THE LAW SOCIETY OF HONG KONG 香港律師會

Submissions of the Law Society of Hong Kong on the Consultation Paper on Detailed Legislative Proposals on Trust Law Reform

General Comments

1. The Law Society's Working Party on Review of Trustee Ordinance has reviewed the legislative proposals on trust law reform put forward by the Financial Services and Treasury Bureau in its March 2012 Consultation Paper.

2. The Working Party noted the stated aims of the trust law reform are to bring the regulatory regime in line with other comparable common law jurisdictions, better cater for the need of modern-law trusts in order to strengthen the competitiveness of Hong Kong's trust services industry and consolidate the status of Hong Kong as an international asset management centre. It is, however, disappointing to note that after all these years of extensive research and consultation, the Government has chosen to adopt a rather conservative approach in the trust law reform and has failed to grasp the opportunity of this review to attempt to bring the Trustee Ordinance ("TO") at least in line with current practices in premier offshore jurisdictions, let alone provide anything which gives Hong Kong a competitive edge.

3. It is observed that many of the Law Society's submissions made in 2009 in response to the Government's last consultation have not been taken on board. For instance, the statutory duty of care on trustees will be subject to express contrary intention in the trust instrument, notwithstanding the Law Society's expressed concern that professional trustees will likely exclude the statutory duty in their professional drafted standard trust instruments and the suggestion made that certain core duties of a trustee should not be opened to exclusion. No concrete proposals have been put forward on the provisions against forced heirship rules and the list of authorized investments in Schedule 2 of the TO has yet to be reviewed.

4. Whilst it is understandable that the Government may not wish Hong Kong to be perceived as a tax haven given the current opprobrium attached to the offshore trust industry, the legislative proposals now put forward have failed even to bring the legislation up to a standard which can compete well with that available in Singapore. And these proposals have also failed to meet the expectations of modern-day trust industry.

Comments on the Consultation Paper

Chapter 2 – Amendments to the Trustee Ordinance

A. Statutory Duty of Care – Annex A of the Consultation Paper:

5. **Section 3A(3)** excludes the statutory duty of care "*if, or in so far as, it appears from the instrument creating the trust that the duty is not meant to apply.*"

6. There are no core duties that will not be subject to exclusion as recommended by the previous Law Society's submission. Unless professional trustees can be persuaded to adopt it as best practice not to do so, exclusion of the statutory duty will become the default provision in standard form trust deeds. The standard duty of care will therefore tend to apply only to those non-professional trustees who are least equipped to comply with it.

7. The proposed provision also does not permit exclusion in respect of existing trust deeds – making the imposition of the duty essentially retrospective. There should at least be the option to amend the existing trust deeds to exclude the statutory duty if the settlor is still alive or the beneficiaries agree. This approach is taken in **Section 40D(2)** in respect of power to change trustees.

B. Power to Delegate – Annex B of the Consultation Paper

8. In regard to **Section 27(2A)**, if under the terms of the trust, it is permissible to have only one trustee, we do not see the logic in limiting delegation only to circumstances where there is at least one other trustee administering the trust, particularly given that **Section 27(5)** makes the donor of a power liable for acts or defaults of the donee.

9. If under **Section 27(1),** a sole trustee can delegate to a third party, what is the rationale in preventing a joint trustee delegating to his co-trustee? C.f. **Section 41B** which (by virtue of **Section 41A**) permits a single trustee to delegate "*delegable functions*" to an agent.

10. This is not an entirely consistent approach.

C. Power to Employ Agents – Annex C of the Consultation Paper

11. We do not understand the rationale for the prohibition on delegation to a beneficiary contained in **Section 41C(3).** In appropriate circumstances (and the statutory duty of care applies unless excluded), why should a trustee not be entitled to delegate authority over property (e.g. investment powers) to those directly interested in it?

12. In **Section 41E(2)** the expression "*...unless it is reasonably necessary for them to do so*" appears to be problematic. Although it attempts to introduce an objective standard, we can foresee difficulties in advising whether something meets that standard. For example, if a trustee wishes to appoint an agent to do something on the agent's standard terms which contain an exclusion clause, is it reasonably necessary to accept that clause or must the trustee find another

agent who does not have such terms, even if the trustee, subjectively, does not believe they can do as good a job?

D. Trustee's Power to Employ Nominees and Custodians - Annex D of the Consultation Paper

13. In regard to **Section 41H(2)**, although it repeats verbatim Section 17 of the UK Trustee Act 2000, the provision that "*...a person is a custodian in relation to any assets if the person undertakes the safe custody of the assets or of any documents or records concerning the assets*" appears to be unduly broad as far as it relates to "*documents or records*". These need not be documents of title but could be any documents relating to the assets. An auditor of the trust, for instance, may impliedly undertake to keep records safe during the course of his audit. Is he therefore a custodian for these purposes?

14. When it comes to a custodian, we believe it should actually be talking about the safekeeping of the assets themselves, rather than, for instance, investment reports or recommendations. If a Registered Agent keeps the company register of a BVI holding company underlying the trust, is it a custodian for these purposes? On the face of it, it would seem so, and the trustee would have to ensure that not only is the appointment evidenced in writing (which we accept it is likely to be) but also keep the suitability of that Registered Agent under constant review. This seems unnecessarily onerous in regard to a purely administrative (and statutory) function.

15. It may be better to say "*...a person is a custodian in relation to any assets if the person undertakes the safe custody of the assets or of any documents of title concerning the assets.*"

16. The point on **Section 41E(2)** above in paragraph 12 with regard to the expression "*...unless it is reasonably necessary for them to do so*" applies equally to **Section 41K(2)**.

E. Safeguards in relation to Appointment of Agents, Nominees and Custodians - Annex E of the Consultation Paper

17. The requirement in **Sections 41M** and **41N** that the trustee must keep under review the arrangements under which the agent, nominee or custodian acts is subject to the statutory duty of care, but no guidance is given as to how often the review should take place. If it is a constant duty to review every time an agent or custodian does, or does not do, something, then this could be quite burdensome. **Section 40O** provides that a trustee is not liable for the default of an agent, nominee or custodian if it has discharged the statutory duty of care when carrying out the duty to review, but the decision as to when to review must presumably also be part of this duty.

18. It may be helpful for trustees, and lay trustees in particular, to have a minimum review period, and we would propose that an additional provision be added to the effect that review by the trustee under **Sections 41M** or **41N** shall be carried out as frequently as the circumstances may reasonably require according to the nature of the duties or transactions undertaken by the agent, nominee or custodian, but in any event at least annually.

F. Trustee's Power to Insure – Annex F of the Consultation Paper

19. We have no comment.

G. Professional Trustees' Entitlement to Receive Remuneration – Annex G of the Consultation Paper

20. We agree with the proposals and have no comment.

H. Statutory Control on Trustee's Exemption Clause – Annex H

21. As to the substitution of "*reckless act*" for "*gross negligence*" it should be noted that *Sin Kam Wah v HKSAR* is a criminal case. The definition quoted is based on mens rea. The full sentence reads:

> *"So juries should be instructed that, in order to convict for an offence under s.118(3)(a) of the Crimes Ordinance, it has to be shown that the defendant's state of mind was culpable in that he acted recklessly in respect of a circumstance if he was aware of a risk which did or would exist, or in respect of a result if he was aware of a risk that it would occur, and it was, in the circumstances known to him, unreasonable to take the risk."*

22. Intuitively, it seems wrong to base the exemption on a definition derived from the criminal law. We agree that there is considerable debate over whether the word "*gross*" in "*gross negligence*" actually has any meaning. However, on balance, it would be better to retain this expression as it is the common formula used in most existing documentation, and to offer a definition which distinguishes it from "*ordinary*" negligence by reference to the seriousness of the negligence in question. The term "*a serious or flagrant degree of negligence*" referred to in the case of *Midland Bank Trustee (Jersey) Ltd v Federated Pension Services Ltd* emphasizes the distinction and is a useful starting point, while leaving the courts to determine in any given case whether something is serous or flagrant.

I. Beneficiaries' Right to Remove Trustees – Annex I of the Consultation Paper

23. Although it follows the UK legislation, the stipulation in **Section 40A(3)(b)** that there must be at least 2 continuing trustees is not logical in the context of a trust where the trust deed permits there to be only one trustee. This is not a power which may be subject to contrary intention under **Section 3(2)**, but rather an express requirement in regard to the mechanism for requiring a trustee to retire.

24. Also the logic of the further stipulation in **Section 40A(3)(c)** which requires either a new trustee to be appointed on his retirement of for the continuing trustees to consent to his retirement is hard to follow. By giving the continuing trustees power of consent this substantially detracts from the rights of the sui juris beneficiaries, whose only option if the continuing trustees do not consent would seem to be to appoint another trustee. Why should continuing trustees be required to consent to the retirement of a co-trustee in circumstances where he is being required by the beneficiaries to retire?

25. In regard to incapacitated trustees, we have already identified that the Enduring Powers of Attorney Ordinance is defective in regard to powers granted by trustees (as it can only be an enduring power over his own property and affairs) and therefore **Section 40B(2)** appears to be redundant – particularly in view of the proposal that **Section 8(3)(a)** of the EPAO be repealed.

26. As **Section 40B** applies only in the case of sui juris beneficiaries beneficially entitled, in order to protect their interest and permit action to be taken promptly it seems to us to make more sense to grant them the power to appoint a replacement trustee rather than have to wait for a committee to be appointed or an application made to court (as the entire rationale behind these provisions is expressed to be to provide "*a simple, time-saving and court-free process*").

27. The definition of beneficiary in **Section 40C(a)** [NB there is no "(b)"] seems to imply that the trustee of the trust has an interest in the property in the capacity of trustee and as such should be treated as a beneficiary for these purposes. We believe the intention is to refer to a person who is the trustee of any other trust or the personal representative of a deceased beneficiary or one who is otherwise under a disability, and we think it should say this. We would suggest:

> ***"beneficiary**, in relation to a trust, means a person who under the trust has an interest in the property subject to the trust (including a person who has such an interest as a trustee of another trust or as personal representative of a deceased beneficiary or one who is otherwise under a disability)."*

28. In **Section 40(2)(a),** we would propose amending this to read "*...by that person or his personal representatives*". This would at least partly ameliorate the position where a settlor has passed away before the operative date.

J. Validity of Certain Trusts - Annex J of the Consultation Paper

29. In our view, this does not go far enough. We would revert to the Law Society's submission on powers to be included in the list of reserved powers. The proposed **Section 41X** is hardly worth the effort of legislation. A trust in which the settlor only reserves the power of asset management is unlikely to prove invalid in any case. Where it may become invalid is where the Settlor reserves a wide raft of powers which are incompatible with the trust relationship. The purpose of providing that certain things will not invalidate the trust is to create certainty in the extent to which a Settlor can retain rights in respect of the trust, and by limiting this to powers of investment management functions it invites challenge in respect of trusts which reserve other legitimate powers.

30. Moreover, we believe that instead of applying this provision only to trusts created after the date of the amending ordinance (which is the effect of **Section 41X(3)**) it would be appropriate to extend what small protections it confers over trusts whenever created. It is illogical to say a trust that reserves powers is valid if created after a certain date but that one which contains

exactly the same powers may not be valid if created before that date. The inherent nature of the two trusts is identical.

Chapter 3 – Amendments to the Perpetuities and Accumulations Ordinance

31. We agree with the proposals and have no comment.

Other Matters

32. Trustee's Power of Investment
We noted that despite the Law Society's submissions, the Government has not committed to putting in place a mechanism for periodic review of the list of authorized investments specified in the Second Schedule of the TO to enable timely updating of the Schedule to cope with fast moving market trends.

33. Beneficiaries Rights To Information
Whilst we respect Professor Lucina Ho's opinions, it is regrettable that the Government has decided that there are "*no imminent or compelling reasons to introduce legislation*". This simply perpetuates the unsatisfactory current lack of certainty for both beneficiaries and trustees. It does not help Hong Kong to consolidate its position as a trust centre.

34. Forced Heirship
We noted that the Government has yet to come up with its proposals on introduction of provisions against forced heirship. This looks like another lost opportunity to update the law in accordance with international practice.

35. Powers of Advancement
At paragraph 56 of the original Conclusions document following the initial consultation round, it was indicated that the Government would propose repeal of **Section 34(1)(a)** (*limitation on amount of advancement*). However this does not seem to have been included.

36. Purpose Trusts
We note that the Government has not advanced any proposals on the introduction of Purpose Trusts, which are a common feature in succession planning. This appears to be another lost opportunity to bring Hong Kong into line with modern trust and estate planning practice.

The Law Society of Hong Kong
Working Party on Review of Trustee Ordinance
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