

For information
on 7 November 2011

**Legislative Council
Panel on Financial Affairs**

Modernization of Corporate Insolvency Law

PURPOSE

This paper briefs Members on the Administration's plan to modernize Hong Kong's corporate insolvency law and seeks Members' support for the retention of a directorate post in the Financial Services Branch ("FSB") of the Financial Services and the Treasury Bureau to spearhead the exercise.

BACKGROUND

2. We launched a rewrite of the Companies Ordinance (Cap. 32) ("CO") in mid-2006. This is important for enhancing Hong Kong's status as a major international business and financial centre. In view of the extensive nature of the CO Rewrite exercise, we have adopted a phased approach by first tackling most of the provisions concerning over 910 000 live companies in Hong Kong. The Companies Bill ("CB"), which represents the outcome of the first phase of the Rewrite exercise concerning live companies, was introduced into the Legislative Council ("LegCo") on 26 January 2011. It is now being scrutinised by a Bills Committee in LegCo and is expected to be enacted in mid-2012.

3. Upon the commencement of the new CO, the remaining provisions of the existing CO will be retitled as the Companies (Winding Up and Miscellaneous Provisions) Ordinance ("C(WUMP)O"), which will mainly comprise provisions on (a) company winding-up and insolvency; and (b) prospectuses. The provisions on prospectuses in the C(WUMP)O will be dealt with in a separate review by the Securities and Futures Commission and will likely be moved to the Securities and Futures Ordinance.

MODERNIZATION OF CORPORATE INSOLVENCY LAW

Objectives

4. We propose to roll out a new exercise to modernise Hong Kong's corporate insolvency law. In addition to conducting a review of the company winding-up and insolvency-related provisions in the existing CO (i.e. the C(WUMP)O after the enactment of the CB), the exercise will also take the opportunity to consider the need for formulating new provisions concerning our corporate insolvency regime. The underlying objectives of the exercise will be threefold, namely –

- (a) to **streamline and rationalize the company winding-up procedures** having regard to international experience with a view to facilitating more efficient administration of winding-up and increasing protection of creditors;
- (b) to **provide for a new statutory corporate rescue procedure** for companies in short term financial difficulty to turn around or restructure; and
- (c) to **enhance regulation** of the winding-up regime and insolvency practitioners.

(a) Streamline and rationalize the company winding-up procedures

5. The company winding-up and insolvency-related provisions in the existing CO are broadly based on the provisions contained in the Companies Act 1929 and Companies Act 1948 of the United Kingdom (“UK”) . While many amendments have been made to these provisions in Hong Kong over the years with focus on particular issues, other jurisdictions have embarked upon exercises to reform their corporate insolvency laws¹. To consolidate Hong Kong’s position as a major international business and financial centre, we consider it beneficial to conduct a holistic review of the company winding-up and insolvency-related provisions in the existing CO to streamline and rationalize the company winding-up and insolvency-related procedures to ensure that our corporate insolvency regime can keep up with latest developments and meet social and economic needs.

(b) Providing for a new statutory corporate rescue procedure

6. At present, Hong Kong companies facing financial difficulty may try to come to an arrangement with their creditors by means of non-statutory voluntary workouts or restructuring arrangements under section 166 of the CO. However, neither of those methods provides for a moratorium that can bind creditors while an arrangement proposal is being formulated, thereby lacking certainty. A statutory corporate rescue procedure will provide for a moratorium on creditors’ legal action while an independent professional third party, namely the provisional supervisor, can take effective control of the company during the provisional supervision period and formulate a voluntary arrangement proposal for creditors within a specified timeframe. We conducted a review of the legislative proposals to introduce a statutory corporate rescue procedure in 2009 and 2010. Members were consulted on the review in previous meetings². Since the issue of the consultation conclusions on the review in

¹ For example, in the UK, as a result of the recommendations in the Report of the Review Committee on Insolvency Law and Practice (commonly referred to as the “Cork Report”) issued in 1982, the Insolvency Act 1985 made substantial changes to insolvency provisions of the Companies Act 1985. The Insolvency Act 1985 was replaced by the Insolvency Act 1986, which was a consolidating enactment that repealed and re-enacted the Insolvency Act 1985 and the insolvency provisions of the Companies Act 1985. In Australia, the Law Reform Commission published a Report on its General Insolvency Inquiry in 1988 (commonly referred to as the “Harmer Report”) which had led to substantial corporate insolvency law changes in 1993.

² The Administration briefed the Panel on the corporate rescue legislative proposals on 7 December 2009, and on the public feedback on the proposals on 19 July 2010.

July 2010³, we have been working on detailed proposals of the statutory corporate rescue procedure. However, in view of other competing priorities and resource constraints, it is not possible for the Bill on the corporate rescue procedure to be introduced into the LegCo within its current term. We will therefore consider how best to take forward the proposals on the statutory corporate rescue procedure in the modernisation of corporate insolvency law.

(c) Enhancing regulation of the winding-up regime and insolvency practitioners

7. Over the years, the Official Receiver's Office (ORO) has been gradually moving away from its previous role as the liquidator of last resort in court winding up cases to being a regulator of insolvency practitioners. Since 2000, ORO began outsourcing court winding-up cases to insolvency practitioners. There is a need to review the existing provisions concerning the regulation of the winding-up regime to improve transparency for creditors, ensure appointment of competent insolvency practitioners, better insulate companies from delinquent officers and insolvency practitioners as well as to ensure that proper control can be exercised over the work of insolvency practitioners when they administer the winding up process.

8. We will also take the opportunity in the new exercise to follow up on the technical recommendations of the "Report on the Winding-up Provisions of the Companies Ordinance" ("the LRC Report")⁴ issued by the Law Reform Commission (LRC) in 1999. Since the release of the Report, the Administration has already made clear its position regarding the LRC Report, and pledged to review other technical amendments to the company winding-up and insolvency-related provisions in the CO recommended by the LRC⁵. Although some of these recommendations may no longer be relevant to the present circumstances having regard to changes in the business, legal and social environment since the release of the LRC Report, they may nonetheless serve as useful reference as we conduct a comprehensive review of the winding-up and insolvency-related provisions in the CO.

9. Having regard to the aforesaid objectives, we have conducted an initial scoping exercise to identify some of the issues to be addressed in the modernization exercise. A list of the preliminary proposals is set out in **Annex A**. The list is not intended to be exhaustive, and only represents the Administration's initial thinking on the areas to be focused under the modernization exercise. We will work closely with stakeholders in finalizing the list of proposals as the exercise progresses.

Implementation Strategy and Timetable

10. We aim to substantially complete the modernization exercise within the 2012-2016 LegCo term. Given the timetable, we do not propose a complete overhaul of the C(WUMP)O just as we have done in the first phase of the Rewrite exercise. Instead, we propose implementing the deliverables of the modernization exercise

³ Available at http://www.fstb.gov.hk/fsb/ppr/consult/doc/review_crplp_conclusions_e.pdf

⁴ The LRC Report is available at <http://www.hkreform.gov.hk/en/docs/rwind-e.doc>

⁵ The Administration's responses to the LRC Report are set out at <http://www.hkreform.gov.hk/en/news/2009.htm#windingup>.

through amendments to the C(WUMP)O. On the assumption that the necessary resources to support the planning of the modernization exercise would be obtained (see paragraphs 16 to 22 below), we have drawn up a tentative timetable setting out the key steps of the exercise, as follows –

Timeline	Key Steps
Q1 2012 to Q3 2012	● Advisory Group to consider legislative proposals
Q4 2012 to Q1 2013	● Public consultations and analyzing responses collected
Q2 2013	● Finalising drafting instructions (DIs) for legislative proposals
Q3 2013 to Q1 2014	● Drafting the Bill
Q2 2014	● Introducing the Bill into LegCo
Before mid-2016	● Enactment of the Bill

Engagement Process

Consultation with the Standing Committee on Company Law Reform

11. The Standing Committee on Company Law Reform (“SCCLR”)⁶ shall continue to play a key role in providing advice to the direction of and the key policy issues arising from the insolvency law modernization exercise.

12. In this regard, we consulted SCCLR on our proposed implementation strategy of the modernization exercise on 24 September 2011. Members expressed full support for the rolling out of the modernization exercise, and urged for its early completion. Some members suggested that the Administration should also address cross-border insolvency issues as part of the exercise, including the possible adoption of the United Nations Commission on International Trade Law (“UNCITRAL”) Model Law on Cross-Border Insolvency (“the Model Law”) in Hong Kong. The Model Law has been promulgated to assist jurisdictions to formulate a modern, harmonized and fair legislative framework to address more effectively instances of cross-border insolvency and has been adopted by a number of our major trading partners⁷.

⁶ The SCCLR was established in 1984 to advise the Financial Secretary on necessary amendments to the Companies Ordinance as and when experience shows them to be required. It also advises on amendments required to the relevant legislation on the securities side with the objective of providing support to the Securities and Futures Commission in administering the legislation. Members of SCCLR include representatives of Securities and Futures Commission, the Hong Kong Exchanges and Clearing Limited and relevant Government departments, as well as personalities from the relevant sectors or professions such as accountancy, legal and company secretarial.

⁷ As at October 2011, 19 jurisdictions, including the United States of America, the United Kingdom, Australia, Japan, New Zealand, South Africa have informed the UNCITRAL Secretariat that they had adopted the Model Law.

13. We agree it is timely to consider the possibility of adopting the Model Law in Hong Kong in consultation with practitioners, legal experts and academia. Nevertheless, as this involves complex international law issues, and likely requires a standalone piece of legislation separate from the Bill mentioned in paragraph 10 above, we can only formulate a timetable after further research and assessment on resources.

Consultation with other stakeholders and the public

14. We have also consulted other stakeholders on our plan to launch the corporate insolvency law modernization exercise, and there is general consensus on the need to roll out of the exercise. We intend to form an Advisory Group, comprising members from the relevant professions and stakeholders to advise us on the technical issues of the legislative proposals to be included in the modernization exercise.

15. Depending on the progress of review, we plan to launch a public consultation in late 2012 to consult the public on the major legislative proposals. Legislative proposals will be finalized after the public consultation, with a view to introducing the Bill into LegCo by the second quarter of 2014.

Staffing Requirements

16. The corporate insolvency law modernization exercise will be a major undertaking necessitating extensive legal/policy research into the existing provisions of the CO as well as developments in insolvency law taking place in other major common law jurisdictions. Besides, it is important to involve relevant stakeholders at an early stage to ensure that the new regime is attuned to modern needs. After finalizing the legislative proposals, there is also a need to prepare draft drafting instructions (“DDIs”) with a view to finalizing the Bill. We envisage that all these work require a significant amount of manpower resources.

17. In the initial planning stage, we propose to absorb most of the workload arising from the preparatory work as far as practicable within the FSB of the Financial Services and the Treasury Bureau, ORO and the Department of Justice (DoJ). However, to spearhead the exercise and to provide high-level policy steer and management of this large-scale project, we propose to extend, for a period of 24 months from 1 August 2012 to 31 July 2014, a supernumerary Administrative Officer Staff Grade B (“AOSGB”) post in FSB (i.e. Deputy Secretary (Financial Services) 3 (“DS(FS)3”)), which is due to lapse by 31 July 2012.

18. DS(FS)3 is currently the head of the Companies Bill Team (CBT) formed in mid-2006 dedicated for the CB. In addition, he is also responsible for overseeing policy issues concerning the accountancy sector and insolvency administration. He is also leading two other major policy initiatives, namely the reform of the Trustee Ordinance (Cap.29) and the Perpetuities and Accumulations Ordinance (Cap.257) and the review of the auditor oversight regime. With the expected enactment of the CB

in mid-2011, DS(FS)3's work with regard to the CB is expected to wind down. However, the current proposal of rolling out a corporate insolvency law modernization exercise will call for similar level of high-level policy steer, which necessitates the need to retain the post for a further period of 24 months till 31 July 2014. The proposed job description of the post during the 24 months is set out at **Annex B**.

19. At present, there are two other Deputy Secretaries (Financial Services) in FSB, i.e. Deputy Secretary (Financial Services) 1 ("DS(FS)1") and Deputy Secretary (Financial Services) 2 ("DS(FS)2"). DS(FS)1 is mainly responsible for policy matters and legislation relating to the securities and futures sector, the banking sector and financial market development. Within these policy areas, there are a number of key initiatives which are being pursued and will require active follow-up within the next few years. These include the development of Renminbi business, the listing platform and the asset management industry in Hong Kong; promotion of the further and sustainable development of the local bond market including the Islamic bond market; implementation of the relevant regulatory reforms and other enhancement measures on financial stability promulgated by international forums including G20 and Basel Committee on Banking Supervision; and formulation of legislative proposals for facilitating market development including the implementation of a scrippless securities market in Hong Kong.

20. DS(FS)2 is mainly responsible for policy matters and legislation relating to the insurance sector, Mandatory Provident Fund ("MPF") schemes and other retirement schemes, anti-money laundering and counter terrorist financing in respect of the financial sectors, and census and statistics. There are a number of key initiatives currently underway, notably the proposed establishment of an independent Insurance Authority and a policyholders' protection fund, legislation for enhancing the regulation of MPF intermediaries, implementation of the proposed increase of the minimum and maximum levels of relevant income for MPF contributions and the Employee Choice Arrangement for MPF schemes, the on-going review of the operation of the MPF system, and preparation for seeking agreement of the Financial Action Task Force to remove Hong Kong from its regular follow-up process in mid-2012.

21. The workload arising from these initiatives will already fully occupy the two DS(FS)s over the next few years. In view of this, it would be unrealistic for them to take on the proposed corporate insolvency law modernization exercise.

22. After the initial planning stage, we envisage that substantial additional legal and policy support for this exercise would be required when public consultation on the modernisation proposals is scheduled to start in late 2012. We will keep the manpower resources requirement under review, and seek for additional resources, if needed, through the established channels and procedures in due course.

Financial implications

23. For the proposed retention of the supernumerary AOSGB post for 24 months, the estimated additional cost is about \$5.2 million. Since DS(FS)3 is expected to spend part of his time in overseeing the preparation of subsidiary legislation to be made under the CB for the period from 1 August 2012 to 30 June 2013, 25% of the staff cost during the said period (i.e. \$0.6 million) will be met by the Companies Registry Trading Fund. The rest of the cost will be absorbed by the FSB internally.

24. Subject to the review of the need for directorate and non-directorate support in due course (see paragraph 22), we will seek additional resources, if needed, through the established channels and procedures.

WAY FORWARD

25. Subject to Members' views, we would proceed with our plan to roll out the corporate insolvency law modernization exercise in accordance with the proposed strategy and implementation timetable as detailed above. We will continue to keep this Panel informed of the progress of the exercise.

26. We plan to submit the staffing proposal as set out in paragraphs 16-22 above to the Establishment Subcommittee in January 2012 and to the Finance Committee in April 2012 for consideration.

Financial Services and the Treasury Bureau
31 October 2011

**Preliminary List of Proposals under the Corporate Insolvency Law
Modernization Exercise**

	Proposal and objective	Overseas Comparison
<i>Streamlining and Rationalizing Company Winding-up Procedures</i>		
1.	Updating the existing provision on “unfair preference” (i.e. sections 266, 266A and 266B of the Companies Ordinance (CO) where the court may void payments made by an insolvent company preferring a particular creditor to other creditors) by making it a self-contained provision without the cross-reference to the provisions of the Bankruptcy Ordinance, including amending the definition of the term “associate” to cater for corporate insolvency.	Both the United Kingdom (UK) and Australia have standalone unfair preference provisions for corporate insolvency
2.	Introducing a new provision on “transactions at an undervalue” to enable the court to unwind transactions made by a company prior to liquidation for which the company received no consideration, or for a consideration which is significantly less than the actual value of the subject of the transaction.	The UK has provisions on transaction at undervalue and Australia has provisions on uncommercial transactions.
3.	Replacing the existing time and cost consuming process of taxation of costs of liquidators’ agents in a compulsory liquidation by that of agreement with the committee of inspection, or in the absence of such a committee or agreement, by the court.	Unless agreed between the liquidator and the agent, the remuneration of the liquidator’s agents in the UK must be decided by detailed assessment. In Australia, such remuneration does not need to be approved by the committee of inspection, creditors or the court but it may be reviewed by the court on an application of a person aggrieved.

	Proposal and objective	Overseas Comparison
4.	Embracing new technology by allowing the committee of inspection to perform its duties and functions (such as holding meetings) by using electronic means, and allowing the liquidators to communicate with creditors, contributories and other interested parties by way of electronic means of communication.	The meetings of creditors and liquidation committee can be held by electronic means in the UK and by using telephone conference facilities in Australia. Office-holders in the UK and Australia can serve notices or send documents required by law by electronic means or use of a website.
5.	Rewriting section 265 of the CO, which sets out the classes of creditors which are accorded preferential status in the payment out of the assets of a company. Section 265 was amended in piece-meal fashion over the years, with each exercise focusing on its own particular issue.	When rewriting section 265, reference will be made to insolvency laws in other jurisdictions which also have provisions governing payment of certain debts in priority to all other unsecured debts in the winding up of a company (e.g. the UK and Australia).
6.	Reviewing and rationalizing the definition of and relevant provisions concerning liquidators (particularly with reference to its meaning in relation to provisional liquidators), and clarifying the basis of calculation of remuneration of provisional liquidators.	Reference will be made to the practices in overseas jurisdictions when reviewing the provisions in Hong Kong.
7.	<p>Introducing a number of technical amendments to rationalize the existing statute and to bring it in line with international practices and developments, such as:</p> <p>(i) combining section 190(4) of the CO and rule 43 of the Companies (Winding-up) Rules as both provisions deal with the costs of preparation of statement of affairs; and</p> <p>(ii) allowing members of committees of inspection to claim their</p>	<p>Reference will be made to the relevant provisions in the insolvency laws of overseas jurisdictions.</p> <p>(i) There is a provision governing the costs of preparation of statement of affairs in respect of court winding-up in both Australia and the UK.</p> <p>(ii) Such expenses are considered as liquidation expenses in the UK</p>

	Proposal and objective	Overseas Comparison
	reasonable traveling expenses to and from meetings of committees, limited to expenses incurred in Hong Kong.	while in Australia, they are one of the priority payments that has priority over other unsecured debts.
<i>Providing for a new Statutory Corporate Rescue Procedure</i>		
8.	<p>(i) Introducing a corporate rescue procedure called “provisional supervision” whereby a moratorium on legal action would be provided to a company in financial difficulty to assist the company to turn around and continue to operate as going concern</p> <p>(ii) In order to encourage directors to act on insolvency earlier rather than later, introducing insolvent trading provisions so that the liquidator of a company would be empowered to make an application to the court to seek a declaration that a “responsible person” (i.e. a director or a shadow director) who failed to prevent the insolvent trading was personally liable to pay compensation which may cover the debts of a company which traded while insolvent.</p>	<p>Corporate rescue procedures also exist in the UK, Australia and Singapore.</p> <p>Both the UK and Australia have provisions which make directors liable for insolvent trading.</p>
<i>Enhancing Regulation</i>		
9.	Reviewing existing provisions on the qualification and disqualification of liquidators and provisional liquidators with a view to considering the possibility of introducing new comprehensive provisions to ensure the quality of liquidators/provisional liquidators and avoiding conflict of interest situations.	Both the UK and Australia have qualification requirements for liquidators and provisional liquidators.
10.	Reviewing and rationalizing provisions for the procedures and	In the UK and Australia, there are specific provisions regarding the

	Proposal and objective	Overseas Comparison
	effect relating to the death, resignation, removal and release of liquidators and provisional liquidators.	removal, resignation, release and filling of vacancy of office of liquidators. In the UK, there are also provisions for the termination of appointment of provisional liquidators.
11.	Reviewing the existing special procedure for voluntary winding up of company initiated by directors in case of inability to continue its business (section 228A of the CO).	There is no similar provision in the UK or Australia.
12.	Providing that, notwithstanding a liquidator has been released, it should not absolve him from the provisions of section 276 of the CO which provide the court with the power to assess damages against a delinquent liquidator.	In the UK, there is a provision specifying that the release does not prevent an application for summary remedy against the delinquent liquidator. In Australia, a release order may be revoked if it is proved that it was obtained by fraud, suppression or concealment of any material facts.

**Proposed Job Description
Deputy Secretary (Financial Services) 3
(from 1 August 2012 to 31 July 2014)**

Rank : Administrative Officer Staff Grade B (D3)

Responsible to : Permanent Secretary for Financial Services and the Treasury (Financial Services) (PSFS)

Main Duties –

1. To oversee the corporate insolvency law modernization exercise.
2. To oversee the preparation of subsidiary legislation to be made under the Companies Bill.
3. To oversee the trust law reform, and to lead the Administration's team to assist the LegCo in scrutinising the proposed amendments to the Trustee Ordinance (Cap.29) and the Perpetuities and Accumulations Ordinance (Cap.257).
4. To oversee policy issues concerning insolvency administration and housekeeping matters concerning the Official Receiver's Office.
5. To oversee policy issues and housekeeping matters concerning the Companies Registry.
6. To oversee regulation of the accountancy sector, including reviewing the existing regime on auditor oversight.
7. To undertake any other tasks as assigned by PSFS.
