Reform of Trust Law
William Ahern at Family Capital Conservation

After seven years of lobbying, Hong Kong now has a new trust law by virtue of the amendments made to the Trustee Ordinance (Cap 29) and the Perpetuities and Accumulations Ordinance (Cap 257) via the Trust Law (Amendment) Ordinance 2013. William Ahern, founder of Family Capital Conservation, examines the major reforms.

The Trust Law (Amendment) Ordinance 2013 (the amending Ordinance) came into effect on 1 December 2013 and put in place several major reforms, which will be dealt with in turn.

The new statutory duty of care for trustees

Pursuant to the amending Ordinance, s 3A, the new statutory standard of care for a non-professional trustee is measured subjectively against his special knowledge and experience, or according to what he holds himself as having. A professional paid trustee is further judged by reference to knowledge or experience that he is reasonably expected to have, ie by both objective and subjective standards.

The standard of care owed depends on whether the common law standard or new statutory duty applies. The common law duty continues to apply insofar as it is possible for the settlor and trustee to contract out of the new statutory duty. For existing trusts, the new statutory standard applies unless it is specifically excluded by deed.

I am not sure that the statutory standard is in fact any more onerous than the common law standard. It has the benefit of being clearly set out in the amending Ordinance and I do not think it will trouble the well-organised and conscientious trustee. Convincing a settlor that it ought not apply may prove difficult, not to mention embarrassing.

Control of trustees’ rights to exemption and indemnity for liability for breach of trust

To what extent can a trustee exonerate himself from liability for a breach of trust? The previous state of law allowed for exemption clauses that excluded liability for ordinary and gross negligence, but not fraud or wilful neglect.

However, the amending Ordinance, Pt 4C provides that paid professional trustees may not be excluded from liability for a breach of trust arising from his own fraud, wilful misconduct or gross negligence, nor may he be granted any indemnity against the trust property for the liability.

These provisions apply to all trusts, but with respect to trusts created before 1 December 2013, they come into effect only after 1 December 2014, giving trustees a one-year window to take the necessary action. It will be interesting to see how trustees react to this, and whether the common law will arrive at this position in due course.
Reservation of investment powers to settlor

This is perhaps the most significant amendment. The amending Ordinance, s 41X(1) resolves the vexed question of whether the reservation of investment powers or asset management functions to the settlor of itself invalidates the trust: it does not. However, the powers of investment or asset management functions are not defined, giving rise to a number of questions.

Does this include, for example, the power to supervise a wholly-owned subsidiary of the trust that conducts a trading business? Of course, this cannot change a shareholder’s rights as those are a matter of corporate law. But does this provision allow, as a matter of trust law, a trustee to reserve to the settlor the exercise of these shareholders’ rights?

The amending Ordinance, s 41X(2) is where it gets even more interesting, providing that a trustee who acts in accordance with the exercise of the reserved power is not in breach of trust. Assume a trust deed were to reserve to the settlor all of its shareholder’s powers over a subsidiary conducting a trading business, and the trustee was instructed by the settlor to vote the subsidiary’s shares to appoint a new board of directors, which subsequently ruined the business. Would the trustee be in the clear?

Could it be a valid reservation of powers to the settlor to appoint him as the trustee’s attorney, or is this a power to delegate? Can a settlor assign or delegate powers validly reserved to him? The Joint Committee on Trust Law Reform lobbied hard to allow the reservation of all sorts of powers to the settlor (and others) but the Hong Kong government rejected this approach as too radical. The amending Ordinance also introduced new powers to trustees to delegate specific investment functions, but it placed conditions on such delegation. I doubt that the legislative intent was to allow a settlor to freely assign or delegate the powers reserved to him by the trust.

Can the settlor of an existing trust whose terms do not reserve investment powers to himself now have the trustee exercise a power of variation of the trust terms to permit such a reservation? Or is it not possible for a trustee to reserve powers to a settlor once they are vested in him?

No doubt academic writings and case law will evolve to define the boundaries of this section. It may be that these limitations will be built around the concept of the exercise of a reserve power being construed to mean ‘the proper exercise of the reserved power’.

The amending Ordinance, s 41X(3) and (4) make it clear that the validity provisions apply to all trusts except those declared invalid before 1 December 2013. However, it should be noted that the section itself does not empower a settlor to reserve a power to himself; it merely makes it clear that such a reservation will not invalidate the trust. This leaves open the question of whether it is possible to reserve existing trustee powers to settlors or whether the reservation, or at least the power to later reserve powers, must be in the trust terms.
Forced heirship provisions

The amending Ordinance, s 41Y provides that a law relating to inheritance or the succession of a foreign jurisdiction does not affect the validity of the transfer of any movable property to be held on trust provided the transferor had capacity under Hong Kong laws, the law of the transferor’s domicile or nationality or the proper law of the transfer.

The transferee trust must further be governed by Hong Kong law and individual trustees must be resident in Hong Kong or, if corporate, either be incorporated or centrally managed and controlled in Hong Kong.

Abolition of the rule against perpetuities and the rule against excessive accumulations

These rules no longer apply to trusts coming into existence after 1 December 2013, except for certain restrictions on accumulations that continue to apply to charitable trusts, as well as the rule regarding the duration of non-charitable purpose trusts. They continue to apply to wills executed before 1 December 2013, but not to special powers of appointment where the instrument creating the power takes effect after 1 December 2013. This means perpetual trusts are now permissible but not, of course, that they are advisable.

Court-free removal of trustees

Most modern trust deeds vest power in a protector or appointor to remove the trustee, without which the beneficiaries would have to resort to court. The new provisions provide a court-free mechanism allowing beneficiaries who are both sui juris and have vested trust interests to remove trustees, though they apply only if there is no person nominated and on the agreement of all beneficiaries.

The provisions stipulate the method of giving trustees notice including the right to nominate successors, and oblige the retiring trustee to make a deed appointing a successor and for the vesting of the trust property in the successor trustees. There are like provisions giving beneficiaries similar rights and powers where trustees become incapacitated.

New trustee powers of delegation

The permitted delegable functions for non-charitable trusts are essentially anything not relating to distributions from the trust, the appointment of trustees or the delegation powers themselves. Charitable trusts may delegate the execution of all decisions, the making of decisions relating to the investment of assets and fund-raising except where that entails carrying on a business.

Trustees may delegate to one or more of the trustees. Where they appoint agents, they must set the terms of that agency and not unnecessarily allow the agent to sub-delegate, allow conflicts to arise or appoint beneficiaries as agents. There are special restrictions regarding the delegation of asset management functions, which essentially require trustees to make such appointments in writing and provide the asset manager with a written investment policy statement. Nominees and custodians must be appointed in writing and must conduct that kind of business, and trustees are similarly
required to set their terms of appointment. The exercise of these powers is subject to the statutory duty of care.

For the first time in Hong Kong, trustees relying on the statutory power of delegation are required to review the performance of the delegate and, in the case of investment delegation, review the policy statement. All such appointments should be regularly reviewed and terminated if necessary. Where trustees fail to exercise their powers as prescribed, they lose the statutory protection that relieves them from liability for the acts or omissions of the delegate. The objective is to empower trustees to delegate, but oblige them to continue to supervise those delegates.

**Conclusion**

The amending Ordinance significantly modifies and improves Hong Kong trust law and is to be welcomed. While the amendments do not go as far as many offshore trust administration centres, whose endless modifications of the trust law have made the trust something that is ‘all things to all men’, I think it strikes a sensible balance between making it more adaptable to modern business, yet not robbing it of its central characteristics, ie a relationship around property, built on the principle of dual ownership and subject to obligations based on fiduciary duty.