

Bills Committee on Companies Bill
Follow-up actions to be taken by the Administration
for the meeting held on 28 June 2011

Purpose

This paper sets out the Administration's response to the following issues and views raised by Members at the Bills Committee meeting on 28 June relating to regulation of listed companies incorporated outside Hong Kong: –

- (I) Reasons for the majority of companies listed on Stock Exchange of Hong Kong (“SEHK”) being incorporated outside Hong Kong;
- (II) Whether the Companies Bill (“CB”) would affect the competitiveness of Hong Kong as a corporate domicile; and
- (III) Whether there is sufficient protection for investors of listed companies incorporated outside Hong Kong as many provisions in the CB do not apply to such companies.

(I) Listed companies incorporated outside Hong Kong

2. As at end June 2011, 1 246 out of the 1 448 listed companies are incorporated outside Hong Kong. There are various factors affecting the choice of domicile for companies listed in Hong Kong, including –

- (a) Historical factor: prior to the handover in 1997, many existing companies re-domiciled for fear of a worst case scenario and it had been the practice for newly listed companies to be incorporated offshore. In the event the fear was not realized, but the habit had been set;
- (b) The presence on SEHK of Mainland enterprises and overseas companies with strong business nexus with the Mainland has

grown significantly in recent years. As at end June 2011, there were 610 Mainland enterprises¹ listed on SEHK. The majority of them are incorporated outside Hong Kong;

- (c) Hong Kong Exchanges and Clearing Limited has been making keen efforts to attract overseas companies to list in Hong Kong. In 2010, we had the first Russian company, the first French company and the first Brazilian company come to list on SEHK. This year, for the first time, we had Swiss and Italian companies listed here.

(II) Whether the Companies Bill would affect the competitiveness of Hong Kong as a corporate domicile

3. The place where people choose to incorporate a company is affected by many factors, including the tax system, incorporation and disclosure requirements and transparency standards. According to the World Bank's *Doing Business 2011 Report* released in November 2010, Hong Kong is the second easiest place to do business in the world. In particular, the improvement in Hong Kong's ranking in *starting a business* from 18th to sixth reflects the Government's continuous efforts to expedite the process of company incorporation. It is noted that the number of incorporations in Hong Kong has been on a rising trend in the past five years². Our efficiency in company incorporation is further enhanced with the introduction of the electronic incorporation service earlier this year.

4. One of the guiding principles of the Companies Ordinance ("CO") Rewrite is to benchmark Hong Kong against comparable jurisdictions like the United Kingdom ("UK"), Australia and Singapore. The Rewrite seeks to produce a modern and easily accessible company legislation with high governance standards. We have been mindful of the need to maintain proper corporate governance standards without unduly discouraging Hong Kong incorporations. We believe we have

¹ Including H shares, Red chips stocks and Non-H Share Mainland Private Enterprises.

² The number of companies incorporated in 2006, 2007, 2008, 2009 and 2010 is 81 974, 100 761, 98 645, 109 424 and 139 530 respectively.

struck an appropriate balance in this regard. An example is that we have proposed to permit private companies not being part of a group of which a listed company is a member to have corporate directors, so long as they have at least one other director who is a natural person. This strikes a balance between enhancing corporate governance and transparency and the legitimate commercial need for flexibility. Further, in the light of diverse views received in our public consultations, we have only proposed to clarify directors' duties of care, skill and diligence in the law instead of opting for comprehensive codification of directors' duties. The new formulation is similar to those of other comparable jurisdictions.

5. We believe that the CB, once enacted, would provide a modern and up-to-date legal infrastructure for the incorporation and operation of companies in Hong Kong, thus enhancing the competitiveness of Hong Kong as a corporate domicile.

(III) Regulation of listed companies

6. The CO, and upon enactment the CB, mainly govern companies incorporated in Hong Kong. This is in line with the regimes in other comparable common law jurisdictions such as the UK, Australia and Singapore where their company laws mainly govern companies incorporated in their respective jurisdictions. The Securities and Futures Ordinance ("SFO") and the Listing Rules set out statutory and non-statutory requirements for listed companies (irrespective of the place of incorporation). For example, pursuant to section 36 of the SFO, the Securities and Futures Commission ("SFC") may make rules in respect of the listing of securities. The Securities and Futures (Stock Market Listing) Rules, made by the SFC under section 36(1), established the "dual-filing" arrangement³. While SEHK is the front-line regulator on listing matters, the SFC has been conducting annual review on SEHK's performance in its regulation of listing-related matters. In addition, Parts XIII and XIV of the SFO prohibit six types of market misconduct related to the trading of listed securities. Part XV of the SFO sets out

³ The Rules stipulate that a listing applicant shall file a copy of its application with the SFC after it has submitted its application to SEHK. The SFC may request further information from an applicant and to object to a listing of any securities. An issuer shall also file with the SFC a copy of any announcement, statement, circular or other document made or issued.

requirements for disclosure of interests in listed securities. The Listing Rules are supplemented by other Codes, like SFC's Codes on Takeovers and Mergers and Share Repurchases. As a latest initiative to further improve our listing regime, the Securities and Futures (Amendment) Bill 2011 was introduced into the Legislative Council on 29 June 2011 to codify in statute, among other things, the requirement for listed corporations to disclose price sensitive information in a timely manner.

7. Given that the vast majority of the 900 000 local companies are non-listed companies and that listed companies incorporated in Hong Kong only account for less than 15% of all companies listed in Hong Kong, we consider that the current approach of setting out general requirements governing local companies in the CO/CB with additional and other requirements governing listed companies in the Listing Rules and other Codes appropriate.

8. We note that there was a concern on whether there was sufficient protection to investors of non-Hong Kong listed companies. In this regard, there are provisions in the CO/CB providing remedies for protection of companies' or members' interests which are applicable to a non-Hong Kong company (i.e. a company incorporated outside Hong Kong that has established a place of business in Hong Kong). These include the unfair prejudice remedy, the statutory injunction that provides for the restraining of conduct that constitutes contravention of the new CO, the statutory derivative action, and the right to seek a court order for inspection of company records (see Annex B to LegCo Paper No. CB(1)2389/10-11(01)). In addition, section 214 of the SFO empowers the SFC to apply to the courts for various orders in cases of unfair prejudice of interests of minority shareholders in relation to a listed corporation.

9. At the same time, applicants incorporated outside Hong Kong seeking listing on SEHK have to demonstrate that they are subject to appropriate standards of shareholder protection which represent some core requirements under Hong Kong law. The shareholder protection standards applicable in the jurisdictions where they were incorporated have to be at least equivalent to those required under Hong Kong law. If not, the applicant may need to change its constitutional documents or use

alternative methods (e.g. by complying with rules of another exchange on which it is listed or giving undertakings) to achieve equivalence.

Financial Services and the Treasury Bureau
Companies Registry
7 July 2011