How do recent Hong Kong trust law changes affect bond trustees? A comparative analysis with Singapore and English law

More than four years in the making, Hong Kong finally implemented much needed reforms to modernise its trust law in December 2013. These reforms are seen as pivotal to strengthening the competitiveness and attractiveness of Hong Kong’s trust services industry, and follow a similar exercise in England (2001) and in Singapore (2004). Whilst most changes brought the trust law regimes in these jurisdictions into closer alignment, there exist some significant differences of which bond trustees operating internationally should be aware. This article discusses the key changes brought about by the Hong Kong reforms and outlines the major similarities with Singapore and English law and key differences between them.

STATUTORY DUTY OF CARE FOR TRUSTEES

In Hong Kong, a new statutory duty of care is imposed on trustees carrying out certain functions such as exercise of the power of investment, appointment of agents, nominees and custodians, and review of arrangements with such parties. The statutory duty of care requires a trustee to exercise the care and skill that is reasonable in the circumstances, having regard to any special knowledge or experience that the trustee has or holds itself out as having (a subjective standard) as well as, in the case of a professional trustee, any special knowledge or experience that is reasonably expected of a professional trustee (an objective standard). The statutory duty will replace the common law and equitable rules regarding the duty and standard of care owed by a trustee to beneficiaries of the trust. The statutory duty of care applies to existing and newly created trusts, but it may be excluded by the trust instrument. This is because trust legislation in the jurisdictions considered here create mainly default provisions although some, such as the ones governing perpetuities and accumulations, are mandatory.

As a corollary to the introduction of the statutory duty of care, a number of legislative amendments were made to require a trustee to discharge the statutory duty of care in taking certain actions before the corresponding statutory exemption from liability resulting from such actions could be relied upon. An example would be where a trustee has discharged the statutory duty of care in exercising or renouncing subscription rights offered to the trustee, the trustee will not be responsible for any loss so occasioned.

Singapore and England introduced a statutory duty of care for trustees in 2004 and 2001, respectively, and the formulations of the standards of care in the three jurisdictions are substantially the same. The expectation is that, following the practice that has developed in these jurisdictions after the introduction of a statutory duty of care, professional bond trustees are likely to expressly exclude the application of the statutory duty of care in the relevant trust documentation.

STATUTORY CONTROLS ON TRUSTEES’ EXEMPTION CLAUSES

In Hong Kong, changes were made to introduce statutory controls on exemption clauses used by a remunerated professional trustee. A trustee exemption clause will be invalid to the extent that it seeks to relieve a trustee from liability for a breach of trust arising from the trustee’s own fraud, wilful misconduct or gross negligence or grant the trustee any indemnity against trust property for such liability. These statutory controls apply to new trusts created on or after 1 December 2013, and to pre-existing trusts with effect from 1 December 2014.

As the statutory controls are mandatory, international bond trustees which use a Hong Kong-law governed trust deed should review their exemption clauses to bring them in line with the statutory controls. However, we do not expect a significant change in practice given that trustee exemption clauses typically used by international bond trustees are usually in line with the statutory restrictions. An exemption which limits a trustee’s liability in respect of third party acts and losses incurred other than through the trustee’s wilful default was correspondingly repealed.

Hong Kong is an outlier in the introduction of statutory controls. It was an intentional policy decision to depart from the positions adopted in Singapore and England, both of which decided against it. The Law Commission of England and Wales concluded in its 2006 report that such exemption clauses might be justified in certain circumstances but recommended an approach whereby professional bodies promulgate non-statutory rules of practice requiring that their members, when acting as a remunerated trustee, take steps to ensure that settlors are aware of the implication of any trustee exemption clause in the trust deed. In a statement...
made by the Ministry of Justice in 2010, the Government has accepted and implemented the recommendations in the Law Commission’s 2006 report.

In its 2003 report, the Law Reform Committee of the Singapore Academy of Law recommended against the introduction of statutory limitations to invalidate exemption clauses that exempt trustees from liability for negligence because, among other things, it may have a negative effect on the development of Singapore as an asset management centre, and the statutory duty of care already holds professional trustees to a higher standard of care.

Note, however, that all three jurisdictions have statutory controls on trustee exemption clauses used in specific contexts. For example, s 332 of the Hong Kong Companies Ordinance, s 271 of the Singapore Securities and Futures Act and s 750 of the English Companies Act 2006 render void any provision in a trust deed or contract relating to an issue of debentures in so far as it would have the effect of exempting a trustee from, or indemnifying him against, liability for breach of trust where he fails to show the degree of care and skill required of him as trustee.

POWERS TO APPOINT AGENTS, NOMINEES AND CUSTODIANS
Hong Kong has introduced statutory default powers to appoint agents, nominees and custodians and provided for restrictions on the persons who may act as such appointees and the terms of their appointment. These restrictions do not apply if the appointees are not appointed under the statutory powers of appointment. Therefore, trustees should ensure that trust instruments contain express powers for the appointment of agents, nominees and custodians.

The corresponding provisions under Singapore and English trust law statutes are substantially the same except that Hong Kong has decided not to import the prohibition against a trustee appointing a beneficiary as agent which exists under Singapore and English law. This is as a result of market feedback during consultation, and in light of the fact that there were already a number of safeguards in place (eg the statutory duty of care applies to the appointment of agents when using the statutory power of appointment and there is an obligation to review the appointment). In addition, the English law position was based on a provision in the Trusts of Land and Appointment of Trustees Act 1996 of England and Wales (TLATA 1996) which has no equivalent in Hong Kong.

Similar to Singapore and English law, Hong Kong has also introduced a new requirement to review the arrangements under which agents, nominees and custodians act and requires the trustee to discharge the statutory duty of care before the statutory exemption from liability for appointees’ (or their delegates’) acts or omissions can be relied upon. Although these requirements apply regardless of whether the appointees are appointed under statutory powers of appointment or express powers under the trust instrument, as these requirements can be excluded, trustees should generally be able to continue to rely on express provisions in their trust instruments relating to the arrangement for supervision of their appointees, and provisions exempting trustees from liability for the acts or omissions of their appointees (subject to the statutory controls on trustees’ exemption clauses discussed above).

The existing requirement in Hong Kong that a trustee must deposit bearer securities with a bank has been slightly modified so as to require a trustee to appoint a custodian for bearer securities. This requirement does not apply if the trust instrument permits a trustee to retain or invest in bearer securities without appointing a custodian. Following the practices developed following the introduction of similar provisions under Singapore and English law, we expect trustees to include an express provision in the trust instrument that the trustee is not obliged to appoint a custodian of securities payable to bearer. A related provision in the Hong Kong Trustee Ordinance that absolves a trustee from responsibility for loss incurred by reason of depositing bearer securities with a bank and allows the trustee to pay any fees relating to the custodial arrangement out of the income of the property, has been repealed. In respect of liability for custodians’ acts or omissions, this will need to be covered either under the statutory exemption from liability for appointees upon discharging the trustee’s statutory duty of care, or an express exemption clause. As for fees and expenses relating to the custodial arrangement, this should be addressed either under the statutory charging provision or, as discussed later in this article, preferably by an express charging provision in the trust deed.

“Hong Kong is an outlier in the introduction of statutory controls. It was an intentional policy decision to depart from the positions adopted in Singapore and England…”

REMUNERATION AND REIMBURSEMENT OF EXPENSES
Hong Kong has introduced default provisions on the remuneration of trustees and agents and reimbursement of their expenses which are substantially similar to those under Singapore and English law. As trust arrangements for international bond transactions generally contain express provisions on remuneration of trustees and reimbursement of their expenses, the new default provisions on remuneration of trustees should be of limited practical significance, although it may be useful to bear in mind that in Hong Kong (as in Singapore and England), there is now a statutory entitlement for trustees to pay properly incurred trust expenses out of trust funds. Trustees also have the statutory power to pay reasonable remuneration to their agents, nominees and custodians and their properly incurred expenses out of trust funds. To avoid any uncertainty as to whether the statutory entitlement applies in these jurisdictions (and in particular whether remuneration is reasonable in the circumstances), trustees should continue to rely on express provisions in the trust instrument on remuneration and reimbursement of expenses of a trustee and its appointees.
**BENEFICIARIES’ RIGHT TO REMOVE/ APPOINT A TRUSTEE**

In the absence of any provision to the contrary in the trust deed, a new power is granted under the Hong Kong Trustee Ordinance to all beneficiaries of full age and capacity who are absolutely entitled to the property under trust to direct the retirement and appointment of trustees without the involvement of a court.

As this power does not apply if the trust instrument expresses a contrary intention, we expect professional trustees acting in the context of bond transactions to continue to provide expressly for the appointment and removal of trustees and displace the operation of the statutory provisions.

The new power is similar to the power set out in a 19 of TLATA 1996 of England and Wales but Hong Kong expressly covers both individual and corporate beneficiaries. No such power is granted to beneficiaries under Singapore law although courts have the power to order the substitution of trustees. In addition, trust deeds can expressly provide who is to appoint new or additional trustees in certain specified situations, eg on the trustee’s death.

**POWER TO INSURE**

Prior to the recent reforms in Hong Kong, the statutory power to insure granted to trustees was rather limited in terms of eg risks covered, amount insured and source of payment for insurance premium. The changes empower the trustee to insure any trust property against loss or damage due to any event and to pay premiums out of trust funds. These changes bring Hong Kong’s statutory insurance power in line with those under Singapore and English law.

**AUTHORISED INVESTMENTS**

The relevant Singapore and English trust law statutes confer on trustees a default general power of investment subject to express restrictions or exclusions under the trust deed. In exercising any power of investment and in reviewing such investments, a trustee is required to have regard to standard investment criteria (ie suitability and diversification), and (unless it is unnecessary or inappropriate to do so) obtain and consider proper investment.

Based on the lessons learnt in the global financial crisis, Hong Kong decided not to introduce a general default power of investment. Instead, it has chosen to retain the current prudent approach of providing for a default power to invest in a defined list of authorised investments which is subject to review from time to time to reflect market needs and developments. However, similar to the relevant Singapore and English trust law statutes, Hong Kong subjects investment decisions to the statutory duty of care.

Having regard to the risks posed by structured products, structured products (as defined in the Hong Kong Securities and Futures Ordinance) were excluded from the scope of default authorised investments. On the other hand, in response to market feedback during consultation, the scope of authorised investments in shares was expanded. These changes are however of limited practical significance as trust instruments used in international bond transactions usually expressly provide for the scope of authorised investments.

**RULE AGAINST PERPETUITIES AND RULE AGAINST EXCESSIVE ACCUMULATIONS**

Simultaneously with the amendments to the Trustee Ordinance, Hong Kong also introduced changes to abolish the rule against perpetuities and (in relation to non-charitable trusts) the rule against excessive accumulations for trusts created after 1 December 2013.

The abolition of the rule against perpetuities, which is complicated and unclear in its application, is welcome to bring more certainty to the operation of trusts in the context of capital markets transactions such as the issue of perpetual non-redeemable debentures.

In relation to charitable trusts, where a duty or power to accumulate income under the trust instrument goes beyond 21 years, such duty or power would, following the changes, cease to have effect after 21 years. After this period, the income must be distributed to persons entitled or applied as if there had been no duty or power to accumulate income. Charitable trusts are used in repackaging transactions as issuers of the repackaging notes are often orphan special purpose vehicles the shares of which are subject to a charitable trust. However, since the terms of repackaging transactions are such that issuers do not accumulate any income, the rule against excessive accumulations is unlikely to have any practical impact on these types of transactions.

The Hong Kong reforms in relation to these rules go beyond those under Singapore and English law. In these jurisdictions, the rule against perpetuities is preserved and a fixed overriding perpetuity period is imposed (100 years under Singapore law and 125 years under English law).

The rule against excessive accumulations was abolished in Singapore with respect to new settlements, with settlements prior to 2004 still being subject to one of the six statutory accumulations periods. For private trusts governed by English law, the accumulation period may extend for the whole of the perpetuity period, whereas for a charitable trust, the accumulation period is limited to 21 years or the life of the settlor.

**CONCLUSION**

Many of the changes to the Hong Kong trust law regime bring it into close alignment with Singapore and English law, allowing international bond trustees to take a consistent approach across the three jurisdictions in relation to most of the areas discussed above. However, the differences in the approaches to trustee exemption clauses means that trustees must ensure that when using a Hong Kong law-governed trust deed, the trustee exemption clauses are brought in line with the statutory restrictions in Hong Kong (and in the case of all jurisdictions, in line with specific restrictions on trustees that apply in specific contexts eg issue of debentures by a local company). When working on a Hong Kong transaction, it is important for bond trustees to ensure that the scope of authorised investments is sufficiently wide given that there is no statutory general power of investment in Hong Kong.