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Panel on Financial Affairs
Meeting on 3 December 2012

Background brief on the proposed legislation on trust law reform

Purpose

This paper sets out background information on the proposed legislation on trust law reform, and provides a summary of views and concerns expressed by members when the subject was discussed at the meetings of the Panel on Financial Affairs ("FA Panel") from 2008-2009 to 2011-2012 sessions.

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"). 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, there has been no substantial review of TO since its enactment. PAO was enacted in 1970, based on UK's Perpetuities and Accumulations Act 1964, to modify the common law rules regarding perpetuities and accumulations of income. PAO has not been reviewed since its enactment.

Review and consultation on the trust law regime

3. In August 2007, the Joint Committee on Trust law Reform¹, which represented the trust industry in Hong Kong, submitted proposals to the Government, advocating a comprehensive review of the trust law regime. The Administration commenced the review in early 2008 with the following aims:

- (a) to modernize the trust law to facilitate more effective trust administration;
- (b) to reform 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 TO and other laws relating to trusts. The Administration received a total of 36 submissions and 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**.

5. Based on the consultation conclusions, the Administration prepared draft provisions to amend TO and PAO and launched a two-month public consultation on the draft provisions on 22 March 2012. According to the Administration, the draft provisions are grouped under three board categories:

- (a) clarification of trustees' duties and powers to provide clearer guidelines on the role of trustees through:
 - (i) imposing a statutory duty of care on trustees;
 - (ii) providing trustees with a general power to appoint agents, nominees and custodians;

¹ The Joint Committee was formed by the Hong Kong Trustees' Association and the Society of Trust and Estate practitioners.

- (iii) giving trustees wider powers to insure trust property against risks of loss; and
 - (iv) allowing professional trustees to receive remuneration for services rendered to trusts;
- (b) enhancing the protection of beneficiaries' interests; and
 - (c) modernization of trust law.

Deliberations of the Panel

6. FA Panel discussed the Administration's consultation proposals on the trust law reform, key legislative proposals to amend TO and PAO, as well as the way forward during meetings in 2009, 2010 and 2012. Major views and concerns expressed by members are summarized in the ensuing paragraphs.

Protection of beneficiaries' interests

Representation of the beneficiaries' interests

7. Members were concerned about the protection of beneficiaries' interests in the trust law reform. As there was no particular organization representing the interests of the beneficiaries, it was concerned that the interests of beneficiaries might not be equally represented as those of the trustees in the public consultation exercise. Members hence requested the Administration to invite the Law Reform Commission ("LRC") to study the reform proposals to ensure protection of beneficiaries' interests, and suggested it to proactively invite views from professional bodies, including the accounting and legal professions, as well as academics, to provide views from the perspective of clients who were beneficiaries of trusts and the public.

8. The Administration advised that in the light of the advice of the Department of Justice ("DoJ") that Hong Kong could leverage the trust law reform experience in overseas jurisdictions, reference had been made to the reform experience/proposals of other common law jurisdictions, including the reform of the Trustee Act in UK and the proposal of beneficiaries' right to information in Canada, in formulating proposals in the reform. The Administration would seek LRC's advice only for the subject matter that had not been studied in-depth in these jurisdictions. In view of members' concern, the Administration undertook to further discuss with DoJ on whether a study by LRC on safeguarding the interests of beneficiaries should be pursued.

Beneficiaries' rights to information

9. Noting that most respondents to the consultation conducted in 2009 were professional trustees, members were concerned that adequate attention had not been given to protecting the interests of beneficiaries. Members considered that the Administration should legislate to provide for the basic rules on disclosure by trustees of information to beneficiaries. The Administration advised that it had decided not to legislate for the beneficiaries' rights to trust information for the time being because 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 the subject.

Exclusion of high risk structured products

10. Noting that the permissible investments contained in Schedule 2 to TO included debentures, members enquired whether the Administration would review the definition of "debentures" to exclude high risk structured products so as to enhance protection for beneficiaries' interests. The Administration advised that the definition of "debenture" under Schedule 2 to 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.

Regulation of trustee

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. Given the difficulty for a plaintiff to prove whether an act constituted gross negligence, fraud or wilful misconduct, members expressed concern on the Administration's proposal that trustees would be 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. It was 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. Members noted that the common law duty of care was already in place and considered the proposed statutory control would not make any difference to the common law control on trustees. They opined that the Administration should eliminate the ambiguities about trustees' duties and responsibilities defined in the existing legislation.

Costs afforded by beneficiaries

13. Regarding members' concern about 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 pointed out that the legislative proposals included a default charging clause to give professional trustees a right to receive remuneration subject to any contrary intention in trust instruments. There were also provisions to empower beneficiaries to remove a trustee through a court-free procedure provided that specified requirements such as unanimous consent among the beneficiaries were met. These proposals should help reduce the cost of the legal procedures involved.

14. In response to members' enquiry about the arrangements to handle complaints against trustees charging unreasonably high management fees for the trusts, the Administration advised that while there would be provisions to provide for remuneration of professional trustees, these provisions would be subject to reasonable safeguards if the trust instruments did not contain a charging clause.

Roles of trustee and custodian

15. On the question of 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. Such power of a trustee would be governed by the statutory duty of care, and the trustee was also required to review the performance of the custodians.

Professional indemnity insurance of trustees

16. As whether trustees would be required to take out professional indemnity insurance, the Administration advised that the legislative proposals did not stipulate such a requirement and trustees could decide on the matter having considered the risks in the investments of the relevant trusts. Moreover, a trust company had to meet the statutory requirements for setting up such company,

such as the required capital level, and depositing a guarantee with the Government.

Regulation of trusts

Non-charitable purpose trust

17. Noting that non-charitable purpose trust had its functions in society, for example, to support the development of a political party in Hong Kong which a charitable trust was disallowed to do so, some members considered that the Administration should formulate a statutory framework to allow the creation of non-charitable purpose trust 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.

Charitable trusts

18. Some members expressed concern about the lack of regulation over some charitable trusts and opined that an effective regulatory system should be put in place to enhance protection for the rights of the beneficiaries. Proposals in this regard included introducing provisions to ensure the transparency of charitable trusts, provisions for the regulatory/enforcement bodies to conduct spot checks on the trustees in preventing malpractice, and establishing a public register system to publicize the detailed information and financial reports of trusts. Pointing out that many charitable trusts were set up in the form of a company limited by guarantee under the Inland Revenue Ordinance (Cap. 112), some members opined that the Administration had a responsibility to regulate such charitable trusts. There was also concern about how charitable trusts set up in overseas countries could be regulated locally.

19. On the regulation over charitable trusts, the Administration advised that some specific requirements had been included in the legislative proposals for such trusts in view of their special nature. For example, while the rules against excessive accumulations of income would be abolished for other trusts, they would still apply to charitable trusts. The Administration also pointed out that currently there was no mandatory registration regime for trusts. Regarding charities established in the form of companies limited by guarantee, the Administration explained that they should be regulated by the Companies

Ordinance (Cap. 32). As the Administration had liaised with LRC on the review of the legal and regulatory framework for charitable organizations in a separate context, members' concern on the above issues would be relayed to LRC. On the issue of regulation of overseas trusts, the Administration would be very prudent in making reference to relevant legislation of comparable jurisdictions so that such trusts would not become a tax evasion instrument.

Tax evasion

20. On members' concern about safeguards for preventing wealthy people from using a trust to evade tax payments if a settlor was allowed to decide the types and amounts of investments of the trust funds, the Administration advised that it had made reference to the trust statute in Singapore in drawing up the proposed provisions for a settlor to retain certain powers in deciding the investments of his trust. However, a settlor might face the risk of his trust being ruled as invalid in court if he controlled fully or to a significant extent the investments of the trust.

Development of wealth management business in Hong Kong

21. On how the trust law reform would facilitate the development of wealth management business in Hong Kong, the Administration advised that as revealed by the trust industry, many potential settlors did not create trusts in Hong Kong mainly because Hong Kong's trust law was outdated. The reform on trust law regime would 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.

22. At members' request, the Administration provided supplementary information (**Appendix II**) comparing its detailed legislative proposals on trust law reform and the latest trust statutes of some common law and offshore jurisdictions.

Recent development

23. The Administration will brief FA Panel on the conclusions of the consultation on legislative proposals on the trust law reform at the meeting on 3 December 2012.

Relevant papers

24. A list of relevant papers is in **Appendix III**.

Council Business Division 1
Legislative Council Secretariat
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**Summary of the key reform proposals and issues in the Administration's
consultation on trust law reform conducted in June 2009 and
the consultation conclusions released in February 2010**

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.

Proposals / Questions in the Consultation Paper	Administration's Conclusions
(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.

Proposals / Questions in the Consultation Paper	Administration's Conclusions
(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.

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

**Comparison between the Administration’s Detailed Legislative Proposals on Trust Law Reform
and the Trust Law Regimes of Selected Jurisdictions¹**

(a) Clarification of trustees’ duties and powers

	Hong Kong Existing Position²	Hong Kong Reform Proposals³	United Kingdom⁴	Singapore⁵	Cayman Islands⁶	British Virgin Islands⁷
Statutory duty of care of trustees	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
Trustee’s power to delegate	Restriction on delegation. Attorney must not be the trustee’s sole co-trustee, except for trust corporation	Provide additional safeguard that if a trust has more than one trustee, the exercise of power of delegation should not result in the	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

¹ These jurisdictions are selected because:

- (a) our detailed legislative 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 Detailed Legislative Proposals on Trust Law Reform (March 2012).

⁴ UK Trustee Act 1925, UK Trustee Act 2000, UK Trusts of Land and Appointment of Trustees Act 1996 and UK Perpetuities and Accumulations Act 2009.

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 Position²	Hong Kong Reform Proposals³	United Kingdom⁴	Singapore⁵	Cayman Islands⁶	British Virgin Islands⁷
		trust having only one attorney or one trustee administering the trust, unless that attorney or trustee is a trust corporation				
Trustees' power to employ agents	Power to appoint agents to carry out administrative functions in relation to properties in Hong Kong, and may exercise all functions in relation to properties outside Hong Kong	Introduce a general power to appoint agents (regardless of the location of trust properties) to exercise any of their functions except for certain core ones, subject to certain safeguards ⁸	General power to appoint agents (regardless of the location of trust properties) to exercise any of their functions except for certain core ones, subject to certain safeguards	General power to appoint agents (regardless of the location of trust properties) to exercise any of their functions except for certain core ones, subject to certain safeguards	Power to appoint agents to carry out administrative functions in relation to properties in Cayman Islands, and may exercise all functions in relation to properties outside Cayman Islands	Power to appoint agents to carry out administrative functions in relation to properties in British Virgin Islands, and may exercise all functions in relation to properties outside British Virgin Islands
Trustees' power to employ	No general power to employ nominees and	Introduce a general power to employ nominees	General power to employ nominees and custodians,	General power to employ nominees and custodians,	No general power to employ nominees and	No general power to employ nominees and

⁸ For trustees of charitable trusts, agents should be allowed to carry out functions of generating income to finance a charitable trust's purposes, but not the execution of those purposes.

	Hong Kong Existing Position²	Hong Kong Reform Proposals³	United Kingdom⁴	Singapore⁵	Cayman Islands⁶	British Virgin Islands⁷
nominees and custodians	custodians	and custodians, subject to certain safeguards	subject to certain safeguards	subject to certain safeguards	custodians	custodians
Trustees' power to insure	Power to insure against loss or damage by fire and typhoon	Expand the 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
Professional trustees' entitlement to receive remuneration	No default charging provision for professional trustees	Provide professional trustees with a right to receive remuneration for services rendered, subject to certain safeguards	Default charging provision for professional trustees, subject to certain safeguards ⁹	Default charging provision for professional trustees, subject to certain safeguards	No default charging provision for professional trustees	No default charging provision for professional trustees

⁹ The default provision is not applicable to charitable trusts.

(b) Better protection of beneficiaries' interests

	Hong Kong Existing Position²	Hong Kong Reform Proposals³	United Kingdom⁴	Singapore⁵	Cayman Islands⁶	British Virgin Islands⁷
Trustees' exemption clauses	No control on trustee exemption clauses	Subject certain professional trustees' exemption clauses to statutory 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 Remove Trustees	No statutory provision but court may order substitution of trustees	Provide an alternative court-free route for beneficiaries (who are of full-age and capacity, and are absolutely entitled to trust properties) to remove trustees	Alternative court-free route for beneficiaries (who are of full-age and capacity, and are absolutely entitled to trust properties) to remove trustees	No statutory provision but court may order substitution of trustees	No statutory provision but court may order substitution of trustees	No statutory provision but court may order substitution of trustees

(c) Modernisation of trust law

	Hong Kong Existing Position²	Hong Kong Reform Proposals³	United Kingdom⁴	Singapore⁵	Cayman Islands⁶	British Virgin Islands⁷
Reserved powers of settlors	No statutory provision	Introduce a statutory provision to the effect that a trust is not invalid by reason only of the settlor reserving to himself powers of investment or asset management functions	No statutory provision	Statutory provision to the effect that a trust is not invalid by reason only of the settlor reserving to himself powers of investment or asset management functions	Wide range of powers can be reserved by settlors	Wide range of powers can be reserved by settlors
Rule against perpetuities	Puts a time limit within which trust properties must vest in the beneficiaries	Abolish the rule against perpetuities	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	Choice among six statutory accumulation	Abolish the rule against excessive accumulations of	Income can be accumulated for the duration of	Income can be accumulated for the duration of	Income can be accumulated for the duration of	Income can be accumulated for the duration of

of income	periods for which the income of a trust may be accumulated	income ¹⁰	the trust ¹¹	the trust	the trust	the trust
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**Financial Services Branch
Financial Services and the Treasury Bureau
April 2012**

(Source: LC Paper No. CB(1)1648/11-12(01))

¹⁰ The abolition of rule against excessive accumulations of income will not apply to charitable trusts. For charitable trusts, except for limited exceptions, a direction to accumulate will cease to have effect 21 years after the first day on which income may be accumulated.

¹¹ UK Perpetuities and Accumulations Act 2009 retains a 21-year restriction on accumulation for charitable trusts.

List of relevant papers

Date	Event	Paper/Minutes of meeting
6 July 2009	The Panel on Financial Affairs ("FA Panel") discussed the review of the Trustee Ordinance	Discussion paper (LC Paper No. CB(1)2095/08-09(02)) Minutes (LC Paper No. CB(1)73/09-10) Follow-up paper (LC Paper No. CB(1)2394/08-09(01))
1 March 2010	FA Panel discussed the review of the Trustee Ordinance and related matters	Discussion paper (LC Paper No. CB(1)1213/09-10(03)) Minutes (LC Paper No. CB(1)1725/09-10)
22 March 2012	The Administration launched a two-month public consultation on the draft legislation on trust law reform	Press Release Consultation paper (LC Paper No. CB(1)1397/11-12(01))
2 April 2012	FA Panel discussed the consultation paper on the detailed proposals on trust law reform	Discussion paper (LC Paper No. CB(1)1411/11-12(03)) Consultation paper (LC Paper No. CB(1)1397/11-12(01)) Follow-up paper (LC Paper No. CB(1)1648/11-12(01)) Minutes (LC Paper No. CB(1)2028/11-12)