An Alternative Australian Trusts Act:

Empirical and Implementation Perspectives

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The University of Sydney Business School and the Financial Services Council

Contents

1 Executive Summary

In this research report (Report), the Financial Services Council and The University of Sydney Business School elaborate on their earlier research report recommendation for the enactment of an Alternative Australian Trusts Act (Cth) (AATA).

The Report presents the findings of field research, carried out by Dr David Chaikin in Singapore and Hong Kong (China). Dr Chaikin interviewed lawyers, industry practitioners, government officials and academics to glean an insight into what drove these city-states to reform their trust law. The field research highlights certain elements of the political and economic landscape in Singapore and Hong Kong which bore on the process and content of reforms and which hold significant comparative value for Australia. A key theme which emerged was the need to adapt their trust law infrastructure to meet modern requirements and remain internationally competitive.

The Report further provides a workable blueprint for an AATA, including how it could be achieved in a common law federation such as Australia, what it might include, and who would be the likely participants. The potential benefits of an AATA are enhanced financial services exports to the Asia Pacific region and modern legal infrastructure for the benefit of consumers. These benefits address key themes in the Financial System Inquiry Interim Report on financial integration and consumer protection.

A case is presented in support of an AATA, so as to boost the trustee, wealth management and private banking sectors, which in turn will promote GDP, tax revenue and employment growth in Australia. Modernising and codifying Australian trust law is essential to ensure that Australia's regulatory structures are competitive with other sophisticated financial system economies, including the UK, US, Singapore and Hong Kong.

However, without complementary reforms to Australia's tax system, some of the key benefits of an AATA may not be realised.

2 The Interim Report and AATA

This Report deals with a number of matters that the Interim Report has addressed. First, the Interim Report advocates for "greater financial integration with the rest of the world, provided it doesn't compromise appropriate standards for financial stability and conduct in Australia" (FSI Interim Report, 2014: 4-85). In particular, the Interim Report acknowledges our earlier research report findings, that a major impediment to financial integration is "Australia's trust law needing greater codification to promote better understanding globally of our regulatory structure in a number of private wealth, debt and equity products" (Ibid, 4-84).

In this Report we elaborate as to how a Commonwealth AATA might work in practice to enhance financial integration, especially in the Asia Pacific region, and provide new legal infrastructure for the benefit of Australian consumers. Not only will an AATA improve corporate governance in relation to the trust sector, it will make a major contribution to the underlying regulatory infrastructure governing Australia's financial services markets. Moreover, the AATA proposal is smart reform - instead of creating yet another layer of regulation, it provides an alternative framework that gives trust users a choice of legal infrastructure.

The AATA proposal is for a modern, codified trust law regime which would govern the role and activities of fiduciary intermediaries vis-a-vis consumers of financial products that are generally not part of the secondary securities market. The secondary market involves investors purchasing securities or assets from other investors, rather than from the company that issues the security. In Australia, non-secondary markets (and some secondary markets) typically involve a fiduciary intermediary. A fiduciary intermediary may be positioned between the issuer of the security and the consumer, or may be the issuing entity itself.

Trust law reform in Australia could serve the dual international and domestic objectives of boosting financial services exports and a new method of consumer protection. We suggest that the following three benefits would flow from a modern, codified and nationally consistent trust law:

1. An AATA regime would provide certainty and efficiency. We expect that a comprehensive legal framework would remove the current necessity for meticulous due diligence, complex negotiations, trade-offs, risk reallocation, cost shifting and highly complex trust documentation, which in turn would minimise transaction costs and delay and reduce the likelihood of litigation (D'Angelo, 2014: 24). The stability and accessibility of an AATA would attract offshore investors from the broader Asia Pacific region and would bolster the protections for domestic retail clients because the role and powers of the fiduciary intermediary would be more certain.

2. An AATA could deal with trust insolvency and could regulate the proper distribution of risk among the participants in the relevant financial market. If trusts are to continue to be used as an instrument of commerce it is critical that the risk profile of trust entities is determined by public policy.

3. The AATA Proposal would establish a specific regime to empower and regulate licensed, capital-backed, fiduciary financial institutions. Such fiduciary institutions could better serve as gatekeepers for the financial services industry by taking a more active role in protecting consumers, which in turn could relieve some of the regulatory burden on ASIC and APRA.

It is important to note that the AATA Proposal is not just a proposal for regulation in an area where there is currently none, or for more regulation in an area that is partly unregulated. It is a proposal to turn trust law into statute law, and in the process, to do away with the current jumble of common law and legislation, state-based law and federal law, and to build a regime similar to company law that will serve the use of trust structures for both personal and commercial purposes in the future.

The evidence that supports the AATA proposal is the evolving use of trust structures in Australia - the ancient concept of the trust remains in widespread use in 21st century Australia; however it has evolved from a device to pass private wealth from one individual to another into a fully-fledged business entity (D'Angelo, 2014A: 1-3). As a business entity the trust suffers from all the risks that attach to other business entities, but trust law in its current form does not envisage the use that is made of trust structures today. At a high level, there is very little difference between a commercial trust and a company and little justification for not applying appropriate legal infrastructure to both.

As noted in our earlier research report, Singapore, Hong Kong, New Zealand, the United Kingdom (UK) and the United States (US) have all taken steps in recent years to modernise and codify trust law, so as to deal with the trust phenomenon. Australia is in a unique position to learn from the trust law reform efforts of these financial centre economies and to use these as a base for building its own fit for purpose regime. Trusts are a major part of the Australian financial services landscape and a comprehensive and modern regime to govern them would be an immense advantage to Australia.

3 Field Research - Singapore and Hong Kong (China)

In order to enhance our understanding of the operation and impact of the trust law amendments in Singapore and Hong Kong, we carried out a research visit to both jurisdictions in July 2014. Besides collecting relevant research materials, we conducted informal, semi-structured interviews with government officials, academics, financial institutions, lawyers, accountants and trust law practitioners. The interviews took place on a non-attributable basis which allowed a greater openness especially in relation to government officials.

In the following descriptive analysis based on the interviews, we have not attributed any comment or view to a specific individual or organisation. The interviews confirmed much of the analysis on Singapore and Hong Kong in our earlier research report (Chaikin & Brown, 2014: 15, 22-8). However, our research visit also gathered new perspectives on the significance of reform of trust laws that may prove useful in understanding the challenges and opportunities in enacting an AATA.

4 Singapore

4.1 Motivation for change in trust law

Trusts in Singapore were historically used for intergenerational transfer of wealth among the patriarchs or founders of major private business empires. The Singaporean trust industry conducted little overseas business, but this has changed under the influence of the Singaporean Government, which has had a keen interest since the 1980s in making Singapore a major regional and international financial centre.

It is the Singaporean authorities that have been the main driver for change in trust law. The motivation for amending the *Trustees Act* (Cap 337) was partly to modernise the trust law regime, influenced by the fact that the UK had updated its law in 2000, but was principally to enhance the wealth management sector in Singapore, by enacting trust law reform ahead of Hong Kong. The enactment of the *Trust Companies Act* (Cap 336) was also designed to grow the private banking and wealth management industries in that it provides a framework for ensuring that only highly reputable persons operate in the trust services industry.

The Singaporean government has taken a holistic approach to improving the competitive position of its trust industry. When implementing changes in the trust law in 2004/5, the Singapore tax regime was simultaneously amended so as to create new tax incentives for non-resident investors and foreign beneficiaries under a simplified tax regime. The view in Singapore among trust law practitioners is that without the tax changes, the use of Singapore trusts would not have increased to the same extent.

4.2 Impact of change in the trust law

According to trust law practitioners, Singapore had previously suffered from a reputation of being an overly conservative trust law economy, as compared to more sophisticated offshore trust regimes in the Caribbean. Consequently, the majority of foreign trusts administered in Singapore tended to be relatively simple, usually holding "merely investable assets" (Binnington & Choi, 2014). It is argued that the enactment of the amendments to the *Trustees Act* has changed this perception, with increased foreign demand for Singapore trusts, and foreign trust companies setting up Singapore offices and using "more complex structures holding less conventional assets" (Ibid).

Although the trust law amendments form part of an evolutionary pattern of updating Singapore's commercial laws, they have had a wider impact in that they have cemented Singapore's reputation as a sophisticated wealth management centre. There is a general consensus that the benefits of the changes in the *Trustees Act* have been shared by all industry participants, not just one sector such as the major banks.

The main marketing points of trusts after the amendments have been described by legal practitioners as: expanding the period for the rule against perpetuities and accumulation of income (ss 88 & 89); reserving powers of investment and asset management functions to the settlor without invalidating the trust (s 90(5)); and creating a firewall against foreign "forced heirship" laws (s 90(2)).

By giving statutory recognition of settlors' reserving powers of investment and asset management, section 90(5) has provided greater flexibility in the operation of the modern trust. Interviewees pointed to the changing nature of assets held within trusts as justification for allowing settlor oversight of investment and asset management operations for the trust. The modern trust is characterised by assets in the form of income producing personal property rather than exclusively real estate holdings, coupled with a demand that trustees manage the trust for the purpose of capital growth not merely capital maintenance (Houston, 2005: 1734-5). The changing circumstances has resulted in trustees being given "much more discretionary powers over the disbursement of trust assets than occurred centuries ago"(Ibid). Further, the increasing complexity of managing the assets of a trust has resulted in settlors arranging for professional trustees to manage the assets (Ibid, 1736; Langbein, (1995): 644).

The promotion of Singapore trusts to foreign High Net Worth Individuals (HNWIs) and families is facilitated by section 90(2) which provides that "no rule against inheritance or succession shall affect the validity of a trust or the transfer of any property to be held on trust if the person creating the trust or transferring the property had the capacity to do so" under section 90(1). The relevant legal capacity may be derived from Singaporean law, the law of domicile or nationality of the person creating the trust or transferring the property, or the proper law of the transfer: s 90(1). Section 90(3) further provides that the asset protection/firewall provision does not apply if the person creating the trust or transferring the property is a "citizen of Singapore or is domiciled in Singapore", in which case Singaporean succession laws may apply. The asset protection provision against foreign forced heirship laws can only be used where the trust instrument provides that it is "governed by Singapore law and the trustees are resident in Singapore": s 90(3).

The effect of section 90(2) and section 90(3) of the *Trustees Act* is to enshrine a public policy in Singapore to prevent enforcement of foreign forced heirship laws against trusts that are governed by Singaporean law, where the trustees are Singaporean residents, and the settlors are neither Singaporean citizens nor domiciled in Singapore. This statutory provision is attractive to citizens from certain civil law jurisdictions in Europe and Latin America, but also citizens in Asia/Pacific jurisdictions such as Indonesia. Indeed, Indonesian nationals who are resident but not domiciled in Singapore would be able to rely on Singaporean law to protect their assets from the complex and rigorous forced heirship laws under the Islamic law and Civil Code of Indonesia (Bunjamin, Darmawan & Adiyasa, 2012).

Although the changes to the *Trustees Act* are important, there are several other relevant factors that interviewees suggested may have contributed to Singapore's attractiveness as a trust law jurisdiction. There is general agreement concerning the considerable tax advantages, such as tax transparency for offshore resident investors, whereby there is no tax applicable to distributions to foreign beneficiary investors.

Some interviewees pointed to the geographic location of Singapore, including its physical proximity to Indonesia, while others suggested that financial secrecy is still important, although it has become less significant given the increasing global demands for financial transparency. One interviewee linked the utilisation of Singaporean trusts to the availability of quality investment management expertise. In Singapore most trust structures are passive, with trustees employing professional investment managers to give advice and to manage investments. There are an increasing number of savvy and reputable investment managers who are licensed in Singapore and used by trustees.

This observation has particular relevance to Australia in that it shows that if Australian trusts were more greatly used by foreign investors, there would be collateral benefits such as an increased use of investment management expertise in Australia.

One of the difficulties of assessing the impact of changes in trust law in Singapore is the dearth of trust law litigation and court rulings. However, academics in Singapore consider that Singapore trust jurisprudence is likely to follow traditional English trust law principles, apart from instances where Singaporean statutory law has diverged from the English legal position.

There is little public material showing the extent to which settlors in foreign (especially civil law) jurisdictions are using Singaporean trusts. Although the Monetary Authority of Singapore (MAS) requires all licensed trustee companies to provide statistics about the size of trust business and geographical source and destination of funds, it does not publish any figures concerning the specific countries which are the source or destination of funds. For example, Singapore has stated that 80% of total Assets Under Management (AUM) is sourced from outside Singapore (MAS, 2013), but there is no breakdown by country or region concerning the source of those funds. The MAS has not provided any reason why it does not publish such information, albeit that the trust company industry would find such information very helpful in benchmarking their activities and performance.

4.3 How important is settlor control?

As was mentioned in our first report, there has been a paradigm shift in the importance of settlor autonomy in the development of offshore trusts (Chaikin and Brown, 2014:6, 29). Settlor autonomy is related to other trust issues such as settlor control, and the general rule that settlors have no standing to enforce the terms of a trust which they have created (Houston, 2005: 1734).

One of the critical questions is whether the demand by settlors to exercise continuing or effective control over the trustee and the trust will result in some trusts being considered to be shams. The consequences of a trust being held to be a sham are dramatic, in that the trust will be invalid and unenforceable, and the trust assets may be considered to be held on a resulting trust in favour of the settlor or the transferor of the assets (Pryke, 2005: 11-3). This will mean that the assets will be treated as those of the settlor, and so available to the creditors of the settlor.

A leading academic pointed out that in Singapore there is no judicial case concerning sham trusts and this may be because of the practical obstacles to proving a sham; it is difficult to obtain admissible evidence concerning abuse by a settlor of the trust partly because of financial secrecy.

Tax exposure is also a significant issue for settlors. There is a potential conflict between the desire of settlors to exercise control over the distribution of the trust's assets and tax policy, which in most jurisdictions will require settlors to give up control over those assets (Houston, 2005: 136-8). There is a risk that the courts will treat the trust as a sham or as an alter ego of the settlor with adverse tax consequences (Pagone, 2012), albeit that Australian courts are reluctant to hold trusts as shams (Kirby, 2008).

There is another complication in that historically settlors in civil law countries have found the concept of a trust difficult to understand, and so many wealthy families prefer to use offshore companies to manage their wealth. According to one trust law practitioner, Indonesians and mainland Chinese clients have been uncomfortable using trusts because of their lack of familiarity with the trust concept and their concern about the lack of control by settlors. These concerns may become less significant as China has enacted its own trust law as part of its development of a "modern system of private law" (Ho, 2010: 124), and Chinese legal and business advisers become more familiar with trust law concepts.

4.4 Recognition of offshore trusts

We have previously observed that Singaporean law has recognised the validity of and is prepared to enforce foreign trusts, subject only to public policy considerations (Chaikin and Brown, 2014:14). As we observed in our first report: "This meant that, for example, an expatriate German national settlor could establish a non-charitable purpose (Cayman Islands) trust, and the trust would be recognised in Singapore, permitted to carry on trust business in Singapore and could even be enforced by the courts in Singapore, subject only to the condition that the trust not offend broader public policy" (Ibid, 24).

We have little information as to whether and to what extent offshore trusts have been recognised in Singapore. An academic trust law specialist suggested that Singaporean judges are likely to recognise non-charitable purpose trusts that are foreign domiciled trusts, as these trusts are not generally viewed as being contrary to public policy. On the other hand however, the same specialist suggested that it was unlikely that the Singaporean courts would recognise foreign trusts with more extreme debtor-friendly clauses, such as a Cook Islands asset protection trust, as such a trust would offend the bankruptcy and family law legislation of Singapore.

4.5 Licensing Regime for Trusts

Interviewees suggested that one of the major reasons why Singapore is attractive to the international wealth management business is that it offers a high degree of protection to foreign investors through its reputable licensed trustee companies. The mandatory licensing of all persons carrying on trust business in Singapore is said to be vital to protect the interests of foreign investors. It is also considered to be a competitive advantage vis-à-vis Hong Kong which has no such registration or licensing system. A licensing requirement would appear to impose significant pressure on trustee professionals to comply with all laws, including Anti-Money Laundering and Counter-Terrorist Financing Laws. The risk for a licensed trustee in breaking these laws or acting unethically is that the government could revoke its license, which in turn would diminish its business livelihood. The risk is compounded by the fact that it is a crime under section 3 of the *Trust Companies Act* for any person to carry on any trust business in or from within Singapore unless that person is a trust company licensed by the MAS.

A trust company license is not required for certain specified persons, such as "advisors on wills, executors and administrator of the estate of deceased persons...as the trusts involved are not actively used for investment and wealth planning purposes"(MAS, 2014; *Trust Companies Act* s 3(2) & Second Schedule). There are also various categories of persons who are exempt from holding a trust company licence, such as banks, holders of a capital markets services license for providing fund management or custodial services for securities, lawyers and accountants, private trust companies, overseas persons, trustees of a collective investment scheme, and persons carrying out introducing activities: *Trust Companies Act* s 15, *Trust Companies (Exemption) Regulations).* Companies exempt from holding a business trust license are nevertheless subject to various reporting requirements under the *Trust Companies Act*.

The licensed trust companies in Singapore provide investment and wealth management services, including succession planning, to affluent families in Singapore and overseas. Many of the licensed trust companies operate as offshoots of family offices headquartered in other countries. There is one listed trust company in Singapore, namely the British and Malayan Trustees Limited, which is the oldest trust company in Singapore

In Singapore there are about 5-6 financial institutions that are "fully-fledged" trust companies, in that they have licenses in respect of various lines of trust business. Typically, fully-fledged trust companies have capital markets services licenses under the *Securities and Futures Act (Cap 289)* in relation to the provision of custodial services for securities and real-estate investment management, and financial advisers' licenses in relation to collective investment schemes under the *Securities and Futures Act*. Typically these companies are exempt from holding a trust company licence for their wealth management business because they are already intensely regulated by the MAS.

There is a separate regime for the registration and regulation of business trusts under the *Business Trusts Act* (Chapter 31A). It is the trustee/manager which applies for registration of a business trust. According to MAS, there are 25 listed business trusts as at August 2014, which is a significant increase from the 10 listed business trusts as at May 2012 (MAS 2014A). The reasons for the growing popularity of business trusts both from the viewpoints of the sponsoring entity and investors are matters that require further investigation, should the Australian authorities decide to implement trust law reform (see Tang, 2012).

5 Hong Kong (China)

5.1 Motivation and the reform process

The Hong Kong government's consideration of amendments to its trust legislation started officially in 2008, but the process actually began at an earlier date. Most of the Hong Kong reforms were based on the reforms to the United Kingdom trust law in 2000, and to a lesser extent, on the reform of Singaporean trust law in 2004/2005.

The reform of Hong Kong's trust law was an industry driven initiative that was facilitated by the Hong Kong government through an extensive consultative process. Some interviewees claimed that this reform process was inordinately long compared to Singapore, and this has resulted in a loss of business opportunities for Hong Kong. This reflects a general concern of the private sector that Hong Kong does not have a sufficiently committed political leadership in the corporate/corporate securities/trust law space. The delay was probably compounded because Hong Kong's reform process took place after the Global Financial Crisis (GFC), whereas Singapore had the good fortune to revise its laws prior to the GFC.

5.2 Size of trust industry & impact of trust law amendments

Statistics are difficult to find concerning the size of the trust industry in Hong Kong. There are a large number of lawyers in Hong Kong who have significant practices involving trusts. It is estimated by one interviewee that there are about 20,000 trust and corporate service providers in Hong Kong. According to one survey carried out by the Hong Kong Trustees' Association, there is about $2,600 Billion of assets managed by Hong Kong trustees as at the end of 2011 (Hong Kong Trustees' Association, 2013).

Apart from these estimates, there are few statistics concerning the trust industry in Hong Kong. There are no government statistics concerning the size of the trust sector, or the extent to which assets under management (AUM) are held through trust vehicles as compared with the use of companies or partnerships or other alternatives to trusts. The Hong Kong Government's ability to collect statistics is hampered because there is no register for trusts, no register for trustees, and no register for trust companies in Hong Kong. There is also no mandatory reporting of trusts to the Internal Revenue because there is no tax payable by foreign owned trusts.

5.3 Key trust law amendments

According to trust law practitioners, the key changes which have proved useful in practice are: the abolition of the rule against perpetuities and the rule against excessive accumulation of income; the enhancement of trustees' default powers so as to "facilitate effective administration of trusts" (Hong Kong Trustees' Association, 2013); the creation of reserved powers to settlors in relation to investment and asset management (s 41X); the removal of risks and liabilities faced by trustees who act on settlors' instructions (s 41X(3)); the new statutory duty of care of trustees (s 3A); the restrictions on exemptions of liability (s 41W); and firewall provision against forced heirship laws (s 41Y).

At common law, it is well accepted that professional or paid trustees have a higher duty of care as compared to unpaid trustees, given that professional trustees hold themselves out as having special expertise (see *Barclays v Barclays Bank Trust Co Ltd* [1980] Ch 515 at 534). In Hong Kong a new statutory duty of care in section 3A of Part 1A of the amendment Ordinance reflects this distinction. It provides that a trustee must exercise "the care and skill that is reasonable in the circumstances" taking into account "any special knowledge or experience" that the trustee has, or holds itself out as having, or that is reasonably expected of a professional or paid trustee. The statutory duty of care only applies to trustees when they exercise certain powers as specified in the Third Schedule, such as the power of investment.

There are restrictions on exemption clauses in trust instruments relating to the modification of the new statutory duty of care imposed on professional or paid trustees. Section 41W of Part IVC of the amending Ordinance provides that a trust instrument cannot "relieve, release or exonerate a trustee from liability for breach of trust arising from the trustee's own fraud, wilful misconduct or gross negligence". Accordingly, it is not possible for professional or paid trustees in Hong Kong to exclude their liability for conduct amounting to gross negligence. Some trust law practitioners in their submissions to the Hong Kong government, argued that there should be no statutory regulation of trustee exemption clauses, as is the position in England, and that the matter should be left to the common law and market practice (Hong Kong Legislative Council, 2013: 88-90). However, there is a lively debate as to whether the common law allows a trustee to be exempted from liability for gross negligence in that there is an 'irreducible core' of minimum obligation on trustees which cannot be removed by a trust instrument.

It would appear that most trust law practitioners in Hong Kong do not seem to be overly worried about the new statutory duty of care and the limited ability of trustees to modify their duty through the trust instrument. The reason for this may be that it is not evident whether the courts would be prepared to countenance professional or paid trustees from exempting themselves from liability for grossly negligent conduct (Ahern, 2013). Another reason may be because of the increased protection available to trustees who act on settlors' instructions, a matter which is discussed below.

One leading trust law practitioner suggested that the reservation of investment powers to the settlor is perhaps the most significant amendment to the trust law. Hong Kong's amendments are similar to Singapore in relation to the reserved powers of investment for settlors, with one important practical difference. Section 41X of Part IVD of the amending Ordinance provides that a trust is not invalid merely because the settlor reserved certain powers of investment and asset management under the trust instrument. Hong Kong law goes further than Singapore in that it provides by section 41X(3) that a trustee who acts in accordance with instructions from the settlor under such reserved powers is not in breach of trust.

This means that if the trustee complies with the settlor's instructions, for example, in relation to investment and/or asset management, or distribution of assets and income under a letter of wishes, any allegation of a breach of trust is not sustainable as a cause of action, because the trustee is deemed not to be liable when acting on instructions. Of course, this does not mean that the trust might not be held to be a sham, but from the perspective of the settlor and the trustee, there is a new allocation of risk and responsibility.

In effect, the Hong Kong law has created a new balance by protecting the interests of beneficiaries through the enactment of a statutory duty of care owed by trustees and imposing a limit on exemption clauses, while giving comfort to trustees who act in accordance with settlors' instructions. The approach of Hong Kong has much to recommend it if the Australian authorities decide to impose a statutory duty of care on trustees.

5.4 Private purpose trusts

The Hong Kong trust industry is generally satisfied with the changes in the legislation, with the Joint Committee on Trust Law Reform (JCTLR) obtaining most of the reforms that it advocated. Indeed, of the 18 issues that the Hong Kong Government raised through the public consultation process, there was only 4 matters that did not proceed to legislation: whether there should be statutory definition of a protector; whether beneficiaries should have a right to information; whether there should be a codification of the governing law of trusts; and whether the law on non-charitable/private purpose trusts should be altered.

A significant change which the JCTLR did not obtain, was the reform of the law governing non-charitable/private purpose trusts which was opposed by the more conservative members of the legal fraternity. One of the issues concerned who, in the absence of human beneficiaries, would have standing to enforce the trust, given that the Attorney-General of Hong Kong is unlikely to consider that this was his/her responsibility.

5.5 Beneficiaries' right to information relating to the trust

A number of interviewees considered that they should have pushed harder for statutory reform in relation to access to information by beneficiaries under a trust. Presently, the law is so uncertain, that in order for trustees to protect their position, it is necessary to obtain a senior barrister's opinion on whether they are obliged and/or required to supply information to a beneficiary. This legal morass is not confined to Hong Kong, but is also apparent in other common law jurisdictions. As a leading Australian judge has observed, there are conflicting judicial opinions as to the principles to apply so as to "compel a trustee to disclose documents to someone who has either a right to receive or a prospect of receiving some or all of the trust property" (Campbell, 2008:1). One of the interviewees suggested that statutory reform would reduce legal uncertainty on a very practical issue. However, the issue is complex, and is one of the matters that will require further consideration.

5.6 Licensing of trusts

The trust services industry in Hong Kong has expressed interest in the licensing/regulation of trustee business in order to enhance its reputation, which is critically important in light of the adverse publicity and scandals arising in the financial services industry post GFC.

There is currently no plan for Hong Kong to emulate Singapore and introduce a licensing regime, albeit that the industry is not opposed to such legislation. The issue is whether any licensing regime would be "light touch" such as Singapore, or whether it would be "heavy handed" imposing considerable compliance costs, thereby making Hong Kong less competitive than Singapore in trust wealth management business.

5.7 Business trusts

In Hong Kong, there is extensive use of Cayman Islands STAR trusts, which have a number of advantages both in the wealth management space but also in relation to business trusts. There is no proposal to enact a business trust regime in Hong Kong in the near future.

6 Australia as a Federation and a Financial Centre

Australia aspires to establish itself as a major financial centre in the Asia Pacific region, where the demand for trusts is rocketing, not only to serve the needs of the emerging HNWI market but also for the purpose of business and trade in financial assets (Chaikin and Brown, 2014: 5-6). While Australia has been an innovative leader in the retirement savings field and has successfully created a $1.9 trillion superannuation savings system, it has been less successful in establishing itself as a major exporter of Australian wealth management services.

The statistics are stark both in absolute and comparative terms as to Australia's export record on financial services. Only 3.5% of all funds under management in Australia are sourced from foreign investors, which compares unfavourably to Hong Kong and Singapore, both of which manage 65% and 80% in offshore funds respectively (Deloitte, 2014: 1, 6). As the mining boom slows, a focus on promoting Australia's financial services exports to the Asia Pacific region could potentially boost GDP by $4.2 billion, create 10,000 new jobs over the next 15 years and deliver an additional $1.2 billion in annual tax revenue to the federal government (Eyers, 2014).

In our previous report we have explained how the absence of modern and efficient legal infrastructure, in particular the application of outdated, state-based trust laws to modern trusts, is a major obstacle to the export of Australia's wealth management industry (Chaikin and Brown, 2014). The key problems with the current trust law are: a lack of development in the commercial context; limited accessibility for non-lawyers/non-experts due to the lack of codification of the law; no executive government body such as ASIC to monitor and enforce the law; and supervision by the state supreme courts, which cannot act on their own initiative and provide remedies purely at their discretion, which in turn fosters great uncertainty (D'Angelo, 2014: 23). It is imperative that the federal government takes steps to remove this barrier to trade and to provide greater access to new markets (Eyers, 2014).

There are a number of differences between the political and legal systems of Australia on the one hand and Hong Kong and Singapore on the other. These differences make it easier for our Asia Pacific neighbours to imitate law reform in Australia, than vice-versa. Singapore's *Business Trusts Act*, for instance, is substantially based on Australia's managed investment scheme (MIS) regime (chapter 5C of the *Corporations Act 2001* (Cth)). Despite the similarities, the *Business Trusts Act* departs from the Australian legislation in certain key areas; generally those that have been problematic for Australia. The Singapore legislation is also innovative and novel in its own right. For example, a Singaporean business trust can be used for both collective loan capital and collective equity investment schemes (debt and equity capital market structures); whereas Australia's MIS laws only regulate equity investment schemes where the investors are retail clients. The Singaporean approach has been to adopt the parts of the Australian law that work well, to fix the parts that don't, and to bolster the law by including unique features, suitable for the Singaporean context. Consequently, the *Business Trusts Act*, while based on the Australian law, is purpose built for Singapore. This is not to detract from the value of examining the content of Singaporean law on business trusts, but rather to demonstrate the need for a different mechanism for implementing trust law reform in Australia.

Australia is the only common law federation in the Asia Pacific region (apart from countries such as Malaysia and India, which have mixed systems of law). Independent government operation within the separate states of Australia's federation does not always impede national progress (Richard H. Leach, 1963: 206-223); however, in the context of financial markets, as people and economies become more integrated, the lack of a uniform approach may become a more serious impediment to Australia's progress as a financial centre in the region. Australia has a comprehensive and uniform disclosure regime, which is generally appropriate for secondary securities markets, but it does not have a uniform regime governing the role and conduct of fiduciary intermediaries. As we observed in our first report, the role and conduct of corporate fiduciaries is governed primarily by a collection of common law and state-based trustee legislation and administratively by various regimes within the Commonwealth *Corporations Act* (Chaikin and Brown, 2014: 7-9).

Because Australia is a common law federation, nation-wide trust law reform could be achieved through two legislative avenues – uniform model laws (Model Laws) that are adopted at the state level or implementation of an AATA at the federal level. For reasons that are set out in this report, we consider that the best option for Australia is the enactment of a federal AATA.

The US has achieved trust law reform through Model Laws, rather than through an alternative regime such as an AATA. However, the US experience on trust law reform is still relevant to Australia in terms of implementing reform in a federal, common law system. The US has effectively turned trust law into statute law and has achieved close to full national adoption of Model Laws at the state level. The US recognised the need for uniform trust law early. Five separate pieces of uniform trust law fed into the current *Uniform Trust Code 2000* (US), which is described as "the last step in a trend toward statutory intervention in American trust law that has been underway for decades" (Langbein, 2007: 1069). One leading US trust law academic explains that the recent trend to turn common trust law into statute law is due to trusts today bearing only a distant resemblance to the trusts of the 14^{th}-19^{th} centuries (Ibid, 1071). This observation is especially relevant to Australia, in light of its unique use of trust structures for trading purposes.

US trust law is now, on the whole, nationally consistent and has evolved to suit the changing use of trust structures for commercial purposes. A renewed focus on how Australia might promote the export of its financial services is an opportunity for Australia to look to economies such as the US, Singapore and Hong Kong for inspiration on the development and modernisation of trust law, rather than doing what it has always done, that is, looking back to ancient English trust law that is no longer fit for purpose.

As stated above, while one option for Australia is to follow the US route and seek to achieve trust law reform through the implementation of Model Laws at the state level, we do not recommend this approach, as it would require an agreement between the Commonwealth and the states and territories through a formal Council of Australian Governments process. There would be substantial difficulties surrounding jurisdiction and powers and all the states and territories would need to buy-in to the reforms and be willing to negotiate. There is also a risk that certain types of trusts would be carved out of the regulatory scope of the Model Law due to the added complexity of trying to include them. For example, a Model Law may be expressed not to apply to MISs, which might then continue under the current Chapter 5C regime. This means a Model Law approach could result in yet another piece of standalone trust law, applying only in certain circumstances and in conjunction with all other existing trust law. In addition, Australia does not have a successful track record in implementing Model Laws at the state level, as demonstrated by our painful experience with corporate law reform.

At the core of this trust law reform proposal is that Australia can achieve a range of economic benefits by modernising and reforming its trust law. However the extent of the economic benefits, and the speed and ease in which they might be achieved, will hinge on the approach to legislative reform that is adopted. This is why we suggest that Australia takes a new approach in enacting an AATA; an approach that is based on the twin policy objectives of increased consumer protection and promoting Australia's financial services exports. The AATA is a novel concept for two key reasons. First, it suggests an alternative regime that could apply to both personal and commercial trusts as well as debt and equity capital market structures. Secondly, there is no other common law federation, similar to Australia, which has enacted an alternative trust law to operate alongside an original common law regime as a choice of laws.

Enactment of an AATA would not disturb the current state-based trust law infrastructure as it would be an alternative to the current law. Trust users could opt in to the AATA in circumstances where the mandatory features of the regime are acceptable to the trust user. In order to enliven the Commonwealth's jurisdiction in this area, all AATA trusts would require the appointment of at least one corporate, licensed trustee; and all potential AATA trust users would therefore have to be comfortable with appointing such a trustee.

Because an AATA trust would require a corporate trustee, we are confident that the corporations power in section 50(xx) of the Commonwealth Constitution would support Commonwealth legislative action in this area of trust law, which has traditionally fallen within the exclusive jurisdiction of the states and territories (see *State of New South Wales v Commonwealth of Australia* (2006) 231 ALR 1). An AATA would operate prospectively as a choice of law for the trust users of the future. It would not affect the operation or regulation of trusts that currently exist and would be more certain, stable and efficient so as to promote the export of Australia's wealth management industry.

6.1 Need for political leadership and commitment to reform

As noted earlier in this report, in the absence of any strong political leadership in the field, Hong Kong's trust law reform was almost entirely an industry led initiative, which many interviewees thought contributed to the significant time in which it took to achieve the reforms. Similarly, in Australia, we have witnessed countless reviews of the laws affecting commercial trusts, by various review bodies, all of which have failed to address the practical problems associated with commercial trusts and in particular the collective investments regime (D'Angelo, 2014A: 341-2).

In light of this, a critical ingredient for the success of an AATA will be political leadership and commitment to the reforms. Trust law is a little known, technically complex area and the immediate benefit of reforming it is unlikely to be apparent to the public. However, it is also an area that is non-contentious politically. There is no sound reason why trust law reform could not be undertaken as a bipartisan project. An AATA therefore has immense potential to address the problems associated with an out of date body of law and to provide a smart new framework for consumer protection that is politically neutral.

The AATA should be viewed as a technical law reform project which is both necessary and desirable to provide better protection for domestic trust users and a codified regime that will appeal to foreign resident trust users.

7 The Design of an AATA

7.1 Licensing and registration of an AATA

Despite the fact that Australia is somewhat restrained by its federation, it is also supported by other legal/regulatory infrastructure advantages. For example, Australia has an established and sophisticated company law framework and a comprehensive financial services licensing regime. As mentioned above, in order to enliven the Commonwealth corporations power and to give jurisdiction to the Commonwealth in this area, an AATA would need to mandate the appointment of a corporate, licensed trustee. The AATA would harness the current licensing regime and all AATA trust users would have the benefit of well established licensing controls, such as net tangible asset (NTA) requirements, disclosure requirements, professional indemnity insurance, ownership controls, external dispute resolution scheme access and more. The licensing regime would provide some assurance of the robustness of the fiduciary institution responsible for the AATA trust's governance.

The licensing regime could also be refreshed in conjunction with the enactment of an AATA, so as to ensure a level playing field and consistent licensing conditions across all the entities that hold the same form of AATA license. Discrepancies in the current requirements such as NTA levels could be addressed, and broader competition policy could be factored in by identifying and removing barriers to entry to the licensing framework. Consideration could be given to the granting of different subsets of licence or mini licences, such as an AATA Personal Trust licence, an AATA Commercial Trust licence, an AATA Foreign Trust licence, or any combination of these.

The Australian government could also consider a requirement for registration of all AATA trusts. By registration we refer to a form of regulatory measure and record - be that self-reporting, a power to inspect records, or some other method - of the features of an AATA trust, including: the terms of the trust; the identity of the trustee and any trust enforcer; the identity of the settlor(s) and the trust property settled; the trust property at the end of each financial year; and the trust distributions throughout the year (Mack, 2010: 3).

A licensing and registration requirement, or either one of these, would have the advantage of assisting both the AATA trustee and the Australian government to comply with global regulatory anti-money laundering, counter-terrorist financing and tax-evasion initiatives, such as the US Foreign Account Tax Compliance Act. The mandating of such requirements might also cement Australia's reputation as a leading and responsible trust law reformer in global policy making forums, such as the Financial Action Task Force, the OECD, G20 and APEC. As identified through the field research conducted for this report, Singaporean interviewees thought that the mandatory licensing of all persons carrying on trust business in Singapore was vital to the protection of foreign investors, and was also considered to be a competitive advantage over Hong Kong, which has no similar registration or licensing system.

7.2 The Trustee of an AATA

In addition to requiring the appointment of at least one licensed trustee company, the AATA regime could restrict or permit the involvement of non-licensed or offshore co-trustees. Individual or off-shore co-trustees might be desirable in the personal trust or foreign trust space and these issues could be considered and debated as part of an industry consultation process for a new AATA

It would also be necessary, as part of the consultation and design of the new regime, to acknowledge and facilitate the role of other service providers to the AATA trustee licensee.

Because the AATA regime would set out more substantially the powers and duties of the licensed fiduciary or AATA trustee, this would indirectly clarify the scope of the role of other providers including investment managers, insurers, administrators and promoters. The AATA legislation could incorporate an investment manager regime, another issue which has been raised in submissions to this Inquiry, and, as the new Hong Kong trust law has done, provide explicit trustee powers (as the default position) to delegate a range of functions and activities to various agents (Ahern, 2013: 43).

7.3 Scope of an AATA – Personal Trusts, Commercial Trusts, Foreign Trusts

This report does not purport to set out in detail the entire scope of application of a new trust law, nor every provision that could be included in it. A starting point however would be to consider the problems identified in our first research report and the items set out in the Gap Analysis to that report (Chaikin and Brown, 2014: Part 2, Appendix A). The task of designing a new federal trust law might seem difficult, but there is a rich pool of resources available for Australia to build on, to kick-off the process of reform.

The state trustee Acts, and in particular the recent Queensland Law Reform Commission's review of the state's *Trusts Act*, would be a useful place to start for personal AATA trusts (Queensland Law Reform Commission, 2013). The next step would be to look at the *Singapore Trustees Act*, the Hong Kong *Perpetuities and Accumulation*s and *Trustee Ordinances* and the UK and US trustee statutes. In the commercial trusts field, Australia's MIS regime would provide a basis from which to build a new law, and close consideration could also be given to Singapore's *Business Trusts Act*.

In terms of the broad themes that might emerge from a consultation process, we suggest that like the *Corporations Act*, an AATA should be made up of chapters which focus on the different types of trusts that the law will cover. Each chapter of an AATA could include default deed provisions that apply as a matter of law in the absence of a contrary intention in the trust instrument, similar to the replaceable rules for companies. Some default trust provisions may not be permitted to be contracted out of, such as a positive duty of care on the AATA trustee or the restrictions on trustee indemnity from trust assets in cases of breach of trust (Ahern, 2013: 38-41). The AATA regime could go even further and include model deeds or constitutions that could link-in with concurrent trust registration requirements, where these were also introduced.

Other company law features that could be considered for incorporation into an AATA include indoor management assumptions; a more appropriate fiduciary regime that balances the trustee's traditional duty of loyalty with the requirement to govern a trust like one would a company by taking risks to generate investment returns; statutory limitation of liability for investors/beneficiaries; a legislated scheme for dealing with insolvency which is based on public policy; and better remedies for investors/beneficiaries, such as the oppression remedy (D'Angelo, 2014: 24)

Our preliminary view is that at AATA should have three chapters – an AATA Personal Trusts chapter, an AATA Commercial Trusts chapter and an AATA Foreign Trusts chapter.

The personal trusts chapter should seek to appeal to the increasing High Net Worth Individual and Family market in the Asia Pacific region. It would deliver a high degree of settlor autonomy and include modern trust law concepts, such as reserve powers to settlors; the abolition of rule against perpetuities for all personal property assets of a trust; and automatic exclusion of the rule in *Saunders v Vautier* (see Chaikin and Brown, 2014: 7-8).

The commercial trusts chapter would need to solve the raft of problems that currently plague commercial trusts in Australia, due to the lack of proper infrastructure and application of outdated trust law principles. At a high level, this would start with an appropriate risk allocation framework and a system for dealing with insolvent trust situations. More detailed aspects might include better remedies for investors, greater protective powers for the trustee, creditor direct access to trust assets, and limited liability for investors.

We would expect the content of the foreign trusts chapter to be guided more by public policy than industry consultation. As identified by the field research for this report, one emerging area of trust law reform is in relation to private purpose trusts. Traditionally it was not possible to have a private purpose trust as the common law permitted only charitable purpose trusts, which in the absence of human beneficiaries could be enforced by the Attorney General (Waters, 2007: 241; Antoine, 2013). In recent years, in a number of offshore trust jurisdictions, there has been a move away from acceptance of this common law prohibition toward permitting, legally, the establishment of private purpose trusts with a nominated human 'enforcer' for the trust. Both Singapore and Hong Kong considered allowing private purpose trusts as part of their trust law reforms, but did not in the end take this approach. In lieu of this, Singapore expressly recognised foreign trusts, including foreign private purpose trusts, subject only to public policy considerations.

An AATA foreign trusts chapter could also recognise foreign trusts subject to public policy in Australia. For example, the foreign trusts chapter could accept private purpose trusts; though only permit them to hold personal property, thereby avoiding the tying up of real property in Australia for an indefinite period of time. The chapter could also look to provide other innovative incentives to foreign trust users, such as firewall provisions to insulate foreign trust assets from unfavourable inheritance laws in the beneficiary's country of domicile. Both Singapore and Hong Kong have provided firewall provisions for the benefit of foreign trust users, although Singapore maintains the application of the city-state's family provision laws to citizens and persons domiciled in Singapore.

Australia has ratified the Hague Convention on the Law Applicable to Trusts and their Recognition. An AATA foreign trusts chapter would need to be drafted with this convention in mind; however a preliminary review of the *Trusts (Hague Convention) Act 1991* (Cth) does not present any obvious challenge to Australia legislating to recognise foreign trusts on its own terms.

7.4 AATA and Tax Reform

When Singapore amended its trust law in 2004, it recognised the benefit and efficiency of concurrently updating its trust tax laws. The Singaporean experience with trust tax law reform is worth considerable attention. Many of the submissions to this Financial System Inquiry have suggested a need for tax reform and the committee has acknowledged these concerns by referring them to the upcoming Tax White Paper.

It is important to make the distinction between tax policy that is directed toward Australian residents (albeit which may apply indiscriminately to both residents and non-residents) and tax policy settings that are specifically formulated to attract offshore investment (Offshore Settings) and which apply only to non-residents. In relation to Offshore Setting, there is merit in separating out matters of tax policy that apply only to non-residents and having these considered and determined by a specialist body, established for the purpose of promoting Australia's financial services exports.

Such a body could consider tax incentives that might be offered to foreign AATA trust users, as balanced against the projected increase in tax revenue which could potentially flow from greater financial services exports.

7.5 AATA, ASIC and the FSC

An AATA would dovetail in with the current licensing and disclosure regime and the new protective powers of AATA trustees would complement those of ASIC. As is currently the case for AFSL holders, ASIC would have the power to audit, monitor, fine, take legal proceedings against and revoke the licence of an AATA trustee. ASIC's regulatory powers vis-à-vis the AATA trustee would be persuasive in encouraging the trustee to use its protective powers to safeguard consumers and to play an effective gatekeeper role for the financial services industry as a whole. More specific standards of conduct could also be mandated for the AATA trustee through either prudential regulation, or where this is deemed not to be necessary, through standards set by an industry body such as the FSC. These standards could include organisational governance and the skill levels of employees of the AATA trustee company. In this regard, ASIC and other bodies would have the statutory authority to preserve the integrity and reputation of AATA trustee companies.

The regulatory powers of ASIC in relation to licensees are a competitive advantage for Australia, particularly in light of the concern across the Asia Pacific region with safety and stability. Take for example a country such as Switzerland, which has no such equivalent regulator to ASIC, and where trustee companies and other financial institutions are generally unregulated - investors in the Asia Pacific region who were considering Switzerland as an investment destination would be forced to rely solely on their own due diligence on the relevant company's size, reputation and capitalisation (Mack, 2010: 5-6). Given the difficulties associated with individual consumers conducting extensive due diligence on offshore financial institutions, the well-established and comprehensive regulatory architecture in Australia is one of our strongest selling points.

7.6 Post AATA

It is not possible to predict with certainty what the long term effect of an alternative trust law regime might be on the current trust law. The AATA is presented as an efficient, less complex and less risky method of achieving trust law reform in Australia. Other nations have modernised the current law and have decided as a matter of policy to move away from the historic regime. If an AATA is adopted in Australia, the market would decide the fate of both it and the old regime. On the evidence of Australia's increasing use of trust structures for commercial purposes and the surge in High Net Worth Individuals in the Asia Pacific region, we expect that over time the vast majority of trust users would move into the AATA framework. We do not expect that the current state based regimes will completely disappear, however.

There will likely always be a need for public owned, state-based, estate administration bodies, not only to fulfil the public service obligation in relation to low value estates, but also to deliver certain traditional trustee-like services to vulnerable members of society. Similarly, individuals who do not desire the mandatory features of an AATA, primarily the appointment of a corporate trustee, would still be entitled to use the common law system and to appoint a professional individual trustee, such as a solicitor or an accountant.

The state supreme courts would remain the adjudicative bodies for disputes that arise both under the common law/state-based legislation and could also be given jurisdiction in connection with the new AATA regime. Where the new AATA law is silent or not conclusive, the courts would default to the common law position. The codification of trust law through an AATA would prospectively reduce trust law litigation, as the rights and obligations of the stakeholders in an AATA would be clearer and no longer exclusively determined by the negotiation process and the skill of the trust document drafters.

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