

**Bills Committee on
Companies (Amendment) Bill 2002**

**Follow-up actions arising from the discussion
at the meetings on 23 and 9 January 2003**

Introduction

This paper sets out the outcome of the follow-up actions arising from the discussion at the meetings on 23 and 9 January 2003.

(A) 23 January 2003

(a) Governance of shadow directors

2. An updated comparison table on the governance of shadow directors between Hong Kong and overseas countries is at Annex.

(b) Appointment of a person to act in place of the sole director (who is also the sole member) of a company

3. We are awaiting the comments from the Probate Committee of the Law Society regarding the need for appointing a person to act in place of the sole director (who is also the sole member) of a company. We will revert to the Bills Committee after receiving the Probate Committee's comments.

(c) Enforceability of a guarantee or security provided by a company under section 157I

4. We are examining the matter and will revert to the Bills Committee as soon as possible.

(B) 9 January 2003

(a) "as far as they are reasonably able to do so" in the existing section 161B(6)

5. It is in the interest of a company's shareholders to be provided with information relating to loans etc made by the company to its directors

etc. To this end, the existing section 161B requires that the accounts that are required to be laid before a company in general meeting should include such information. The existing section 161C also requires that the director should make disclosure to the company any matter relating to them that is necessary for the purpose of section 161B. In the event that the disclosure requirement in section 161B is not complied with, the existing section 161B(6) places a specific duty on the company's auditors to include in their reports, as far as they are reasonably able to do so, a statement giving the required particulars. It is worth noting that this requirement has existed in the Companies Ordinance at least since 1932, though the scope of the loans has changed over the years.

6. Our policy intent is to limit the extent to which auditors would be required to include in their reports loans to directors to only cases where they are reasonably able to do so and not cases where they are not reasonably able to do so. We are not aware of any judicial discussion or decision on this phrase but we cannot see any reason to doubt that if this matter is litigated in court, the court will look into the facts and circumstances of the case to determine what a reasonable auditor in the position of the auditor in question would have done in those circumstances. It is worth noting that the reference to "reasonably able to do so" appears in the UK Companies Act 1985, and sections 161 and 161BA of the Ordinance.

7. There has been some past correspondence between the Hong Kong Society of Accountants (HKSA) and the former Registrar General (RG) on the interpretation of the words "officer of the company" for the purpose of section 161B (relating to the disclosure of particulars of loans) in relation to companies generally. The former RG's interpretation is that the word "officer" is defined in section 2 of the Ordinance as including "a director, manager or secretary" and for the purpose of practical administration, the word "director" includes a "shadow director" i.e. one in accordance with whose directions or instructions the directors of the company are accustomed to act. We understand that the interpretation has been included in the Accounting Bulletin of the HKSA since 1985. Such Bulletin is understood to provide general guidance.

(b) New section 165(3)(b)

8. We have consulted the HKSA on the new section 165(3). The HKSA considers that there is no reason why auditors for whom insurance has been purchased by companies would be encouraged to lower their standards of professional conduct any more than what would have

been if they had purchased professional indemnity insurance at their own initiative. Furthermore, any auditor who fails to comply with the standards of professional conduct and practice will be liable to disciplinary action.

Financial Services Branch
Financial Services and the Treasury Bureau
February 2003

**Governance of Shadow Directors -
Comparing Hong Kong with United Kingdom, U.S.
Australia, New Zealand, Malaysia and Singapore**

1. <u>Definition</u>	
Hong Kong	In relation to a company, “shadow director” means a person in accordance with whose directions or instructions the directors of a company are accustomed to act. However, a person is not deemed to be a shadow director by reason only that the directors act on advice given by him in a professional capacity. The Companies (Amendment) Bill 2002 proposes to modify the definition of “shadow director” to mean a person in accordance with whose directions or instructions the directors or a majority of the directors of a company are accustomed to act.
United Kingdom	In relation to a company, “shadow director” means a person in accordance with whose directions or instructions the directors of a company are accustomed to act. However, a person is not deemed to be a shadow director by reason only that the directors act on advice given by him in a professional capacity.
U.S.	The US law does not appear to contain any reference to “shadow director” as defined in the Companies Ordinance or the Companies (Amendment) Bill 2002. Note disclosure requirement under item (4) below.

Australia	Unless the contrary intention is shown, a person who is not validly appointed as a director is regarded as a “director” if the directors of the company or body are accustomed to act in accordance with the person’s instructions or wishes. The definition will not apply merely because the directors act on advice given by the person in the proper performance of functions attaching to the person’s professional capacity, or the person’s business relationship with the directors or the company or body.
Malaysia	The definition of “director” includes a person as defined as a “shadow director” in Hong Kong.
New Zealand	<p>For the purpose of sections 131 to 141, 145 to 149, 298, 299 and 301 of the New Zealand Companies Act 1993, the definition of “director” includes –</p> <ul style="list-style-type: none"><li data-bbox="712 671 1921 738">(i) a person in accordance with whose directions or instructions a director may be required or is accustomed to act;<li data-bbox="712 783 1921 850">(ii) a person in accordance with whose directions or instructions the board of the company may be required or is accustomed to act;<li data-bbox="712 895 1921 962">(iii) a person who exercises or who is entitled to exercise or who controls or who is entitled to control the exercise of powers which would fall to be exercised by the board. <p>A person acting only in a professional capacity is excluded.</p>
Singapore	The definition of “director” includes a person as defined as a “shadow director” in Hong Kong.

2. <u>Liabilities or Prohibitions</u>	
Hong Kong	<p>The relevant provisions of the Companies Ordinance are -</p> <ul style="list-style-type: none">• A shadow director shall not be the investment adviser for the purposes of section 49BA.• A shadow director shall be liable for defaults in relation to the requirements of completing and filing annual returns. (section 109)• A shadow director shall be liable for defaults in relation to the requirements of keeping a register of directors and secretaries etc. (section 158)• A shadow director shall be liable for certain offences in relation to his conduct (e.g. conceal any debt due from the company) if the company of which he is a shadow director is wound up. (section 271)• A shadow director shall be liable for any defaults he authorizes or permits in relation to Part XI of the Ordinance by an oversea company. (section 341)• A shadow director shall be liable for any debt or liability of the company arising from a relevant transaction when a company is deemed to be dormant. (section 344A)• A shadow director shall be liable for the default, refusal or contravention (which he knowingly or wilfully authorizes or permits) in any provision of the Ordinance. (section 351(2))• A shadow director can be disqualified as a director under certain circumstances. (Part IVA of the Ordinance)

United Kingdom	<p>The relevant provisions of the Companies act 1985 are – those relating to the register of directors and secretaries and the inclusion of directors’ names in business letters (sections 288(6) and 305(7), substituted by Companies Act 1989, section 145 and Schedule 19, paragraph 4); the duty of directors to have regard to the interests of employees as well as members (section 309(3)); the disclosure of directors’ interests in contracts and transactions with the company (section 317(8)); publicity in respect of directors’ service contracts (section 318(6)); the need for the duration of directors’ contracts of employment and the terms of contracts for the acquisition of substantial amounts of assets by or from them to be approved by a general meeting (sections 319(7) and 320(3)); the prohibition on directors buying options to purchase or sell shares, debentures or other loan securities issued by the company or companies in the same group (section 323(4)); the duty of directors to report the acquisition or disposal of interests in shares, debentures or loan securities of the company or of other companies in the same group and the entry of such interests and disposals of them in a register of directors’ holdings (sections 324(6) and 325(6)); the restrictions imposed on loans and quasi-loans and credit transactions for the benefit of directors and persons connected with them and the reporting of such transactions in the company’s annual accounts (section 330(5)); and those relating to the annual return of the company (section 365(3), substituted by Companies Act 1989, section 139). Relevant provisions of the Insolvency Act 1986 are – those relating to criminal offences committed before a company goes into liquidation (section 206(3)) or during the liquidation (sections 208(3), 210(3) and 211(2)); wrongful trading by a company which goes into liquidation (section 214(7)); and persons connected with a company subject to insolvency proceedings (section 249). The relevant provisions of the Company Directors Disqualification Act 1986 are – disqualification for fraudulent trading (section 4(2)) and the disqualification of unfit directors of insolvent companies (section 6(3)).</p>
U.S.	NA.
Australia	All liabilities and prohibitions in the Australian Corporations Law which apply to directors apply equally to shadow directors.

New Zealand	The relevant provisions are – those relating to directors’ duties and avoidance of transactions involving self-interest (sections 131 – 141); use of company information etc (sections 145-149); transactions for inadequate or excessive consideration with directors (section 298); power of court to set aside certain securities and charges (section 299); and power of court to require persons to repay money or return property (section 301).
Singapore	All liabilities and prohibitions in the Singapore Companies Act which apply to directors apply equally to shadow directors.
Malaysia	All liabilities and prohibitions in the Malaysia Companies Act apply to directors apply equally to shadow directors.
3. <u>Filing Requirements of Particulars of Shadow Directors</u>	
Hong Kong	Particulars of shadow directors are required to be filed with the Registrar of Companies as “directors” includes “shadow directors”. A company’s register of directors is open to inspection by the public.
United Kingdom	Ditto.
U.S.	NA.
Australia	Particulars of shadow directors are required to be filed with the Australian Securities and Investments Commission (ASIC) as “directors” include “shadow directors” but companies are not required to keep a register of directors. Any member of the public can access to information in relation to directors kept by the ASIC.
New Zealand	The extended definition of “director” referred to on page 2 of this table is not subject to section 159 of the New Zealand Companies Act 1993, which requires all changes regarding directors of a company to be registered with the Companies Registrar.

Singapore	Particulars of shadow directors are to be filed with the Registrar of Companies as “directors” include “shadow directors”. A company’s register of directors is open to inspection by the public.
Malaysia	Ditto.
4. <u>Disclosure Requirements of Loans to Shadow Directors</u>	
Hong Kong	At present, particulars about loans to shadow directors are not required to be disclosed in the accounts of public or private companies. The Bill proposes that particulars about loans, quasi loans etc to shadow directors should be disclosed in the accounts of public and private companies.
United Kingdom	Particulars about loans, quasi loans and other transactions to shadow directors are required to be disclosed in the accounts of public and private companies. Section 741 of the Companies Act 1985 however provides that for the purposes of certain provisions in the Act relating to matters like disclosure of loans, a body corporate is not to be treated as a shadow director of any of its subsidiaries by reason only that the directors of the subsidiary are accustomed to act in accordance with its directions or instructions.
U.S.	The US public companies are required to disclose in their financial statements loans to their directors or other related parties. The term “related parties” appears to include a person who might be deemed to be a “shadow director” as defined in the Companies Ordinance or the Companies (Amendment) Bill 2002.

Australia	Particulars about financial benefits e.g. loans to shadow directors are required to be disclosed in the accounts of large proprietary companies. Section 292 of the Corporations Act 2001 provides that all public companies and large proprietary companies (consolidated gross operating revenue exceeds A \$10 million, consolidated gross assets exceeds A \$5 million or have more than 50 employees) have to prepare an annual financial report. Subject to the prescribed circumstances, such requirement does not apply to small proprietary companies.
New Zealand	Transactions with the company in which a director (including a shadow director) is interested have to be disclosed and entered in the Interest Register. The Interest Register forms part of the Annual Return which must be sent to all shareholders of the company prior to the Annual General Meeting.
Singapore	Particulars about loans to shadow directors are required to be disclosed in the accounts of public and private companies.
Malaysia	Ditto.
5. <u>Enforcement Approach</u>	
Hong Kong	Act on complaints received from the public.
United Kingdom	Ditto.
U.S.	NA.
Australia	Enforcement of breaches of the law is assessed on a case-by-case basis.
New Zealand	NA.
Malaysia	Awaiting response from the relevant authority.

Singapore	No specific enforcement policy. The general policy is to consider each case on its merits and assess whether there are any aggravating factors warranting prosecution.
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