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Report of the Bills Committee on Trust Law (Amendment) Bill 2013

Purpose

This paper reports on the deliberation of the Bills Committee on Trust Law (Amendment) Bill ("the Bills Committee").

Background

2. According to the latest survey conducted by the Hong Kong Trustees' Association, as at the end of 2011, the trust industry held assets of an estimated HK\$2,600 billion¹. While Hong Kong is a major asset management centre in Asia, its trust law regime, mainly based on common law and supplemented principally by the Trustee Ordinance (Cap. 29) ("TO") and the Perpetuities and Accumulations Ordinance (Cap. 257) ("PAO"), has not been substantially reviewed or modified since the enactment of the two ordinances in 1934 and 1970 respectively. According to the Administration, some of the provisions of TO and PAO are outdated and cannot meet the need of present-day trusts. By comparison, some major common law jurisdictions like the United Kingdom ("UK") and Singapore have recently reformed their trust laws.

3. Broadly speaking, where a person has property or rights which he holds or is bound to exercise for or on behalf of another or others, or for the accomplishment of some particular purpose or particular purposes, he is said to hold the property or rights on trust for that other or those others, or for that purpose or those purposes, and he is called a trustee².

4. The Administration commenced a review in early 2008 on Hong Kong's trust law regime in response to proposals from the Joint Committee

¹ Source: Legislative Council Brief on the Trust Law (Amendment) Bill 2013. File reference: G4/55/5C.

² Halsbury's Laws of Hong Kong, vol. 26(2) (2009 reissue), at para. 400.003

on Trust Law Reform ("JCTLR")³, which represented the trust industry in Hong Kong, and subsequently published a "Consultation Paper on Review of the Trustee Ordinance and Related Matters" in June 2009 for a three-month public consultation on the broad direction for modernizing the trust law in Hong Kong. It briefed the Legislative Council ("LegCo") Panel on Financial Affairs on the consultation proposals in July 2009 and on the consultation conclusions in March 2010. Based on the public views on the proposed modernization exercise, and having regard to the recent trust law reform of the UK and Singapore, the Administration conducted a second public consultation in March 2012 on the detailed legislative proposals to amend TO and PAO. It briefed the LegCo Panel on Financial Affairs on the consultation proposals in April 2012 and on the consultation conclusions as well as the proposal to introduce the Trust Law (Amendment) Bill 2013 ("the Bill") in December 2012.

The Bill

5. The date of First Reading of the Bill was 20 February 2013. It seeks to modify the common law position and update the existing legislation in certain specific aspects of Hong Kong's trust law regime with a view to bolstering the competitiveness of Hong Kong's trust services industry. To that effect, TO and PAO are proposed to be amended to, inter alia --

- (a) enhance trustees' default powers;
- (b) impose a statutory duty of care on trustees;
- (c) provide for the validity of certain trusts;
- (d) abolish the rule against perpetuities and the rule against excessive accumulations of income for new trusts; and
- (e) provide for related and consequential amendments.

6. The Bill does not cover the common law rules with respect to how a trust is constituted and when a person is to be regarded as a settlor, trustee, or beneficiary. The Administration has advised that there will be no change to other aspects of trust law or legislation not specifically covered by the Bill.

³ The Joint Committee was formed by the Hong Kong Trustees' Association and the Society of Trust and Estate Practitioners Hong Kong Branch.

7. The key legislative proposals in the Bill are as follows:

Amendments to TO

Part 2 of the Bill contains amendments to TO in the following areas:

- (a) *enhancing trustees' default powers in the following aspects:*
 - (i) power to appoint agents, nominees and custodians (new sections 41A to 41K and 41V);
 - (ii) power to insure the trust property (the amended section 21);
 - (iii) entitlement to receive remuneration and recover expenses (new sections 41Q to 41U);
 - (iv) relaxation of the scope of authorized investments (the amended Second Schedule);
- (b) *providing for appropriate checks and balances against trustees' powers through:*
 - (i) introducing statutory duty of care for trustees (new section 3A and the new Third Schedule);
 - (ii) imposing statutory control on exemption clause in relation to remunerated trustees acting in a business or profession (new section 41W);
 - (iii) requiring trustees to review the arrangements under which agents, nominees and custodians act (new sections 41L to 41P);
 - (iv) providing for beneficiaries' rights to appoint and retire trustees (new sections 40A to 40D);
- (c) *enhancing the certainty of the validity of certain trusts (new sections 41X and 41Y);*

Amendments to PAO

Part 3 of the Bill contains amendments to PAO to abolish the rule against perpetuities and the rule against excessive accumulations of income to allow a new trust to continue in existence for an unlimited period of time under certain circumstances (new Part 2 containing new sections 3A, 3B and 3C); and

Related and consequential amendments

Part 4 contains related and consequential amendments to the Enduring Powers of Attorney Ordinance (Cap. 501) and its subsidiary legislation.

The Bills Committee

8. At the House Committee meeting on 22 February 2013, members agreed to form a Bills Committee to study the Bill. Under the chairmanship of Hon NG Leung-sing, the Bills Committee has held eight meetings. The membership list of the Bills Committee is at **Appendix I**. The public including relevant trade and professional organizations have been invited to give views on the Bill. The Bills Committee received oral representations from deputations at the meeting on 27 May 2013. A list of the organizations and individuals which/who have submitted views to the Bills Committee is at **Appendix II**.

Deliberations of the Bills Committee

9. The Bills Committee supports the modernization of the trust law regime in Hong Kong so as to enhance the competitiveness of Hong Kong's trust services industry, attract settlers to set up trusts in Hong Kong and further consolidate Hong Kong's status as an international asset management centre. While the Bills Committee generally supports the proposals in the Bill, some members have expressed concerns about the proposed abolition of the rule against perpetuities and the proposed statutory control on trustees' exemption clauses; and made suggestions on the provision against forced heirship rules. The deliberations of the Bills Committee on the legislative proposals and related issues are summarized in the ensuing paragraphs.

Abolition of the rule against perpetuities (new section 3A of PAO)

10. The rule against perpetuities ("RAP") puts a time limit within which trust properties must vest in the beneficiaries. Under the common law, RAP, in gist, dictates that the future interest in trust properties must vest in the beneficiaries not later than 21 years after the death of the last life in being at the time of the creation of such interest. If there is any possibility that the interest may vest outside that period, the interest fails from the outset. RAP was modified by PAO, which contains provisions which seek to mitigate the strictness of the rule. Among others, PAO introduces a "wait and see" rule such that the creation of a future estate or interest is not invalidated until it becomes apparent that the future estate or interest must vest outside the perpetuity period. On the other hand, PAO provides that settlors may choose a fixed perpetuity period of 80 years.

11. The Administration has proposed to abolish RAP for all new trusts and allow settlors to set up perpetual trusts in Hong Kong. The justifications submitted by the Administration are, inter alia, as follows --

- (a) Diminished need of the rule -- RAP has its origin in the UK in the consideration that it is against public policy to allow immovable property, especially land, to be removed from the market. However, unlike other countries where freehold land exists, almost all private land in Hong Kong is leasehold land held from the Government with a fixed lease term, and the lease term for land granted after July 1997 is usually 50 years. In addition, if any private land is required for redevelopment purposes, there are several Ordinances⁴ which give a power of resumption or compulsory sale. Accordingly, in Hong Kong, RAP has become irrelevant in ensuring that land would not be tied up for a certain outdated purpose. For trusts with movable assets, trustees are under a duty to invest the trust fund and therefore the trust fund will be put to circulation in the market. There is no need for RAP to ensure that movable assets would not be tied up in a trust.
- (b) Complexity of the rule and possible uncertainties -- RAP as applied in Hong Kong is complicated and can be difficult to apply in practice. If a fixed perpetuity period is not chosen for a trust and the period is defined by reference to some lives in

⁴ For example, the Roads (Works, Use and Compensation) Ordinance (Cap.370), the Lands Resumption Ordinance (Cap.124) and the Land (Compulsory Sale for Redevelopment) Ordinance (Cap. 545).

being, the perpetuity period can be difficult to determine. Knowledge of the relevant case law and the effect of PAO will be required to ascertain whether the relevant disposition would be void at a particular point in time. This creates uncertainties concerning the validity of the trust. In case a disposition is invalidated after the trust has been set up because of non-observance of RAP, this would frustrate the settlor's wish, which might appear to be not illegitimate when the settlor set up the trust, as the property may be vested in someone whom the settlor had not intended to provide for.

- (c) Enhancing Hong Kong's attractiveness as a trust domicile -- The proposal to abolish RAP, thereby allowing the setting up of perpetual trusts, would enhance Hong Kong's attractiveness as a trust domicile vis-à-vis the UK and Singapore where there are still fixed perpetuity periods (125 years and 100 years respectively) for trusts.
- (d) Precedence in major international financial centres and other common law jurisdictions -- As advised by JCTLR, many states in the United States and some common law jurisdictions have already abolished RAP or made it possible for settlors to elect out of it in the trust deeds.

12. The Bills Committee has examined whether the proposed abolition of RAP would have any impact on the property market and property prices. Hon James TO is particularly concerned that given the abolition of RAP may encourage more trusts to be established in Hong Kong but the Government would not resume land except for public purposes, the abolition of RAP may lead to a situation whereby the number of properties circulated in the market would be reduced. The Bills Committee has enquired about the percentage/value of trusts in force holding Hong Kong properties.

13. The Administration has reiterated that under the leasehold system operated in Hong Kong, there is a fixed term to the land leases and any renewal is subject to conditions imposed by the Administration. This could ensure that land would not be tied up for outdated purposes and hence RAP would be irrelevant in this respect. Also, RAP has little relevance in ensuring the circulation of properties by the beneficiaries as RAP only serves to impose a time limit in which future interest of a trust must be vested in beneficiaries. In fact, if all the beneficiaries are of full

age and legal capacity, they have the right to act together to terminate the trust.

14. The Bills Committee notes the views of the JCTLR that most trusts hold movable assets and, as Hong Kong does not impose estate duty, there are only few cases in which local properties are held by trusts. In any case, the proposed abolition of RAP would not affect existing trusts. For future trusts, even if RAP has been abolished, it would be up to the settlors to decide the perpetuity periods of the trusts. According to JCTLR, the settlors would be advised to consider carefully if they intend to set up perpetual trusts. It considers that other measures, such as stamp duty, would have an impact on property prices but the trust law would not. JCTLR supports the abolition of RAP.

15. Some members, including the Deputy Chairman and Hon Martin LIAO have pointed out that for the trusts governed by Hong Kong law which hold immovable assets in other jurisdictions where RAP is in force, perpetuity will not apply even though RAP is abolished in Hong Kong. They have cast doubt on whether the abolition of RAP will attract more trusts to set up in Hong Kong.

16. The Administration has advised that, according to JCTLR, the vast majority of assets held by trusts are movable assets. It believes that the abolition of RAP will attract settlors to set up trusts in and bring funds to Hong Kong. The Administration acknowledges that in the unlikely event that a trust holds immovable properties in another jurisdiction, the court of that jurisdiction may not recognize a trust governed by the law of other jurisdictions if its purpose is against the public policy in the jurisdiction of the court. In this connection, given that there are different perpetuity periods in different jurisdictions, if the court in a jurisdiction considers that the different perpetuity period of a foreign trust is against the public policy of the jurisdiction of the court, the court may also not recognize the trust. Therefore the concern expressed in paragraph 15 could equally apply even if Hong Kong maintains a relatively long fixed perpetuity period. On the other hand, such concern would not arise for trusts with movable assets, as the settlor can move the assets to a jurisdiction of his choice. The Administration therefore maintains its position that the abolition of RAP will enhance the attractiveness of Hong Kong as a trust domicile.

17. The Bills Committee notes that more than 20 states in the United States of America, including the District of Columbia, New Jersey and Illinois, alongside some common law jurisdictions, have either abolished RAP or made it possible for settlors to elect out of it in the trust deed. The

UK and Singapore have retained RAP for trusts and fixed the perpetuity period at 125 years and 100 years respectively after they have reviewed and reformed their trust law regimes. Given that the proposed abolition of RAP under the Bill would lead to a major change to Hong Kong's trust law regime, the Deputy Chairman and members including Hon James TO and Hon Albert HO have requested the Administration to re-examine whether Hong Kong should allow perpetual trusts or, taking a progressive approach, to extend the perpetuity period of trusts. Mr Martin LIAO holds the view that in making such a significant change in the trust law regime by abolishing RAP, the Administration should consider not only the views of the trust industry, but also those of settlors and beneficiaries. Other than the impact on private trusts, the Administration should also consider the proposed abolition from a wider perspective of public interest. Some members including Hon Ronny TONG and Hon Dennis KWOK agree with the Administration that since land in Hong Kong is leasehold, there is no need for fixing a finite perpetuity period for the purpose of ensuring that land would not be tied up.

18. The Administration has emphasized that the abolition of RAP will be in the overall interest of Hong Kong as the proposal will enhance the attractiveness of Hong Kong as a trust domicile and bring funds as well as business opportunities to Hong Kong. It will also enhance the certainty of trusts for settlors by addressing the existing problem that the RAP as applied in Hong Kong is overly complicated and can be difficult to apply in practice. The Administration maintains its position that there is no longer a the need for RAP in Hong Kong as the issue of tying up land in trusts, which exists in some other common law jurisdictions, is not relevant to the situation in Hong Kong. It believes that the abolition of RAP will give Hong Kong an important competitive edge over other asset management centres in attracting trust business and bringing in investment funds. It also states that the abolition of RAP has received wide support in its public consultations.

19. In response to some members' concern that allowing trusts to be perpetual would keep trust assets from beneficiaries against their will, the Administration has advised that under common law, if all the beneficiaries are of full age and legal capacity and are absolutely entitled to the trust property, they have the right act together to terminate the trust. The Bills Committee has asked the Legal Adviser to the Bills Committee to advise if the termination of a trust under the said circumstances is subject to certain conditions and restrictions. The Legal Adviser opines that in the light of

the existing case law, there does not seem to be any conditions and restrictions to which the termination of a trust by beneficiaries is subject⁵.

Abolition of rule against excessive accumulations of income (new section 3A of PAO)

20. The Bills Committee notes that a trust instrument may direct that the income of the trust be accumulated for a certain period and be distributed only at the end of that period. The rule against excessive accumulations of income ("REA") was introduced by PAO as a statutory rule that restricts accumulation of income. The rule stipulates that settlors may choose one of the six statutory accumulation periods⁶, e.g. the life of the settlor, a term of 21 years from the death of the settlor or the date of the making of the disposition etc., for which the income of a trust may be accumulated. Accumulation beyond those periods is not allowed. Clause 46 of the Bill adds a new section 3A to PAO to provide that both RAP and REA cease to have effect in relation to trust instruments taking effect on or after the commencement of the enacted Bill. The proposed new section 3B maintains certain restriction on the accumulations of income of new charitable trusts so that the income will be applied for the intended charitable purposes.

21. The Bills Committee has examined the justifications for the proposal of abolishing REA and how REA is applied in other common law jurisdictions. The Administration has advised that REA was introduced in the UK for the fear that a large portion of the nation's wealth may eventually fall into a few hands after a long accumulation period and threaten the power of the state. However, the fears were subsequently considered unfounded and the UK has already abolished REA in 2009. Furthermore, under common law, a court is empowered to declare a trust void for capriciousness and may also invalidate any provision which directed accumulation without a rational purpose or for an unreasonable period. As at today, many other comparable common law jurisdictions including Singapore and New Zealand have abolished REA. In Australia, the subject is governed by state law. REA has been abolished in the state

⁵ The Legal Adviser's analysis and findings are set out in LC Paper No. LS57/12-13.

⁶ Briefly, the six accumulation periods are, subject to certain conditions --

- (a) the life of the settlor; or
- (b) a term of 21 years from the death of the settlor; or
- (c) the duration of the minority of any person in being at the death of the settlor; or
- (d) the duration of the minority only of any person who under the limitations of the instrument directing the accumulations would, for the time being, if of full age, be entitled to the income directed to be accumulated; or
- (e) a term of 21 years from the date of the making of the disposition; or
- (f) the duration of the minority of any person in being at the date of the making of the disposition.

of South Australia. As for the situation in Hong Kong, the Administration has pointed out that the application of REA is complicated, with six accumulation periods for the settlor to choose from and there are exceptions to the rule. In case there is an absence of a selection by the settlor, there will be uncertainties as one will have to apply to court to determine the relevant accumulation period. The uncertainty in the application of this rule can give rise to unnecessary litigation. The Administration has further advised that the majority of the respondents to past consultation exercises on the abolition of REA as applied in Hong Kong support the proposal.

22. The Bills Committee notes the view expressed by the Deputy Chairman that since the subject of trust law is technical, the respondents to the public consultations on the proposals in the Bill were mostly members of the trust industry. He opines that any proposals that are only based on minorities' views may be biased and not representing the public interest. While he supports the general objective of the Bill, i.e. to modernize the trust law and to enhance Hong Kong's status as an asset management centre, he considers it important to balance the public interest and the need to facilitate the operation of the trust business. He has warned that an over-simplified trust regime, upon the dual abolition of RAP and REA, may lead to lack of regulation on trusts.

23. The Administration has advised that past public consultations on the proposals represented a holistic due process that was intended to canvass views from different sectors of the community. In fact, it has received feedback from not only the trust industry, but also others including professional bodies and business organizations. The Administration has stressed that it has considered carefully the merits and the wider implications before adopting any proposal put forth by the industry. There are a number of proposals from the industry which have not been adopted in the Bill having regard to Hong Kong's reputation as an international financial centre, or the need to assess the impact of the proposals on beneficiaries and settlors.

Definition of "charitable trusts" in new section 3B

24. The Bills Committee notes that under the proposed new section 3B of PAO, certain restrictions will be maintained on the accumulations of income of new charitable trusts. It has enquired whether the definition of "charitable trusts" will tie in with that of the charitable trusts registered under section 88 of the Inland Revenue Ordinance (Cap. 112) ("IRO"). The Bills Committee has examined whether all the provisions that make

reference to "charitable trusts" should be listed out in a separate section in PAO/TO to facilitate the compliance of trustees. Separately, as the legal definition of a charitable trust is well established in the common law regime by case law and, in the UK, there is the *cy-près* doctrine which allows the court to amend the terms of a charitable trust to prevent its failure, the Bills Committee has enquired if the Administration will consider adopting a similar system in Hong Kong.

25. The Administration has advised that charitable trusts are characterized by their purposes and are not restricted to those registered under section 88 of IRO. It has pointed out that the concept of charitable trusts is not new and there is already a body of case law on what constitutes a charitable trust. It has no intention to introduce any fundamental change to the trust law regime for charitable trusts. The Administration has also advised that the *cy-près* doctrine is outside the scope of the Bill.

Providing for appropriate checks and balances against trustees' powers

26. The Bills Committee notes that while some of the proposals in the Bill seek to enhance the default powers of trustees, there are, in parallel, proposals to provide for checks and balances against trustees' powers. Such proposals include introducing statutory duty of care for trustees; imposing statutory control on exemption clauses in relation to remunerated trustees acting in a business or profession; requiring trustees to review the arrangements under which agents, nominees and custodians act; and providing for beneficiaries' rights to appoint and retire trustees by way of a court-free process.

Introducing statutory duty of care for trustees (new section 3A of TO)

27. To enhance the protection for beneficiaries, the Administration has proposed to provide for a clear statement in TO of the standard of care to be expected of trustees. The proposed standard is that a trustee must 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; and if the trustee is acting in the course of a business or profession, having regard to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession. Subject to the terms of the trust instruments, the statutory duty of care will apply to trustees when they are exercising the powers and duties in relation to making investments, appointment of agents, nominees and custodians, taking out insurance, etc.

The proposed statutory duty of care will be default in nature (i.e. the duty can be excluded or modified by the trust instrument) and, when it is applicable, will replace the existing common law duty of care. The Bills Committee has not raised any objection in principle to the proposal.

28. In examining the clauses relevant to the introduction of statutory duty of care for trustees, the Legal Adviser to the Bills Committee has pointed out that in clause 40, which seeks to add a new Third Schedule to TO to specify the circumstances in which a trustees' statutory duty of care applies, the reference to section 6 of TO should be removed. Section 6 only seeks to clarify the power under sections 4 and 5 (the exercising of which is covered by the statutory duty of care). The Administration agrees with the Legal Adviser and will propose a Committee Stage amendment ("CSA") to delete the reference to section 6 from the Third Schedule.

Statutory control on trustees' exemption clause (new section 41W of TO)

29. Under common law, a trustee's exemption clause in the trust instrument can validly exempt the trustee from liability of all breaches of trust except fraud. To better protect beneficiaries in the event of a breach of trust, a new section 41W of TO is proposed under the Bill to provide, inter alia, that trustees acting in a professional capacity and receiving remuneration would not be exempted from liability for breach of trust arising from the trustees' own fraud, wilful misconduct and gross negligence. Any exemption clause seeking to exempt a trustee from liability in those circumstances will be invalid. It is proposed that this new section applies to trusts whether created before or after the commencement of the enacted Bill, but in case of existing trusts, it will take effect one year after the commencement of the enacted Bill to allow trustees of existing trusts to make necessary preparation for the change.

30. The Bills Committee notes the reservation of the Hong Kong Bar Association ("HKBA") about the use of the term "gross negligence" in the proposed new section 41W. According to HKBA, its reservations arise from the concern that the concept of gross negligence is vague and problematic⁷ and the courts have in some cases doubted whether there is any real distinction between negligence and "gross" negligence. HKBA has advised that in 2002, the English Law Commission published a consultation paper on trustee exemption clauses, in which the Commission considered whether statutory control on trustee exemption clauses should be introduced. Among other formulae, the Commission considered

⁷ HKBA's views are detailed in its submission to the Bills Committee (LC Paper No. CB(1)1089/12-13(03)).

preventing trustees from excluding liability for "gross negligence". However, the Commission subsequently opined that the concept was too ill-defined to form the basis of regulating trustee exemption clauses. In its submission to the Bills Committee, HKBA has cited a variety of definitions, which are in its view often inconsistent, of "gross negligence" adopted by the courts of common law jurisdictions.

31. HKBA opines that if "gross negligence" is to be included in the proposed new section 41W without an accompanying definition, that would lead to significant uncertainties and probably an increased risk of litigation. Thus, it holds the view that one solution may be the introduction of a statutory definition for the term "gross negligence". Members including Hon Albert HO and Hon Dennis KWOK share HKBA's concern and have requested the Administration to consider giving a statutory definition for "gross negligence". Hon Martin LIAO has also asked the Administration to consider HKBA's suggestion.

32. The Bills Committee notes the suggestion from Hon Dennis KWOK that the Administration should draw reference to section 26 of the Mandatory Provident Fund Schemes Ordinance (Cap. 485) ("MPFSO") by adopting the terms "failure to act honestly" and "an intentional or reckless failure to exercise the degree of care and diligence that is to be reasonably expected of a trustee" to replace "fraud, wilful misconduct or gross negligence"⁸. His proposal is supported by Hon Albert HO.

33. On the proposed introduction of a statutory definition for "gross negligence", the Administration has advised that the term "gross negligence" is not new in Hong Kong's legal system and has been adopted in a number of ordinances without specific definition in those ordinances. It opines that it is necessary to consider all relevant factors in a particular case in determining whether a conduct in respect of that case falls under "gross negligence". This would allow the court to construe "gross negligence" in light of the circumstances of each case. The Administration considers that it is not prudent to create a definition of the term in the trust law regime at this stage, pending further development of case law, and without going through a due process of consultation with relevant stakeholders on the draft provision before inclusion in the Bill. It holds the view that it is important to consider carefully the possible implications of any proposed definition of the term on different stakeholders. The Administration has advised that it is prepared to consider in the future if there is any need to include a definition for "gross negligence".

⁸ Hon Dennis KWOK's proposed amendments have been circulated to members of the Bill Committee and the Administration vide LC Paper No. CB(1)1235/12-13(01).

34. As regards Hon Dennis KWOK's proposed amendments, the Administration has advised that the model in section 26 of MPFSO has been considered before and was one of the options put forward for public consultation on the reform of the trust law regime in 2009. Among the responses, there was a view from HKBA that the proposed regime is peculiar to a specific type of trusts and the rationale may not readily apply to all trusts. Moreover, during the public consultation in 2012, the majority of respondents who commented on the relevant provision preferred the threshold of "gross negligence" to that of "reckless". There were views that the formulation of "reckless" was inappropriate as it was derived from criminal law. Having considered the comments received during the consultations in drafting the proposed new section 41W, the Administration considers its current proposal appropriate. The Bills Committee notes the Administration's explanation and Hon Dennis KWOK's view that two of the cases cited by HKBA in its submission, namely "Red Sea Tankers v Papachristidis (The Ardent)" and "Midland Bank Trustee (Jersey) Ltd v Federated Pension Services", could provide guidance to litigants and the courts in respect of the interpretation of "gross negligence".

Inapplicability of the rules governing exemption clauses in contracts to trust deeds

35. The Bills Committee has examined whether the rules governing exemption clauses in contracts apply to trust deeds. The Administration has explained that the Control of Exemption Clauses Ordinance (Cap. 71) ("CECO"), which sets out the statutory rules that regulate exemption clauses in contracts, seeks to limit the extent to which civil liability, mainly for breach of contract and negligence or other breach of common law duty, can be avoided by means of contract terms. The legislation prevents a person from excluding or restricting his liability for contractual obligations and common law duties by reference to any contract term, unless the term satisfies the requirement of "reasonableness". The Administration considers that the statutory rules under CECO are not applicable to trust deeds, as it has been established in case law that trust deeds are not contracts⁹, and a contract and a trust are mutually exclusive concepts. It has advised that the UK Law Reform Commission ("UKLRC") also considers that the nature of the obligations arising from trust deeds and contracts are distinct. UKLRC concluded in its report published in 2006 that it was inappropriate to adopt the test of "reasonableness" in the context of trustees' exemption clauses in trust deeds. The test may give rise to considerable uncertainty and litigation, as unlike the case of contracts, there

⁹ *Baker v J.E. Clark & Co (Transport) UK Ltd* [2006] EWCA Civ 464

is no guiding body of case law for trust deeds. The Bills Committee notes the Administration's explanation.

Enhancing trustees' default powers

36. In view of the increasing complexity of present-day trusts, the Administration has proposed to enhance the default powers of trustees under TO so as to facilitate effective administration of trusts in case the trust instruments do not contain specific provisions. The Bills Committee notes that the relevant proposals include: (a) giving trustees a general power to appoint agents, nominees and custodians to perform their functions other than the more important ones specified in the law; (b) empowering trustees to insure the trust property against risks of loss or damage caused by any event and removing the restrictions on the amount of insurance that the trustees may take out; (c) enabling trustees acting in a professional capacity to receive remuneration under specific circumstances; and (d) relaxing the scope of authorized investments.

Relaxation of the scope of authorized investments (the amended Second Schedule to TO)

37. Section 4 of TO provides that trustees may invest any trust funds in authorized investments specified in the Second Schedule. Clause 39 of the Bill amends the Second Schedule to lower the market capitalisation of the company issuing the shares from HK\$10 billion to HK\$5 billion, replace the current five-year dividend requirement by a requirement of dividend payment in any three of the previous five years and accept dividends in forms other than cash for the purposes of satisfying the dividend requirement. It is also expressly stipulated that the authorized investments do not include structured products as defined in the Securities and Futures Ordinance (Cap. 571), having regard to the risk of these financial products.

38. The Bills Committee has enquired whether it is more appropriate to adopt a "prudent man approach"¹⁰ to trustee investments, as suggested by a member of the trust industry, than to list out the authorized investments in a piece of legislation, i.e. the Second Schedule to TO. The Administration has explained that the Second Schedule to TO is default in nature and is

¹⁰ According to a report prepared by Mr David GUNSON for the Hong Kong Trustees' Association Ltd in 1994 (provided to the Bills Committee vide LC Paper No. CB(1)798/12-13(01)), the "prudent man approach", introduced to the Trustee Act of New Zealand in 1988, requires all trustees to take account of the need for diversification of investments, the need to maintain the real value of the fund and the effects of inflation, the level of risk of depreciation and the potential for capital gain, the liquidity of the investments, the tax efficiency of the investment strategy and the need to take professional advice.

subject to the trust instruments. Settlers can provide very wide investment power to trustees and in those cases the Second Schedule will not be applicable. The Second Schedule is intended to provide a benchmark for prudential investments for lay trustees and its retention was supported by most respondents to the public consultation exercises. The Administration has undertaken to keep the list under review in the future.

Enhancing the certainty of the validity of certain trusts

39. To enhance the certainty of the validity of trusts where some (but not excessive) powers are reserved to the settlor, the Administration has proposed to add a new section 41X to TO to put it beyond doubt that a trust would not be invalidated because of the mere fact that the settlor has kept to himself the power of investment or asset management functions. The new section 41X also provides that a trustee who has acted in accordance with the exercise of settlors' reserve power is exempted from liability. Separately, a new section 41Y has been proposed to ensure that foreign forced heirship rules will not affect the validity of a lifetime transfer of movable assets to a trust expressed to be governed by Hong Kong law.

Provision against forced heirship rules (new section 41Y of TO)

40. Forced heirship rules are mandatory rules typically found in some civil law jurisdictions to restrict the freedom of testators in determining how to pass their estate on their death. In essence, the rules require a particular portion of the estate be reserved for designated categories of heirs. If there is not enough left in the estate to satisfy the indefeasible portions of the aforesaid heirs, property in trusts set up by the testator during his/her lifetime may be clawed back to make up for the shortfall. The Bills Committee notes that the Administration has commissioned a consultancy study on the possibility of introducing provisions against forced heirship rules in Hong Kong. The study concludes that such a statutory change could help reassure potential settlors that trusts set up in Hong Kong during their lifetime will be protected from forced heirship rules. In response to the strong requests of the trust industry and having considered the implications, including the possibility to enhance Hong Kong's attractiveness as a domicile for trusts, the Administration has proposed in the Bill to add a statutory provision to the effect that foreign heirship rules will not affect the validity of a lifetime transfer of movable assets to a trust governed by Hong Kong law.

41. The proposed new section 41Y stipulates that the transfer of movable property held on trust is not affected by foreign law of inheritance

if the settlor has the requisite capacity to make the transfer. The provision applies to trusts governed by Hong Kong law of which each trustee is either (a) an individual who ordinarily resides in Hong Kong; or (b) a body corporate the central management and control of which is in Hong Kong.

42. The Bills Committee is of the view that the coverage under (b) above should be extended to cover companies incorporated in Hong Kong so as to encourage company incorporation and bring ancillary benefits to Hong Kong. Taking into account the views of the Bills Committee, the Administration agrees to move a committee stage amendment to include "a body corporate incorporated or established in Hong Kong" in the new section 41(Y).

Suggestions on further amendments

43. The Bills Committee has taken the opportunity to deliberate a number of suggestions on the reform of the trust law regime in Hong Kong which are not covered by the Bill. A gist of the discussion is at **Appendix III**.

Regular review of the trust law regime

44. The Bills Committee acknowledges the importance of updating Hong Kong's trust law regime regularly for maintaining and enhancing Hong Kong's status as a major international asset management and financial centre. It has urged the Administration, having made the first step in the reform of the trust law regime by proposing the Bill, to continue the review on the regime, address the various outstanding issues raised in the submissions of concerned parties, and make new proposals within a reasonable time. The Administration has undertaken to keep in view the implementation of the proposals in the Bill after its coming into operation and will continue to liaise with the stakeholders on further review of the trust law regime.

Committee Stage amendments

45. The Administration will propose CSAs which cover the amendments in response to the Bills Committee's suggestions (paragraphs 28 and 42 of this report refer), the commencement date of the Amendment Ordinance (to replace "on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette" with "on 1 December 2013"), textual amendments to improve the drafting

of the Bill and other consequential amendments. The draft CSAs are set out at **Appendix IV**. The Bills Committee agrees to the Administration's proposed CSAs and has not proposed any CSA in its name.

Recommendation

46. The Bills Committee supports the Administration's proposal to resume the Second Reading debate on the Bill at the Council meeting of 17 July 2013.

Consultation with the House Committee

47. The House Committee at its meeting on 5 July 2013 noted the deliberations of the Bills Committee.

Council Business Division 1
Legislative Council Secretariat
8 July 2013

Bills Committee on Trust Law (Amendment) Bill 2013

Membership list

Chairman Hon NG Leung-sing, SBS, JP

Deputy Chairman Hon Kenneth LEUNG

Members Hon Albert HO Chun-yan
Hon James TO Kun-sun
Hon Abraham SHEK Lai-him, GBS, JP
Hon Ronny TONG Ka-wah, SC
Hon Cyd HO Sau-lan (up to 21 April 2013)
Hon Starry LEE Wai-king, JP
Hon CHAN Kin-por, BBS, JP
Hon Paul TSE Wai-chun, JP
Hon Dennis KWOK
Hon Martin LIAO Cheung-kong, JP

(Total: 11 members)

Clerk Ms Sharon CHUNG

Legal Adviser Miss Winnie LO

Bills Committee on Trust Law (Amendment) Bill 2013

List of deputations which have given views to the Bills Committee

Organizations

1. Baker & McKenzie
2. The Chinese General Chamber of Commerce
3. The Chinese Manufacturers' Association of Hong Kong
4. The Hong Kong Association of Banks
5. Hong Kong Bar Association
6. Hong Kong General Chamber of Commerce
7. Joint Committee on Trust Law Reform
8. The Law Society of Hong Kong
9. Zurich Insurance (Hong Kong)

Individuals

10. Mr David GUNSON
11. Mr YEUNG Wai-sing, Eastern District Council member

Summary of the Bills Committee's Deliberations on Other Suggestions¹¹ on the Reform of the Trust Law Regime

Recognizing the validity of non-charitable purpose trusts

Non-charitable purpose trusts ("NCPTs") are trusts set up for the fulfilment of a non-charitable purpose but not for the benefit of a person¹². NCPTs have no beneficiaries and are normally considered invalid by courts. The Bills Committee notes the view of the Hong Kong General Chamber of Commerce ("HKGCC") that NCPTs have useful legitimate purposes in family planning and financing vehicles structuring. JCTLR opines that NCPTs are very useful in many legitimate commercial transactions which call for a neutral party to be entrusted to carry out a specific purpose of the transaction without being controlled by or subject to the claims on persons who would otherwise own such entities. JCTLR supports legislative action to recognize the validity of NCPTs which comply with requirements of certainty and legality. It considers that the recognition of such trusts by the law would greatly assist Hong Kong in establishing itself as the region's premier trust administration jurisdiction. The Bills Committee has enquired whether the Administration has any intention to allow for the establishment of NCPTs under the law.

2. The Administration has advised that no major comparable common law jurisdictions have provided for the setting up of NCPTs as the proposal represents a radical departure from the common law and there are regulatory concerns on the transparency of such arrangements, which could put Hong Kong's reputation of being an international financial centre at risk. It holds the position that the implications of the proposals have to be duly assessed and it would not be appropriate to adopt them in the current Bill. The Administration will take these suggestions into consideration in future review of the trust law.

Widening the reserve power of settlors

3. HKGCC has proposed that Hong Kong's trust law should allow settlors to have greater reserve powers without affecting the validity of their trusts. These powers may include the power to manage the trust investments and the power to control and run a family business vested in a

¹¹ These suggestions are not covered by the Bill.

¹² Examples are trusts created for keeping a pet animal or maintaining the grave of the settlor.

trust. The Bills Committee notes the position of the Administration on this proposal, i.e. that it is necessary to ensure that there is a reasonable balance such that the reserve powers would not be excessive, and it will take considerable time beyond the target timeframe for the enactment of the current Bill to assess carefully the implications and desirability of the proposal.

Incorporating statutory provisions on "anti-*Barlett v Barclays*" clauses

4. The proposed statutory provisions on "anti-*Barlett v Barclays*" clauses give statutory effect to clauses in trust deeds which relieve trustees from management and supervisory obligations with respect to underlying companies in certain situations and correspondingly exonerate them from claims in relation to such companies. The Bills Committee notes JCTLR's view that the inclusion of such provisions in trust law will add certainty that, because trustees' duties regarding underlying companies are not core, irreducible duties a trustee owes to beneficiaries, a trustee may be relieved of duties with respect to underlying companies by express language in the trust instrument. According to JCTLR, the provision would also give settlors certainty that they can control family companies owned by trusts, which is considered to be something particularly in demand in the region where much business and wealth remains in families.

5. On JCTLR's proposal, the Administration has advised that under the existing regime, settlors can relieve trustees of certain duties through provisions in the trust deeds. The effect and enforceability of the provisions in the trust deed would depend on the drafting of the provisions and relevant facts of the case, and ultimately be determined by the court. The proposed inclusion of the statutory provisions on "anti-*Barlett v Barclays*" clauses would have implications for the interest of settlors and beneficiaries as well as trustees. Given that there are no such statutory provisions in any major comparable common law jurisdictions and there was no focused or detailed discussion on the matter in the past, the Administration considers it prudent and imperative to study the implications of such provisions carefully before a policy view is taken. Therefore it would not be appropriate to adopt the proposal in the current Bill.

Trust Law (Amendment) Bill 2013

Committee Stage

Amendments to be moved by
the Secretary for Financial Services and the Treasury

<u>Clause</u>	<u>Amendment Proposed</u>
1(2)	By deleting everything after "on" and substituting "1 December 2013".
27	In the proposed section 41M(1)(b), in the Chinese text, by deleting "致使該等受託人行使其干預權力屬適當" and substituting "令到該等受託人適宜考慮是否有需要行使其干預權力"。
27	In the proposed section 41N(1)(b), in the Chinese text, by deleting "致使該等受託人行使其干預權力屬適當" and substituting "令到該等受託人適宜考慮是否有需要行使其干預權力"。
27	In the proposed section 41Y(1)(b), by deleting everything after "of the trust" and substituting— "is— (i) an individual who ordinarily resides in Hong Kong; (ii) a body corporate incorporated or established in Hong Kong; or (iii) a body corporate incorporated or established outside Hong Kong and the central management and control of which is in Hong Kong."
36	(a) By renumbering the clause as clause 36(1). (b) By adding— "(2) Section 77(2)(f)— Repeal "investments or"."

New

By adding—

"36A. Section 80 amended (deposit to be held as security)

(1) Section 80(1)—

Repeal

"the investments or the sum of money deposited under section 77 shall"

Substitute

", the sum of money deposited under section 77 must".

(2) Section 80—

Repeal subsection (2)

Substitute

"(2) If at any time, the Registrar of Companies is of opinion that a trust company should furnish additional security because of the company's increase of its gross liabilities, the Registrar may order the company to make, within a period specified in the order, a further deposit of a sum of money (as contemplated by section 77(2)(e)) of a specified amount with the Director of Accounting Services.

(2A) The company may appeal against the order to the Chief Executive in Council, whose decision is final."

(3) Section 80—

Repeal subsection (3)

Substitute

"(3) If a trust company has deposited a sum of money with an authorized institution or a finance company under section 77(2)(e), the trust company may, with the approval of the Director of Accounting Services and subject to the terms that the Director may specify, withdraw the sum and deposit it with another authorized institution or finance company referred to in that section."

(4) Section 80—
Repeal subsection (4)
Substitute

"(4) All money accruing by way of interest in respect of sums deposited with an authorized institution or a finance company under this Part must be paid to the trust company which made the deposit.".

40 In the proposed Third Schedule, in section 1(b), by deleting "
6".