The Evolution of the Modern International Trust: Developments and Challenges

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ABSTRACT: As the first generation of wealthy entrepreneurs in Hong Kong begin to age, the issue of how best to transfer their family fortunes to the next generation has emerged. This Article first discusses the recent trends in financial planning for high-net-worth individuals in Hong Kong. It then addresses the growing use and evolution of trusts in wealth transfers from two perspectives, namely, (i) the innovative features of the modern international trust that render the use of a trust more palatable to Hong Kong settlors and (ii) the challenges posed by those features for both the validity of the trust and integrity of the trust concept. As the discussions show, the Hong Kong experience is indeed shared by most trust jurisdictions worldwide and provides the latter useful reference in confronting the controversies arising from the evolution of the trust.

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I. INTRODUCTION

As the first generation of wealthy entrepreneurs in Hong Kong ages,[1] the issue of how best to transfer their family fortunes to the next generation has emerged. In the past decade, the territory has witnessed a number of high-profile family legal battles. Whereas property used to be transferred predominantly by the conventional method of a will, the last few decades have seen an increase in the use of the trust as an asset protection device.[2] The trust is a long-established legal institution in the common law world. Despite its versatility, the traditional concept of a trust as a form of property holding by one party (trustee) for the benefit of another (beneficiary) has been held largely constant. In recent decades, however, the boundaries of the trust have evolved as it has become more widely utilized for a greater variety of purposes—including tax mitigation, asset protection, and wealth management.[3] In order to attract trust businesses, trust planners have displayed little hesitation in catering to the wishes of potential settlors who do not wish to lose control of their assets by manipulating certain trust features

1. "In Asia Pacific excluding Japan, 31 percent of high net worth people are over 55." KPMG & HONG KONG TRUSTEES' ASS'N, HONG KONG TRUST INDUSTRY: A CROSS-SECTOR PERSPECTIVE 54 (2013). In fact, many of these first-generation of wealthy entrepreneurs are post-war baby boomers and are now reaching the age of 70 to 75.

2. This is especially true amongst the wealthy individuals in Hong Kong. For an overview of the recent key developments of the trust industry in Hong Kong, see generally KPMG & HONG KONG TRUSTEES' ASS'N, HONG KONG TRUST INDUSTRY SPOTLIGHT: ENHANCING ITS COMPETITIVE EDGE (2017). In particular, it was noted that "[t]here is a growing demand for [trust] services from [ultra-high-net-worth individuals] seeking to manage the inter-generational transmission of wealth and implement succession plans for family-owned businesses." *Id.* at 34.

3. *See, e.g.*, David Hayton, *The Uses of Trusts in the Commercial Context in the UK*, *in* MODERN INTERNATIONAL DEVELOPMENTS IN TRUST LAW 145–68 (David Hayton ed., 1999); Sarah Worthington, *The Commercial Utility of the Trust Vehicle*, *in* EXTENDING THE BOUNDARIES OF TRUSTS AND SIMILAR RING-FENCED FUNDS 135 (David Hayton ed., 2002).

of the trust.[4] This trend has been sanctioned, if not actively bolstered, by many jurisdictions, both onshore and offshore.[5] As the modern international trust evolves, it is also coming under increasing attack and scrutiny.

In light of these developments and challenges, this article has two objectives. The first is to draw upon the emergence of the use of the trust in Hong Kong in recent decades to highlight the major trends and developments in the jurisdiction. Those trends/developments—which are in fact shared by most trust jurisdictions worldwide—include the widespread use of trusts involving such innovative features as trust protectors, the reserved powers of settlors, and letters of wishes. The article's second objective is to highlight, by reference to relevant trust litigation in Hong Kong, the challenges posed by these innovative features for the institution of the trust. It critiques the impact of the evolution of the modern international trust on both the validity of the trust and the nature and content of the trust obligation. The innovative features of the modern international trust may inevitably curtail the scope of a trustee's independent exercise of discretion and ultimately undermine the delicate balance of rights and obligations in the trust relationship that lies at the core of the trust concept. The evolution of the modern international trust necessitates further research on the definition of a trust and the content of fiduciary duty.

II. TRENDS IN FINANCIAL PLANNING: WILLS AND WILL-SUBSTITUTES

A. WILLS: THE NINA WANG SAGA

The number of disputes involving succession issues has escalated with the aging of Hong Kong's first generation of wealthy entrepreneurs. Recent prominent examples of such disputes include those of the Stanley Ho family,[6]

4. JONATHAN GARTON ET AL., MOFFAT'S TRUST LAW: TEXT AND MATERIALS 289–90 (6th ed. 2015) (noting the development of the "protector" as a response to the market demand for it); Lionel Smith, *Massively Discretionary Trusts*, 70 CURRENT LEGAL PROBS. 17, 17 (2017) (citing onshore examples of extremely settlor-friendly discretionary trusts such as the trusts in Chief Comm'r of Stamp Duties (NSW) v. Buckle, [1998] HCA 4, 192 CLR 226 (Austl.) and Clayton v. Clayton, [2016] NZSC 29 (N.Z.)).

5. *See infra* Part III.

6. Ho's company is Macau's largest casino operator; there have been lawsuits among his four wives with 16 children. *See* Gary Cheung, *Ho Family Jewels Divided, but How Long Will the Peace Hold?*, S. CHINA MORNING POST (Oct. 3, 2016, 5:52 PM), http://www.scmp.com/article/740683/ho-family-jewels-divided-how-long-will-peace-hold.

Kwok Family,[7] and Fok Family,[8] to name but a few, many of which have ended up in unfortunate or even ugly court battles.

The Wang family saga is probably the most notable—and dramatic—high-profile family legal battle in the history of Hong Kong. Nina Wang, reputedly one of Asia's wealthiest women, together with her late husband Teddy, expanded the Chinachem Group, a large property developer in Hong Kong.[9] A will was involved in each and every set of legal proceedings in the family's notorious legal battles. The initial dispute began with a fight between Nina and her father-in-law over Teddy's estate which was alleged to have been left to Nina by way of a will.[10] When Nina died in 2007, an alleged secret lover of hers claimed to hold a valid will to her entire estate which raised a new set of legal battles.[11] That will was held to have been forged. The saga's final episode[12] was Nina's own 2002 homemade will, which was comprised of just four clauses written in Chinese attempting to pass on her entire estate valued at an estimated HKD 83 billion (USD 10.6 billion) to the Chinachem Charitable Foundation. Clause 1 contained a gift of all of Nina's properties to the said Foundation, whereas clause 2 provided as follows:

> 2. [1] After I pass away, I wish to entrust "Chinachem Charitable Foundation Limited" to the supervision of a managing organization jointly formed by the Secretary General of the United Nations; the

7. The Kwok family founded Sun Hung Kai Properties, one of the largest property developers in Hong Kong. The three brothers of the Kwok family were fighting for control over the HKD 260 billion (USD 33.3 billion) business empire, the controlling shareholder of which was the family trust. *See* Barclay Crawford & Sandy Li, *Family Ructions Shake Kwok Empire*, S. CHINA MORNING POST (Feb. 24, 2008, 12:00 AM), http://www.scmp.com/article/627373/family-ructions-shake-kwok-empire; Sandy Li & Peggy Sito, *Feuding Kwok Family Reach "Amicable Agreement" over SHKP Property Empire*, S. CHINA MORNING POST (Jan. 29, 2014, 5:12 AM), http://www.scmp.com/property/hong-kong-china/article/1415693/feuding-kwok-family-reach-amicable-agreement-over-shkp; *Walter Kwok Not Pleased with Assets Carve-Up, Report Says*, STANDARD (Aug. 25, 2017, 8:07 PM), http://www.thestandard.com.hk/breaking-news.php?id=95780&sid=4.

8. The Fok Family was involved in hostile litigation over the late tycoon's development project in China worth HKD 38 billion (USD 4.9 billion). The tycoon died in 2006 with a fortune then valued at around USD 3.7 billion. *See* Eddie Lee, *Henry Fok's Children Set to Return to Court over Tycoon's Estate*, S. CHINA MORNING POST: HONG KONG (Jan. 13, 2016, 8:21 PM), http://www.scmp.com/news/hong-kong/article/1900996/henry-foks-children-set-return-court-over-tycoons-estate; Eddie Lee, *Company Representing Children of Late Hong Kong Tycoon Henry Fok Wants in on HK$38 Billion Project*, S. CHINA MORNING POST: LAW & CRIME (Feb. 16, 2016, 9:05 PM), http://www.scmp.com/news/hong-kong/law-crime/article/1913572/company-representing-children-late-hong-kong-tycoon-henry.

9. Sec'y for Justice v. Joseph Lo Kin Ching, [2015] 18 H.K.C.F.A.R. 169, 182 (C.F.A.).

10. Nina Kung v. Wong Din Shin, [2005] 8 H.K.C.F.A.R. 387, [126], [457], [565], [567], [646]-[648] (C.F.A.) (holding that the handwritten will of Teddy Wang in 1990, naming his wife Nina as sole beneficiary of his estate, was his last valid will, and thus awarding his estate to Nina).

11. Chinachem Charitable Found. Ltd. v. Chan Chun Chuen, [2010] HKCFI 88, 114 (C.F.I.) (holding that Nina's alleged secret lover had used a fake will and declaring the one held by the Foundation to be genuine). Leave to appeal to the Court of Final Appeal was denied. Chinachem Charitable Found. Ltd. v. Chan Chun Chuen, [2011] 14 H.K.C.F.A.R. 798, [106] (C.F.A.).

12. *Sec'y for Justice*, 18 H.K.C.F.A.R. at 185.

> Premier of the PRC Government as well as the Chief Executive of the Hong Kong Special Administrative Region. [2] Under its supervision, . . .
>
> [i] . . . [the Foundation must] continue all the [current] projects . . .
>
> [ii] . . . [and set up] a Chinese prize . . . similar to that of the Nobel Prize.[13]

The Foundation argued that it should receive Nina's entire estate as an absolute gift (to be used for various charitable purposes as they arose).[14] The Court of Final Appeal disagreed, holding "that the Foundation [should] hold N[ina]'s estate as a trustee" and be obliged to give effect to her will and use the estate for the specific purpose stated therein so far as possible.[15] Lord Walker N.P.J., delivering the unanimous judgment of the Court, held that Nina's will imposed conditions on the gift to the Foundation, and, therefore, the Foundation could not simply do as it wished with her estate.[16] Even though some conditions in Nina's will were unworkable as drafted, any uncertainties could be rectified "and clarified by the [Anglo-Hong Kong] law's benevolent treatment of charitable trusts."[17] Accordingly, the establishment of a Nobel-like Chinese prize and the formation of a managing organization with members of unquestionable integrity, experience, and judgment were considered valid conditions.[18]

Needless to say, the disputes involving the Wang family are probably the most extreme example of the types of problems that may arise (e.g., construction of the will and forgery) from the inter-generational transfer of wealth by way of a will. The Court of Final Appeal aptly described the Wang family litigation as "protracted and contentious."[19] This is because disputes involving the construction of a will such as that in the Wang case can be avoided if the will is drafted with the aid of professional advice. But the case remains a perfect reminder to local tycoons who might contemplate the use of a will to pass on their fortunes. In any event, despite the informality and hence lower cost of preparing a will, a will takes effect only upon the death of the testator and so does not provide any lifetime planning; and, further, the probate process for wills is time-consuming, and can be particularly tricky if they pertain to a complex estate with assets in multiple jurisdictions. In fact, when such advice is sought, legal professionals will inevitably recommend alternatives to wills.

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13. *Id.* at 185.
14. *Id.* at 169–70.
15. *Id.* at 170.
16. *Id.* at 201–02.
17. *Id.* at 200.
18. *Id.* at 203–05.
19. *Id.* at 179.

B. TRUSTS AS WILL-SUBSTITUTES

Even several decades before the Nina Wang dispute, local tycoons had begun to appreciate the advantages of private family trusts over wills. At first, private family trusts were used to mitigate estate duties.[20] Although that consideration became irrelevant in Hong Kong with the abolition of estate duties in 2006,[21] today's tycoons almost invariably opt for trusts because their use allows property to be ring-fenced from the creditors (and even spouses) of the settlor, and also offers a high degree of confidentiality, and makes professional management possible. Philanthropy can still be channeled through family foundations (as in Nina Wang's case) or charitable trusts. The innovative developments of trust law in offshore jurisdictions over the past few decades have rendered trusts more appealing to local settlors who prefer to retain as much control as possible over their assets. Those developments include the reservation of powers to the settlor, the appointment of protectors, and the use of letters of wishes, among others, all of which have made the modern international trust very different, at least in outlook, from the traditional English trust.[22]

At the end of 2011, the Hong Kong trust industry held assets estimated at HKD 2.6 trillion (USD 333 billion).[23] Two trends in the developments of the trust industry can be discerned. First, notwithstanding the booming trust industry and growth in the use of private family trusts, most of the express trusts administrated in Hong Kong are not governed by Hong Kong law because most of them are settled offshore and have adopted the laws of the offshore jurisdictions as the governing law of their trust.[24] Second, alongside the growing demand for private trusts in Hong Kong is a surge in demand for family trusts in mainland China, where a significant number of high-net-worth families have emerged in the 30 years since the country launched its open-door policy and a series of economic reforms.[25] It is estimated that approximately one-third of high-net-worth individuals and half of ultra-high-

20. Shiu Wing Ltd. v. Comm'r of Estate Duty, [2000] 3 H.K.C.F.A.R. 215, 221 (C.F.A.).

21. Estate duty in Hong Kong was abolished in 2006. *See generally* REVENUE (ABOLITION OF ESTATE DUTY) ORDINANCE, No. 21 (2005) (H.K.) (abolishing estate duty in Hong Kong).

22. In a traditional English trust, the settlor drops out after setting up the trust, see *infra* note 36 and accompanying text. For details of the differences between the traditional English trust and the modern international trust, see Part III below.

23. FIN. SERVS. & THE TREASURY BUREAU, LEGISLATIVE COUNCIL BRIEF: TRUST LAW (AMENDMENT) BILL 2013, at 1 (2013), http://www.legco.gov.hk/yr12-13/english/bills/brief/b04_brf.pdf.

24. *Id.* at 8–9. Hence, one of the purposes of the trust law reform in Hong Kong was to "attract settlors to set up trusts in Hong Kong." *Id.* at 2; *see also* Mary Ellen Hutton & Philip Munro, *Trust Planning in Asia*, IFC REV. (Feb. 3, 2010), http://www.ifcreview.com/restricted.aspx?articleId=1016&areaId=35 (describing the origins of Hong Kong law and legislative efforts to make Hong Kong more attractive for trust planners).

25. Scott MacDonald, *How Wealthy Are the Chinese?*, 15 WORLD ECON. 1, 5 (2014).

net-worth individuals[26] currently consider wealth inheritance planning, including the establishment of family trusts.[27] Many high–net worth individuals from the mainland use trust services provided in Hong Kong.[28] In light of these trends, the trust industry called for reforms of the trust law regime in Hong Kong to attract more trust businesses, in particular also to attract settlors to use Hong Kong trust law as the governing law of their trust.

Hong Kong's trusts law is based on English common law and equity principles, supplemented principally by the Trustee Ordinance[29] and the Perpetuities and Accumulations Ordinance.[30] Until the recent trust-law reform in 2013, these two ordinances had not been substantially reviewed or modified since their enactment in 1934 and 1970 respectively. The emergence of offshore trusts with innovative features along with the development of the trust industry in Hong Kong, prompted Hong Kong to reform its trust-law regime in 2013. The goal was to introduce certain offshore features that would make Hong Kong more attractive as a trust domicile. The reforms were also prompted by similar reforms that had been recently implemented by major common law jurisdictions such as England and Singapore.[31]

Hong Kong's reforms covered three major areas. The first two related to enhancing trustees' default powers[32] and enhancing beneficiaries' protection.[33] Both were uncontroversial, as they had little impact on modern

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26. "[U]ltra-high net worth individuals amounted to about 17,000 with the total assets of [¥]31 trillion and assets per person of [¥]1.82 billion. The number of individuals with a net worth of over [¥]10 billion increased to 176 from 50 in 2008." KPMG, 2015 CHINA TRUST SURVEY 32 (2015).

27. *Chinese High Net Worth Individuals Shift Wealth Management Focus from Growing to Preserving Assets; Overseas Diversification on the Rise, Finds New China Private Wealth Report*, BAIN & CO. (May 7, 2013), http://www.bain.com/about/press/press-releases/chinese-high-net-worth-individuals-shift-wealth-management-focus-from-growing-to-preserving-assets.aspx. "China Merchants Bank and Bain & Co. pointed out in the China Private Wealth Report 2015 that wealth inheritance has become the second biggest demand of high net worth individuals next only to wealth security, and that nearly 70 percentage of high net worth individuals are facing inheritance problems." KPMG, *supra* note 26, at 32.

28. *See, e.g.*, MENG ZHEN, OWNERSHIP OF TRUST PROPERTY IN CHINA: A COMPARATIVE AND SOCIAL CAPITAL PERSPECTIVE 146 (2017).

29. *See* Trustee Ordinance, (2014) Cap. 29 (H.K).

30. *See* Perpetuities and Accumulations Ordinance, (2014) Cap. 257 (H.K.).

31. The UK reformed its trust law by introducing the Trustee Act 2000. *See* Trustee Act 2000, c. 29 (U.K.). Singapore amended its Trustees Act in 2004. *See* Trustees Act, c. 337 (Sing.).

32. *See* Trustee Ordinance, (2014) Cap. 29, §§ 41A–41P (H.K.) (power to appoint agents, nominees and custodians to execute administrative functions, vest trust assets in nominees, etc.); *id.* § 21 (power to insure trust property); *id.* §§ 41Q–41V (entitlement to receive remuneration); *id.* §§ 4–12, 90–91 (relaxed general powers of investment and extended scope of authorized investments); Perpetuities and Accumulations Ordinance, (2014) Cap. 257, § 12 (H.K.) (powers of appointment); *id.* § 13 (entitlement to receive remuneration).

33. *See* Trustee Ordinance, (2014) Cap. 29, § 3A (H.K.) (statutory duty of care); *id.* § 41W (no exclusions for professional trustees for liability arising from fraud, willful misconduct and gross negligence); *id.* § 40A (beneficiaries rights to appoint and retire trustees). The more controversial reform on introducing statutory requirements on beneficiaries' right to

trust instruments, which normally contain similar express provisions. The third area concerns enhancing Hong Kong's status as an asset management center, and reforms in this area have been met with varying degrees of success. Although several reforms designed to introduce certain offshore features into the local trust law regime to increase Hong Kong's attractiveness as a trust domicile were considered, only a few were ultimately adopted, including a provision declaring that a trust would not be invalidated solely because a settlor has reserved to him or herself powers of investment or asset management functions.[34] In terms of competing with offshore jurisdictions, Hong Kong's new laws are not as innovative or robust as local tycoons would like and continue to prefer the option of offshore trusts. For example, several offshore jurisdictions have already introduced novel vehicles (e.g., STAR trusts in the Cayman Islands and VISTA trusts in the British Virgin Islands ("BVI")) to make non-charitable purpose trusts and settlor control possible, or even enacted extensive firewall legislation to protect trusts from attacks by spouses in divorce proceedings.[35] Although these offshore features of the trust will undoubtedly attract business from settlors seeking greater protection, the issue of whether they should become part of the local trust law regime raises a more fundamental question concerning the direction of that regime, a question that the 2013 reforms do not seem to have expressly addressed.

III. EVOLUTION OF THE MODERN INTERNATIONAL TRUST

A century ago, Maitland described the trust as "the greatest and the most distinctive achievement performed by Englishmen in the field of jurisprudence."[36] In the modern era, however, the trust's development has not been dominated by English law, but by various offshore jurisdictions who

information to delineate that right more clearly was not adopted. Thus, disclosure of trust information remains to be governed by common law principles and is seen as part of the courts' overall supervisory jurisdiction. *See* Schmidt v. Rosewood Tr. Ltd. [2003] 2 AC 709 (PC) (Eng.) (appeal taken from IoM); *see also* Pang Chun Kwong v. Pang Hang Lau, [2013] HKEC 1985 (C.F.I.) (H.K.) (discussing and applying *Schmidt v. Rosewood*).

34. Trustee Ordinance, (2013) Cap. 29, § 41X (H.K.). For other examples (not relevant to the present article), see Perpetuities and Accumulations Ordinance, (2013) Cap. 257, § 3A (H.K.) (abolishing the rules against perpetuities and excessive accumulations of income and allowing settlors to set up perpetual trusts); Trustee Ordinance, (2013) Cap. 29, § 41Y (H.K.) (protecting against foreign forced heirship rules so that trusts governed by Hong Kong law will be protected from foreign heirship rules in other countries).

35. *See* THE WORLD TRUST SURVEY 89–123, 140–57 (Charles Gothard & Sanjvee Shah eds., 2010) (providing an overview of the development of trusts in Bermuda, the British Virgin Islands, and the Cayman Islands).

36. FREDERIC WILLIAM MAITLAND, *The Unincorporate Body*, *in* 3 THE COLLECTED PAPERS OF FREDERIC WILLIAM MAITLAND 271, 272 (H.A.L. Fisher ed., 1911).

have achieved notable developments.[37] Today, there is often an international element in the creation or management of a trust, which may be settled offshore, while some trust assets are located overseas. As a result, trusts in offshore jurisdictions operate very differently from those in onshore jurisdictions. For example, trust planners in offshore jurisdictions are far more eager to pioneer innovative developments to accommodate settlors' desires in order to compete for trust business.

What follows is an outline of the main features of a modern private trust.[38] As will be seen, the traditional paradigm whereby the settlor drops out after setting up the trust[39] such that the trust essentially constitutes a bilateral relationship between the trustee and the beneficiary—with the former holding legal ownership of the trust assets and enforceable duties owed to the latter, who holds equitable proprietary interests—has radically changed. What has emerged is a tripartite, more dynamic relationship among the settlor/protector, trustee, and beneficiaries.

A. NEW PARTIES TO THE TRUST PARADIGM: RESERVED POWERS OF SETTLOR AND PROTECTOR

In the past few decades, trusts have been widely utilized as an effective and flexible tool for wealth preservation and advancement. Rather than transferring trust assets to a family friend, a settlor will usually transfer his or her assets to a third-party professional trustee, who then manages and invests those assets in a professional manner. Nonetheless, the settlor (especially the first-generation wealth entrepreneurs in Hong Kong who may not understand the mechanics of a trust) may not want to relinquish control over their trust assets. Trust planners have therefore allowed settlors who do not wish to lose control over their assets to reserve significant and substantive decision-making powers to themselves in the trust instrument. This is in stark contrast to a traditional English trust where the settlor retains no control over the trust assets after creating the trust.[40] It is customary for Anglo-Hong Kong settlors to reserve the power to direct trustees to make investments; to add or remove beneficiaries; to appoint income or capital to beneficiaries (or to give and withhold consent before such distributions are made); to appoint or remove

37. *See generally* David Brownbill, *The Role of Offshore Jurisdictions in the Development of the International Trust*, 32 VAND. J. TRANSNAT'L L. 953 (1999) (discussing the development of trust law in offshore jurisdictions).

38. Other features such as non-charitable purpose trusts and the use of enforcers are not discussed in this article. *See, e.g.*, Paul Matthews, *From Obligation to Property, and Back Again? The Future of the Non-Charitable Purpose Trust*, *in* EXTENDING THE BOUNDARIES OF TRUSTS AND SIMILAR RING-FENCED FUNDS, *supra* note 3, at 203.

39. Upon the establishment of the trust, the settlor retains no beneficial interest and hence no control over the trust assets. *See* Turner v. Turner [1984] Ch 100 (Eng.); Astor v. Scholfield [1952] Ch 534 (Eng.).

40. *See supra* note 39.

trustees; to revoke the trust;[41] and to veto the trustee's administrative or dispositive decisions. In some instances, settlor control may also be achieved by the settlor establishing a more complex structure involving a series of corporate vehicles and trusts, with the trusts holding shares in the companies established. In this case, the settlor continues to run the companies as director, and the trustee is a company shareholder.[42]

A settlor may also reserve powers, not to him or herself, but to a third party known as the protector of the trust.[43] The office of protector is now well-established to allow settlors some degree of influence over a trustee's exercise of discretion.[44] The trust protector is usually a close friend or family member of the settlor who is able to provide some checks on the trustee, with whom the settlor may not be familiar. Protectors are thus appointed to monitor trustees in the administration of the trust and to ensure that it is administered in accordance with the settlor's wishes.[45] It is unclear what duties are owed by the protector of a given trust.[46] Some take the view that a protector, as a holder of powers, holds a fiduciary office just like a trustee, whereas others posit that the protector is not a power-holder or at most holds personal powers alone, and hence need not be held accountable.[47] Although English law does not accept the general principle that protectors are fiduciaries, it is still possible to review the powers afforded to a protector to determine whether he or she should be regarded as a fiduciary for the purposes of those powers.[48] Likewise, it is possible for the courts to monitor a protector's exercise of powers either by ensuring that he or she complies with the terms of the trust or as part of its inherent jurisdiction to supervise the trust's administration.[49]

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41. *See, e.g.*, Charman v. Charman [2007] EWCA (Civ) 503 (Eng.); Kan Lai Kwan v. Poon Lok To Otto, (2014) 17 H.K.C.F.A.R. 414 (H.K.). In relation to the power to revoke the trust, see generally Fonu v. Merrill Lynch Bank & Tr. Co. [2011] UKPC 17 (Cayman Is.) (holding that an unfettered power to revoke could be treated as a type of property which could be claimed by the settlor's receivers for the benefit of his creditors).

42. *See, e.g.*, Tey Tsun Hang, *Reservation of Settlor's Powers*, 21 SING. ACAD. L.J. 517, 543 (2009).

43. *See* Donovan W.M. Waters, *The Protector: New Wine in Old Bottles?*, *in* TRENDS IN CONTEMPORARY TRUST LAW 63, 63 (A.J. Oakley ed., 1996); Matthew Conaglen & Elizabeth Weaver, *Protectors as Fiduciaries: Theory and Practice*, 18 TR. & TRUSTEES 17, 19–20 (2012); *see generally* Emily Campbell et al., *Protectors*, *in* THE INTERNATIONAL TRUST 195 (David Hayton ed., 3d ed. 2011); ANDREW HOLDEN, TRUST PROTECTORS (David Brownbill ed., 2011).

44. *See* Waters, *supra* note 43, at 64; Conaglen & Weaver, *supra* note 43, at 19.

45. *See, e.g.*, Steven Kempster, *Rights to Information*, *in* INTERNATIONAL TRUST DISPUTES 191, 199 (Sarah Collins et al. eds., 2012).

46. Tsun Hang Tey, *The Office of Protector: Its Nature and Duties*, 24 TR. L. INT'L 110, 120–25 (2010).

47. DAVID HAYTON ET AL., UNDERHILL AND HAYTON: LAW RELATING TO TRUSTS AND TRUSTEES ¶¶ 1.79–1.80 (19th ed. 2016); Waters, *supra* note 43, at 68.

48. Campbell et al., *supra* note 43, at 198–200.

49. The inherent jurisdiction of the court in relation to trust was well-established in the old English case of *Morice v. Bishop of Durham*. Morice v. Bishop of Durham [1805] 32 Eng. Rep. 947. *See* Richard C. Nolan, *"The Execution of a Trust Shall be Under the Control of the Court": A Maxim in Modern Times*, 2 CANADIAN J. COMP. & CONTEMP. L. 469, 470 (2016).

While the reserved powers of a settlor or protector do not necessarily undermine a trust, there is a question as to how much control a settlor can safely retain without rendering the trust a sham.[50] Some offshore jurisdictions have settled the question by enacting specific legislation to deal with a settlor's reserved powers to the effect that a settlor (or protector) can retain the powers specified in that legislation without affecting the validity of the trust.[51] Jersey Trust Law, for example, allows a settlor to reserve the power to revoke, vary, or amend the terms of a trust; give binding directions to the trustee in connection with the management of the trust property; and appoint or remove any trustee or beneficiary.[52] Similarly, some offshore jurisdictions regulate protectors by statute.[53] A number of offshore courts have held that a protector's powers to appoint and remove trustees and consent to a trustee's nomination of beneficiaries are fiduciary powers that must be exercised in good faith in the interests of all beneficiaries.[54]

B. DISCRETIONARY POWERS WITHOUT LIABILITIES: TRUSTEES' POWERS, DUTIES AND LIABILITIES

In a traditional English trust, the trustee is usually given specific instructions on how to distribute the trust property among the beneficiaries. Modern private trusts are predominantly settled as discretionary trusts rather than fixed trusts to ensure maximum flexibility to cater for changes in settlors' circumstances.[55] Accordingly, the discretionary trust deed confers various powers, both administrative and dispositive, on trustees.

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50. Geraint Thomas & David Hayton, *Shams, Revocable Trusts and Retention of Control*, *in* THE INTERNATIONAL TRUST, *supra* note 43, at 597, 597–98; Nicholas Jacob & Lawrence Graham, *The Legal Realities of Reserved Powers Trusts*, 12 TR. & TRUSTEES 25, 25 (2006); Donovan Waters, *Trusts: Settlor Reserved Powers*, 25 ESTS., TR. & PENSIONS J. 234, 235 (2006).

51. Cook Islands: International Trusts Act, § 13C (1984) (as amended by the International Trusts Amendment Act 1989); Bahamas: Trustee Act, ch. 176 § 3 (1998); Trusts (Jersey) Law, art. 9A (1984) (as amended by the Trusts (Amendment No. 4) (Jersey) Law 2006); Anthony Travers, *Cayman Islands New Law on Trust Validity*, 4 TR. & TRUSTEES 17, 17 (1998) (discussing the Cayman's Islands legislation regarding settlor's reserved powers). This legislation by and large provides a rebuttable presumption that a trust which reserves powers of the kind stipulated in the relevant legislation is not an ineffectual or sham trust.

52. Trusts (Jersey) Law, art. 9A(2) (1984) (as amended by the Trusts (Amendment No. 4) (Jersey) Law 2006). Compare the declaratory provisions in Singapore and Hong Kong legislation that the reservation of powers by settlors does not per se invalidate a trust: Trustees Act, ch. 337 § 90(5) (2005) (Sing.) and Trustee Ordinance, Cap. 29 § 41X (2014) (H.K.).

53. *E.g.*, Belize Trusts Act, ch. 202 § 16 (2011); BVI Trustee Act, ch. 303 § 86 (1961); Cook Islands International Trusts Act, § 20 (1984) (as amended by the International Trusts Amendment Act, 1995–96).

54. *See, e.g.*, Von Knieriem v. Bermuda Tr. Co. [1994] 1 B.O.C.M. 116 (Berm.); Steele v. Paz Ltd. (*sub nom.* Rawcliffe v. Steele) [1995] M.L.R. 426 (Isle of Man); *In re* Papadimitriou [2002] M.L.R. 287.

55. *See* I.J. HARDINGHAM & R. BAXT, DISCRETIONARY TRUSTS 6–9 (2d ed. 1984).

At one end of the spectrum, modern trusts tend to vest extensive discretionary powers in trustees. In terms of administrative powers, a trustee is usually afforded wide powers of investment,[56] along with the power to delegate certain trustee functions. In terms of dispositive powers, the trustee of a discretionary trust is usually given wide powers of appointment coupled with the power to distribute trust property to potential beneficiaries, who may include the settlor.[57] Despite the trustee's extensive discretionary powers, his or her liability is often limited by wide trustee exemption clauses. English courts have attempted to regulate such exemption clauses by invalidating clauses purporting to exempt trustees from liability for fraudulent or reckless breaches.[58] In a similar vein, Guernsey and Jersey have enacted legislation to prohibit exemption of liability arising from the trustee's own fraud, willful misconduct, or gross negligence.[59] Hong Kong followed suit in 2013 when the government proposed statutory control of trustee exemption clauses in reviewing its trust law regime. The new section 41W of the Trustee Ordinance provides that a remunerated professional trustee cannot be relieved of liability for his or her own fraud, willful misconduct or gross negligence.[60]

At the other end of the spectrum, however, a trustee may be given very limited powers. As previously noted, a settlor may confer powers on parties other than the trustee, usually by "reserving" powers to him or herself or to a third-party protector. As a result, not only is trusteeship divided between the trustee and the protector, but the trustee may also be given either very limited powers and passive duties as a result or wide powers that are exercisable only with the consent of the settlor/protector.[61] In such cases, extensive discretionary powers are in effect conferred on the settlor or protector.

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56. The trustees may also be given statutory powers of investment, but such powers are usually modified by the terms of the trust deed to suit the circumstances of the particular trust.

57. Professor Smith labels these kinds of trusts as "massively discretionary trusts." *See* Smith, *supra* note 4, at 52. One recent example is *Clayton v. Clayton* [2016] NZSC 29 at [51] (N.Z.) (discussing the trustee's wide power to appoint or remove discretionary beneficiaries in a discretionary trust).

58. *See, e.g.*, Armitage v. Nurse [1998] EWCA (Civ.) 241, 252 (Eng.).

59. The Trusts (Guernsey) Law, § 34(7) (1989); Trusts (Jersey) Law, art. 30(10) (1984).

60. Section 41W(3) of the Trustee Ordinance provides: "(3) The terms of a trust must not—(a) relieve, release or exonerate a trustee from liability for a breach of trust arising from the trustee's own fraud, wilful misconduct or gross negligence . . . ." Trustee Ordinance, § 41W(3) (20130) (H.K.).

61. In the United States, the trust may be regarded as a "directed trust," and the Uniform Laws Commission is currently working on a uniform "Divided Trusteeship Act." *See generally* DIVIDED TRUSTEESHIP ACT (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAW, Proposed Draft for Discussion 2016), http://www.uniformlaws.org/shared/docs/divided%20trusteeship/2016apr_DTA_Mtg%20draft.pdf (demonstrating the limited powers of the U.S. trustee).

C. BENEFICIARIES' DIMINISHING RIGHTS AND POWERS

Traditionally, a trust is enforceable only by the beneficiaries who enjoy an equitable proprietary interest in the trust property.[62] Beneficiaries are the core of the trust, both enforcing it and holding trustees accountable. However, as noted above, to enable a trustee to respond to unforeseen circumstances, modern trusts normally vest him or her with wide dispositive powers. Some jurisdictions have even gone as far as empowering trustees (or protectors) to add or remove beneficiaries or allowing trusts that have no beneficiary but merely objects to whom a trustee may appoint capital or income.[63] In the extreme example of the Cayman Islands Special Trusts (Alternative Regime) ("STAR"), the beneficiary of a STAR trust does not even enjoy the standing to enforce the trust.[64] A corollary of the settlor/protector/trustee's wide powers is the beneficiaries' diminishing rights and powers. Beneficiaries, who once lay at the center of the trust, are now merely in a "position of being a hopeful individual . . . at the fringe of the structure."[65]

The diminishing role of beneficiaries can be illustrated by their evolving right to seek the disclosure of information about trusts, and in particular, letters of wishes. The preference for modern family trusts to be settled as discretionary rather than fixed trusts has led to a surge in the use of letters of wishes drawn up by trust settlors.[66] In letters of wishes, settlors express non-binding requests to trustees concerning how the latter's wide dispositive discretion is to be exercised.[67] This situation gives rise to the difficult question of whether such letters should be disclosed.[68] Letters of wishes are usually written by settlors to ensure that trustees exercise their immense discretionary powers within the parameters intended by the settlors, although in a non-legally binding manner. Accordingly, in recent years, most offshore

62. LYNTON TUCKER ET AL., LEWIN ON TRUSTS ¶ 1–005 (19th ed. 2014).

63. HARDINGHAM & BAXT, *supra* note 55, at Ch. 3.

64. Special Trusts (Alternative Regime) Law 1997 (now incorporated into Part VIII of the Trusts Law (2011 Revision) (Cayman Is.)).

65. Donovan Waters, *The Future of the Trust from a Worldwide Perspective*, *in* THE INTERNATIONAL TRUST, *supra* note 43, at 837, 884.

66. Alternatively, the trust may be accompanied by an internal memorandum of the settlor's wishes drawn up by the trustees. *See, e.g.*, Tam Mei Kam v. HSBC Int'l Tr. Ltd., [2011] 14 H.K.C.F.A.R. 512, 512 (H.K.) (describing an instance in which an individual included an internal memorandum with the trust of the settlor's wishes).

67. *See Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405, 408 (Austl.); Breakspear v. Ackland [2008] EWHC 220, [5] (Ch) (Eng.); *In re* Rabaiotti 1989 Settlement [2000] JLR 173, 173–74 (Jersey).

68. *See, e.g.*, *Breakspear*, EWHC at [9] (discussing the challenges in deciding whether to disclose letters of wishes); Schmidt v. Rosewood Tr. Ltd., [2003] Pens. L.R. 145, [43]–[55] (Isle of Man) (determining whether it is appropriate to release letters of wishes); *In re Rabaiotti 1989 Settlement*, JLR at 174 (discussing whether the court should disclose letters of wishes); *Hartigan Nominees Pty Ltd*, 29 NSWLR at 407 (discussing the difficulty in deciding whether to disclose letters of wishes).

jurisdictions have enacted legislation on the disclosure of trust information in an attempt to restrict common law rights of disclosure and render offshore trusts more impregnable to attacks. For example, Section 83 of the 1998 Bahamas Trustee Act provides for the revocation of a trustee's obligation to inform beneficiaries of their rights if they have no vested interests but are interested only as contingent beneficiaries or under discretionary trusts.[69]

In sum, the aforementioned features commonly found in the modern international trust have transformed the traditional English trust into a more innovative and flexible device. At the same time, the relationship between various parties to the trust arrangement has also undergone radical change.

IV. CHALLENGES IN TRUST PLANNING

Not surprisingly, the modern international trust has also come under increasing attack and scrutiny. The evolving relationship of the parties to the modern form of a discretionary trust has given rise to the problems of holding trustees accountable and controlling the exercise of their discretionary powers. In addition to being used to manage family wealth, the modern international trust can also be used—or misused—to protect assets from creditors or other legitimate claimants.[70] Furthermore, while the trust has been adapted and customized to meet the practical needs and concerns of settlors, it remains doubtful whether recent developments are consistent with the instrument's nature. In the context of these developments, this Article analyzes, by reference to relevant trust litigation in Hong Kong, the challenges posed by emerging trends to the validity of the trust and, more fundamentally, to the integrity of the trust concept.

A. CHALLENGES TO THE VALIDITY OF THE TRUST

1. Divorce and Bankruptcy Protection

The asset protection function of trusts is beyond dispute. If a trust is settled offshore, the asset protection function of offshore trusts also means that the settlor's assets are removed from the onshore jurisdiction in question. If a settlor retains extremely aggressive control over the offshore trust or can exercise his or her power to obtain beneficial ownership for him or herself at a later date, then should the trust property still be immune from claims by his or her creditors[71] or spouse onshore? To what extent can the trust be used—

69. *See also* The Trusts (Guernsey) Law, 1989, § 22 (1989).

70. GARTON ET AL., *supra* note 4, at 330–31 (noting that against the claims of creditors in both commercial and family contexts).

71. In Hong Kong, the Conveyancing and Property Ordinance, (1984) Cap. 219, § 60, provides that every disposition of property made with the intention to defraud creditors is voidable at the instance of any person who is prejudiced. The Bankruptcy Ordinance, (2005) Cap. 6, § 42, provides that a transfer made by a person, beginning from the day of the presentation of the petition for bankruptcy to the vesting of the bankrupt's estate in a trustee, is void unless it was made with the consent of the court or was subsequently ratified by the court.

or misused—to protect assets from such claims? The recent Hong Kong Court of Final Appeal case of *Kan Lai Kwan v. Poon Lok To Otto* provides an illustration.[72] The case also features most of the innovative elements of the modern international trust discussed above.

Poon was a leading engineer in Hong Kong and the chairman of Analogue Holdings Ltd., a company holding all of the shares in the operating companies that generated profits.[73] In 1995, Poon set up an offshore (Jersey) discretionary family trust whose assets consisted mainly of shares in Analogue and whose beneficiaries were his three children.[74] Poon was the settlor, protector, and potential beneficiary.[75] As settlor and protector, he reserved important powers to himself, including the powers to remove beneficiaries and to remove and appoint trustees.[76] The trustee was given the power "to appoint capital and to distribute income to any eligible object of its discretion to the exclusion of the others."[77] In other words, it was possible for the trustee to appoint the entire trust fund to a single beneficiary (including Poon). At the same time, the trustee played only a passive role in running the company, as the trust deed authorized it to leave the administration, management, and conduct of Analogue's business to the company's directors and managers.[78] In addition, the trustee also had the power to remove beneficiaries at its discretion with the consent of Poon as protector.[79] Poon had also written "letters of wishes" to the trustee, which revealed that the trustee had accorded Poon's wishes great weight and implemented them in a timely manner.[80]

Poon was married in 1968.[81] When he divorced his wife in 2009, his wife argued in ancillary relief proceedings that the entire trust should be treated as the husband's "financial resource,"[82] and hence as matrimonial property for the purpose of the divorce.[83] The Court of Final Appeal affirmed and

72. Kan Lai Kwan v. Poon Lok To Otto, [2014] 17 H.K.C.F.A.R. 414, [16] (C.F.A.) (H.K.).

73. *Id.* at [3]–[6].

74. *Id.* at [7].

75. *Id.* at [26].

76. *See id.* at [63]. The Court of Final Appeal considered that the husband's power as protector to remove and appoint trustees "might well be lawfully exercisable." *See id.* at [69].

77. *Id.* at [62].

78. *Id.* at [65].

79. *Id.* at [63].

80. *See id.* at [63]–[65].

81. *Id.* at [3].

82. *Id.* at [26]. Matrimonial legislation in many common-law jurisdictions now expressly empowers family courts to include trust interests in divorce settlements. In Hong Kong, this is governed by the Matrimonial Proceedings and Property Ordinance. Matrimonial Proceedings and Property Ordinance, (2011) Cap. 192, § 7(1)(a) (H.K.); *see also* Matrimonial Causes Act 1973, c. 18, § 25(1)(a) (Eng.) (stating that "[O]ther financial resources" may extend to a vested and even contingent interest which a spouse may receive upon the trustee's exercise of discretion in his favor (i.e., interest as a discretionary beneficiary)).

83. *Poon*, 17 H.K.C.F.A.R. at [23].

applied the English Court of Appeal test in *Charman v. Charman (No. 4)*.[84] In that case, the husband argued that the offshore trust he had set up was a discretionary trust that was dynastic in nature (set up for the unborn members of his family), and hence should not be treated as a financial resource available to him in ancillary relief proceedings.[85] However, because the husband had reserved extensive powers to himself as settlor, including the power to remove existing trustees (and replace them with others who would accede to his request for advancement), and because the trustees were empowered to ignore the interests of all other beneficiaries in exercising their discretion in favor of a particular beneficiary, the court treated the entire £68 million (USD 88 million) value of the trust as a financial resource available to the husband.[86] In arriving at that decision, the court held that the applicable test was that, if the husband were to request that the trustees advance the whole (or part) of the trust capital to him, they would be likely to do so.[87] However, to note this formulation considers whether a trustee would be *likely* (not certain) to advance trust assets in the *foreseeable future* (not immediately) should the need arise even though there had been no past capital distribution to the spouse in question.

Applying the *Charman* test, the Court of Final Appeal in *Poon* ruled that the full value of the family trust (more than HKD 1.5 billion, USD 192 million) was a "resource" available to Poon, the husband, and accordingly awarded the wife HKD 840 million (USD 107.5 million) in matrimonial assets,[88] which, at the time, was the largest award in the history of divorce disputes in Hong Kong. The Court arrived at this conclusion after taking into consideration Poon's high level of involvement throughout the creation and management of the trust, including his reserved powers as settlor, his powers as protector to consent to the removal of beneficiaries, and the passive role of the trustee in running the company and in complying with Poon's wishes.[89] All these characteristics showed that the crucial factor to treating the trust assets as part of his matrimonial assets was Poon's access to or control over the resources, not his ownership thereof.[90]

It is worth noting that the Court of Final Appeal was careful to emphasize that the trust structure in *Poon* remained intact.[91] Notwithstanding so, when a settlor attempts to reserve as many powers as possible to him or herself in establishing a trust, even an ostensibly validly created discretionary trust can become susceptible to attack and lose its asset protection function.

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84. Charman v. Charman [2007] EWCA (Civ) 503, [48] (Eng.).
85. *Id.* at [7], [23].
86. *Id.* at [7], [57].
87. *Id.* at [48]–[49].
88. Kan Lai Kwan v. Poon Lok To Otto, [2014] 17 H.K.C.F.A.R. 414, [89]–[90] (C.F.A.) (H.K.).
89. *Id.* at [63].
90. *Id.* at [28] (citing Whaley v. Whaley [2011] EWCA (Civ) 617, [113] (Eng.)).
91. *Id.* at [55].

2. Sham Trusts

If too much control is retained, a settlor may be held to not have created an effective trust at all—in other words, the entire arrangement is attacked as a sham. The classic definition of a sham trust in *Snook v. London and West Riding Investments Ltd.*[92] was applied by the court in *In re Esteem Settlement*[93]: A trust may be declared a sham if there was a common intention on the part of both the settlor and the trustee to create an arrangement different from that which would appear to have been created by the settlement documentation, as well as a common intention to mislead.[94] A sham trust is held void for all purposes, and the trust assets revert back to the settlor and are made available to his or her creditors and/or divorcing spouse.[95]

If it is clear from the trust instrument that settlor control over administration and distribution is intended when the settlor acts in accordance with his or her reserved powers, then that action supports the operation of the trust in accordance with its terms, and the trust may not be regarded as an instance of a sham. However, if he or she acts beyond his or her reserved powers, and there is evidence of the necessary shared intention not to create a trust but instead to give a false impression that one has been created, then the trust may be declared a sham. Further, in cases of extremely aggressive settlor control, there remains the risk that the degree of settlor control has in itself violated the trust concept. For example, in *Rahman v. Chase Bank (CI) Trust Co.*,[96] the settlor retained the power to appoint a certain amount of capital to anyone, including himself.[97] The trustee had the power to transfer capital to the settlor, but, in exercising that power, was to pay exclusive regard to the settlor's interests.[98] There was evidence suggesting that the settlor had in fact treated the trust property as his own, and the trustee was a mere agent or nominee.[99] The settlor exercised direct control over the trust funds, leaving the trustee without any independent role in investment decisions.[100] This was evidence that the settlor retained beneficial ownership

92. Snook v. London & West Riding Invs. Ltd. [1967] 2 QB 786, 802 (Eng.).

93. *In re* Esteem Settlement [2003] 2003 JLR 188 (Royal Ct.) (Jersey).

94. *See* Matthew Conaglen, *Sham Trusts*, 67 CAMBRIDGE L.J. 176, 176–77 (2008); TUCKER ET AL., *supra* note 62, at 111–15.

95. TUCKER ET AL., *supra* note 62, at 115.

96. Rahman v. Chase Bank (C.I.) Tr. Co. [1991] 1991 JLR 103 (Royal Ct.) (Jersey); *see also* Midland Bank PLC v. Wyatt [1994] EWHC (Ch) 696 [707] (Eng.) (analyzing where the settlor's declaration of a trust was not intended to be acted upon, but was merely "put in the safe for a rainy day").

97. Rahman v. Chase Bank (C.I.) Tr. Co. Ltd. [1991] 1991 JLR 103 [108] (Royal Ct.) (Jersey) (discussing clause 4(1) of the trust deed in dispute).

98. *See id.* at 109 (discussing clause 10 of the settlement in the trust deed).

99. *Id.* at 146–47.

100. The Court found evidence in the form of a series of examples of the dominion and control exercised by the settlor over his assets and over the trustee. *See id.* at 146–66.

of the trust property, and the Royal Court of Jersey therefore held that the settlement "was made to appear to be what it was not."[101]

The sham argument has also been raised by creditors and divorcing spouses. For example, in *Minwalla v. Minwalla*,[102] the husband had set up a Jersey trust which was subsequently attacked by the wife upon divorce. The English High Court applied English law (to the English divorce proceedings) to declare the Jersey trust to be a sham, notwithstanding the fact that it had been established under and was governed by Jersey law.[103] Justice Singer invoked *Snook* in concluding that Mr. Minwalla was the "true and sole owner" of the trust assets because he had always intended those assets to continue to be his.[104] Therefore, the trust was considered to be a sham and the divorcing spouse was able to gain access to those trust funds.

The decision in *Minwalla* may be contrasted with those in *Charman* and *Poon*, wherein the courts stressed that it is only settlor-controlled trusts that may be vulnerable in post-divorce asset allocation:

> A trustee—in proper "control" of the trust—will usually be acting entirely properly if, after careful consideration of all relevant circumstances, he resolves in good faith to accede to a request by the settlor for the exercise of his power of advancement of capital, whether back to the settlor or to any other beneficiary.[105]

The foregoing statement was quoted and applied by Justice Munby in *A v. A*,[106] where the court rejected the divorcing wife's allegation of a sham in relation to two trusts, and, as a result, ruled that the trust assets could not be treated as matrimonial property for the purposes of the divorce.[107] Justice Munby emphasized that the mere fact that a trustee complies with a settlor's request to exercise his or her discretion in a particular way does not provide a basis for a sham allegation.[108] The court further stated that particularly when the trustee is a professional, it would be difficult to establish that he or she shared the settlor's intention to mislead.[109]

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101. *Id.* at 168.

102. Minwalla v. Minwalla [2004] EWHC (Fam.) 2823 (Eng.).

103. *Id.* at [56]–[60].

104. *Id.* at [60].

105. Charman v. Charman [2005] EWCA Civ 1606, [12] (Eng.). The sham trust argument was not raised in *Charman v. Charman*.

106. A v. A [2007] EWHC (Fam) 99, [72] (Eng.).

107. *Id.* at [79], [86].

108. *Id.* at [79]–[81].

109. *Id.* at [54], [86].

B. CHALLENGES TO CONCEPTUAL NATURE OF THE TRUST

1. The Irreducible Core Content of Trusteeship

In *Armitage v. Nurse*,[110] Lord Justice Millett asserted that "[t]here is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts."[111] This endorses Professor Hayton's "irreducible core" duty of the trustee to account: Enforceability is founded upon the trustee's duty to provide information to and account to the beneficiaries.[112]

> [T]he accountability of the trustees . . . is fundamental to the very existence of the trust. . . . [Any attempt to oust accountability] would . . . be ignored as repugnant to the trust intended to be created by the settlor . . . . The settlor, surely, cannot require his trustees to withhold the information without which the beneficiaries cannot vindicate the rights that the settlor purported to give them in his trust instrument. He cannot wholly give with one hand and wholly take away with the other . . . .[113]

i. Duty to Notify Discretionary Objects of Their Beneficial Entitlements

The trustee's duties to provide information are made more complex in a modern international trust.[114] As mentioned above, a modern international trust may diminish the rights of beneficiaries and allow for trustees to be given extensive dipositive discretions. What is the scope of a trustee's corresponding duty, specifically his or her duties to provide information, including the duty to notify discretionary objects (namely, beneficiaries of discretionary trusts and objects of fiduciary powers of appointment) of their beneficial entitlements[115] and the duty to grant them access to trust information? How far can a settlor seek to modify the trustee's duties to provide information without being treated as having ousted accountability and hence being repugnant to the trust? These questions were considered by the Hong Kong Court of Final Appeal in *Tam Mei Kam v. HSBC International Trust Ltd.*[116]

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110. Armitage v. Nurse [1998] EWCA (Civ) 241, 241 (Eng.).

111. *Id.* at 253.

112. David Hayton, *The Irreducible Core Content of Trusteeship*, *in* TRENDS IN CONTEMPORARY TRUST LAW, *supra* note 43, at 47, 52–53.

113. *Id.* (footnotes omitted); David Hayton, *Anglo-Trusts, Euro-Trusts and Caribbo-Trusts: Whither Trusts?*, *in* MODERN INTERNATIONAL DEVELOPMENTS IN TRUST LAW 1, 16–18 (David Hayton ed., 1999); Terence Tan Zhong Wei, *The Irreducible Core Content of Modern Trust Law*, 15 TR. & TRUSTEES 477, 477–78 (2009).

114. Smith, *supra* note 4, at 17–18.

115. TUCKER ET AL., *supra* note 62, ¶ 23–007.

116. Tam Mei Kam v. HSBC Int'l Tr. Ltd., [2011] 14 H.K.C.F.A.R. 512, 512 (H.K.).

In *Tam Mei Kam*, Madam Tam was the mother of the late Anita Mui, a well-known pop singer.[117] In 2003, a month before her death, Anita executed a will leaving her entire estate to a trust for which HSBC acted as the trustee.[118] She did not want her mother to receive a lump sum because she was poor at managing her finances.[119] Hence, Anita wished to distribute her assets via a discretionary trust.[120] Under Clause 5(a) of the trust deed, the trustee was given wide powers to apply or appoint the trust fund for the benefit of one or more of the beneficiaries to the exclusion of others.[121] Madam Tam was one of the beneficiaries,[122] and a Buddhist association was named as the final repository.[123] The trust was accompanied by a trust memorandum of wishes in which Anita's wishes were recorded.[124] Litigation ensued because Madam Tam was dissatisfied with what she received under the trust, namely, monthly maintenance of HKD 70,000 (USD 8,965).[125] She challenged the validity of both the will and the trust on various grounds, the most pertinent of which related to the trustee's duty of disclosure.[126] Clause 33 of the trust deed provided "that the Trustee shall not be obliged to make known to any Beneficiary or the Final Repository that this Trust exists or any matters in relation thereto or that they are named as such."[127]

Relying on *Armitage*, Madam Tam argued that Clause 33 effectively deprived the beneficiaries of the rights to enforce the trust by allowing the trustee to keep the trust's existence from the beneficiaries.[128] The "irreducible core" was lacking and thus the whole trust was void.[129] The Court of Final Appeal disagreed, holding that the clause was an unusual one: Since the trustee had "very wide discretionary powers under the [t]rust" (to appoint virtually anyone except Anita and the trustee), "it [might] not exercise [those] powers in favour of any particular potential beneficiary," and so it was not necessary "to inform any beneficiary that the [t]rust exist[ed] or that he or she [had been] named as a beneficiary."[130] Clause 33 was aimed at preserving confidentiality and protecting the trustee from unwanted requests for discovery or litigation.[131] Accordingly, the trustee's duty to provide

117. *Id.* at 520.
118. *Id.*
119. *Id.* at 521.
120. *Id.* at 522.
121. *Id.* at 524.
122. In fact, she was the only person named as beneficiary in the trust deed. *Id.* at 531.
123. *Id.* at 520.
124. *Id.* at 524–25.
125. *See id.* at 520–25.
126. *Id.* at 525, 529.
127. *Id.* at 524.
128. *Id.* at 529.
129. *Id.* at 529 (quoting Armitage v. Nurse [1997] Ch 241 at 253 (Eng.)).
130. *Id.* at 529–30.
131. *See id.* at 530.

information arose only when the trustee had positively "exercised its power[]" in favor of a potential beneficiary.[132] Only if the trustee "exercised its powers [would] any beneficiary become[] absolutely and indefeasibly entitled to any part of the [t]rust [f]und[,]" and only then would the trustee be "obliged to . . . inform him or her of such entitlement."[133] In practice, if a beneficiary was appointed he would have been informed of his entitlement and the courts, following *Schmidt v. Rosewood Trust Ltd.*,[134] always have supervisory jurisdiction over a trust.[135]

Given that it is increasingly common for modern discretionary trusts to give trustees absolute discretionary power to appoint from a wide class of persons, *Tam Mei Kam* raises more fundamental questions on what a trust entails. The orthodox definition of a trust is that it "is an equitable fiduciary obligation, binding [on the trustee] to deal with [trust] property . . . for the benefit of [beneficiaries]."[136] This means that the trustee is obliged to hold the trust property for the benefit of the beneficiaries. This is also known as the "beneficiary principle"[137] at common law: Except for non-charitable purpose trusts, there is no trust unless there is a beneficiary.[138]

With respect, the Court's decision seemed to have confused the position of a beneficiary of a trust and an object of a fiduciary power. Clause 5(a) of the trust deed envisages the trustee to exercise its powers of appointment to appoint virtually anyone in the world as beneficiary.[139] Such persons were merely "objects" of the trustee's dispositive power. But Madam Tam's position was different. She was clearly already a "beneficiary" of the trust; in fact, as the only beneficiary, the trust catered for the possibility that the trust would fall foul of the "beneficiary principle" at common law if Madam Tam were to pass away before the trust fund was exhausted. By naming a Buddhist organization as the final repository, it ensured that there was a (residuary) beneficiary so that the trust would remain a valid one.[140]

Whereas objects of powers do not have any proprietary interest in the trust property and accordingly have no enforceable obligations against the

132. *Id.*

133. *Id.*

134. *See supra* note 33 and accompanying text.

135. *See generally* Richard Nolan, *Invoking the Administrative Jurisdiction: The Enforcement of Modern Trust Structures*, *in* EQUITY, TRUSTS AND COMMERCE 151 (Paul S. Davies & James Penner eds., 2017) (relying on *Schmidt v. Rosewood Trust Ltd.* in arguing that objects of powers can enforce the trust).

136. HAYTON ET AL., *supra* note 47, at 3.

137. Morice v. Bishop of Durham [1805] 9 Ves. 399, 32 Eng. Rep. 947, 947–49 (Eng.).

138. Tam Mei Kam v. HSBC Int'l Tr. Ltd, (2011) 14 H.K.C.F.A.R. 512, 513–15 (C.F.A.).

139. *Id.* at 524.

140. In other words, the beneficiary principle discussed in the preceding paragraph is complied with.

trustee,[141] the position of beneficiaries is different. Unlike objects of a power, the beneficiaries have standing to enforce trust administration against the trustee. While it is possible for Clause 33 to take away the rights of objects to be notified of their beneficial entitlements because the trustee might not exercise its powers of appointment in their favor (indeed objects of a power did not, until *Schmidt v. Rosewood Trust Ltd.*,[142] have such a power), the same argument should not apply to undermine the rights of Madam Tam as a beneficiary. Madam Tam's interest in the trust property, albeit being contingent initially, should have become vested when the trustee exercised its discretion to distribute a monthly maintenance to her. As Lord Millett and Professor Hayton envisaged, the beneficiaries' right to have the trust properly administered and the trustee's correlative duty are necessary for a trust obligation to arise.[143] Accordingly, there should be at least some beneficiaries with unrestricted rights to bring trustees to account and to enforce their rights for there to be a valid trust. Any attempt to remove the beneficiary's right to receive the trust deed and accounts, or even to curtail their right to be notified, would seem to have compromised the "irreducible core content of trusteeship."[144] In this connection, it was certainly correct for the Court to observe that Clause 33, which modified the duty of disclosure by the terms of the trust, did not render the trust as a whole invalid.[145] However, it remained unclear whether such a clause was itself invalid.[146]

ii. Duty to Provide Access to Trust Information

A related issue arises in the context of modern developments concerning the trust and the trustee's duties to provide information. Nowadays, it is increasingly common for settlors and/or trustees to limit a trustee's duties to provide information via the modern trust instrument. However, notwithstanding the rejection of the "proprietary" basis of the beneficiaries' right to trust information,[147] the Privy Council's affirmation in *Schmidt v. Rosewood* of justifying disclosure on the basis of holding trustees accountable[148] means that even when the trust instrument seeks to remove

141. *In re* Manisty's Settlement Manisty v. Manisty [1974] Ch. 17, 25 (Eng.) (suggesting in dicta of Templeman J. that the object of a fiduciary power does not have standing to bring proceedings to enforce the trust). *Cf.* Nolan, *supra* note 135, at 165–67 (arguing that objects of powers can invoke the court's jurisdiction to administer trusts).

142. Schmidt v. Rosewood Trust Ltd. [2003] Pens. L.R. 145, 145–47 (Eng.).

143. *See supra* notes 110–12 and accompanying text.

144. Hayton, *supra* note 112, at 47.

145. Tam Mei Kam v. HSBC Int'l Tr. Ltd. [2011] 14 H.K.C.F.A.R. 512, 529–31 (C.F.A).

146. *Id.* at 530–31. The Court did not decide on the validity of the clause, though it acknowledged that "it may be void." *Id.* at 530.

147. *In re* Londonderry's Settlement [1965] Ch 918 at 923 (Eng.), *abrogated by* Schmidt v. Rosewood Tr. Ltd. [2003] Pens L.R. 145, 145–47 (PC) (Isle of Man).

148. Schmidt v. Rosewood Tr. Ltd. [2003] Pens L.R. 145, 156–57 (PC) (Isle of Man) (appeal taken from Isle of Man) ("[T]he right to seek disclosure of trust documents [is] one aspect of

such rights to information from the beneficiaries, the court's jurisdiction to order disclosure cannot be ousted.

However, the prevalent use of letters of wishes in modern trust planning poses a further challenge to trustee accountability. The first English case pertaining to the issue of the disclosure of such letters, *Breakspear v. Ackland*,[149] held that, notwithstanding *Schmidt*, letters of wishes are prima facie non-disclosable because they are "brought into existence for the sole purpose of serving and facilitating an inherently confidential [decision-making process of the trustee]."[150] Disclosure of such letters is a matter for the trustee's discretion and cannot be challenged unless there is evidence of *mala fides* or failure to take into account relevant considerations.[151] This approach is extremely favorable to settlors and trustees, and clearly demonstrates that the protection of trustee autonomy and confidentiality trumps beneficiaries' demand for accountability.

At first glance, it seems difficult to reconcile *Schmidt* with *Breakspear*, which reflects the underlying policy tensions between holding trustees accountable and protecting confidentiality in the trustee's administration of the trust. It is submitted that the court should simply take the confidential nature of the letter of wishes as well as the trustee's decision-making process into account in its balancing exercise.[152] This view seems to have the support of the Supreme Court of New Zealand, which, while affirming the supervisory discretionary power of the court as laid down in *Schmidt*, held that jurisdiction "must be exercised in accordance with principle, after careful assessment of the factors relevant to the disclosure sought by the particular beneficiary."[153]

2. Integrity of the Trust Concept

The foregoing discussions demonstrate that the emergence of offshore, private-client trusts has extended the boundaries of the trust from commercial use to private client asset protection and estate planning. As some recent trust litigation in Hong Kong shows, the growing use of the modern international trust has increased the likelihood of the potential misuse of trusts to protect assets from claims by creditors/spouses or undermine trustee accountability. More fundamentally, does the evolving roles of the settlor, trustee, and beneficiaries in the modern international trust call for a re-conceptualization of the trust, re-interpretation of the content of fiduciary duty, and/or re-

the court's inherent jurisdiction to supervise, and if necessary to intervene in, the administration of trusts.").

149. Breakspear v. Ackland [2008] EWHC 220, [32] (Eng.).

150. *Id.* at [58].

151. *See id.* at [5], [70–72].

152. Other relevant factors in the balancing exercise include the position of the claimant (beneficiary or object of a power); the type of the information being sought; and the interests of all parties concerned. Schmidt v. Rosewood Tr. Ltd. [2003] Pens L.R. 145, 150 (PC) (Isle of Man).

153. Erceg v. Erceg [2017] NZSC 28, [50] (N.Z.).

definition of the irreducible core content of trusteeship? Each of these questions may pose a challenge to the integrity of the trust concept.

In the traditional English trust, once a trust has been set up, the property of the settlor is vested in a trustee who must administer the trust property for the benefit of the beneficiaries who enjoy equitable proprietary interest in that property. The settlor effectively drops out of the scene, for he or she no longer owns the property, and hence does not possess the requisite standing to enforce the trust.[154] In contrast, the settlor in the modern international trust may reserve extensive powers to him or herself or to a third-party protector. Such settlor autonomy can transform the trust into a mere settlor–trustee arrangement because it is arguable that the settlor may not have the requisite intention to transfer ownership of the assets to the trustee to create something more than nomineeship. Consequently, rather than conceptualizing the trust as a property concept focusing on the relationship between the trustee and beneficiaries to the exclusion of the settlor, the modern international trust looks increasingly like a settlor–trustee agreement—where the settlor is the dominant party and the trustee acts more like an agent.[155]

Nevertheless, even assuming that the reservation of powers does not of itself invalidate the trust (unless he or she retains de facto control over the trust property), there remains the issue of how to ensure that the settlor/protector's exercise of powers is subject to proper constraints. One suggestion is that the settlor/protector should owe fiduciary duties to the beneficiaries.[156] A traditional trust entails a strong fiduciary duty of loyalty on the part of the trustee, which is both strict and prophylactic. The classic exposition of its strictness can be found in such fiduciary rules as no self-dealing, no conflict of interests,[157] and no unauthorized profit from the

154. Astor v. Scholfield [1952] Ch 534, 542 (Eng.).

155. *See* John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 627 (1995) ("[T]he deal between settlor and trustee is functionally indistinguishable from the modern third-party-beneficiary contract. Trusts are contracts."); *see also* Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434, 470 (1998) (explaining the interplay and similarities between trust law, contract law, and property law); Adam S. Hofri-Winogradow, *Contract, Trust, and Corporation: From Contrast to Convergence*, 102 IOWA L. REV. 1691, 1705–16 (2017) (comparing agency law and fiduciary duties in the business context with fiduciary duties in the trust context).

156. *See* Belize Trusts Act, ch. 202, § 16(5) (2011) (stating, in relation to protectors that "in the exercise of his office a protector shall owe a fiduciary duty to the beneficiaries of the trust or to the purpose for which the trust is created").

157. RESTATEMENT (THIRD) OF TRUSTS § 78(2) (AM. LAW INST. 2007); UNIF. TRUST CODE § 802(b) (UNIF. LAW COMM'N 2004); *see also* Tito v. Waddell [1977] Ch 106, 113 (Eng.) (barring certain transactions based on a conflict of interest or a fiduciary duty); Regal (Hastings) Ltd. v. Gulliver [1967] 2 AC 134, 137 (HL) (Eng.) (discussing the prohibition of one with a fiduciary duty to contract with another where there is a personal conflict of interest); Boardman v. Phipps [1967] 2 AC 46, 88 (HL) (Eng.) (discussing liability of entering into an agreement where a conflict of interest exists with one whom a fiduciary has a duty to protect).

fiduciary position.[158] However, this classical interpretation of fiduciary obligation is likely to be too strict to be applicable to settlors or protectors even if they were to be subject to some form of fiduciary duty. In fact, its applicability to trustees is on the decline as well. For example, although it is trite law that trustees owe fiduciary duties to beneficiaries, the settlors of some modern international trusts may provide in the trust deed that the trustee owes merely passive duties to hold the trust property or is not required to act in the best interests of the beneficiaries.[159] The Restatement (Third) of Trusts has already acknowledged in its comments that the "fiduciary duty of loyalty is a default rule that may be modified by the terms of the trust."[160] The evolution of the modern international trust seems to have weakened the classical severity of the fiduciary obligation of loyalty. In any event, the current, orthodox formulation of the fiduciary obligation does not seem to cater to these modern developments. Given that the settlor, protector, and trustee may all be subject to some form of fiduciary duty at different times, it remains to be seen whether the classical severity of the fiduciary obligation needs to be watered down in certain circumstances, and if so, what the precise content of this version of fiduciary obligation should be and how it relates to the classic formulation.

Finally, the integrity of the trust may further be weakened by re-defining the core content of trusteeship. In a traditional trust, the trustee is an office-holder with duties, powers, and liabilities attached to that office. It is the beneficiaries who are supposed to enforce the trust, and thus, for it to be valid, there must also be ascertainable beneficiaries in whose favor the court can decree performance. However, the settlor's reserved powers inevitably curtail the scope of the trustee's independent exercise of discretion (which is supposed to take into account the interests of the beneficiaries as opposed to the settlor). The settlor's preference for confidentiality may also diminish both the trustee's duty to account and the beneficiaries' correlative right to demand trust information to hold trustees accountable. Some offshore jurisdictions have already modified the well-entrenched "beneficiary principle" to allow an enforcer to enforce the trust.[161] While this position has not (yet) been adopted by most onshore jurisdictions, the growing preference for discretionary trusts means that there is only a list of

158. The content of the fiduciary obligation has also been characterized by the proscriptive no-conflict and no-profit rules: *See, e.g.*, R.P. Austin, *Moulding the Content of Fiduciary Duties*, *in* TRENDS IN CONTEMPORARY TRUST LAW, *supra* note 43, at 154, 158; Matthew Conaglen, *The Nature and Function of Fiduciary Loyalty*, 121 L.Q. Rev. 452, 459–60 (2005).

159. *See, e.g.*, Citibank NA v. QVT Financial LP [2007] EWCA (Civ) 11, [58–60] (AC) (Eng.).

160. RESTATEMENT (THIRD) OF TRUSTS § 78 cmt. c(2) (AM. LAW INST. 2007) (emphasis omitted).

161. For example, the STAR trust of the Cayman Islands introduced the role of enforcer: Special Trusts (Alternative Regime) Law 1997, now incorporated into Part VIII of the Cayman Islands Trusts Law. Trusts Law, §§ 95–109 (2011 Revision) (Cayman Is.). An enforcer may be a natural person or a corporate entity. It is created by statue and is charged with specific duties under the law.

discretionary beneficiaries or objects as opposed to fixed beneficiaries. In some instances, the discretionary beneficiaries may not even be treated by the court as such (*e.g.*, Madam Tam in *Tam Mei Kam*), with the result that beneficiaries might have only weak powers to seek disclosure of information to hold trustees accountable. There is little doubt that such evolving roles of trustees and beneficiaries are undermining the tension of accountability between these two parties[162] and the delicate balance of rights and obligations in the trust relationship, both of which lie at the core of the trust concept.[163] In this regard, it seems unlikely to develop an irreducible core of the (modern international) trust without undermining the integrity of the trust concept.

V. CONCLUSION

The trust is a long-established legal institution in the common law world. By permitting a settlor to split the management and enjoyment of assets, it is an inherently versatile instrument that can be molded to suit the needs of a particular case. Today, not only are trusts increasingly settled by high-net-worth individuals to pass on their wealth to the next generation, the traditional English trust has also evolved as a result of modern developments pioneered by offshore jurisdictions, with the result that some classic features of a traditional trust have been eroded. Unfortunately, this evolution of the trust is a trend which is difficult, if not impossible, to reverse.

This Article has examined the use and abuse of the modern international trust as an asset protection device in Hong Kong. After identifying the innovative features of that trust that render its use more palatable to settlors, the Article shows, by reference to recent trust litigation in Hong Kong, that although the modern international trust is the most flexible device available for intergenerational wealth transfer, its evolution is increasingly posing a threat to the integrity of the trust concept. As the discussions show, the Hong Kong experience is indeed shared by most trust jurisdictions worldwide and provides the latter useful insights in confronting the controversies arising from the evolution of the trust. On the one hand, a more vigorous re-assessment of the conceptual nature of the trust, the content of the fiduciary duty, and the irreducible core of trusteeship is thus necessary to develop the conceptual requirements of its modern international incarnation. On the other hand, given that such a refined definition of the trust may weaken the integrity of the trust concept as traditionally understood, the question of whether onshore English and

162. Hayton, *supra* note 112, at 52–53.

163. *See, e.g.*, Armitage v. Nurse [1998] EWCA (Civ) 241, 253 (Eng.); BEN MCFARLANE, THE STRUCTURE OF PROPERTY LAW 551 (2008); Hayton, *supra* note 112, at 52–53; David Hayton, *Developing the Obligation Characteristic of the Trust*, *in* EXTENDING THE BOUNDARIES OF TRUSTS AND SIMILAR RING-FENCED FUNDS, *supra* note 3, at 189.

Hong Kong courts should follow the extremely settlor-friendly approach of the offshore tax havens indiscriminately, should require a policy debate of its own.