

**Bills Committee on
Companies (Amendment) Bill 2003**

**Update of the Companies Ordinance and
Corporate Governance Review**

Introduction

This paper informs Members of the latest position on the update of the Companies Ordinance.

2. Provisions in the Companies Ordinance are reviewed from time to time by the Standing Committee on Company Law Reform (SCCLR), whose terms of reference include advising the Financial Secretary on amendments to the Companies Ordinance as and when experience shows them to be necessary. In recent years, a number of recommendations for changes have been put forward by SCCLR in the context of –

- (a) the Report of the SCCLR on the Recommendations of a Consultancy Report on the Review of the Hong Kong Companies Ordinance (SCCLR Report) published in 2000; and
- (b) the Corporate Governance Review (CGR) it has undertaken.

SCCLR Report

3. There are 62 recommendations arising from the SCCLR Report. The details of these items, which are categorised in four phases, are set out at the Annex.

Corporate Governance Review by the SCCLR

4. A Consultation Paper on Phase I of the CGR containing 21 proposals in respect of directors' duties, shareholders' rights and corporate reporting enhancement was issued in July 2001. The comments received from the professional bodies, trade associations, academia and individuals indicated general support for most of the proposals. The present position

on these proposals is as follows –

- 1 item regarding the rights of an individual member of a company has been included in the Companies (Amendment) Ordinance 2003 which was enacted in July 2003;
- 4 items concerning shareholder protection and remedies have been included in the Companies (Amendment) Bill 2003;
- 1 item regarding the nomination and election of directors will be included in the next company amendment bill, because a number of issues relating thereto have to be put to the public for further consideration and we also wanted to assess the reaction to nomination committees in Phase II of CGR;
- 2 items on regulatory reforms require further consultation. They include a proposal to give the SFC the power to conduct derivative actions for minority shareholders against a listed company, and another proposal to set up a body to investigate financial statements, similar to the Financial Reporting Review Panel in the United Kingdom;
- 6 items on connected transactions, dominant shareholders, role of independent directors and non-statutory code of directors' duties, are being taken forward in Phase II of the CGR;
- 3 items on financial reporting have been subsumed by the Government/Hong Kong Society of Accountants (HKSA) Joint Working Group which was established in early 2002 to review the accounting and auditing provisions of the Companies Ordinance;
- 1 item on listed companies' Management Discussion and Analysis is being taken forward by the Hong Kong Exchanges and Clearing Limited;
- 2 items on the opening up of the accounting and auditing standards process and the strengthening of the audit practice review programme are being taken forward by the HKSA;
- 1 item regarding the proposal that private companies file financial statements was rejected by the majority of consultees and would not be further pursued.

5. A consultation paper on Phase II of the CGR was issued in June 2003. The proposals relate to different aspects of directorship (including directors' roles, duties, qualifications, training and remuneration, as well as connected transactions, board procedures and board committees etc.); shareholders' rights and conflicts of interests; company general meetings; corporate reporting with focus mainly on external auditors and corporate regulation. The consultation period will end in late September 2003.

Overall Restructuring of the Companies Ordinance

6. One of the recommendations of the SCCLR's Report relates to the restructuring and rewriting of the Companies Ordinance. We also note Members' views expressed during the scrutiny of the Companies (Amendment) Bill 2002 that the Government should proceed with a comprehensive rewrite and update of the Ordinance. The restructuring and rewriting exercise would be a mammoth exercise which requires extensive legal research for the drafting of the new Bill. The drafting and consultation process would be substantial and complex. We are considering how best to take forward this exercise having regard to the availability of necessary resources. In the meantime, we suggest that urgent proposed amendments to the Ordinance, including recommendations relating to corporate governance, should proceed.

Financial Services Branch Financial Services and the Treasury Bureau September 2003

**Implementation of the Recommendations
arising from the Review of Companies Ordinance**

Phase I

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
1	One member companies.	Included in the Companies (Amendment) Ordinance 2003
2	One director companies.	Ditto.
3	Incorporation of a company limited by guarantee with share capital be prohibited in the future.	Ditto.
4	Regulation 82 of Table A be amended along the lines of the U.K. Table A.	Ditto.
5	Removal of directors by ordinary resolution notwithstanding any provision in the company's constitution.	Ditto.
6	Enabling provisions be inserted in Table A to permit electronic communications.	Ditto.
7	Subject to contrary provision in the articles, a director be vicariously liable for the acts and omissions of his alternate.	Ditto.
8	The statutory provisions be extended to cover in generic terms the provision of financial assistance to directors.	Ditto.

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
9	A statutory definition of shadow directors be provided.	Ditto.
10	A shadow director be defined to include someone who can influence less than the whole board of directors.	Ditto.
11	The definition of manager be clarified to indicate a rank immediately below and reporting to the board.	Ditto.
12	The Ordinance should confirm that indemnities may be given to directors for liability incurred by them to others in the course of performing their duties and that the permissible scope of such indemnities should be studied further.	Ditto.
13	Companies be permitted to insure directors and officers except in certain specified circumstances.	Ditto.
14	The threshold for shareholders' proposals be reduced to 2½% of voting rights or 50 shareholders.	Ditto.
15	A strict time limit (10 business days) be stipulated for completion of transfers of shares of public companies.	Ditto.
16	Giving every shareholder a personal right to sue to enforce the terms of the Memorandum and Articles of Association.	Ditto.

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
17	The right to resort to the court under section 8 (Statutory procedure for amending the objects clauses of a company's memorandum) be repealed as regards public companies.	Ditto.
18	Court approval for reduction of capital should not be required for the redesignation of par-value to a lower amount provided that the company has only one class of shares; the issued shares are fully paid-up; the reduction is distributed equally to all shares; and the reduction is credited to the share premium account.	Ditto.

Phase II

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
1	Further study be made of the appropriate board structure for public companies as part of the programme to improve corporate governance.	The further study has been subsumed under Phase II of SCCLR's CGR.
2	The question of appointment of directors be reviewed .	Phase I of CGR, but further reviewed in Phase II of CGR.
3	The question of a statutory statement of directors' duties and whether directors be able to rely in good faith on reports prepared by officers and professional advisers be kept under review in the light of international developments.	Phase I of CGR, but further reviewed in Phase II of CGR.
4	The question of self-dealing be further studied .	The further study has been subsumed under Phases I and II of CGR.
5	The dispersed notice provisions be consolidated into one general criterion: the notice must provide a full explanation (including conflict of interests) of a proposed transaction to enable shareholders to form a judgement.	Being considered in Phase II of CGR.
6	Provisions for a proxy system be further studied .	Ditto.

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
7	The impact on the right of shareholders to vote when shares are registered in the name of Central Clearing and Settlements System (CCASS) be further studied after the completion of the market restructuring.	Being pursued.
8	The following principles be studied further : transactions in which controlling shareholders have an interest different from that of other shareholders is proposed to be subject to approval by shareholders, with the controlling shareholder abstaining from voting; adequate exceptions is proposed to be made available to accommodate immaterial transactions and bona fide transactions in the ordinary course of business on arm's-length terms; compliance with rules stipulated by securities regulators is proposed to be deemed to be compliance with the law; it is proposed that private companies may include exemptions in their articles.	Phase I of CGR, but further reviewed in Phase II of CGR.
9	The issue of access to corporate records be further studied.	Has been included in the Companies (Amendment) Bill 2003.
10	A statutory right of derivative action to be considered.	Ditto.

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
11	Section 155A be repealed and its contents moved to Table A with the following amendments: the requirement for approval should be triggered by dispositions of the same percentage of net assets of the company; the provision should apply to all companies, provided that transactions between parents and wholly-owned subsidiaries and between wholly-owned subsidiaries of the same holding company shall be exempt.	The further study has been subsumed under Phase II of SCCLR's CGR.
12	The question of class rights and variation be further studied .	Ditto.
13	The suitability of judicial control, multiplicity of provisions and class votes be further studied .	Ditto.
14	Section 141D of the Ordinance be amended to refer to a 'true and fair' view.	To be considered by the Government/HKSA Joint Working Group and would be included in the restructuring of the Ordinance.

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
15	A study be undertaken as to whether, and if so to what extent, section 141D (regarding simplified accounts for private companies) should be modified and extended.	To be considered by the Government/HKSA Joint Working Group and would be included in the restructuring of the Companies Ordinance.
16	Further study and consultation be conducted on exempting private companies from publication of financial statements.	Will not proceed as majority of respondents did not favour private companies filing audited accounts with the Companies Registry.
17	The Tenth Schedule be updated, and the HKSA's offer of assistance in this respect be accepted.	Has been considered by the Government/HKSA Joint Working Group and would be included in the restructuring of the Ordinance.
18	The concept of a register of directors interests be studied further .	SCCLR reviewed this in Phase I of CGR and agreed that this proposal should not be pursued.

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
19	Directors' minimum qualifications including requirement that all directors must be natural persons i.e. abolition of corporate directors.	Review completed and will be included in the next companies amendment bill.

Phase III

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
1	No-par value shares to be permitted for all companies on an optional basis.	Will be included in the restructuring of the Ordinance.
2	Section 341 (Interpretation of Part XI – Companies incorporated outside Hong Kong) be redrafted.	Has been included in Companies (Amendment) Bill 2003.
3	The filing requirements for registration as a foreign company should be simplified.	Ditto.
4	The filing requirements applicable to foreign companies under the new Ordinance should be co-ordinated with those of the Business Registration Ordinance.	Ditto.
5	The offences and punishment provisions in the Ordinance be further studied .	The Companies Registry (CR) will submit the proposals to the SCCLR in late 2003. Follow up action will be taken in the context of the restructuring of the Ordinance.

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
6	The investigation provisions in the Ordinance be further studied .	Follow up action will be taken in the context of the restructuring of the Ordinance.
7	The study of the issue of the status of shares as negotiable instruments be deferred until the completion of the securities and futures market reforms.	Being reviewed.
8	The issue of scripless securities to be studied after the completion of the securities and futures market reforms.	SFC conducted a public consultation in February 2002 on the initiative. HKEx will conduct another consultation on the detailed model of implementation later this year. Legislative amendment proposals will be introduced in due course.

Phase IV

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
1	The new Ordinance should cover solvent liquidations and dissolutions but insolvent liquidations and dissolutions should be left to a comprehensive Insolvency Ordinance.	To be taken forward in the overall restructuring of the Ordinance.
2	The provisions in the Ordinance applicable to listed companies be applicable to Public Companies.	Ditto.
3	Removal of Prospectus provisions from the Ordinance.	Ditto.
4	Review of the “Charges” provisions under Part III with a view to introducing a separate, comprehensive regime governing security interests in personal property.	Ditto.
5	The Ordinance to be written in plain language so as to be accessible to users like business people, lawyers and accountants etc.	Ditto.
6	Public Companies to be defined to mean companies limited by shares that are not private companies.	Ditto.
7	Companies limited by guarantee be referred to as ‘Guarantee Companies’.	Ditto.
8	Memorandum and Articles of Association be retitled the constitution.	Ditto.

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
9	The drafting of the provisions regarding financial assistance to directors be simplified.	Ditto.
10	A separate part of the Ordinance be dedicated to matters dealing with shareholders' rights and remedies.	Ditto.
11	Improve the overall organization of provisions regarding the fundamental changes of a company, such as changing the scope of the business or restructuring the share capital, to make the legislation more user-friendly.	Ditto.
12	Reform of section 47A (financial assistance by a company for acquisition of its own shares) be further studied .	Ditto.
13	Further study be made of restraints on issuance of shares for consideration in kind.	Ditto.
14	The application of section 79C (regarding restrictions on the distribution of a company's assets) to private companies should be further studied .	Will be reviewed by the Government/ HKSA Joint Working Group.
15	The issue of liability of controllers of companies for employees' wages be referred to the Administration for further consideration .	Will be reviewed.

<u>Item</u>	<u>Subject</u>	<u>Latest Position</u>
16	The provisions of Parts VII and XIII regarding the administration of the Ordinance be consolidated and updated.	To be taken forward in the overall restructuring of the Ordinance.
17	Provisions be made for the concept of 'record dates' for the payment of dividends, issue of notices of meetings and voting purposes.	To be taken forward in the overall restructuring of the Ordinance.