

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

**Follow-up actions arising from the discussion
at the meeting on 6 November 2002**

Introduction

This paper sets out the Administration's responses to the issues relating to shadow directors raised at the meeting on 6 November 2002.

Policy intent

2. At present, the Companies Ordinance recognizes the concept of shadow directors and imposes a number of liabilities or prohibitions on a shadow director, though the term "shadow director" is not generally adopted and defined in the Ordinance. This is achieved by including a reference to "shadow director"¹ in certain provisions (i.e. sections 168C and 199 of the Ordinance) or by providing that the term "director" includes any person in accordance with whose directions or instructions the directors of the company are accustomed to act (such person being in effect a shadow director) in some other provisions (i.e. sections 49BA(10)(b), 109(5), 158(10)(a), 271(3), 341, 344A(7) and 351(2) of the Ordinance).

3. During the review of the Ordinance, the Standing Committee on Company Law Reform (SCCLR) supported the concept of shadow directors but recommended that the Ordinance should be amended to define the term generally and to lower the threshold to include someone who can influence less than the whole board of directors. On the basis of this recommendation, we propose in the new section 2(1) that the term "shadow director" be defined to mean a person in accordance with whose directions or instructions the directors or a majority of directors of a company are accustomed to act. This section is, however, subject to the new section 2(2) which provides that a person shall not be regarded as a shadow director of a company by reason only that the directors or a majority of the directors of a

¹ The term "shadow director" is defined to mean, in relation to a company, a person in accordance with whose directions or instructions the directors of a company are accustomed to act but a person shall not be considered to be a shadow director by reason only that the directors act on advice given by him in a professional capacity.

company act on advice² given by him in a professional capacity. Consequential to the inclusion of the definition of “shadow director” in the new section 2(1), we propose to substitute “shadow director” for “any person in accordance with whose directions or instructions the directors of the company are accustomed to act” and replace the existing definition of “shadow director” by the new one. In implementing SCCLR’s recommendation to extend the statutory provisions to cover in generic terms provision of financial assistance to directors, we also propose that the definition of “director” include “shadow director” having regard to the situation in other common law jurisdictions.

Impact

4. The concept of shadow directors in the Ordinance is not unique and is also found in the company law of other common law jurisdictions (see paragraph 8 below). As in these jurisdictions, we consider it necessary to continue our existing approach of imposing liabilities or prohibitions on a shadow director such as prohibiting a shadow director from acting as a director or otherwise taking part in the management of any company for a specified period of time. With the exception of the provisions relating to loans to directors, liabilities or prohibitions to be imposed on a shadow director in the Bill are the same as those under the existing provisions in the Ordinance.

5. A de facto director of a family-owned company or a nominee director of an offshore company registered in Hong Kong falls within the scope of the definition of “director” in section 2 of the Ordinance and therefore should not be affected by the proposals relating to shadow directors in the Bill. As regards foreign investors, they need not be concerned with the proposals as they would not be caught by the definition of “shadow director” unless the directors or a majority of the directors of a company are accustomed to act in accordance with their instructions or directions. Similarly, the settlor of a trust would not be regarded as a shadow director of a company within the portfolio of the trust unless the directors or a majority of the directors of the company are accustomed to act in accordance with his instructions or directions. If this were the case, it would not be unjustified to treat such settlor as the shadow director of the company.

² The term “advice” is different from the phrase “directions and instructions” in that the directors or a majority of the directors of a company are not obliged to follow the advice but should follow the directions and instructions.

Receiver or Manager

6. If a person³ is appointed as a receiver or manager, he is obliged to act for the benefit of the secured creditor and within the powers conferred on him under the relevant debenture or loan security agreement. Hence, he should not be regarded as a shadow director of the company.

Section 158

7. As in other jurisdictions (see paragraph 8 below), section 158 of the Ordinance requires a company to file with the Companies Registry (CR) particulars of its directors (including the particulars of shadow directors). It is, however, worth noting that that section does not require the company to indicate in the return whether a director is a shadow director or not. We acknowledge that shadow directors do not wish to be known and that prosecution is not easy to be taken given the CR's existing approach of acting on complaints received from the public. This, however, does not mean that we should allow persons who have influence over the board or a majority of directors to evade the law by remaining in the shadow. Therefore, we do not consider it justified to delete this requirement for a return to include shadow directors, nor other provisions relating to shadow directors. We believe that in cases where a company is shown to be in breach of this section or other provisions relating to shadow directors (e.g. in the course of winding up the company, investigation shows the existence of shadow directors), prosecution could then be taken. In response to Members' suggestion, the CR would raise the issue of this disclosure requirement with its Customer Liaison Group.

Overseas experience

8. We have looked into the situation of four common law jurisdictions (namely the UK, Australia, Singapore and Malaysia) regarding the governance of shadow directors and found that the concept of shadow directors appears in their company law. In all these jurisdictions, a company is required to file with the relevant authority particulars of its shadow directors. As regards the disclosure requirement of loans to shadow directors, we understand that the UK, Australia, Singapore and Malaysia have such a requirement.

Disclosure of loans made to shadow directors

9. When examining the above issues in relation to shadow

³ In most cases, if not all, a receiver or manager is a qualified accountant.

directors, we have had regard to the requirement of filing with the CR particulars of loans to shadow directors as proposed in the Bill.

Financial Services Branch
Financial Services and the Treasury Bureau
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