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Trustee 香港信託人公會
Hong Kong Trustees' Association

FINANCIAL SERVICES

Hong Kong Trust Industry

A Cross-Sector Perspective

June 2013

kpmg.com/cn

Foreword

Vivian Chui
Partner, KPMG China

KPMG

On 8 February 2013, the Trust Law (Amendment) Bill ('the Bill') was gazetted, propelling the Hong Kong trust industry into a new phase. The Bill seeks to modernise the trust law to facilitate more effective trust set-up and administration, and to enhance and consolidate Hong Kong's status as an international asset management centre in the long term. A Bills committee has been set up to study the Bill in detail.

This report highlights the important role that the Hong Kong trust-related industry plays in supporting a healthy financial services industry by providing trust-related services, including fiduciary, professional trustee, advisory and legal services to corporates, retail and private individuals.

Our research has identified a number of challenges the trust-related industry is facing, many of which are shared with the wider Hong Kong financial services industry. Discussions with some of the key players in the industry have revealed their passion, innovative ideas and long-term strategies for overcoming such challenges. There are also, however, clear opportunities within the market, and this report serves to share our views on how the industry in Hong Kong may be able to take advantage of them.

We would like to express our utmost gratitude to the Hong Kong Trustees' Association for their input, and to all the executives we interviewed and the many who made themselves available for discussions. We would also like to thank the many institutions and professional services that participated in our independent Hong Kong trust survey. The insights, candid views and expertise that we received have been essential to the enrichment of the report.

Last but not least, we are grateful for the comments and feedback from the Financial Services and the Treasury Bureau, and the local regulators who provided their views and valuable insights regarding the present and future of Hong Kong trust-related industries.

Ka Shi Lau
Chairman, HKTA

Hong Kong Trustees' Association

Hong Kong is a major international financial centre and the Hong Kong Trustees' Association (HKTA) represents the trust and fiduciary services industry in Hong Kong. I am therefore delighted that KPMG has joined with the HKTA to produce the first ever report on the Hong Kong trust industry. The objective of the report is to give an overview of Hong Kong's diverse trust market by providing a snapshot of its characteristics, wide range of participants, current development and issues, and by offering insights into the trends and developments in the coming years.

The HKTA's collaboration with KPMG on this project reflects our commitment to facilitating the growth and development of the trust industry. Our active participation in various initiatives has reinforced our position as an important representative body that deals with the government and regulators to steer the direction of the trust and fiduciary industry. These initiatives include the pending trust law reform and the review of the MPF system, to the impact of the Foreign Account Tax Compliance Act (FATCA) and the formulation of Best Practice Guides to raise the standards and credibility of Hong Kong trust practitioners.

I am grateful for the support of the Executive Committee, and would like to express our sincere appreciation to the excellent team of professionals at KPMG whose expertise and dedication were invaluable in putting this report together. My gratitude also goes to the many groups and individuals who have contributed to this report: members of the HKTA taskforce responsible for collaborating with KPMG on this initiative, the association's members, the HKSAR government and regulators, as well as trust practitioners, professional groups and companies for providing useful information for the survey and for giving their candid views in interviews with the KPMG team.

We hope that you will find this report interesting and useful for understanding the diverse trust industry in Hong Kong and that you will support us in promoting this important sector of the Hong Kong economy. The trust and fiduciary industry is entering a challenging and exciting phase. If we face it with vigour and a commitment to professionalism and excellence, we can strengthen Hong Kong's role as a modern trust jurisdiction and reinforce the city's position as a major financial and trust centre.

Acknowledgements

Our deepest thanks go to the individuals who participated in our interviews (in alphabetical order):

Au, Dr King Lun	Chief Executive Officer, BOCHK Asset Management Limited
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We would also like to thank all participants who spent their time completing our survey, as well as Hong Kong Trustees' Association and the Society of Trust and Estate Practitioners who facilitated the process by distributing the survey form to their members.

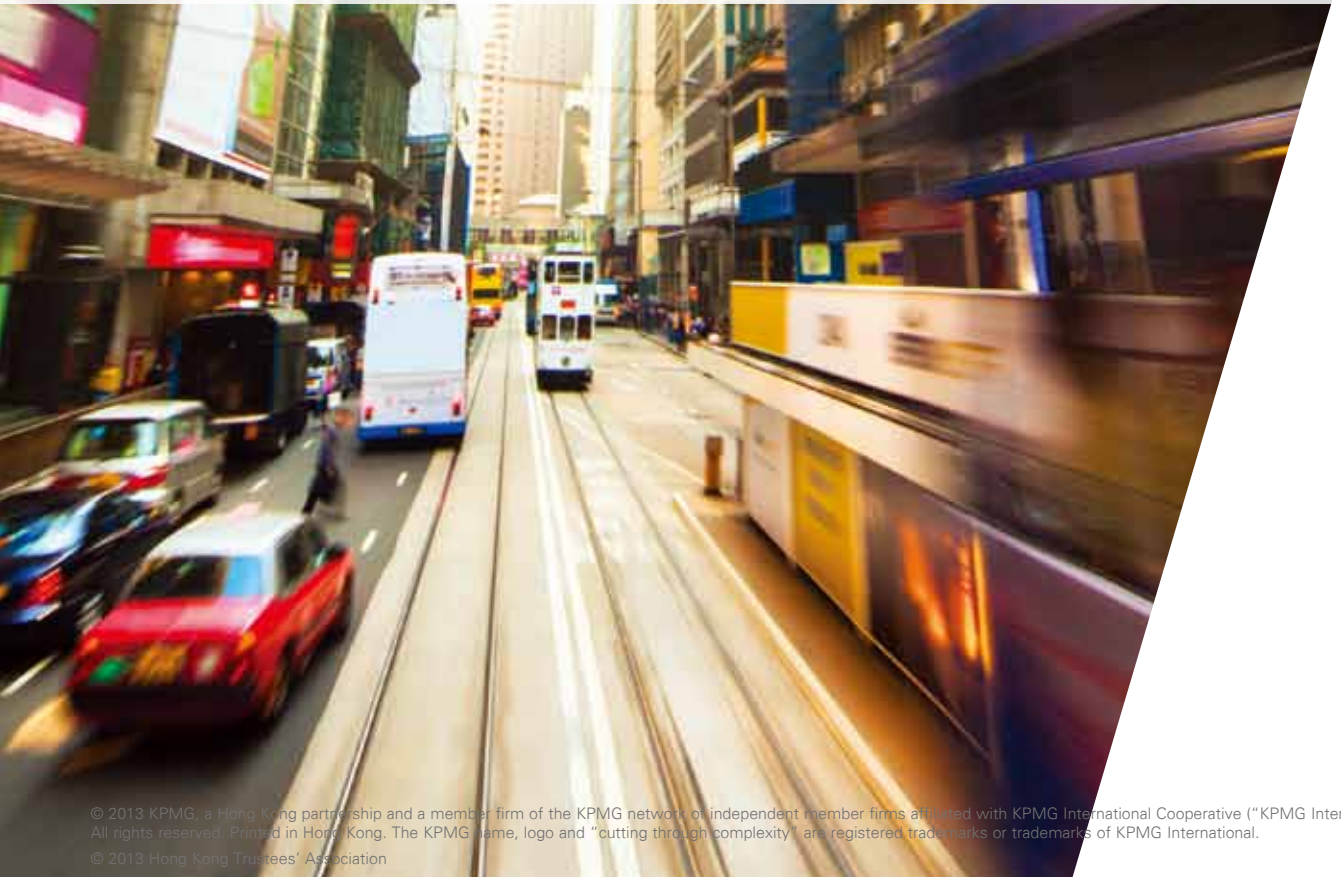
Glossary

AML	Anti-Money Laundering
C&SD	Census and Statistics Department of Hong Kong SAR
CSRC	China Securities Regulatory Commission
ECA	Employee Choice Arrangement
ETFs	Exchange-Traded Funds
FATCA	Foreign Account Tax Compliance Act
FSTB	Financial Services and Treasury Bureau
GDP	Gross Domestic Product
HKMA	Hong Kong Monetary Authority
the government	Hong Kong Special Administrative Region government and Hong Kong government (used interchangeably)
HKTA	Hong Kong Trustees' Association Limited
HKTO	Hong Kong Trustee Ordinance
HNWI	High-Net-Worth Individual
IGA	Intergovernmental agreement
IRS	Internal Revenue Service of United States federal government
'KPMG Hong Kong Trust Survey' or 'the survey'	Independent KPMG Hong Kong trust survey
KYC	Know Your Customer
MAS	Monetary Authority of Singapore
MNCs	Multinational Corporations
MPF	Mandatory Provident Fund
MPFA	Mandatory Provident Fund Schemes Authority
OCI	Office of the Commissioner of Insurance
ORSO	Occupational Retirement Schemes Ordinance
REITs	Real Estate Investment Trusts
RMB	Renminbi
SEHK	Hong Kong Stock Exchange
SFC	The Securities and Futures Commission
STEP	The Society of Trust and Estate Practitioners
the Bill	Trust Law (Amendment) Bill
'the trust-related industry' or 'the industry'	The trust business and its related businesses
UCITS	Undertakings for Collective Investment in Transferable Securities
UHNWI	Ultra-High-Net-Worth Individual

Contents

Executive summary

KPMG and the HKTA are proud to bring you this inaugural report on the Hong Kong trust industry. With the forthcoming reform of the Hong Kong Trustee Ordinance (HKTO), we consider the timing of this report to be particularly opportune – it provides an overview of the trust and related businesses ('the trust-related industry' or 'the industry') operating in Hong Kong, and highlights current trends and developments in the market.



Key features of the Hong Kong trust industry:

- Hong Kong's well-established, diverse trust industry supports various financial services sub-sectors with the financial services sector being one of the four pillars of the Hong Kong economy.
- As a global financial centre with a well-educated workforce, robust infrastructure, and a strong, sound legal system, Hong Kong offers the industry a deep and solid foundation.
- Although the industry faces vigorous competition from global and regional players, Hong Kong is the gateway to China and therefore still has a clear comparative advantage over other economies in Asia.
- The proposed amendments to the HKTO, gazetted in February 2013, aim to facilitate modern trust administration and attract more trust business to Hong Kong.
- Many industry players believe that various global and local regulatory developments will be extremely important to the development of the local trust industry.
- The ability to attract and retain talent is seen as one of the major challenges to the industry going forward.

The Hong Kong trust industry can be characterised by four important segments:

Corporate trusts

Retail funds, which are supported by corporate trust structures, have seen significant growth over the past decade. The industry players provide core trustee services and important associated activities, such as acting as custodians and administrators.

Pension schemes

These schemes are likely to continue to grow and the role of the trustee within the design of the scheme will remain pivotal. As the government is looking to increase participation in, and make enhancement to, MPF schemes, the pension system shall continue to mature over time with assets reaching a scalable size.

Private trusts

The growth of high-net-worth individuals (HNWIs) across the region, especially in China, has stimulated a surge in the demand for wealth and estate planning services, supported by advisors who specialise in private trusts.

Charitable trusts

As wealthy individuals look to create long-term legacies through philanthropy, charitable trusts are becoming important to advisors working with these individuals.

In this report, we look at how the trust industry is supporting these sectors as they expand. The various stakeholders including government officials, regulators, industry bodies and individuals are trying to grow the industry. A number of novel ideas have been put forward in several areas, including talent development, the reform of regulatory requirements and the promotion of growth, which may help the trust industry deal with the challenges and increase the opportunities that exist in the short to medium term.

State of the trust industry in Hong Kong

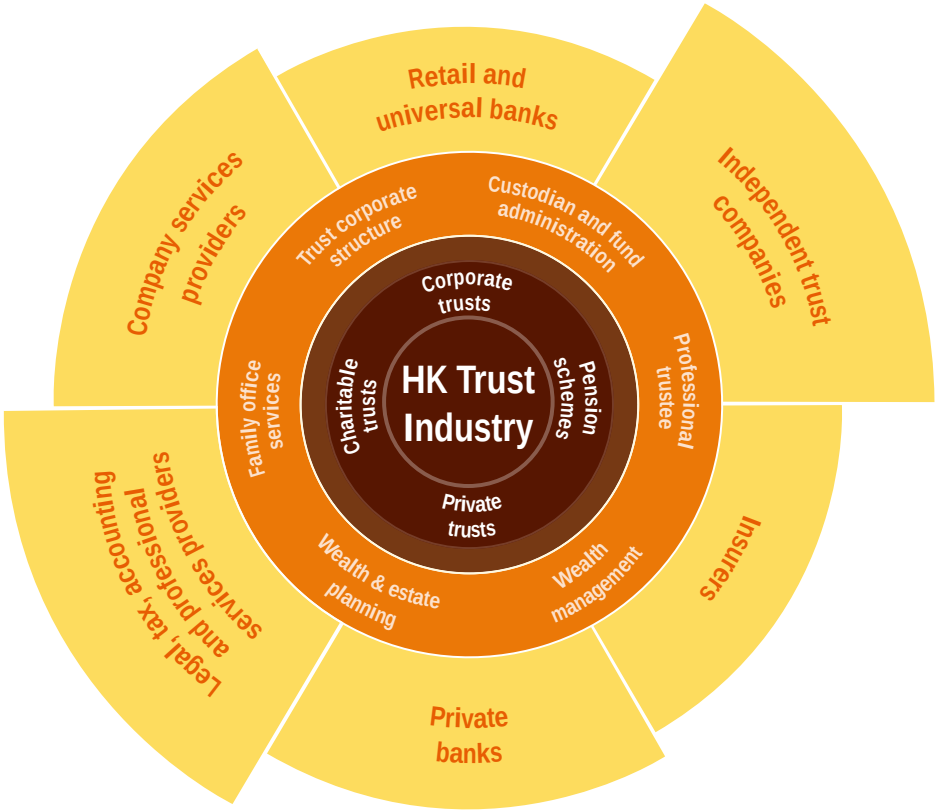
The financial services industry remains one of the four pillars of the Hong Kong economy, contributing 16.1 percent of the gross domestic product (GDP) in 2011 according to the Census and Statistics Department of Hong Kong SAR (C&SD). One of the Hong Kong government's stated policy aims is to sustain and strengthen the industry to support a stable and affluent Hong Kong.

The four pillar industries – trading and logistics, financial services, business and professional services and tourism – have for years been promoted by the Hong Kong government as the engines powering Hong Kong's economic development.

Hong Kong has an established, diverse trust industry to support various financial services sub-sectors. The common-law concept of trusts, understood by practitioners and businesses around the world, has been in use in Hong Kong from its early days as a British colony. With this robust foundation, a sophisticated industry has emerged that offers products and solutions for institutional businesses, wealthy individuals and families, retail investors, and charities. In addition to specialised technical trust services, Hong Kong has become a centre for trust administration as well as for an expanding array of trust-related businesses such as legal, tax, accounting and professional services.

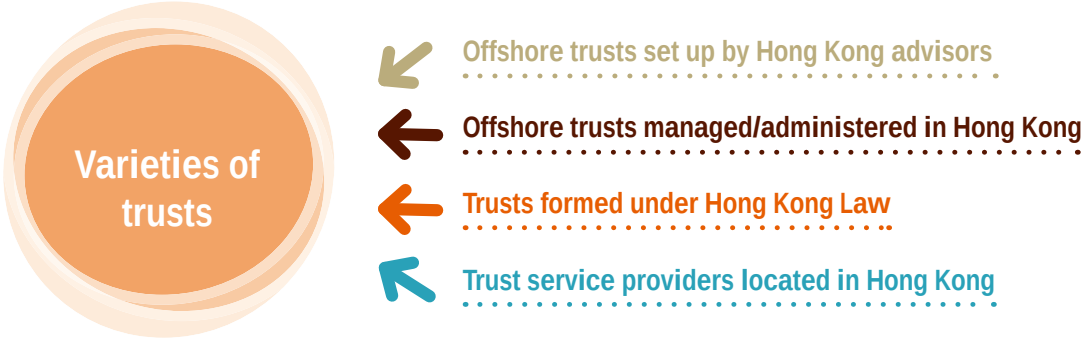
At a glance

The Hong Kong trust and related industries provide a wide variety of services, including succession advice, bespoke and conventional retail products and contemporary and sophisticated trust structures.



Source: KPMG Research

This diverse range of services and products is being marketed to and consumed by customers spanning low-income to ultra-high-net-worth individuals (UHNWIs) and families, thereby impacting on a broad segment of residents in Hong Kong and abroad. A wide range of institutions also employs trust structures, and these organisations are consumers of trust-related services. The Hong Kong trust and related businesses serve local, regional and international clients, with a variety of services including wealth and estate planning, trust administration, and fund and pension services.



Source: KPMG Research

Size of the Hong Kong trust market and related economic activities

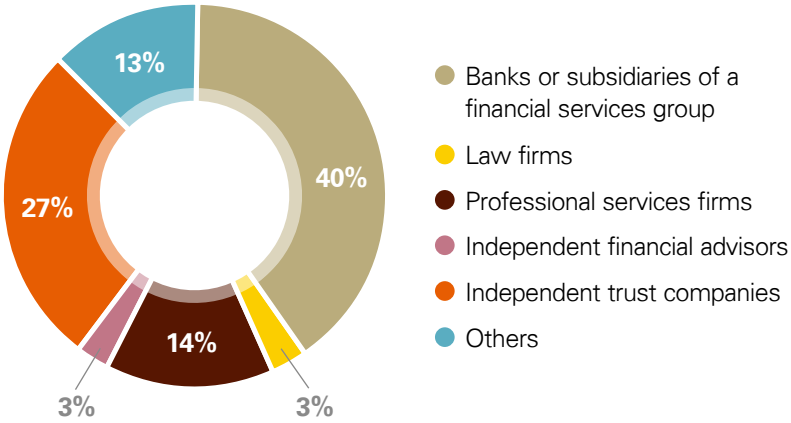
The Hong Kong trust market has extensive coverage and versatility. Therefore, estimating the size of the trust and related industries is an arduous task, without carrying out an extensive survey across all sectors of the broader financial services industry. This report attempts to give an overview of the trust and related industries in Hong Kong. It is supported by the independent KPMG Hong Kong trust survey ('KPMG Hong Kong Trust Survey' or 'the survey') as well as interviews with some industry practitioners, government officials and regulators.

While some statistical data on the number of trustees and custodians is available from the C&SD, the Hong Kong trust industry is very broad, with stakeholders from different segments of the Hong Kong financial services industry. The results of our survey and from our discussions with market players lead us to believe that the actual number of players/stakeholders in the Hong Kong trust industry could be far more than what is suggested by the official data. The information in the C&SD statistics does not separately identify market players not working as trustees or custodians – such as those in law firms, insurance companies, pension funds, private banking, and investment advisory services – but who are nonetheless extended members of the trust family.

KPMG Hong Kong Trust Survey

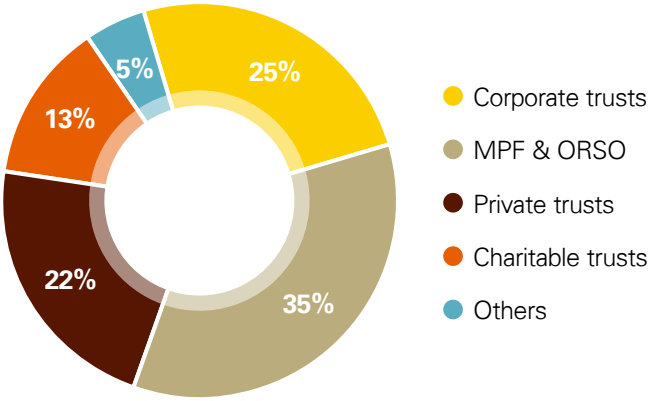
The information presented in this report was primarily sourced from KPMG research, the HKTA Executive Committee, and interviews with leading industry experts. KPMG conducted an independent survey in 2012 covering a sample of a broad spectrum of institutions from within the local market, with the majority of respondents engaged in multiple trust segments. The survey results will be referred to throughout the report as appropriate. The survey results show that the market is indeed very diverse and dynamic, with close to 50 percent of respondents managing trust assets over USD 1 billion, versus approximately 10 percent not managing any trust assets. In addition, a large proportion of trustee companies (40 percent) belong to banks or are subsidiaries of financial services groups.

Breakdown of respondents by type of organisation



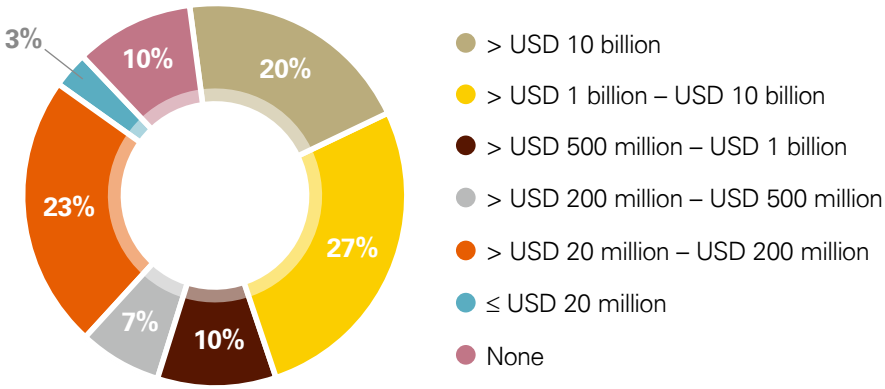
Source: KPMG Hong Kong Trust Survey 2012

Breakdown of respondents by trust segment



Source: KPMG Hong Kong Trust Survey 2012

Breakdown of respondents by Asset Under Management "AUM" size



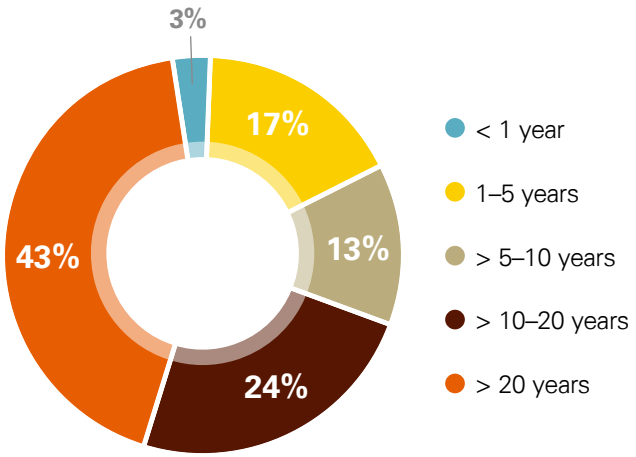
Source: KPMG Hong Kong Trust Survey 2012

The dominance of well-established firms

Nearly half of the respondents in the survey (43 percent) have been engaged in the trust-related industry for more than 20 years. Of those that employ 101–500 employees, 71 percent have been engaged in the industry for more than 20 years; of those employing fewer than 20 employees, only 31 percent have been engaged in the industry for more than 20 years. In summary, the market is dominated by well-established, mid-sized firms with a very experienced team of practitioners. The flip side is that there appears to have been limited new entrants to the industry.

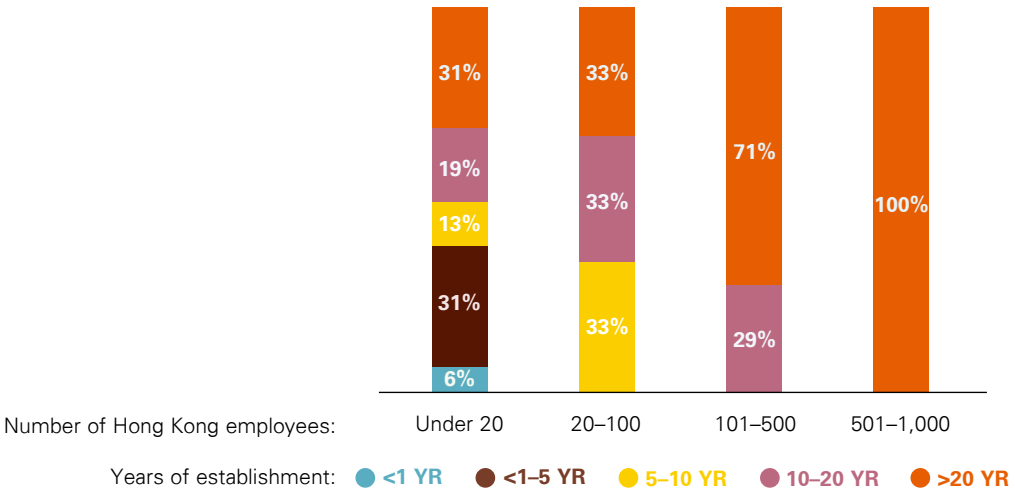
Under the general law of trusts, a trustee will incur personal liability towards the beneficiaries in respect of breaches of its duty. This could act as a barrier for entry for smaller firms, as only large financial institutions generally have sufficient capital to assume the risk.

Years of establishment



Source: KPMG Hong Kong Trust Survey 2012

Hong Kong employees across establishment



Source: KPMG Hong Kong Trust Survey 2012

In this paper, we have adopted the categorisation proposed by the HKTA, i.e. the major trust sectors within the Hong Kong industry are corporate trusts, pension schemes, private trusts and charitable trusts:

Corporate trusts

- Corporate trust providers offer core trustee services and important associated activities, such as setting up trusts, administering trusts, and acting as custodians. These service providers are vital to Hong Kong's fund management industry.
- Corporate trustees provide professional services for wholesale and retail investment products which are generally set up using a unit trust structure, and offer investors the opportunity to invest in stocks or assets that they might not normally have access to in the open market. This is combined with the ability to diversify risk.

Pension schemes

- The Hong Kong MPF system is still at an early stage of development, so the fund size is relatively small compared with mature schemes in other jurisdictions. The proportion of pension assets as a share of GDP will continue to grow, mirroring the global trend.
- Prior to the implementation of the MPF system, a number of Hong Kong employers had voluntarily been operating retirement schemes to provide retirement benefits for their employees. In many cases, these voluntary schemes, regulated under the Occupational Retirement Schemes Ordinance (ORSO), have continued to operate. The features of the schemes, including the contribution level, choice of investment options and vesting scale of accrued benefits, are governed by the individual scheme rules.

Private trusts

- The primary use of private trusts within wealth management relates to wealth and estate planning. While Hong Kong is at the centre of the world's largest and fastest growing markets for the super-rich in Asia, there is a growing demand for these services from UHNWIs seeking to manage the inter-generational transmission of wealth and implement succession plans for family owned businesses.
- As the pool of wealthy individuals increases, wealth and estate planners in Hong Kong are seeing increasing demand from second- and third-tier wealthy individuals.

Charitable trusts

- Represent a small proportion of the wider Hong Kong trust industry.
- Unlike other areas of the Hong Kong trust industry where offshore trusts dominate, onshore charitable trusts are usually formed in Hong Kong under the HKTO, where a charitable trust is one of the four structures that can be used to set up a charity in Hong Kong.

Why Hong Kong is the place to be

Over the last decades, a number of characteristics have helped Hong Kong sustain and grow a diverse trust industry:

- **Global financial centre** – As one of the world's leading financial centres, Hong Kong offers a wide range of financial, legal and supporting professional and corporate services from experienced and market-leading global, regional and local providers. This drives demand for trust services and ensures that providers of trust services have access to the full range of financial services they require. The Hong Kong government frequently organises road shows around the world to promote its financial market and institutions. Trusts set up in Hong Kong can also benefit from the relatively simple tax regime with low tax rates and favourable tax treaties.
- **Strong legal system** – Hong Kong is the only place within China governed under common law, a legal framework which overseas investors are familiar with. As a Renminbi (RMB) offshore hub as well as a trust administration centre, Hong Kong provides a stable legal and political certainty to protect assets, and thus continues to capture the new-growth market in China.
- **Wealthy, sophisticated population** – By international standards, Hong Kong is an affluent city with an educated population and a culture that likes to invest. This drives demand for retail investment, retirement planning and wealth planning services, which all use trust services.
- **Proximity to China** – China already has an important influence on the trust industry in Hong Kong due to growth of its UHNWI population as well as providing investment opportunities for offshore RMB funds and products for foreign investors.
- **Well-educated workforce** – Over the decades, Hong Kong has built up a strong pool of professional talent to serve a variety of increasingly sophisticated trust-related services. In addition, much of the workforce is multi-lingual, fluent in Cantonese, English and Mandarin, which helps capture business needs arising from the growing importance of mainland China and the Asia region.
- **Robust infrastructure** – Hong Kong has a well-established infrastructure to support business activities, including an efficient transportation network and award-winning airport, as well as a state-of-the-art telecommunications network connecting businesses with the rest of the region and the world.

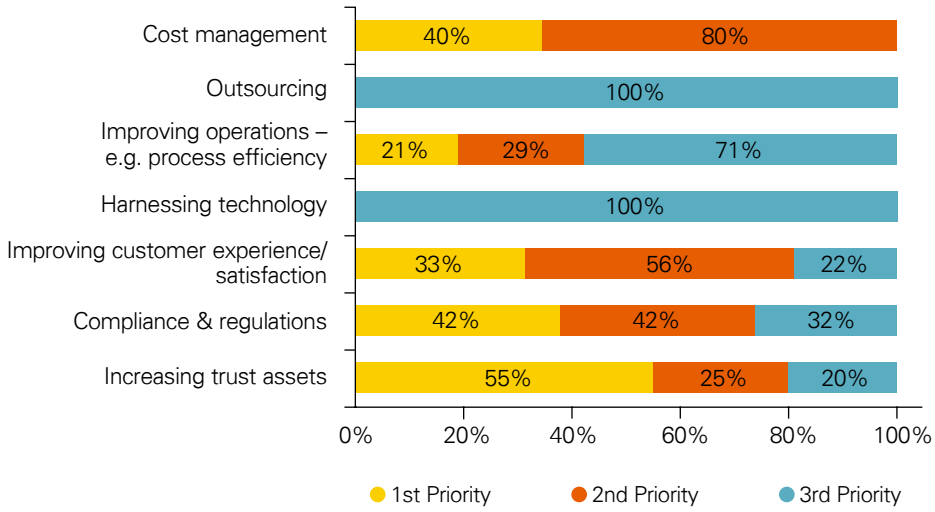
Some challenges

Despite the trust industry generally being perceived as growing and vibrant, it is facing challenges on a number of fronts:

- **Competition** – In addition to the conventional global offshore locations such as the Cayman Islands, Jersey and Luxembourg, Singapore's rise as a financial services hub is challenging Hong Kong's pre-eminence as the trust destination in Asia.
- **Role of the Hong Kong government** – A number of interviewees believe the Hong Kong government should "do more" to promote the industry internationally to consolidate Hong Kong's role as an international financial centre, given that trusts are an important vehicle for a number of financial services business activities.
- **Legal challenges** – The governing trust law, the HKTO, is outdated and the forthcoming updates[1] are long overdue. The Sino-British Joint Declaration, which guarantees that Hong Kong will not have to adopt mainland China's socialist system, will expire in 2047,[2] and this has created some uncertainty over the long-term legal status of trusts. Moreover, Hong Kong is not a sovereign state. As a result, many wealthy Hong Kong families seek to set up family trusts under the laws of other jurisdictions, even if they are administered in Hong Kong.
- **Regulatory framework** – Some industry players consider the trust industry's regulatory environment to be fragmented. This is because multiple regulators have jurisdiction over different areas of the trust and related industries, while some areas of the industry are only subject to Companies Ordinance and anti-money laundering (AML) requirements.
- **Talent** – Hong Kong has a well-educated workforce and a strong pool of local and expatriate professionals. However, the industry is facing competition from other segments of the financial services industry as well as from other jurisdictions in terms of attracting and retaining talent.

All survey respondents believe they have a clear picture of their areas of focus in the near future. Not surprisingly, they placed heavy emphasis on the increase in trust assets, but also highlighted compliance and regulations, as well as cost management, as areas they will focus on in the next 12 to 18 months.

Key areas our survey respondents will focus on most in the next 12 to 18 months



Source: KPMG Hong Kong Trust Survey 2012

1 The Trust Law (Amendment) Bill 2013 was gazetted on 8 February 2013 and a Bills committee is currently reviewing the HKTO Amendment Bill.

2 The handover of Hong Kong to China under the 'Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong' protected Hong Kong's common law legal system and therefore the trust concept. However, there was a great deal of uncertainty preceding the declaration and uncertainty remains regarding what will happen when it expires in 2047.

Hong Kong Trustees' Association

The HKTA was established in 1991 by members of the trust and fiduciary services industry as an independent non-profit organisation to represent the trust industry in Hong Kong, particularly in the areas of legislation and education. The association currently has more than 100 members, comprising predominantly fiduciary services and trust companies, and represents thousands of people working in the trust, private banking, fund services, and legal and accounting fields.

Stated mission

The HKTA's mission is to represent the trust industry in promoting high standards of professionalism and contribute towards advancing the status of Hong Kong trust professionals and the industry in the PRC and internationally.

Best Practice Guides

To help raise the standards in the trust industry and to provide better credibility to Hong Kong trust practitioners, the HKTA introduced a set of Best Practice Guides (covering trustees' conduct with regard to corporate, pension, private and charitable trusts) in 2012 to educate members and assist them in the practical application of these best practices. The HKTA also provides guidance notes and practice guidelines for the guiding principles which are specific to each of these four areas of trustee activities.

Current initiatives

Amendment Bill to the Trustee Ordinance

As the Trustee Ordinance (TO) has not been substantially amended since its enactment in 1934, the HKTA and the Society of Trust and Estate Practitioners, Hong Kong Branch decided to form the Joint Committee on Trust Law Reform to push for reform to the trust law. The committee has lobbied the government and relevant bodies for several years to try and amend the TO and the relevant peripheral legislation to create an internationally competitive trust jurisdiction in Hong Kong that meets the needs of modern-day trusts and enhances Hong Kong's position as a major financial centre.

We are pleased to say that because of the Joint Committee's work over the past years and the support of the Financial Services and Treasury Bureau (FSTB), the government's introduction of the Bill through the legislative process is now imminent.

Mandatory Provident Fund

The MPF system is in its 13th year of operation. The HKTA has played an important role in enhancing this important pillar of retirement protection and has acted as a bridge between the government/regulators and the industry participants. Recognising the prevailing sentiment of the Hong Kong people regarding the MPF system, the association joined with the Hong Kong Federation of Insurers and the Hong Kong Investment Funds Association to engage a consulting firm to review the system in terms of fund options and performance, as well as management fee. The report, released in May 2012, presents a balanced assessment of the overall system and provides sensible recommendations.

Another development in the MPF system took place in late 2012 with the introduction of the Employee Choice Arrangement (ECA) and the release of an administrative cost study by the Mandatory Provident Fund Schemes Authority (MPFA). At the invitation of the MPFA, the HKTA is now actively involved in contributing to the work of the MPF Industry Taskforce, which aims to enhance the efficiency and cost-effectiveness of MPF schemes' operation – part of which can be achieved by streamlining related procedures and automating administrative processes.

FATCA

The proposed regulations issued by the US Treasury in February 2012 regarding the implementation of the Foreign Account Tax Compliance Act (FATCA) have substantial implications for financial industries globally. The HKTA has been taking the lead in bringing FATCA to the attention of the industry, the regulators and the FSTB. The HKTA actively participated in the joint industry FATCA working group (WG) which was formed with two other associations, the Hong Kong Investment Funds Association and the Hong Kong Federation of Insurers. To represent Hong Kong's interests, the WG made submissions to the US Treasury in April and August 2012 regarding the retirement plans, investment funds, insurance companies and private trusts. Since late 2012, the WG has been proactively providing industry views to the FSTB on Annex II (covering the various Hong Kong financial products) under the proposed Intergovernmental Agreement (IGA). Moreover, FATCA seminars were organised from time to time to keep the industry participants informed of FATCA regulations and to provide input on how the industry can prepare for the requirements under FATCA.

Future direction

With a rapidly changing global economy, increasing regulation, an ageing population requiring a robust system for retirement protection and the growth of very affluent families in Asia, the HKTA sees its increasing role in continuing to protect the best interests of beneficiaries and promoting the Hong Kong trust industry.

Singapore – a closer look

Hong Kong and Singapore are both significant global financial centres. In addition, both are dominant players within the Asian market for the provision of trust-related services and as a jurisdictional base for trusts. For the past decade, the Singapore government, through the Monetary Authority of Singapore (MAS), has been actively promoting and positioning its wealth management industry, and has in turn fuelled the strong growth of its trust services industry. Some tactics adopted by Singapore are:

- **Government backing** – Development of Singapore's trust services was founded in clear policy and backed with investment. The nascent industry was then heavily promoted globally to incentivise global players and clients.
- **Regulation** – Two requirements have helped drive demand for local trust services: the requirement that trust practitioners be licensed to practise in Singapore and the condition that specific services must be performed by Singaporean licensed practitioners/providers.
- **Training and accreditation** – Some of our interviewees pointed out that Hong Kong has a well-educated workforce and an established pool of professional talent ready to support the industry. However, Singapore has taken a proactive approach and established an institution to provide accredited training, which is partially subsidised by the government.

While not all of the measures adopted in Singapore would work in and be beneficial to Hong Kong, some industry figures think the Hong Kong government should consider policy responses to some of these areas. Action may not be possible – or desirable – in all of the areas identified, but through analysing the characteristics of this competitor, Hong Kong can develop a strategy for sustaining its long-term goals for the trust and related industries.

> "The Singaporean government has been strategic in its efforts to attract the trust industry to Singapore and has coordinated with the industry on virtually every step it has taken. On the regulatory front, people can obtain one-stop guidance from the MAS.[3]"

"The competitive advantage of Hong Kong includes its location, which can capture the growth of China, and the fact that it is under the common law practice, which is the same as in Jersey, the Cayman Islands, the British Virgin Islands and Singapore. This is very important to the clients – this mature legal system and the Hong Kong legislation core system having a long history.[4]"

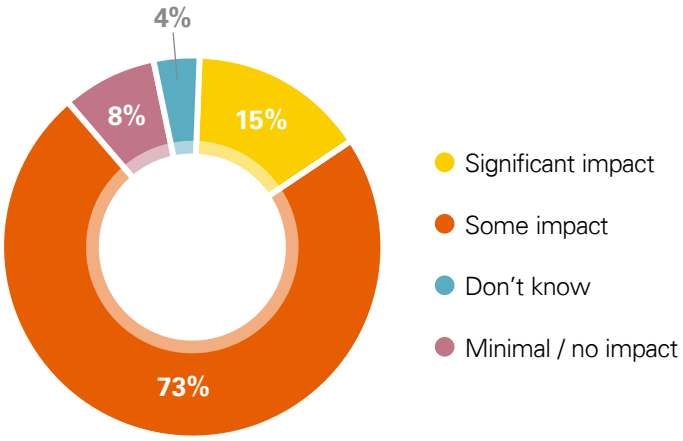
3 Philip Marcovici
4 Brian Kenyon

Legal framework – the Hong Kong Trustee Ordinance

With its roots in the common law concept of trusts, Hong Kong trust law is widely understood in the global business world; however, it is unfortunately perceived as being out of date and inflexible.

The legislative source of law on trusts in Hong Kong is the HKTO. We found that nearly three-quarters of the survey respondents agreed that the HKTO that exists today has shaped the current industry. The HKTO was enacted in 1934 to supplement and amend the common law rules relating to trustees, and was substantially based on the UK Trustee Act 1925. Since its enactment, it has not been substantially reviewed and amended, and much of the law on trusts is therefore derived from case law, and is considered outdated by a number of Hong Kong trust players.

The Hong Kong Trustee Ordinance as it exists today has shaped the Hong Kong trust industry

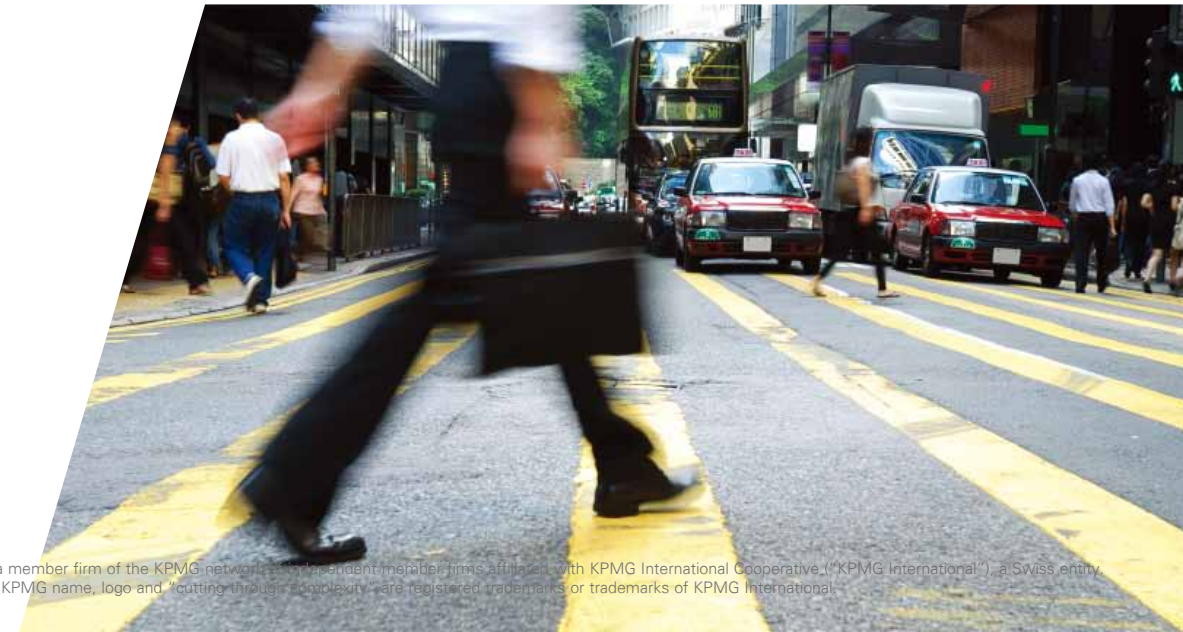


Source: KPMG Hong Kong Trust Survey 2012

Despite the growing importance of the Hong Kong trust industry and its contributions to strengthening Hong Kong's role as one of the main asset management centres in the region, some of the major common law jurisdictions such as the UK and Singapore have recently reviewed and reformed their trust laws to facilitate modern trust administration and attract more trust-related business. The Hong Kong trust industry started a dialogue with the government back in the early 2000's about modernising the trust law. The proposals and collaboration from the industry and academia, specifically from the Joint Committee on Trust Law Reform, have resulted in proposed amendments to the HKTO.

In June 2009, the Hong Kong government launched a three-month public consultation on the review of the HKTO and related matters. The consultation conclusions were considered and the government launched detailed legislative proposals for further consultation in March 2012.

The Bill was gazetted on 8 February 2013, and in view of its importance to the Hong Kong trust industry, a Bills committee was subsequently set up to scrutinise the Trust Law (Amendment) Bill 2013.



Proposed amendments to the HKTO

The Trustee Ordinance in Hong Kong has not been updated for almost 80 years, and the rules that influence the trust-related industry go beyond the HKTO. The HKTA has therefore discussed with the FSTB the proposed amendments to the HKTO and the development of the trust industry in Hong Kong. Although the proposed amendments to the HKTO are still pending the approval of the Hong Kong Legislative Council, they should make Hong Kong a more comparable jurisdiction for common law practice, putting it on a level playing field with other recognised international financial centres.

Regulators such as the MPFA and SFC also have certain regulations and guidelines to regulate relevant business activities and pension schemes. These regulators also shaped the legal framework in its present form.

Objective of the HKTO amendments

Source: KPMG Research

The proposed HKTO amendments will modernise Hong Kong trust law in response to recent trust law reforms by some major common law jurisdictions, including the UK and Singapore, and aim to enhance Hong Kong's status as an international asset management centre. Trust law reform is not a one-off exercise and should continue to be reviewed whenever necessary. The revision would allow more flexible clauses on trustees' default powers, which include enhancing trustees' power to appoint agents, nominees and custodians; expanding the power to insure against loss or damage by any event; incorporating the entitlement to receive remuneration; and expanding the scope of authorised investments.

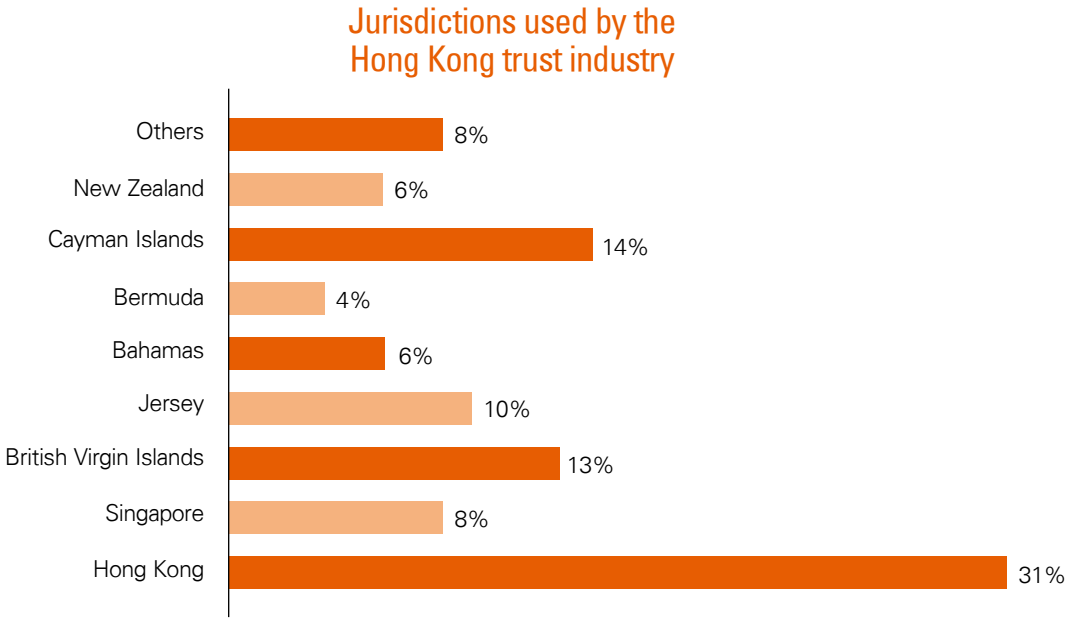
In addition, the trustee should be encouraged to have clearer responsibilities and fiduciary duties to safeguard the beneficiaries' interests. These amendments to HKTO should help achieve the right balance for different parties and stakeholders and would provide appropriate power to the trustee in the execution of its duties.

The provisions in the proposed HKTO amendments could make Hong Kong a favourable trust location and give the city the ability to continue competing on the global platform through its breadth and depth as an international financial centre.

Many trusts administered in Hong Kong are not Hong Kong jurisdictionally based for choice of law. The absence of a modern trust law has contributed to the move towards the use of offshore jurisdictions for the setting up of trusts or other company structures since clients seek legal certainty. As such, the industry welcomes the proposed changes. Although these amendments are not expected to have a transformative influence and effect on the Hong Kong market, many of the survey respondents view them optimistically, which may suggest the changes will encourage future growth in the local trust industry.

Around one-third of our respondents have used Hong Kong as a trust jurisdiction, while the remaining participants have used more traditional offshore jurisdictions, such as the British Virgin Islands, Cayman Islands, Jersey, and Bermuda.

In other words, while the business environment and investment opportunities nurture a comprehensive, well-developed trust industry, the industry has yet to realise its full potential.



Source: KPMG Hong Kong Trust Survey 2012
(Note: The results only reflect the presence in various jurisdictions, without accounting for the volume of transactions.)

Highlights of amendments to the HKTO[5]

Clarification of trustees' duties and powers:

- Impose a statutory duty of care on trustees
- Improve and clarify the law relating to short-term delegation by a single trustee
- Provide trustees with general power to appoint agents, nominees and custodians
- Give trustees wider powers to insure any trust property against risks of loss by any event
- Allow professional trustees to receive remuneration for rendering services to charitable and non-charitable trusts

Better protection of beneficiaries' interests:

- Regulate the exemption clauses of professional trustees who receive remuneration for their services
- Provide a mechanism for beneficiaries to remove a trustee on fulfilling certain conditions

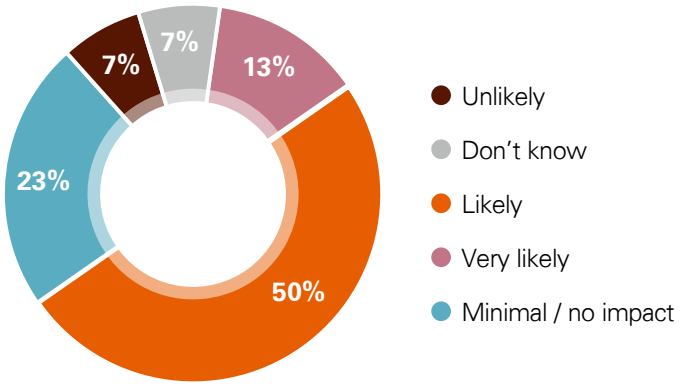
Modernisation of trust law:

- Clarify that a trust is not invalid only by reason of a limited reservation of the settlor's power
- Abolish the rule against perpetuities with respect to new trusts
- Abolish the rule against excessive accumulations of income with respect to new non-charitable trusts

5 Detailed Legislative Proposals on Trust Law Reform – Consultation paper: www.gov.hk/en/residents/government/publication/consultation/docs/2012/Trust_Law_Reform.pdf

Although some of the respondents feel the impact of the amendments to the HKTO are limited, close to two-thirds of our survey respondents are optimistic that the revised HKTO will encourage the growth of the local trust industry (e.g. new business, new entrants). This level of pre-emptive support could be crucial for better capturing the potential of the refreshed HKTO.

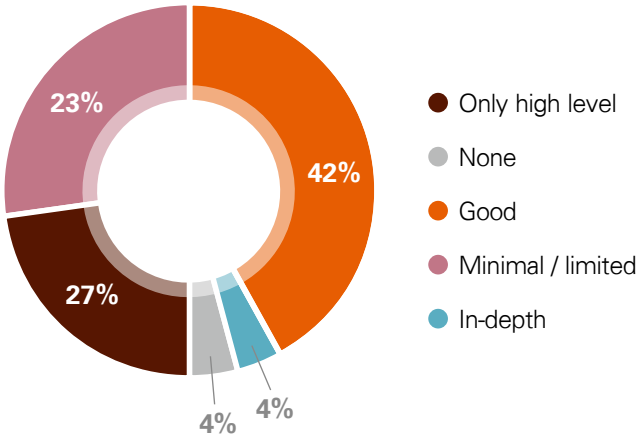
Encouragement of the growth of the local trust industy through the implementation of the proposed amendments to the HKTO



Source: KPMG Hong Kong Trust Survey 2012

Despite the importance of the proposed HKTO amendments to the Hong Kong trust-related industry, fewer than half of our survey respondents believe they have a good or in-depth understanding of these proposed changes. The industry, with the support of the government, should look at how to promote the modernised HKTO effectively, taking advantage of the momentum for increased business that it could probably generate.

Level of understanding of the proposed amendments to the HKTO

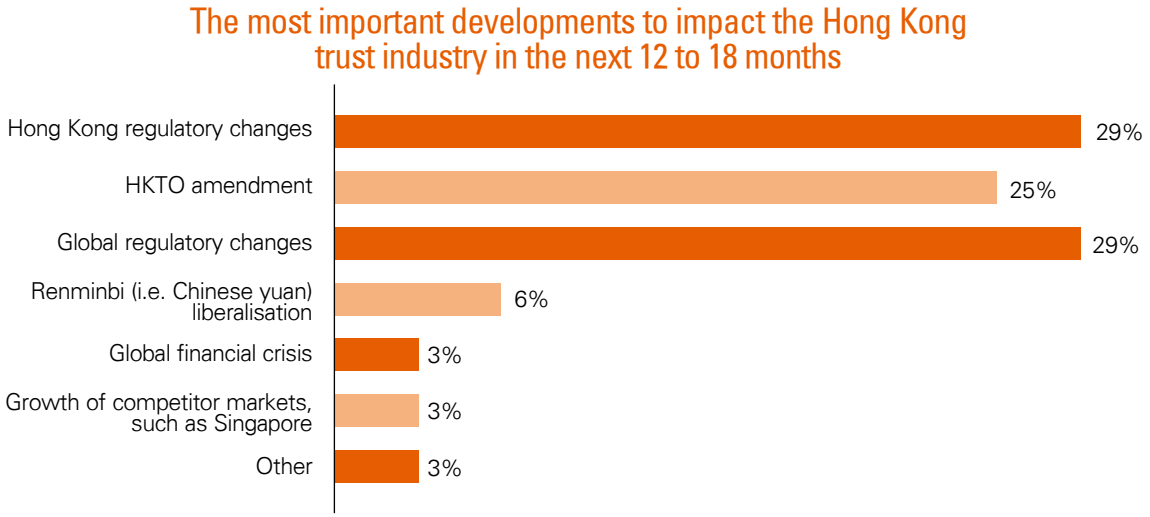


Source: KPMG Hong Kong Trust Survey 2012

The regulatory landscape

Many interviewees confirmed that their work is in some way affected by local and global regulations, and that compliance activities are now taking up an increasing proportion of their time. However, they also acknowledged the importance of regulations in fostering confidence in the industry and that they cannot be overlooked. Some players believe that enhancing the local regulatory environment is necessary for Hong Kong to retain its position as a leading trust jurisdiction.

Similarly, the majority of our survey respondents believe that in the near future, the Hong Kong trust industry is likely to focus on the various global and local regulatory developments more than other factors such as the global financial crisis, RMB liberalisation, and the growth of competitor markets.



Source: KPMG Hong Kong Trust Survey 2012

Regulation of the Hong Kong trust industry

At the moment, there are no single, specialised regulators in the Hong Kong trust industry. A number of regulators have jurisdiction over the portfolio of products and services being offered and managed in the market, often by virtue of regulating the wider banking and financial services industry. The regulators and the areas they cover are:

Mandatory Provident Fund Schemes Authority (MPFA) www.mpfa.org.hk	• Regulates and supervises the operations of MPF and ORSO schemes in accordance with the Mandatory Provident Fund Schemes Ordinance (MPFSO). It registers provident fund schemes, approves trustees of registered schemes, regulates the affairs and activities of approved trustees and formulates relevant rules or guidelines.
Securities and Futures Commission of Hong Kong (SFC) www.sfc.hk	• Regulates the securities and futures markets in accordance with the Securities and Futures Ordinance and subsidiary legislation, its responsibilities include setting and enforcing market regulations, licensing and supervising intermediaries seeking to conduct regulated activities for which the SFC has regulatory responsibility, supervising market operators, authorising investment products and/or offering documents prior to their distribution.
Hong Kong Monetary Authority (HKMA) www.hkma.gov.hk	• Regulates financial institutions (including banks, deposit-taking companies and money lenders) and aims to keep the Hong Kong dollar stable through management of the Exchange Fund and monetary policy operations in accordance with the Exchange Fund Ordinance and the Banking Ordinance.
Office of the Commissioner of Insurance (OCI) www.oci.gov.hk	• Regulates insurance companies and intermediaries in accordance with the Insurance Companies Ordinance, while self-regulatory bodies also help with supervision. • The OCI is also given the statutory role for monitoring compliance of registered MPF intermediaries, of whom the IA has been assigned as the frontline regulator, with the conduct requirements stipulated in the MPFSO.

The FSTB works together with the market regulators on policy and legislation relating to the financial market, aimed at developing a robust financial system in line with international standards, and provides an open, fair and orderly operating environment for market participants. As one of its policy initiatives, the FSTB is reforming the trust law in Hong Kong to promote the competitiveness of Hong Kong's trust services industry and attract settlors to set up trusts in Hong Kong, in order to enhance Hong Kong's status as an international asset management centre.

Some trust providers are only subject to provisions under common law, while a small but important group of industry players, such as pension trustees, has a concern over the perceived regulatory overlaps of information disclosures to regulators caused by this situation. For example, all MPF schemes and pooled investment funds established for the purpose of the MPF system have to be authorised by the SFC in Hong Kong. While pursuant to the relevant statutory requirements, MPF schemes are also required to be registered, and constituent funds and pooled products investment funds approved, by the MPFA. Pursuant to the SFC code on MPF products issued by SFC, applications of MPF schemes and pooled investment funds have to be made to both authorities concurrently under separate covers.

Single regulator model?

With the appropriate trust law in place, there is huge potential for growth in Hong Kong's trust market. Asset management, wealth management and succession planning all use trust structures. The Hong Kong government sees the possibilities and importance of trusts as a vehicle for growing wider financial services segments.

Four regulators are involved in regulating the Hong Kong financial market – the HKMA regulates banks, the MPFA regulates MPF/ORSO trustees, etc. The areas under governance are clearly defined and they have an appropriate level of information disclosure. Although these four industry regulators understand which specific rules to apply in different segments of the financial industry, the complexity of the product profiles might result in overlap, possibly in the reporting, licensing and approval processes. Some industry players we interviewed expressed the sentiment that Hong Kong could look at the feasibility of a single regulator model (i.e. a super regulator) to govern the financial market, as this could help streamline disclosures and avoid supervisory overlap.

In general, trust companies and companies or individuals providing trust services are not required to apply for regulatory approval or licensing. Only certain trustees and products are regulated by different regulators (e.g. MPF trustees are regulated by the MPFA), even though certain services in Hong Kong can only be conducted by a Hong Kong registered trust company. For example, only a registered trust company can:

- apply for a probate or administration
- be appointed by the court as a trustee, or
- apply to be an approved trustee for an MPF scheme.

Industry players from across segments of the trust industry say the industry faces the following problems:

- multiple overlapping requests for compliance information and other data
- a heightened level of risk in unregulated areas of the industry
- a challenge for some segments of the business to attract new entrants to the Hong Kong market as both providers and customers often prefer to operate in regulated markets with less onerous and simpler rules.

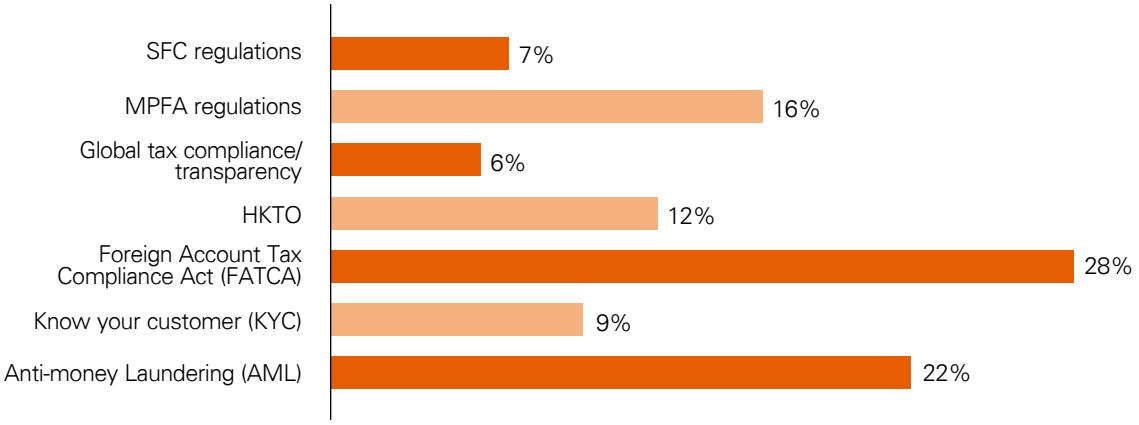
At present, the challenge is that the trust industry supports a broad range of financial services, each of which has its own laws, regulations and regulators. Any changes to the regulatory approach for the trust industry must be carefully considered and widely consulted as they must take into account the wider regulatory implications.

Global regulations

The broad financial services industry is subject to a high level of scrutiny and an increasing number of domestic and global regulations. Selling practices and AML legislation, know your customer (KYC) requirements, the emerging FATCA regulations, and changes to tax legislation have specifically targeted the trust and wealth management industries – the list goes on and trust practitioners are not immune to these challenges.

Almost 50 percent of our survey respondents agreed that FATCA and AML are the regulations that they are most concerned about because they will have significant effect on the governance process when they are fully implemented.

Law and/or regulation or regulatory initiative that survey respondents are most concerned about

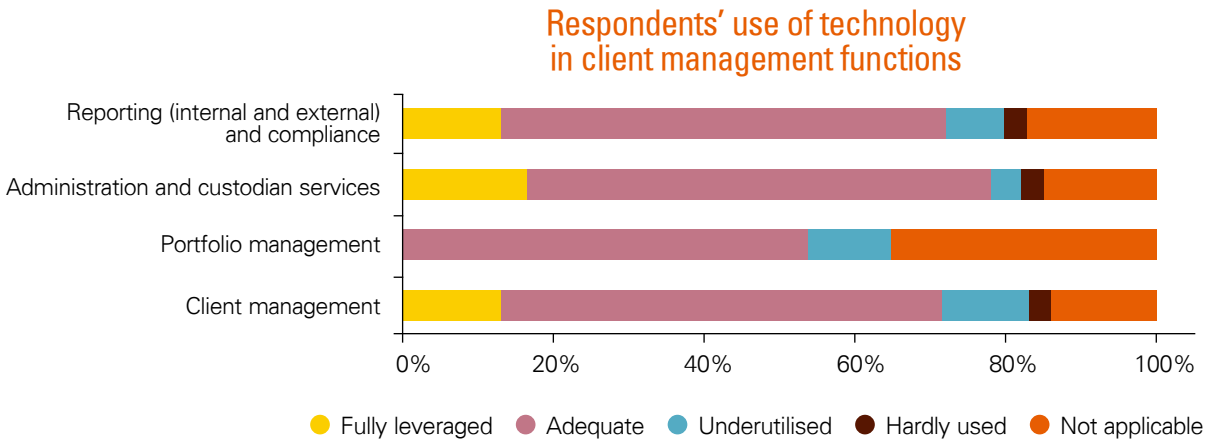


Source: KPMG Hong Kong Trust Survey 2012

What can technology do for the trust industry?

Unsurprisingly, all the industry participants we interviewed believe they are spending an increasing amount of their work day dealing with risk and compliance matters. Providers are spending more of their precious budgets on reporting, operation, technology and other specialist resources on compliance. For many, the increased costs will further reduce profitability, particularly in fund-related business where transaction volumes are high and pricing is competitive. These costs will be passed on by way of increased fees and charges. The commercial reality could drive consolidation as providers seek to exploit and achieve improved economies of scale through their target customer segments as well as by optimising their operations. Organisations are increasingly turning to an operating model which leverages global business support for managing their processes and technology while central compliance teams maintain oversight functions, amongst other responsibilities. This trend could increase the potential of driving out smaller players.

Most of the survey respondents feel they have adequately utilised technology in the areas of reporting and compliance, administration and custodian duties, and client management. However, none of the respondents feel they have fully utilised technology in their portfolio management. The survey revealed that 55 percent believe they have adequately utilised technology in terms of portfolio management, while 34 percent believe technology is not applicable to portfolio management.



Source: KPMG Hong Kong Trust Survey 2012

MNCs, with their global networks, could have less of a burden in terms of addressing the changing regulatory and compliance landscape, as their networks can monitor, understand and respond to the implications of changes to laws and regulations around the globe.

Local players, however, without global resources at their disposal, establish structures for their clients that are often susceptible to changes in the jurisdictions where trust settlors, beneficiaries or trust property reside. This means they tend to be more responsive to local market changes.

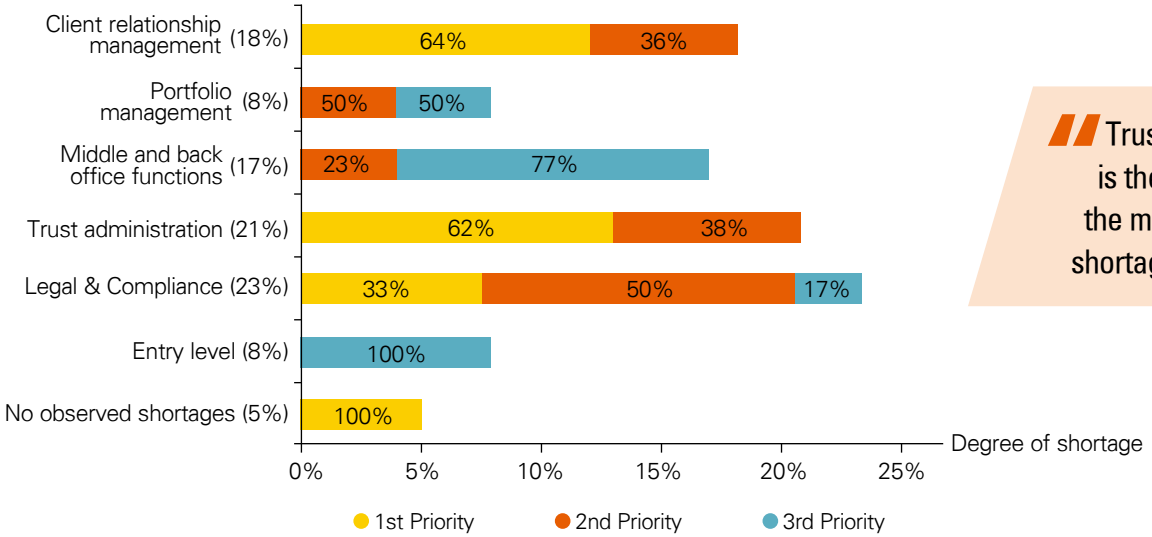
While technology may assist trustees operationally, the exercise of fiduciary responsibilities requires human judgement based on experience and knowledge. This capability is dependent on the quality of the trustee's human capital, i.e. the staff it can recruit, develop and retain.

Attracting and retaining talent

A common theme expressed by the interviewees is that attracting and retaining talent has recently become a significant challenge for the Hong Kong trust industry. The impact has been felt across the full spectrum of roles, from back-office trust administration to front-office advisors involved in sales and marketing management. Our survey shows that there is generally a shortage of personnel in the trust administration, legal and compliance, and client management areas of the trustee industry, with the biggest shortage being trust administrators. The trust industry faces internal competition for talent from other providers as well as from the wider financial services industry that is facing similar challenges. This is especially true as companies grow their business while tackling increasing regulatory issues, which can result in increased recruitment and retention costs, high training costs, a loss of intellectual property to competitors, increased risk to the businesses and constraints on future growth.

Many agree that Hong Kong is perceived to have a better talent pool of educated workers and professionals, both local and expatriates, than other parts of Asia. However, the respondents believe the lack of critical business knowledge – knowledge which tends to be held by a few key employees who have been with the company for a substantial amount of time – is their most common challenge for attracting and retaining talent (28 percent). They also consider there to be a lack of succession planning (15 percent) for key resources.

Shortage of skills in the trustee sector



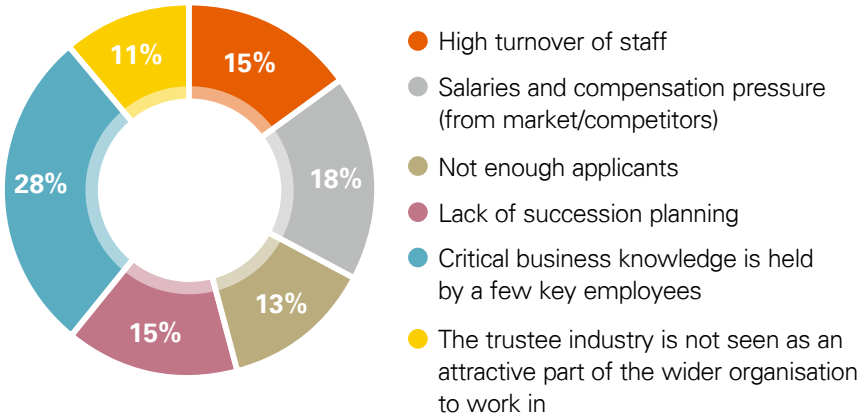
Source: KPMG Hong Kong Trust Survey 2012

> "Trust administration is the area subject to the most serious talent shortage[6]"

While the globalisation of the financial industry and the outsourcing/offshoring of tasks over the last decade have provided the industry with many specialists, they may not have a thorough understanding of the end-to-end operating model of their respective organisation as a trustee. It can therefore be difficult for them to understand the full picture and appreciate all the different types of risks involved and fiduciary duties a corporate trustee owes to its beneficiaries/investors. There have also been concerns that experienced people will retire in the years to come. The lack of talent is indeed a growing concern.

6 KPMG analysis

Staffing challenges faced by the Hong Kong trust industry



Source: KPMG Hong Kong Trust Survey 2012

The appropriate use of technology and automation could help reduce dependence on human resources and lessen the workload. The benefits would depend on the type of risks to be mitigated, i.e. a well-developed system may be a useful monitoring tool for operational and fiduciary duties that are measurable. However, there would still need to be judgement calls for unquantifiable issues. This is especially true when there is a change in internal or external circumstances and corporate trustees have to exercise due care and act in the interest of the beneficiaries/investors while still maintaining a viable business model.

To start developing talent in a systematic manner, practitioners have suggested that companies look internally for development programmes, though it may be more effective for various industry bodies to work together to develop and launch professional accreditation.

> "For quite a while, there has been no formal training or qualifications of trust professionals similar to that offered by STEP. Those who are in the industry are trained through many years of hands-on experience.[7]"

7 Pauline Wong

Corporate trusts

Corporate trust providers play an important role in the Hong Kong financial services sector, providing core trustee services and important associated activities such as acting as custodians, as shown in the table below:

Core activities	Related activities	Industry segments
• Trust set-up • Professional trustee • Trust administration • Trust structuring for corporates	• Custodian duties • Fund administration	• Fund management (including MPF funds) • Professional services – legal, tax, accounting and corporate advisory services

Retail funds, which are supported by the corporate trust structure, have seen significant growth over the past decade, although the market remains small compared to more established jurisdictions. An important element of Hong Kong's strategy is to build on the number of recently established offshore RMB funds to help achieve the city's goal of being the main offshore RMB centre.

The trust industry is vital to Hong Kong's fund management industry, providing professional trustee services for retail investment products which are generally set up using a unit trust structure. Some of the most significant products in this category include unit trusts, exchange-traded funds (ETFs) and real estate investment trusts (REITs). These products offer individual investors the opportunity to invest in stocks or assets that they might not normally have access to in the open market, combined with the ability to diversify risk.

9 REITs and 100 ETFs were listed on the Hong Kong Stock Exchange as at 31 December 2012

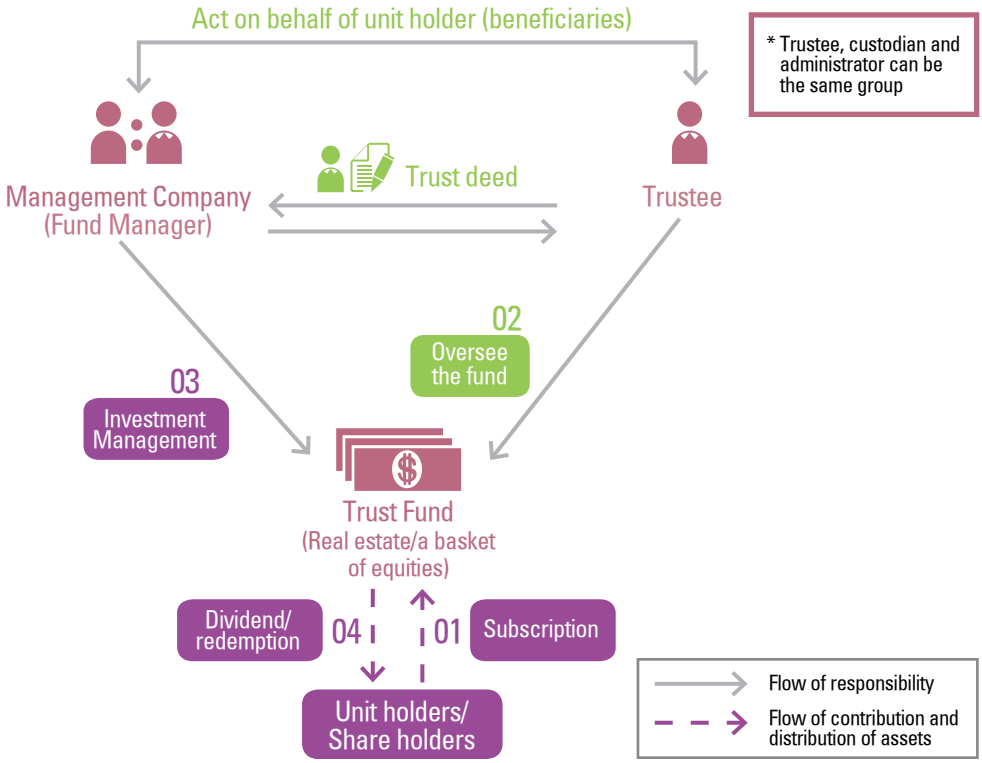
In the next few sections, we will discuss the role played by the trust sectors for several of the common products seen in the Hong Kong market.

Retail funds

The primary role of the trust industry in the retail funds sector is to provide professional trustee services, which includes providing support for setting up of the trust and the ongoing trustee services in relation to the fund. The professional trustee is appointed by the fund management company, which can also be a subsidiary of a local bank, a registered trust company, or a bank or trustee company incorporated outside Hong Kong and acceptable to the SFC. A trustee of authorised funds in Hong Kong must be independently audited and must have a minimum of paid-up capital and reserves of HKD 10 million (or must fulfil certain criteria). Trustees are subject to ongoing compliance with the regulatory obligations as stipulated in the Code on Unit Trusts and Mutual Funds issued by the SFC ('the Code').[8]

8 Securities and Futures Commission, www.sfc.hk

Using a simplified model and excluding the money flows, the ecosystem for a retail product can be described as in the diagram below:



* *The service provider, including trustees, custodians and fund administration services, will often provide a 'bundled service' to the fund manager as there are operational overlaps between these roles that offer synergistic opportunities.*

The management company and the fund manager will often be the same entity or within the same group.

Source: KPMG and HKTA analysis

The trustee must act in the best interests of the investors/beneficiaries, exercising a formal supervisory role. Although there is no exhaustive list of responsibilities and specific obligations prescribed in the trust deed, the key elements of the trustee's role include:[9]

- assisting in the legal set-up of products
- ensuring the fund is invested in accordance with the trust deeds – this requires monitoring the investment strategy and the investment restrictions, etc.[10]
- maintaining and disclosing a clear statement of the risks and objectives of the trust together with a transparent fee structure[11]
- ensuring that fees of the trustee's delegates and agents are fair and reasonable[12]
- ensuring the segregation of assets (note that in practice, this role is usually performed by the custodian)
- carrying out administrative tasks, for example maintaining the registers of shareholders
- monitoring the fund manager
- fulfilling regulatory obligations.

In terms of retail funds, the Hong Kong market is dominated by a relatively small number of global trust services providers. In addition, many of the large fund managers may have a trust company within the group which can act as a trustee as well, provided it meets the independence requirements of the Code.

Trustees for retail funds have to meet certain requirements and obligations stipulated in the Code and are strictly accountable for any failure. A trustee is not directly regulated by the SFC or HKMA, but is regulated by virtue of its role in connection with the supply of these regulated products.

In the face of high transaction volumes, complexity of products and indices, and commercial and regulatory reporting requirements, trustees rely heavily on technology to deliver their services and meet compliance obligations. The benefits that technology offers include the automation of processes and alerts, exception reporting, and complex, real-time data analysis. Organisations with fit-for-purpose systems are in a position to gain a significant competitive advantage through reduced costs, improved compliance and performance enhancements, which could result in better customer experience as well.

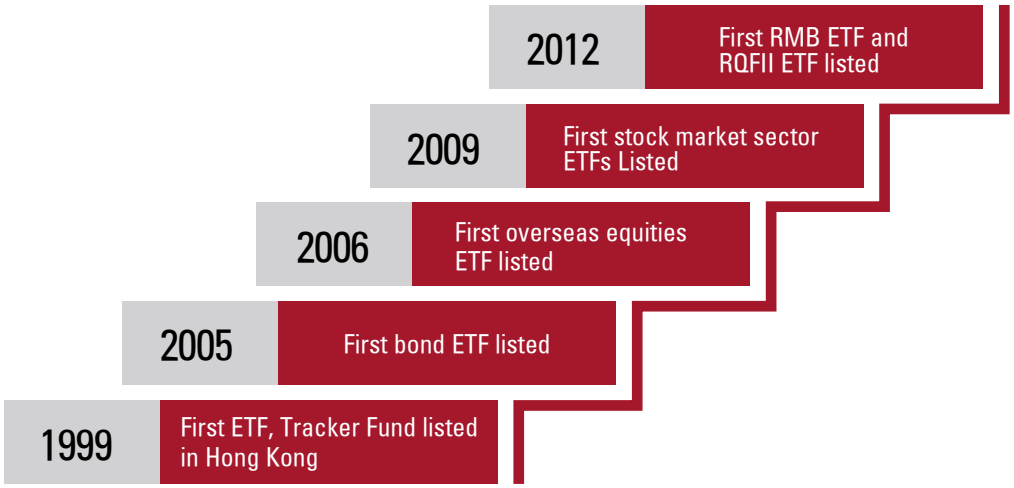
9 Note that these are not necessarily legal obligations. The role of the trustee may differ based on the terms of the trust deed and the commercial relationships between the parties.

10-12 HKTA Best Practice Guide for Trustees of Corporate Trusts

Unit trusts

A unit trust is a form of collective investment constituted under a trust deed which enables a number of investors to pool their assets and have those assets professionally managed by an independent manager.

The most common form of unit trust structure in Hong Kong is the two-party trust deed. Essentially, the trust vehicle pools the money of investors and invests in assets with a specific goal, for example investing in emerging markets. The fund manger purchases a basket of stocks (or other assets) and pools these in a fund, while the investors are in turn issued with units of the fund and become the beneficiaries (i.e. unit holders of the fund). The benefit of the trust structure is that it allows the professional fund manager to retain sole investment power over the underlying assets which are held in trust by the trustee for the unit holders to obtain a beneficial interest in the fund. A number of retail funds and ETFs have taken the form of unit trusts.



Source: Hong Kong Stock Exchange

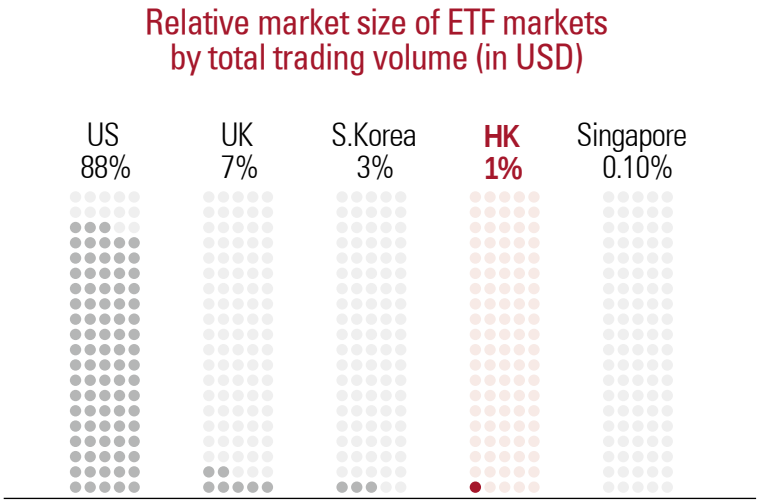
Exchange-traded funds (ETFs)

ETFs are based on the conventional unit trust, with the key difference being that shares in the fund are tradable on the Hong Kong Stock Exchange (SEHK). The first ETFs were set up in 1999 by the Hong Kong government, which was looking for a way to return significant equity stakes in listed companies without distorting the market. The market grew from there, but Hong Kong only became a major global player in ETFs when the first A-shares fund was launched by Barclays Global Investors in 2001.

"The concept of beneficial ownership enables an interest in the underlying asset to be traded without any transfer of legal ownership. By allowing investors to create units within an ETF from assets they own without diluting legal ownership, trades in ETFs do not incur stamp duty, reducing the transaction cost compared to other tradable assets.

From an investor's viewpoint, the requirement to appoint a professional trustee provides a high level of oversight and investor protection," Andrew Law from HSBC Institutional Trust Services explained.

As with other retail products, one attraction is that an ETF provides investors with the opportunity to indirectly access a broad range of markets. China A-share ETFs, for example, provide the opportunity to invest in China where this would not otherwise be possible.



Source: World Federation of Exchanges – Statistics database, KPMG Analysis

The ETF market in Hong Kong is growing fast, and is the second largest in Asia after South Korea; however, its turnover remains small compared to the US and London markets.[13]

13 Interim Report of the ETFs, World Federation of Exchanges, 2012

> The five RQFII ETFs listed on the SEHK brought in over USD 7 billion AUM as of the end of May 2013 since being launched in September 2012. Further growth is expected in RQFII funds with over 10 more new RQFII ETFs in the pipeline and an increase in the different types of funds available to investors is anticipated; for example, additional funds in precious metals, which were launched in November 2012. In the long term, future growth will be determined by Hong Kong's success in continuing to act as a financial centre recognised for its legal system and transparency, and specifically to what degree China continues to use Hong Kong as the major market for Chinese ETFs and other funds.[14]

Real estate investment trusts (REITs)

REITs are collective investment schemes designed to provide returns to investors through targeted investment in a portfolio of income-generating real estate. They employ a structure similar to that of unit trusts. As with other retail funds, REITs provide investors with the opportunity to invest in high-end and commercial property. RMB-denominated REITs have recently been introduced: the first RMB-denominated REIT and the REIT with the largest capitalisation, Hui Xian REIT, is listed in Hong Kong.

Use of trust structures by corporates

Under Hong Kong law, businesses can be set up using a trust structure. However, this structure is relatively uncommon in Hong Kong, using either onshore or offshore trusts, as corporations tend to use other corporate structures.

The China market

As we have seen, the Hong Kong corporate trust market mainly exists to support the retail funds market. The rise of the China economy has already benefited the ETF market, with the success of A-share funds driving significant growth. In the short term, the Hong Kong market expects to see a continued increase in RMB-denominated products in the retail funds sector.

Another effect of Chinese growth has been the entry of Chinese fund managers into the Hong Kong market, a trend that is expected to continue. Hong Kong trustees can help new market entrants navigate the Hong Kong market.

In the longer term, the future of the Hong Kong corporate trust industry will be significantly impacted by the policies of the Chinese government. If China chooses to use Hong Kong as the main centre for ETFs and other retail funds, the market will continue to grow.

Dr King Lun Au from Bank of China (Hong Kong) Asset Management Limited expressed: "Undertakings for Collective Investment in Transferable Securities[15] has achieved sufficient economies of scale to gain market importance. Hong Kong would need to start something using its own structure to get consensus from the mainland regulator, the China Securities Regulatory Commission. Once the structure and rules have been set up, Hong Kong can then start striving for economies of scale and develop itself into mainland China's asset management centre for overseas investments."

In early 2013, the SFC announced its current work plan on the mainland China–Hong Kong mutual recognition of funds, with the aim of streamlining the process of the local authorisation of funds. This was in the HKSAR government's 2013–14 Budget as a means of developing the asset management business in Hong Kong. It is envisaged that qualified SFC-authorised funds domiciled in and operating from Hong Kong would enjoy the status of 'recognised Hong Kong funds'.

Legal and regulatory challenges

The corporate trust industry is facing and will probably encounter in the foreseeable future:

- **Multiple regulators** – The service providers acting as trustee for funds in the financial industry are regulated according to their licensing regime, for example, by the HKMA (banks) and MPFA (MPF funds). Additionally, the trustees are not directly regulated in the funds sector (other than under the MPF scheme). This may lead to overlaps and gaps in regulation and a lack of specialised regulatory oversight.
- **Independence of trustees** – Under the SFC Code on Unit Trusts and Mutual Funds, independence between the trustees and fund managers is required. However, some market participants are concerned that there may be a perceived lack of segregation of duties within the Hong Kong market, with many providers in the same group acting as fund manager, trustee, custodian and fund administrator.

> "If the Hong Kong regulators can come up with tailored rules that mainland regulators are comfortable with, Hong Kong domiciled funds can then enter the mainland China market and further strengthen Hong Kong's role as mainland China's gateway in the long run.[16]"

14 Andrew Law

15 According to the European Union (europa.eu), Undertakings for Collective Investment in Transferable Securities are investment funds regulated at the European level and were first introduced in 1985. "Under the EU UCITS Directive, a fund authorised in one Member State can be marketed in any other provided that the authorities of that Member State are notified (the 'host' authority)."

16 Dr King Lun Au

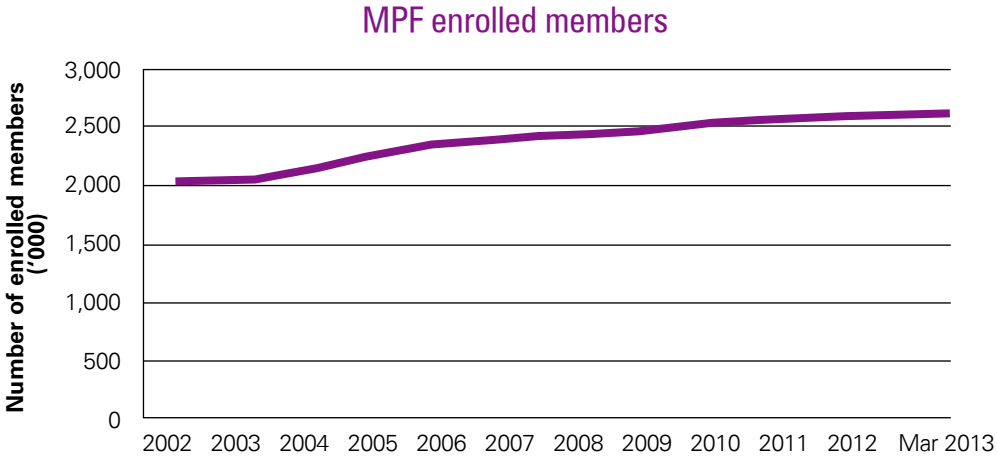
Pension schemes

The Hong Kong MPF system was established in December 2000 with the aim of developing a robust retirement system for an ageing population. It is a mandatory, privately managed, fully funded contribution scheme. As at the end of June 2012, around 71 percent of the employed population was covered by the MPF schemes and 14 percent by other retirement schemes such as the MPF-exempted ORSO schemes. The scheme is at an early stage of development and the fund size is relatively small compared with mature schemes in other jurisdictions. The proportion of pension assets as a share of GDP will continue to grow, mirroring the global trend. In addition, a number of our interviewees remarked that they feel the creation of the MPF system marked a turning point in the Hong Kong trust industry and led to the rise of a number of funds in Hong Kong. As at 31 March 2013, there were 41 registered MPF schemes offered in the market, which in turn delivered 469 constituent funds.

The number of enrolled MPF members has increased to 2.6 million, resulting in the average assets under management totalling HKD 11.1 billion per scheme and HKD 175,465 per enrolled member.

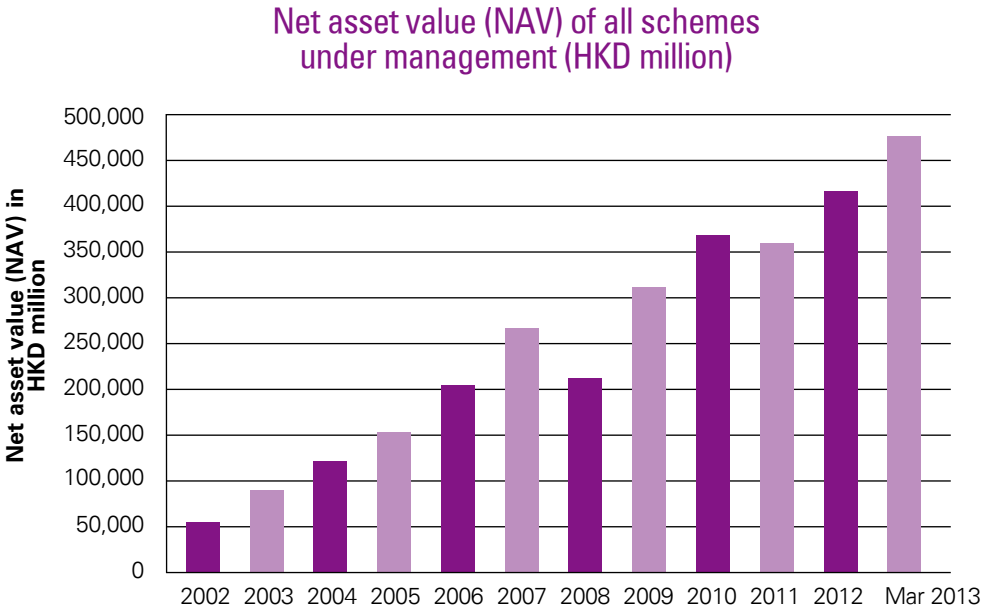
ORSO

Before the implementation of the MPF system, many Hong Kong employers had been voluntarily operating retirement schemes to provide retirement benefits for their employees. In many cases, these voluntary schemes, regulated under ORSO, have continued to operate. The features of the schemes, including the contribution level, choice of investment options and vesting scale of accrued benefits, are governed by the individual scheme's rules.



Source: MPFA statistics

The aggregate net asset value (NAV) of all schemes under management has continued to grow over the years and reached HKD 455.3 billion as at 31 March 2013.[17]



Source: MPFA statistics

17 MPFA, www.mpfa.org.hk/tch/information_centre/statistics/mpf_statistics_update/index.jsp

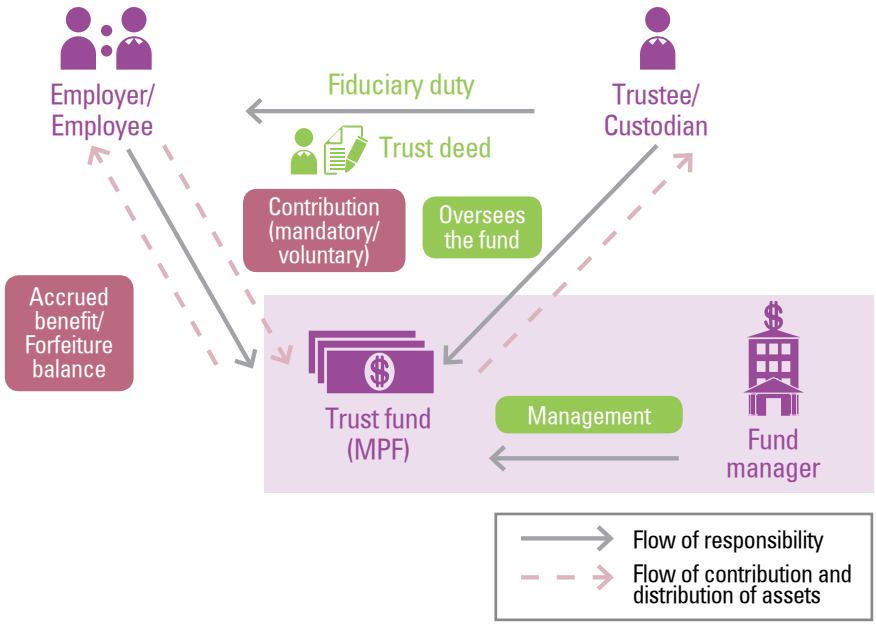
These schemes are likely to continue to grow and the role of the trustee within the design of the scheme will remain pivotal. As the government is looking to increase participation in, and make enhancement to, MPF schemes, the pension system shall continue to mature over time with assets reaching a scalable size.

A trustee applicant must meet stringent criteria before being granted approval. There are currently 19 trustees which have been approved by the MPFA. It would be difficult for an approved MPF trustee to exit its role since a successor must be sought before a trustee is permitted to resign.

The role of MPF trustees

The MPF was set up based on a trust structure, in which the trustees assume significant fiduciary responsibility in relation to the MPF schemes and are entrusted with the overall administration and management. While investment decisions are made by the fund managers, the trustees have a high degree of responsibility to ensure that investment decisions are in accordance with the trust deeds and the applicable laws and regulations. In addition, approved MPF trustees have a duty to supervise and exercise proper control over persons selling/advising on MPF schemes, i.e. MPF intermediaries.

The ecosystem for MPF can be summarised in the diagram below:



* *Trustee, custodian and administrator can be the same legal person*

Source: KPMG and HKTA analysis

The regulatory environment and challenges

Financial services companies including insurers, banks, investment management companies and trust companies currently may participate in the MPF scheme as trustees, scheme sponsors, custodians and/or investment managers. Investment decisions for all MPF scheme assets are generally executed by investment managers who have registered with the SFC; approved trustees will have oversight over these investment managers. Intermediaries and the selling process are required to comply with the relevant regulations and requirements set out by the MPFA and supervised by other frontline regulators (i.e. the HKMA for banks, the OCI for insurers as well as the SFC for the securities sector).

The MPF system as a whole is regulated by the MPFA, which takes a "proactive, risk-based supervisory approach in supervising MPF approved trustees".[18]

Mission of the MPFA

To ensure the provision of retirement protection for Hong Kong's workforce through an effective and efficient system of regulation and supervision of privately managed provident fund schemes.

In implementing its regulatory role, the MPFA is perceived to have adopted a more rules-based approach to supervising trustees. This practice, supported by significant human resources, certainly seems to encourage rigorous compliance. However, some industry players commented that such an approach may lead to a focus on the 'letter of the law' rather than on the objective. Some in the industry are calling on the MPFA to take a more strategic approach to supporting the development of the industry, based on a clear long-term vision.

From the regulator's perspective, it is critical that detailed and clear requirements are in place so that there is no ambiguity for the trustees and so they can better protect the assets of the participants.

The MPFA has focused much of its regulatory effort on the trustee, and it has been suggested that the role of other stakeholders, such as sponsors, could also be examined. As with corporate trusts, there is a concern within the trust industry that the regulator is placing responsibility for fund performance on trustees when the trustee players believe that it should really be the responsibility of sponsors. Another issue common to a number of trust areas is that there are perceived overlaps and gaps in regulators' activity. For example, similar MPF products are regulated by different regulators depending on which channels they are sold through (insurers, banks or investment advisors).

FATCA also represents a challenge for the MPF sector as the scheme is currently within the scope of the regulations and MPF schemes are unable to achieve exemption based on the current regulations. The industry hopes that MPF and ORSO schemes could be exempted from the US IRS rules, as such have been achieved by provident fund systems in other jurisdictions. The involvement of the government and the regulators is of critical importance.

Prescriptive approach versus principles-based approach

"The MPF industry often asks for more outcome, or principles-based regulation, but this is in contrast to the way they actually behave. Any regulatory instrument that we issue that is drafted at the principles level will usually be met with endless requests for more details.[19]"

Some of the trustees interviewed regard the compliance reporting requirements as onerous, with one interviewee noting that there has been no "rationalisation". Of the four trust-related segments covered in this report, interviewees in the MPF sector said they spent the highest proportion of their time on regulatory and compliance matters. One interviewee felt that this compliance focus is having a negative impact and that trustees should be allowed to "focus on how to improve the service for members in respect of the scope and investment standards".

18 MPFA, www.mpfa.org.hk/engm/supervision/supervision_trustees/proactive_supervisory/index.jsp.
19 Darren McShane

Where can the MPF trust/trustees go from here?

The MPF system is still young and its continued development will be driven by the way regulators and the industry respond to some key challenges and opportunities:

Adding value towards wealth management

- **Increasing investment opportunities** – The investment returns on MPF schemes may improve if a wider range of asset classes is permitted under the MPF investment rules. Ka Shi Lau of the BCT Group believes that "permitted asset classes and the investment restrictions for MPF are currently rather limited and cannot provide sufficient risk diversification to scheme members, especially with markets becoming much more volatile". ORSO rules offer more flexibility and could therefore be considered by the MPFA as a useful benchmark.
- **Providing financial advice** – To provide a service that truly meets the needs of the scheme participants, many in the industry feel that the provision of affordable personal financial advice could help members make informed choices of the fund options available to them. "Some members do not choose an option and are automatically entered into the designated default fund of a scheme, which may not, however, be the best fund for these individuals. In other jurisdictions, trustees would be regarded as not having carried out their duties satisfactorily if they had allowed the beneficiary to enter an inappropriate fund," elaborated Michael Huddart of Manulife. It is important that the government and regulators work with the industry and relevant parties to set up the framework allowing qualified professionals to offer more holistic retirement planning advice to MPF members.

The implementation of the MPF Employee Choice Arrangement (ECA), which came into effect on 1 November 2012, allows participating employees to transfer their own accrued benefits in their MPF contribution accounts to other schemes of their own choice. It is hoped that this will lead to employees more actively managing their MPF funds.

"We would like to have more flexibility to talk to members about their total retirement needs so that we can help them better understand their financial objectives and provide them with wealth accumulation options to help them achieve these objectives.[20]"

Achieving appropriate levels of return for industry players

- **Fee levels** – The fee levels for MPFs have been a thorny issue and the focus of negative media attention. Though many industry players believe that the fees charged are fair compared to similar schemes around the world, providers are concerned by the high compliance costs involved in running their business. To be successful, the system needs to provide all stakeholders with returns that are fair, but attractive enough to encourage participation.
- **Innovation in the use of technology** – The importance of technology for reducing costs and managing compliance, cannot be understated. There is potential to create a central clearing house for MPF contributions and payments to be used by all trustees and providers. However, the smaller players in the market may not be able to contribute. Another possible development is for employees to make direct contributions to their MPF accounts online.

Some interviewees said they feel that technology is an extremely important tool for managing compliance and reporting requirements effectively. The automation of processes could enable organisations to reduce their costs, which is essential given the low margin and high compliance costs associated with trustees' duties and the administration of the MPF business. Improved returns may therefore be achieved by leveraging efficient technology to create economies of scale. New players are only likely to be attracted to the industry if the pensions sector is further reformed.

20 Michael Huddart

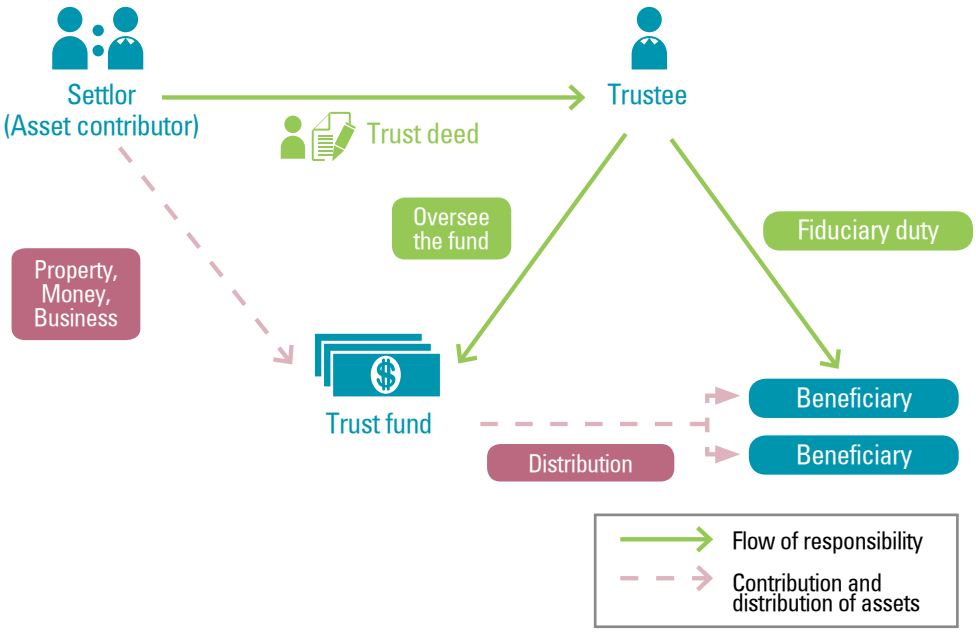
Private trusts

Hong Kong is at the centre of the world's largest and fastest growing markets for the super-rich in Asia. A 2012 study revealed that the number of people in Asia with USD 1 million or more held in easily investable assets hit 3.4 million in 2011, totalling USD 10.7 trillion in asset value,[21] making it the highest number of super-rich individuals in the world. Hong Kong and Singapore are in close competition to be the destination of choice for this wealth, and both have strong and expanding wealth management sectors.

Wealthy individuals are not new to Hong Kong. The growth across the region, and in China especially, has seen a surge in the demand for wealth and estate planning services which are supported by advisors who specialise in private trusts.

The primary use of private trusts within wealth management relates to wealth and estate planning. There is a growing demand for these services from UHNWIs who are seeking to manage the intergenerational transmission of wealth, implement succession plans for family owned businesses and pursue long-term philanthropic goals. As the pool of wealthy individuals expands, wealth and estate planners in Hong Kong are seeing increasing demand from second- and third-tier wealthy individuals. Jonathan Hubbard of UBS Wealth Planning says the industry believes that it is "still only scratching the surface in terms of families who could benefit from wealth planning services".

The ecosystem of a private trust can be summarised below:



Source: KPMG and HKTA analysis

In Hong Kong, wealth and estate planning services are mainly provided by private banks (although they may be offered by an independent trust company within the group), law firms and independent trust companies. Many providers maintain only a representative office in Hong Kong as there are no regulatory restrictions on this.

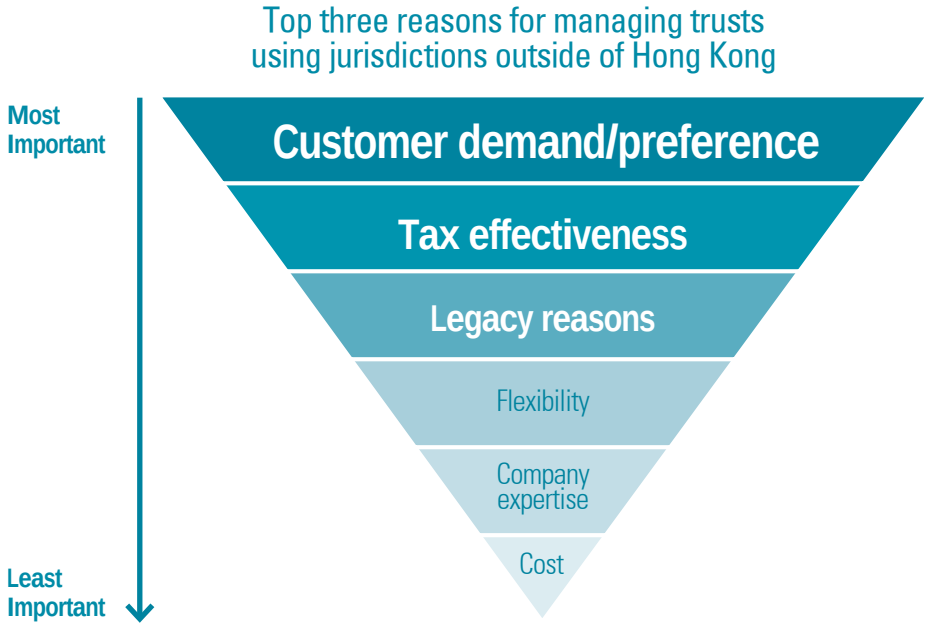
As an area where relationships and reputation are crucial, new entrants find it challenging to build market share unless they have a global brand upon which to build. Private trust businesses that can tap into their bank's private banking client base or leverage existing corporate banking clients are in a strong position to continue growing. At present, the volume of opportunities means that more overseas businesses are coming out to the region.

While the private trust industry is successful in Hong Kong and has huge potential for growth, many of the trusts themselves are not trusts governed by Hong Kong Law. The outdated nature of the HKTO and legal uncertainty around China's position on Hong Kong trust law post-1997 and 2047 (when the 50-year period that Hong Kong's system was to remain unchanged after unification in 1997 is up) have contributed to the preference in the use of offshore trusts by Hong Kong settlors and their advisors.

Our survey respondents say that customer demand, tax effectiveness and legacy reasons are the top three most important factors for establishing trusts under offshore jurisdictions. The abolition of estate duty in Hong Kong, which came into effect in 2006,[22] changed the dynamics of the industry, with estate duty mitigation no longer a factor in structuring. This has not, however, influenced the trend towards offshore trusts. In this market, the clients' financial assets are typically placed in offshore trusts, which manage both onshore and offshore assets, including businesses and property. A similar model is being used in most markets.

21 Royal Bank of Canada and Capgemini study, 'World Wealth Report 2012', quoted in 'Asia's millionaires outgrow those in N America', *Financial Times*, 19 September 2012

22 Revenue (Abolition of Estate Duty) Ordinance 2005



Source: KPMG Hong Kong Trust Survey 2012

The wealth and estate planning advisors' relationships with clients are fundamental for the advisor to be effective. Sufficient trust and confidence must be built up for the clients to share deeply personal, sensitive, confidential information with their advisors in order to come up with a suitable structure. Periodic face-to-face meetings are therefore essential.

The growth of family offices

Family offices – where a UHNWI sets up his/her own company to manage his/her private financial and legal affairs – have become increasingly popular and sophisticated. Private banks are looking to take advantage of this opportunity by setting up dedicated teams to provide family office services. These may be attractive to those super-rich clients who do not want to run their own full-time family office.

What is the potential impact on Hong Kong's private trust industry?

- Wealth and estate planning advisors need to work to build relationships with family offices as well as with the ultimate client in order to win clients; they should also ensure family offices understand their role and the services they provide.
- Family offices tend to use multiple providers and the super-rich will typically have a number of accounts with different private banks – tension therefore exists between this model and the wealth planning advisors' need for a more exclusive relationship with their clients.
- For wealth and estate planning, face-to-face contact with the settlor is vital and so advisors need to learn how to work effectively with the family office, which may act as a 'gatekeeper' for the settlor.

Developments in wealth and estate planning in Hong Kong

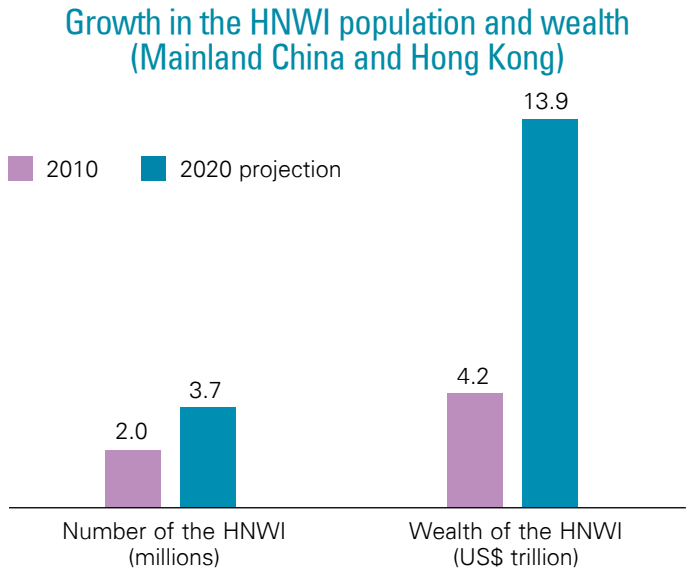
These are interesting times for the Hong Kong private trust market, which is being faced with a number of opportunities, challenges and threats.

- **Wealth transfer** – There is a huge volume of wealth in Asia that will be transferred to the next generation within the coming two decades. This represents a huge risk for wealthy families if the process is not managed effectively, as the wealth tends to be tied up in large, complex family businesses. It is particularly important for Hong Kong that this transfer is managed smoothly, as a significant part of the economy is privately owned. This clearly presents the trust industry with a huge opportunity.

In Asia Pacific excluding Japan, 31 percent of high net worth people are over 55[23]

- **Global coverage** – The geographic spread of the families (i.e. the settlors and their beneficiaries) and the trust assets creates increasingly complex challenges for advisors. Not only do the legal, tax and political regimes of a number of countries need to be factored into the structures created, but changes also need to be monitored. This could give those advisors able to tap into their own global network of legal and compliance teams a competitive advantage over smaller local and regional players.
- **Cultural changes** – Traditionally, wealth and estate planning has been constrained by a cultural taboo around discussing death. While this is still sometimes encountered, it is far less of an issue in Hong Kong today.
- **Media coverage of disputes** – A number of high-profile court cases in Hong Kong have highlighted the family tension that often underlies successful business empires, and the problems of incomplete wealth and succession planning. This will drive demand for private trust services.
- **Political and legal risk** – Legal certainty is a vital condition for professional settlors and their advisors when setting up a private trust. Pre-1997, when the political and legal future of Hong Kong was unclear, many settlors moved to offshore trusts, which has had a lasting impact on the Hong Kong industry. The intergenerational nature of planning, the longevity of the structures and the international characteristics of wealth mean that the industry may react to any uncertainty by moving to new locations. The political and legal future of Hong Kong after 2047 is therefore crucial – the view of the industry is that the longer this uncertainty continues, the greater the impact will be upon the trust industry.
- **Insurance** – Hong Kong has a very strong insurance industry with well established distribution channels, which sells products that can be used for wealth management purposes. This may pose added competition to the private trust industry, particularly amongst the lower tier of wealthy individuals.
- **Regulation and licensing** – The private trust practitioners interviewed highlighted this as an area of particular focus, with the existence of a smart regulatory regime seen as a potential enabler of growth.

23 Extracted from World Wealth Report (2011), Capgemini and Merrill Lynch Global Wealth Management



Source: MPFA

The China market

China is a great source of wealth and is viewed as a key growth area for the Hong Kong market.

The China wealth market has a number of characteristics that distinguishes it from the Hong Kong market:

- There are significant restrictions around moving capital outside of China.
- China is generally regarded as a high tax jurisdiction.
- The concept of succession planning is not well understood, as the overwhelming majority of wealth is first generation and recently created.
- The trust concept may not be well understood in China and clients do not like ceding control of their assets to a trustee. Advice has to therefore be given very carefully as there is a lack of awareness and understanding of the structure.
- The focus remains on growing assets – China's high GDP growth has meant that wealthy entrepreneurs get a better return through reinvesting profits in their own businesses rather than via investments, reducing the demand for external wealth management advice.
- Families tend to be smaller than in Hong Kong, often with only one child, which means that the intergenerational transmission of wealth and succession planning is less complicated.
- Cultural barriers around discussing death are perhaps stronger than in Hong Kong.

Although Hong Kong has unique political and cultural ties with China, it is not a foregone conclusion that China's wealth will flow to Hong Kong for investment and advice. One interviewee pointed out that there are also risks associated with the opportunity. Hong Kong needs to actively discuss the legal and tax implications of Chinese nationals using Hong Kong trusts and advisors as there may be legitimate concerns around wealth flowing out of China via Hong Kong.

Coordination between the trust industry and the Hong Kong government will be required to take advantage of the opportunity and to ameliorate any risks.

For Hong Kong to find its place in Asia, many feel it should focus on the specific needs of a wealth management business.

> After all, it is as important for a wealth manager to channel wealth into the appropriate long-term holding structure as it is to build strategies for investment, preservation and growth.[24]

24 Jonathan Hubbard

Charitable trusts

Charitable trusts represent a small proportion of the wider Hong Kong trust industry. Charitable trusts are one of the four structures – statutory bodies, incorporated companies, charitable trusts and societies – that can be used to set up a charity. Unlike other areas of the Hong Kong trust industry where offshore trusts dominate, charitable trusts in Hong Kong are formed under Hong Kong Law.

By way of example, The Hong Kong Jockey Club Charities Trust is one of the largest charity trusts in Hong Kong and had donated over HKD 1.7 billion to various projects in Hong Kong during the financial year 2011/12. This trust fund's projects promote healthy living, cultivate arts and culture, preserve and create jobs.

The rise of philanthropy

A number of wealth planning and charitable trust advisors we interviewed commented on the trend within the sector of wealthy families looking to set up trusts for philanthropic purposes. They are seeing both an increased demand from their clients for assistance in this area and a change in focus of the philanthropic activities.

Increasingly, the trend is towards setting up charitable organisations, foundations or trusts with a long-term altruistic purpose. This is often being driven by the second generation of these wealthy families, who are less involved in the day-to-day running of the family business. The trust structure provides a tool which the settlor can use to create a fund and a supporting organisation to achieve a specific charitable purpose that can survive generations.

As wealth managers look to build their private family office capabilities in Hong Kong, this represents a potential growth area for trust advisors.

Key issues

Some observers cautioned this sector is facing a number of regulatory and compliance challenges caused by the absence of a comprehensive legal and regulatory framework:

- There is no single, clear statutory definition of a charity.
- There is a limited system of oversight of charitable fundraising activities.
- There is no coherent registration system.
- There are inconsistent standards and requirements on governance, accounting and reporting by charities resulting from the different types of legal structures.

In comparison, a number of overseas jurisdictions such as England, Scotland, Ireland and New Zealand have undertaken major reforms of their laws on charities in recent years. The Charities sub-committee of the Law Reform Commission of Hong Kong released a consultation paper in June 2011 proposing that a wide-ranging regulatory regime for charities should be introduced in Hong Kong and that a charity commission should be set up as the regulatory body for charities.

FSTB

Leveraging on our strength as an international city and the opportunities arising from the 'One country, Two systems', we aim to develop Hong Kong as a global financial centre, asset management centre and offshore RMB business centre attracting capital and talent from within and outside the country.

Looking to the future

In the medium and long term, the operating environment of the industry will be characterised by emerging opportunities, intensifying competition with local and global players, and increasing expectations from customers and regulators.

Considerable pressure is being applied to industry players to grow their business and prepare for the increasingly stringent regulatory requirements. However, they are also looking forward to the benefits that could arise from the forthcoming policy initiatives, for example, HKTO reform, and mutual recognition of funds by mainland China and Hong Kong.

The industry has proposed the changes they would like to see, and is well equipped for these changes.

Regulatory compliance

The multitude of global and local regulatory developments and reforms inevitably bring along the need for increasing effort and costs for compliance. As public awareness of fee levels increases, such as those charged by MPF trustees, we should see the following trends develop:

- Attaining competitive advantages that arise from multinational players with global business support for managing their processes and leveraging technology, while having central compliance teams maintaining oversight functions
- Striving for economies of scale through process efficiencies and better use of technology advancements for cost management
- Restructuring existing business models and practices of certain segments, e.g. creating a central clearing house for MPF contributions and payments that can be used by all trustees and providers
- Enhancing governance, oversight and documentation for compliance with FATCA and AML requirements.

Talent

Many in the industry believe that the experience, skills and knowledge that exist are in silos and are mostly derived from the financial services and legal sectors in which the trust services are used. Professional qualifications and accreditation of trust practitioners could give more credibility to and enhance the professionalism of the trust industry and would provide a more visible career development pathway for practitioners. Investment in people development must be identified to ensure longer term viability of the trust industry and the broader financial services market that fuel the Hong Kong economy.

Before we get there, the industry is trying its best to manage the impact in a number of ways, such as by:

- investing in rigorous internal training programmes to ensure that the fiduciary role of the trustee is properly understood
- identifying and investing in potential recruits with the right core competencies and attitude rather than experience
- seeking recruits from overseas entities from within the same group
- taking a holistic approach to retention that goes beyond salaries to try and foster a stronger bond between the employer and employee.

> "External formal qualifications not dissimilar to the trustee diploma offered by the Chartered Institute of Bankers in the past could be looked at, adapted and adopted."[25]

25 Pauline Wong

There is some support within the industry for considering creating a licensing regime for trust practitioners, underpinned by formal qualifications and training not dissimilar to other professional services, such as accountants, lawyers, etc. Such a move may hold a number of benefits, including:

- providing a clear career path for graduate recruits
- improving the level of skills within the industry, thereby increasing the quality of advice
- enabling the implementation and enforcement of minimum standards
- providing a common approach on core principles across the trust industry as a whole, regardless of the sector.

Promotion of growth

Almost all stakeholders, including government, regulators and industry players, are aware of the opportunities and challenges inherent in the Hong Kong trust-related industry. They all look forward to the growth of the industry along with the passing of long-awaited HKTO amendments. Despite the varying views that arose during our interviews, we observed an overarching anticipation and passion for growth and promotion of the Hong Kong trust-related industry.

In order to build on Hong Kong's strong foundations and leverage on its benefits as a location for financial services, the industry, government and regulators need to increase their collaboration, agree on a medium- to long-term vision for the Hong Kong trust industry, and work together rigorously to achieve it. Greater coordination amongst stakeholders is required to position Hong Kong as the regional destination of choice for trust-related services amidst staff competition. If Hong Kong is able to take advantage of its inherent location strengths, while responding to these challenges, it will help shape its position as a premier trust jurisdiction in the long term.

In addition to various continued efforts to be made by Hong Kong trust industry participants, it is vital for law makers to take a holistic approach to policy setting. That would support the broad range of financial services sub-sectors to foster a self-sufficient, robust and independent Hong Kong financial and administrative services market.

"In summary, Hong Kong presents itself as a world city and a major financial services centre, yet the focus as a trust and fund services centre has been lacking. It is therefore critical, in view of the increasing number of jurisdictions in the world competing with Hong Kong as a trust centre, that the Hong Kong government pursue a long-term vision and policy on developing and promoting the trust industry and creating an enabling environment to foster business growth, thereby further cementing Hong Kong's position as a truly world-class financial services centre in all aspects," says Ka Shi Lau, Chairman of HKTA.

About KPMG

KPMG is a global network of professional firms providing audit, tax and advisory services, with an industry focus. We use our expertise and insight to cut through complexity and deliver informed perspectives and clear solutions that our clients and stakeholders value.

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Integrity, quality and independence are the building blocks of KPMG's approach. Our audit process does more than just assess financial information. It enables our professionals to consider the unique elements of the client's business – its culture, the industry in which it operates, competitive pressures, and the inherent risks.

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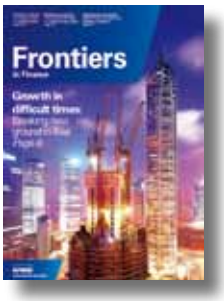

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