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Panel on Financial Affairs

Meeting on 22 March 2016

**Background brief on the retention of two supernumerary directorate posts
in the Financial Services Branch of the Financial Services and the Treasury
Bureau**

Purpose

This paper provides background information on the proposal to retain two supernumerary directorate posts in the Financial Services Branch of the Financial Services and the Treasury Bureau ("FSTB") for taking forward initiatives relating to corporate rescue procedures ("CRPs"), auditor regulatory reform, money lenders and related intermediary activities, Companies Ordinance ("CO"), financial technologies and the Asian Infrastructure Investment Bank. It also summarizes the major views and concerns expressed by Members during discussions on the proposals to retain the above posts and related matters at meetings of the Panel on Financial Affairs ("FA Panel") and Establishment Subcommittee ("ESC") from 2011-2012 to 2014-2015.

Creation and previous extensions of the two supernumerary posts

Creation of the two posts in 2006

2. In mid-2006, the Government launched an exercise to rewrite CO adopting a phased approach with the core company provisions affecting the daily operation of live companies in Hong Kong to be tackled in the first phase, and the review of the winding-up and insolvency-related provisions (mainly administered by the Official Receiver's Office ("ORO")) to be taken forward in the second phase. Having regard to the workload arising from the initiative, the Finance Committee ("FC") approved in January 2006 creation of a supernumerary Administrative Officer Staff Grade B post, designated as Deputy Secretary (Finance Services)³ ("DS(FS)³"), for five years to spearhead the CO rewrite exercise; and a supernumerary Administrative Officer Staff Grade C

post, designated as Principal Assistant Secretary (Finance Services)6 ("PAS(FS)6"), for four years to underpin DS(FS)3.¹

Extension of the two posts in 2010, 2012 and 2013

3. Since creation of the DS(FS)3 and PAS(FS)6 posts, they had been extended for a number of times and their duties had also been changed in tandem with progress of their major assigned tasks, and new initiatives taken forward by FSTB. In early 2010, the Administration submitted a proposal to extend the duration of the DS(FS)3 and PAS(FS)6 posts for 16 months (up to 31 July 2012) and 33 months (up to 30 June 2013) respectively.² Apart from taking forward the CO rewrite exercise, the duties of DS(FS)3 were expanded to cover the legislative exercises relating to the reform of the Trustee Ordinance (Cap. 29) ("TO") and Perpetuities and Accumulations Ordinance (Cap. 257) ("PAO")³, and the introduction of a statutory CRP. PAS(FS)6 was also given the additional duties of preparing subsidiary legislation pertaining to the CO rewrite exercise and assisting DS(FS)3 in the trust law reform. The establishment proposal was approved by FC on 14 May 2010.

4. The Government introduced the Companies Bill ("CB"), which was the outcome of the first phase of the CO rewrite exercise, into the Legislative Council ("LegCo") on 26 January 2011. In November 2011, the Government rolled out the second phase of the exercise to modernize the corporate insolvency law regime.⁴ The Administration envisaged that the corporate insolvency law modernization exercise would call for high-level policy steer similar to that of CB, and therefore proposed retaining the DS(FS)3 post for a further period of two years (i.e. from 1 August 2012 to 31 July 2014).⁵ The proposal was approved by FC on 13 April 2012.

5. CB was subsequently passed by LegCo on 12 July 2012. In view of the substantial workload for preparing the necessary subsidiary legislation to provide for various administrative, procedural and technical matters for the

¹ The relevant establishment proposal was set out in EC(2005-06)9. The posts of DS(FS)3 and PAS(FS)6 were officially created in March and October 2006 respectively.

² The relevant proposal was set out in EC(2010-11)1.

³ According to the Administration, the trust law regime in Hong Kong is mainly based on common law, supplemented principally by TO and PAO. Both ordinances have not been substantially reviewed or modified since their enactment in 1934 and 1970 respectively. The trust law reform seeks to modernize the provisions in TO and PAO and enhance trustee's powers.

⁴ The objectives of the corporate insolvency law modernization exercise are to streamline and rationalize the company winding-up procedures to facilitate more efficient administration of winding-up and increase protection of creditors; provide for a new statutory CRP for companies in short-term financial difficulty to turn around or restructure; and to enhance regulation of the winding-up regime.

⁵ The relevant proposal was set out in EC(2011-12)16.

commencement of the new CO⁶, the Government proposed further extending the duration of PAS(FS)6 for a period of one year (i.e. from 1 July 2013 to 30 June 2014).⁷ The scope of responsibility of PAS(FS)6 was expanded to cover the policy review on the abscondee regime under the Bankruptcy Ordinance (Cap. 6) ("BO") and formulation of relevant reform proposals.⁸ The establishment proposal was approved by FC on 15 March 2013.

6. The Trust Law (Amendment) Bill 2013 reflecting the outcome of the trust law reform was introduced into LegCo on 20 February 2013. The Trust Law (Amendment) Ordinance 2013 ("Trust Amendment Ordinance") was enacted on 17 July 2013 and commenced operation on 1 December 2013. The new CO commenced operation on 3 March 2014.

Further extension of the two posts in 2014

7. In mid-2014, the Administration proposed further extending the posts of DS(FS)3 and PAS(FS)6 for two years and five months and two and a half years respectively to continue providing dedicated directorate support for various legislative exercises and other matters.⁹ In other words, both posts would be due to lapse on 1 January 2017. The main responsibilities of DS(FS)3 were to oversee (a) the corporate insolvency law improvement exercise and the introduction of a statutory CRP; (b) regulation of the accountancy sector, including reviewing the existing regime on auditor oversight; (c) the review of the abscondee regime under BO; (d) follow-up matters concerning the new CO and the reformed trust law; and (e) other policy issues concerning insolvency administration and housekeeping matters concerning ORO and the Companies Registry ("CR"). The main responsibilities of PAS(FS)6 were to support DS(FS)3 on the above areas of work. The proposal was approved by FC on 6 June 2014.

Updates on the legislative exercises undertaken by the two posts

Abscondee regime under the Bankruptcy Ordinance

8. The Bankruptcy (Amendment) Bill 2015 was published in the Gazette on 30 April 2015 and received its First Reading at LegCo on 13 May 2015. BO currently provides that a bankrupt will automatically be discharged from

⁶ When the new CO (Cap. 622) commenced operation on 3 March 2014, the old CO (Cap. 32) with the winding-up and insolvency provisions was re-titled as Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32).

⁷ The relevant proposal was set out in EC(2012-13)22.

⁸ The review seeks to address the constitutionality issues under the existing abscondee regime. Paragraph 8 of this paper discusses the issues.

⁹ The relevant proposal was set out in EC(2013-14)23.

bankruptcy upon the expiry of a "relevant period", which runs for four years for first-time bankrupts or five years for repeat bankrupts. Section 30A(10) of BO provides for an abscondee regime under which the "relevant period" is automatically suspended if the bankrupt concerned has left Hong Kong without notifying the trustee-in-bankruptcy of his/her itinerary and contact means. The abscondee regime has been ruled unconstitutional by the Court of Final Appeal. The Bill seeks to address the constitutionality issues of the abscondee regime. Under the arrangements proposed in the Bill, there will no longer be an automatic suspension of the "relevant period". The court will be provided with discretionary power to determine whether the "relevant period" should be treated as not commencing to run until the bankrupt complies with the relevant terms specified by the court in a non-commencement order. The Bill was passed on 17 March 2016.¹⁰

Corporate insolvency law regime

9. From April to July 2013, the Administration conducted a public consultation on the legislative proposals to improve the corporate insolvency and winding-up provisions. The consultation conclusions were published in May 2014. According to the Administration, all legislative proposals set out in the consultation document were supported by a majority of respondents. The Administration published in the Gazette the Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015 on 2 October 2015, which received its First Reading at the LegCo meeting of 14 October 2015. The Bill is now under the scrutiny of a Bills Committee.

A new statutory corporate rescue procedure

10. In October 2009, the Administration conducted a three-month public consultation on the conceptual framework and key issues relating to the introduction of provisional supervision as a CRP in Hong Kong to seek public views on issues including initiation of provisional supervision, moratorium of legal action to a company in financial difficulty, treatment for employees' outstanding entitlements, and provisions on insolvent trading. The consultation conclusions were published in July 2010. Based on the outcomes of the public consultation, the Administration developed a package of detailed proposals for further engagement with stakeholders in 2014. The FA Panel was briefed on the detailed proposals on 7 July 2014. The Administration is preparing drafting instructions for the amendment bill on the statutory CRP and will continue to engage stakeholders on the details. The Administration's target is to introduce the relevant bill into LegCo in 2017-2018.

¹⁰ The report of the Bills Committee on Bankruptcy (Amendment) Bill 2015 was tabled at LegCo on 16 December 2015 (LC paper No. CB(1)280/15-16).

Regulatory regime for listed entity auditors

11. According to the Administration, it has become international standards that auditor regulatory regimes should be independent of the audit profession and be subject to independent oversight by bodies acting in the public interest. Against this international trend, Hong Kong's present regulatory regime is considered as largely a self-regulatory regime.¹¹ This has rendered Hong Kong not eligible to be represented on the International Forum of Independent Audit Regulators, thus hindering cooperation between Hong Kong regulators and their counterparts in overseas jurisdictions.

12. To address the above, the Administration has developed reform proposals in collaboration with the Financial Reporting Council ("FRC") and the Hong Kong Institute of Certified Public Accountants ("HKICPA") to enhance the independence of the existing regulatory regime for listed entity auditors, and ensure that the regime is benchmarked against international standards.¹² A three-month public consultation was conducted on the proposals from June to September 2014, and FA Panel was briefed on the consultation outcome in July 2015. According to the Administration, an overwhelming majority of the respondents are supportive of the objective and direction of the reform. It is the Administration's target to introduce an amendment bill into LegCo in 2016-2017.

Major views and concerns expressed by Members

13. The major views and concerns expressed by Members on the proposals to retain the supernumerary posts of DS(FS)3 and PAS(FS)6 at meetings of FA Panel and ESC held from 2011-2012 to 2013-2014 are summarized in the ensuing paragraphs. In addition, FA Panel was updated on the progress of the legislative exercises relating to the corporate insolvency law, a new statutory CRP, and auditor regulatory reform at the meetings on 3 May 2013, 7 July 2014 and 6 July 2015 respectively. The major views and concerns expressed by members on related issues at these meetings are also summarized below.

¹¹ At present, Hong Kong's regulatory regime for auditors is primarily administered by the Hong Kong Institute of Certified Public Accountants, which is a statutory professional body established by the Professional Accountants Ordinance (Cap. 50).

¹² These international standards include the International Forum of Independent Audit Regulators' Charter and Core Principles for Independent Audit Regulators, the European Union's Statutory Audit Directive, and the International Organisation of Securities Commissions' Objectives and Principles of Securities Regulatory and Principles for Auditor Oversight.

Workload of the two proposed posts

14. At the FA Panel meeting on 7 January 2013 and ESC meeting on 20 February 2013, some Members expressed concern that given the wide range of duties PAS(FS)6 had to undertake, the proposed extension period of one year might not be adequate to complete all required tasks.

15. The Administration advised that the proposed extension period for the supernumerary post had been drawn up in a prudent manner having regard to the estimated timeframe for implementing the new CO in the first quarter of 2014 and completion of the legislative exercise for the trust law reform by mid-2014. The Administration stressed that it would review the future need for the supernumerary post taking into account the progress of the tasks handled by the post holder, and would seek further extension of the post when necessary.

16. At the ESC meeting on 19 February 2014, some members remarked that with completion of work for improving the trust law and company law regimes following the commencement of the Trust Amendment Ordinance and the new CO in December 2013 and March 2014 respectively, the workload of the two posts in question would be greatly reduced. As for the outstanding exercises undertaken by the two posts, including improvement to the corporate insolvency law and auditor regulatory regime, and introduction of a statutory CRP, CR and FRC were already heavily involved and providing a lot of input. They sought justifications for further retaining the two posts.

17. The Administration pointed out that apart from the above-mentioned legislative exercises, the two posts would also be responsible for the review of the abscondee regime under BO. While the Trust Amendment Ordinance commenced operation in December 2013, there were suggestions put forward by stakeholders for further improving the trust law, which had not been incorporated in the Trust Amendment Ordinance pending further assessment and detailed examination. To this end, the Administration would conduct policy research and analysis, and continue to engage relevant stakeholders. As regards the proposed introduction of a new statutory CRP, the Administration responded that it was a complex project involving a number of complicated and controversial issues as well as various stakeholders. The matter required steering and input from the directorate level.

The need for a statutory corporate rescue procedure and timetable for the legislative exercise

18. At the FA Panel meetings on 7 November 2011, 3 May 2013, 6 January 2014 and 7 July 2014, some members enquired about the timetable for introducing a statutory CRP in Hong Kong, and urged that the Administration should put forward the relevant legislative proposals to LegCo

as soon as possible. They noted that a statutory CRP for companies had merit over the winding-up procedure as it would minimize adverse impacts on the relevant parties (e.g. creditors and employees of a company), and there was general support from the business and the relevant professional sectors for CRP. Members also suggested that, in preparing the legislative proposals, the Administration should make reference to overseas experiences to better understand the essential factors contributing to a successful CRP.

19. Some other members had reservations over the proposed CRP and expressed concern that only large corporations would benefit from the procedure since small and medium-sized enterprises ("SMEs") would not be able to afford the high professional fees involved. Furthermore, there was concern about including insolvent trading provisions in the proposed CRP which might place unfair responsibilities on company directors. These members pointed out that a director would face a dilemma when a limited company became insolvent. This was because if the company was declared insolvent by the director, banks would be reluctant to provide credit facility for the company. These members called on the Administration to consider the proposal on CRP carefully.

20. The Administration responded that it had conducted a public consultation on the conceptual framework and some key issues of a CRP in 2009 and briefed FA Panel on the consultation conclusions in July 2010. Relevant parties, including SMEs, had been consulted. The Administration remarked that, while sizable corporations were more likely to benefit from the proposed CRP, the legislative provisions would provide more protection to the employees and suppliers in case a corporate became insolvent. For the purpose of protecting the interests of directors, the Administration could explore the possibility of providing appropriate safe harbours in the proposed legislation. Given the complexities of the issues involved, it would need more time to work out the detailed legislative provisions for further engagement with stakeholders and prepare the amendment bill. The Administration's target was to introduce the relevant bill into LegCo in 2017-2018.

21. At the ESC meeting on 19 February 2014, members expressed concern about how the Administration could secure LegCo's support for the legislative proposals in relation to the statutory CRP regime. The Administration responded that the latest legislative proposals were built on the majority views received on some major issues (like the handling of wages in arrears) during the public consultation in 2009 and hence they would represent some major changes from the Companies (Corporate Rescue) Bill 2001 ("2001 Bill"), which lapsed at the end of the second term of LegCo ending 2004 due to concerns expressed by Members at that time. Besides, the proposals would be more detailed than the 2001 Bill and include certain key issues, such as the checks

and balances in relation to the conduct of the provisional supervisor, which were not discussed in the 2009 public consultation.

Stakeholder engagement for the auditor regulatory reform

22. At the FA Panel meetings on 6 January 2014 and 6 July 2015, members enquired how the Administration would address the views and concerns raised by the audit profession and business sector on the auditor regulatory reform. In particular, some members stressed that the Administration should not confine its engagement to HKICPA, as the interests of audit firms of different sizes might not be identical, there were other relevant professional bodies in the accounting/audit sector, and the reform would also affect listed entities.

23. The Administration advised that the reform proposals involved stakeholders from different sectors, including the audit profession, listed companies, relevant financial regulators and the investing public. The Administration would continue to make use of the pre-existing tripartite forum to engage HKICPA and FRC, and would also maintain dialogue with other stakeholder groups, including small and medium-sized audit firms and other relevant professional bodies.

Latest development

24. The supernumerary posts of DS(FS)3 and PAS(FS)6 will lapse on 1 January 2017. The Administration will brief FA Panel at the meeting to be held on 22 March 2016 on the proposal to retain the two posts.

Relevant papers

25. A list of relevant papers is in the **Appendix**.

List of relevant papers

Date	Event	Paper/minutes of meeting
7 November 2011	The Panel on Financial Affairs ("FA Panel") was briefed on the staffing proposal to retain a supernumerary post of Administrative Officer Staff Grade B ("AOSGB") in the Financial Services Branch ("FSB") of the Financial Services and the Treasury Bureau ("FSTB")	Administration's paper (LC Paper No. CB(1)237/11-12 (05)) Minutes (LC Paper No. CB(1)614/11-12)
18 January 2012	The Establishment Subcommittee ("ESC") deliberated on the staffing proposal	Administration's paper (EC(2011-12)16) Minutes (LC Paper No. ESC34/11-12)
13 April 2012	The Finance Committee ("FC") approved the staffing proposal	Minutes (LC Paper No. FC175/11-12)
7 January 2013	FA Panel was briefed on the staffing proposal to retain a supernumerary post of Administrative Officer Staff Grade C ("AOSGC") in FSB of FSTB	Administration's paper (LC Paper No. CB(1)358/12-13 (06)) Minutes (LC Paper No. CB(1)782/12-13)
20 February 2013	ESC deliberated on the staffing proposal	Administration's paper (EC(2012-13)22) Minutes (LC Paper No. ESC30/12-13)
15 March 2013	FC approved the staffing proposal	Minutes (LC Paper No. FC180/12-13)

Date	Event	Paper/minutes of meeting
3 May 2013	FA Panel was brief on the legislative proposals to improve Hong Kong's corporate insolvency law	Administration's paper (LC Paper No. CB(1)876/12-13 (01)) Minutes (LC Paper No. CB(1)1789/12-13)
6 January 2014	FA Panel was briefed on the staffing proposal to retain the supernumerary posts of AOSGB and AOSGC in FSB of FSTB	Administration's paper (LC Paper No. CB(1)625/13-14 (08)) Minutes (LC Paper No. CB(1)1310/13-14)
19 February 2014	ESC deliberated on the staffing proposal	Administration's paper (EC(2013-14)23) Minutes (LC Paper No. ESC43/13-14)
6 June 2014	FC approved the staffing proposal	Minutes (LC Paper No. FC55/14-15)
7 July 2014	FA Panel was briefed on the consultation conclusions on corporate insolvency law improvement exercise and proposals on the introduction of a statutory corporate rescue procedure	Administration's paper (LC Paper No. CB(1)1536/13-14 (01)) Minutes (LC Paper No. CB(1)1998/13-14)
6 July 2015	FA Panel was briefed on the consultation conclusions on proposals to improve the regulatory regime for listed entity auditors	Administration's paper (LC Paper No. CB(1)1034/14-15 (08)) Minutes (LC Paper No. CB(1)1258/14-15)