected of a trustee. A trustee will be required to exercise such care and skill as is reasonable in the circumstances, having regard in particular to any special knowledge or experience that the trustee has or holds out as having. If the trustee is acting in the course of a business or profession, the standard of care will take into account the special knowledge or experience that is reasonable to expect of a person acting in the course of that kind of business or profession.

This statutory duty will apply to trustees when they exercise the power of investment; appoint agents, nominees and custodians; take out insurance; etc.

Power to Delegate

7. Under the existing TO, a trustee can delegate his powers and discretions under certain conditions. To better protect the interests of the beneficiaries from excessive delegation by trustees, we propose to provide for an additional safeguard 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 attorney or trustee is a trust corporation.

Power to Employ Agents, Nominees and Custodians

8. TO allows trustees to collectively employ agents to carry out certain administrative functions. Modern-day trusts are becoming more complex and may require various professional skills that trustees may not possess. To enable trustees to effectively administer a trust, we propose to provide trustees of non-charitable trusts with a general power to appoint agents to exercise any of their functions except certain core functions such as the distribution of trust assets, appointment of additional trustee(s), and appointment of nominees and custodians, etc. For trustees of charitable trusts, the functions of generating income to finance a charitable trust's purposes can be carried out by agents, but not the execution of those purposes. We also propose to give trustees a general power to employ nominees and custodians to hold and provide safe custody for trust assets.

9. To protect the beneficiaries' interests, we propose to subject the exercise of this power by trustees to certain safeguards, including the requirements that –

- (a) the statutory duty of care should apply;
- (b) the trustees should give the agent a statement on the exercise of asset management functions; and
- (c) trustees should have the duty to review the arrangements relating to the employment of agents, etc.

Power to Insure

10. The existing TO provides trustees with a power to insure any building or property against loss or damage by fire and typhoon up to its full

value. We propose widening the scope of this power to cover any property against any loss or damage by any event and remove the insured limit so that the property can be insured up to its market value or full replacement value.

Professional Trustees' Entitlement to Remuneration

11. Generally, trustees are not remunerated unless remuneration is expressly authorized by the trust instrument, a court order or a contract between the trustees and the beneficiaries. To facilitate the employment of professional trustees to undertake the complex task of administering a modern-day trust, we propose providing professional trustees with a right to receive remuneration for services rendered, subject to reasonable safeguards.

12. We suggest distinguishing charitable trusts from non-charitable trusts. For non-charitable trusts, we will provide that a trust corporation or a professional trustee is entitled to receive remuneration if the trust instrument contains a charging clause. If the trust instrument is silent on remuneration, a trust corporation or a professional trustee (provided that he is not the sole trustee and each other trustee has agreed that he may be remunerated) is entitled to receive reasonable remuneration.

13. For charitable trusts, if the trust instrument contains a charging clause, a trust corporation or a professional trustee is entitled to receive remuneration. This entitlement is subject to the condition that the professional trustee is not the sole trustee and he has the agreement of the majority of the other trustees that he could so charge.

14. Where the trust instrument of a charitable trust is silent on remuneration, the current law is such that a professional trustee will be automatically barred from receiving any remuneration. As a charitable trust grows in size and possesses more substantial assets, there may be an increasing need for it to engage the services of a professional trustee to properly manage the trust assets. The existing limitation creates a disincentive for professional trustees to provide the services. As we proposed earlier in the consultation conclusions, we suggest giving some flexibility for charitable trusts when the instrument is silent on charging, subject to the safeguard set out below, we propose providing for reasonable remuneration to a trust corporation or a professional trustee.

15. To guard against any possible abuse by trustees in seeking remuneration, we will include in the legislation collective scrutiny of trustees' remuneration, i.e. a professional trustee (other than a trust corporation) is

entitled to remuneration only if he is not the sole trustee and all other trustees have unanimously agreed that he may be remunerated. In practice, the disinterested trustees will need to exercise their duty of care in their scrutiny. The trustees will be subject to their paramount duty at common law to act in the best interests of the present and future beneficiaries of the trust. In so doing, they would need to determine whether it is appropriate to allow any one of them to be remunerated. They would 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. In addition, such remuneration has to be “reasonable”.

16. In this regard, we welcome views, particularly from charitable trusts, on whether the above safeguards would be sufficient to prevent any potential abuse.

Better Protection of Beneficiaries’ Interests

Regulating Exemption Clauses

17. It has been established under case law that a trustee’s exemption clause can validly exempt him from liability of all breaches of trust except fraud. The increasing use of wide trustee exemption clauses tends to reduce the protection to beneficiaries. We recommend subjecting certain trustee exemption clauses to statutory control if the clauses seek to exempt remunerated professional trustees from liability. Specifically, the terms of a trust must not (a) relieve, release or exonerate a trustee from liability for breach of trust arising from the trustee’s own fraud, wilful misconduct or reckless act (including reckless omission), or (b) grant the trustee any indemnity against the trust property in respect of the liability. Such control applies to professional trustees who receive remuneration.

Beneficiaries’ Right to Remove Trustees

18. There is no express provision in TO giving beneficiaries the right to remove trustees. We recommend providing beneficiaries with the right to remove or retire trustees by way of a simple, time-saving and court-free process. The pre-conditions for exercising such power are that all the beneficiaries under a trust should be of full age and capacity, and are absolutely entitled to the trust property.

Modernisation of Trust Law

Validity of Certain Trusts

19. It is generally acceptable under the law for a settlor to reserve to himself some powers to control over the trust property. However, if the settlor reserves to himself excessive powers, the court may consider that there is insufficient certainty as to the settlor's intention to create the trust and may treat the arrangement as a sham. In Hong Kong, the question of whether a settlor's reserved powers will affect the validity of a trust instrument remains to be governed by case law.

20. In the interest of clarity, we recommend introducing a statutory provision to the effect that a trust would not be invalidated by virtue of the mere fact that the settlor has kept to himself certain investment powers or asset management functions.

Abolishing Out-dated Rules against Perpetuities and Excessive Accumulations of Income

21. The current PAO varies the common law rules against perpetuities ("RAP") and against excessive accumulations of income ("REA"). As regards RAP, PAO puts a time limit within which trust properties must vest in the beneficiaries. Non-observance of RAP may render a disposition void, which is a result not expected by settlors. As regards REA, PAO provides that income of a trust may not be accumulated beyond one of the six statutory accumulation periods that has been chosen by the settlor. The REA is said to be archaic and overly complicated, and would also frustrate the wishes of a settlor to accumulate income.

22. We therefore recommend abolishing the RAP and REA through amendments to PAO. We will provide that a trust may continue in existence for an unlimited period, and the accumulation of income will not be subject to any time limits. This change will apply to trust instruments taking effect on or after commencement of the amendment bill.

23. However, the abolition of REA will not apply to charitable trusts. We will provide that for charitable trusts, except for limited exceptions, a direction to accumulate will cease to have effect 21 years after the first day on which the income of a charity may be accumulated. This would prevent the undesirable effect of accumulating income for a long period of time without applying the income for charitable purposes.

Other Related Issues

Beneficiaries' right to information

24. When we last briefed the Panel on Financial Affairs in March 2010, some Members expressed that it was important to balance the interests of parties to a trust and legislation should be in place to provide for basic rules on disclosure of trust information to beneficiaries. In view of the complexity of the issue, we have engaged an authority on trust law in Hong Kong¹ to conduct a dedicated consultancy study. The research findings indicate that most onshore jurisdictions have not introduced legislation to replace or supplement common law rules in this regard, and offshore jurisdictions that adopt statutory rules on disclosure tend to utilise them to restrict disclosure. The study concludes that there are no imminent or compelling reasons to introduce legislation on beneficiaries' rights to information in Hong Kong.

25. We concur with the conclusion of the study. Due to the divergent policies involved in disclosure and the versatile and evolving nature of trust, it is appropriate to treat each case individually rather than by hard-and-fast rules. We note that the common law in this area is evolving and far from settled. If we introduce statutory rules to replace common law rules, there is a risk that we may inadvertently deprive ourselves of the opportunity to take account of the development of new rules that suit the needs of modern-day trusts. On the other hand, if the statutory rules are in addition to common law rules, the trustees may face additional burden in tackling not just one set of rules, but two. This may create compliance problem for trustees because it is possible that an unwary trustee may be lulled into a false sense of security by following the statutory rules and overlooking their common law counterparts.

26. We will monitor the evolution of the common law and overseas practices in this area and keep under review the need and appropriateness to introduce any statutory requirement.

Provisions against Forced Heirship Rules

27. We have also considered the issue of 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 Hong Kong law ("provisions against forced heirship"). By way of background, forced heirship rights are the rights conferred by the laws of foreign jurisdictions (mainly civil law jurisdictions) on a testator's heirs

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irrespective of the provisions of the testator's will. Under forced heirship rules, the heirs will be entitled to claw back part of the trust assets or to recover money judgments for a similar amount.

28. We indicated our intention, in the 2010 consultation conclusions, to introduce provisions against forced heirship rules modeled on the Singapore approach. Subsequent research shows that there is a need to further examine the interaction of such provisions with overseas legislation and rules. We are conducting further study on this subject having regard to the experience of relevant overseas jurisdictions. We will consider incorporating such provisions in the amendment bill in the light of the study findings.

Authorised Investments

29. The Second Schedule to the TO sets out the "default" authorised investments in the absence of express provisions in a trust instrument. In response to some comments that the Schedule should be amended to allow more flexibility and choices for trustees to invest, we are reviewing the Schedule to see if there is scope to update the list of authorised investments. We will consult the relevant regulators, market practitioners and other stakeholders when conducting the review.

WAY FORWARD

30. Subject to the outcome of the public consultation, we plan to introduce an amendment bill into the Legislative Council in 2012-13 to take forward the reform.

**Financial Services Branch
Financial Services and the Treasury Bureau
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