Bills Committee on
Companies (Amendment) Bill 2003

Summary of the Proposals in
the Companies (Amendment) Bill 2003

Introduction

This paper aims to summarize the major proposals in the Companies (Amendment) Bill 2003 and the views collated during the consultation on the proposals.

Overview

2. The Bill consists of the following major four legislative proposals –

(a) improving the prospectus regime (Schedule 1 of the Bill);

(b) enhancing shareholder remedies (Schedule 4 of the Bill);

(c) aligning the definition of "subsidiary" for the purpose of preparing group accounts with the International Accounting Standards (IAS) (Schedule 2 of the Bill) ; and

(d) improving the registration regime for oversea companies (Schedule 3 of the Bill).

Schedule 5 of the Bill contains consequential amendments arising from Schedule 1, 2 or 3 of the Bill.

3. The Legislative Council Panel on Financial Affairs were consulted on the legislative proposals in February 2002 and April 2003. Members of the Panel did not object to the proposals.

Improving the prospectus regime

4. The existing regulatory framework was introduced decades ago and amendments made over the years do not adequately accommodate offering structures and other market practices prevalent in developed markets today. In response to specific requests from market participants,

the prospectus-related proposals were drawn up to, among other things, simplify the procedures for the registration and issue of prospectuses, thereby fostering the development of retail bonds and other financial products. The provisions in Schedule 1 of the Bill aim to -

(a) clarify what types of offers can be made without triggering the prospectus regime;

(b) make clear that subject to necessary investor protection safeguards, it is permissible for issuers to issue "awareness advertisements" to allow investors more time to arrange their financial and other affairs in anticipation of a public offer;

(c) provide a dual prospectus structure, with appropriate safeguards on provision of information to investors, to facilitate the conduct of programme offers;

(d) to remove the discrepancies in certain regulatory requirements applicable to offers made by companies incorporated locally and overseas;

(e) expand the existing exemption power of the Securities and Futures Commission e.g. to increase the number of provisions in respect of which exemptions may be granted, to update certain regulatory requirements by way of subsidiary legislation; and

(f) amend the prospectus civil and criminal liabilities provisions under the Companies Ordinance (CO).

5. In March 2003, we conducted a three-week joint public consultation with the SFC on the amendments proposed to the prospectus regime. There is broad public support from the submissions received from industry associations, professional bodies, the Consumer Council and other interested parties for the initiative to update the regulatory framework and the proposals. These are considered to be facilitative for offers of shares and debentures. The Consumer Council welcomes the safeguards introduced for ensuring that investor protection will not be compromised by such proposals. Comments on relevant proposals under the Bill have been incorporated to the extent that investor protection will not be compromised and policy considerations have been addressed. Certain comments require more detailed consideration and will be dealt with in the third phase of the

of the exercise to overhaul the existing regulatory framework[1] or, where appropriate, through amending the relevant schedules to the CO by way of subsidiary legislation in the interim. Comments relating to implementation will be pursued by the SFC as appropriate.

Enhancing shareholder remedies

6. We propose a number of amendments to the CO to enhance shareholder remedies. These proposals formed part of the recommendations made by the Standing Committee on Company Law Reform (SCCLR) in the Phase I of its Corporate Governance Review. Introduction of these proposals into the Legislative Council is one of the targets set out in the Corporate Governance Action Plan promulgated in January 2003. The provisions in Schedule 4 of the Bill aim to -

(a) provide for a statutory derivative action that may be taken on behalf of a company by a member of the company. In general, prior leave of the court is not required for the commencement of the action. Pre-action notice, unless otherwise dispensed with by the leave of the court, has to be served on the company before the commencement of the action. The court may strike out the action if it is, inter alia, not taken in the best interest of the company or in good faith. The court is also empowered to grant orders as to the costs incurred by a member taking a derivative action provided that there is no evidence of bad faith on the part of the member and there are reasonable grounds on which to commence the action;

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[1] The Financial Secretary highlighted in his Budget Speech in 2002 the importance of increasing liquidity through attracting more financial product issuers to Hong Kong, as well as capital and investors from the Mainland and overseas. One of the initiatives endorsed by the Financial Secretary for increasing liquidity is to implement a three-phase approach to overhaul the existing regulatory framework for offers of shares and debentures. The first phase involved the issue by the SFC in February 2003 various guidelines to streamline the procedures for the registration and issue of prospectuses. The SFC also issued two class exemptions relating to prospectuses for offers of debentures. The second phase is the subject of this Bill. In the third phase, the SFC will conduct a comprehensive review of all local laws and procedures governing public offers of securities as well as relevant regulatory reforms introduced in other leading jurisdictions.

(b) amend section 168A[2] to provide that the court may award damages to the members of a company where it is found that their interests have been unfairly prejudiced, and to award such interest on the damages awarded as the court thinks fit. Past members (and their personal representatives) are also allowed to take action under this section in so far as the conduct complained of took place while they were members of the company. The court is also empowered to make an order for the compensation of costs incurred by the members and past members undertaking the action. Members of oversea companies, as well as companies incorporated in Hong Kong are allowed to commence an action under that section;

(c) empower the court, on application by a member, to make an order to allow the member or his representative to obtain access to such records; and

(d) empower the court, on application by an affected person or the Financial Secretary, to grant an injunction restraining any person from engaging in conducts which constitute contravention of the CO or a breach in fiduciary or other duties owed to a company. The court may also order any person to do any act or thing.

7. The proposals were included in the Consultation Paper on Proposals made in Phase I of the Corporate Governance Review published by SCCLR in July 2001 for public consultation. The submissions received indicated support for such proposals and comments on the relevant details of the proposals such as provision of suitable safeguards have been incorporated in the Bill where appropriate.

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[2] Section 168A of the CO provides for a statutory remedy (short of liquidation) against unfair prejudice. Its underlying premise is that minority shareholders should be treated fairly. This section deals with rights which members have personally, unlike derivative actions where a member seeks to enforce rights of action belonging to the company. A wide range of remedies is available under this section such as providing for the purchase of the shares of the company by other members of the company or the company.

Aligning the definition of "subsidiary" with the IASs

8. Section 124 requires a company having subsidiaries to lay before the company in general meeting, accounts dealing with the state of affairs and the profit and loss of the company itself and its subsidiaries. These accounts are known as group accounts. The definition of the term "subsidiary" in section 2(4)[3] which applies to accounting and other provisions in the CO is narrower than that adopted in the IASs[4]. We consider it necessary to amend the statutory definition for the purposes of group accounts to make it more closely align with the IASs. This would ensure that under the law, the group accounts would better reflect the financial position of the company. The definition of "subsidiary" for purposes other than the preparation of group accounts would not be affected. The provisions in Schedule 2 of the Bill, which are drawn up on the basis of the relevant provisions of the UK, aim to -

(a) introduce new terms of "subsidiary undertaking", "parent company" and "parent undertaking";

(b) Add "right to exercise a dominant influence over another undertaking" (defined as the right to give directions with

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[3] The term "subsidiary" is defined in section 2(4), which deems the relationship between a holding company and its subsidiary to be one of the control of the composition of the board of directors of the subsidiary, control of more than half of the voting power of the subsidiary or the holding of more than half of the issued share capital of the subsidiary.

[4] The Hong Kong Society of Accountants (HKSA) is responsible for issuing the Hong Kong Statements of Standard Accounting Practice (SSAPs), which govern the preparation and presentation of accounts (including group accounts). Since 1993, it has been the HKSA's policy to harmonise SSAPs with the International Accounting Standards (IASs), which are the internationally recognised set of accounting standards. The HKSA issued SSAP 32 "Consolidated Financial Statements and Accounting for Investments in Subsidiaries" in January 2001 to apply in the preparation and presentation of group accounts for accounting periods beginning on or after 1 January 2001. SSAP 32 is based on, and generally consistent with IAS 27 "Consolidated Financial Statements and Accounting for Investments in Subsidiaries" except that SSAP 32 currently accommodates the CO's definition of "subsidiary" for statutory reporting purposes. In both IAS27 and SSAP 32, a subsidiary is defined as "an enterprise that is controlled by another enterprise", where the control is the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.

respect to the operating and financial policies of that other undertaking which its directors will be obliged to comply with) to the existing tests of determining the existence of a parent/subsidiary relationship; and

(c) introduce "true and fair view override" provisions to the effect that if compliance with the requirements of the Ordinance does not result in a true and fair view of the state of affairs of the company or the group, the directors should depart from these requirements to the extent necessary to give a true and fair view.

9. We have prepared the proposals relating to the definition of "subsidiary" in consultation with the Hong Kong Society of Accountants. In April 2003, we invited comments from the Hong Kong General Chamber of Commerce, Chinese General Chamber of Commerce, Hong Kong Mortgage Corporation Limited, and Hong Kong Capital Markets Association. The Hong Kong General Chamber of Commerce has no objection to the proposals. The Chinese General Chamber of Commerce supports the proposals. Both the Hong Kong Mortgage Corporation Limited and Hong Kong Capital Markets Association are concerned about the possible impact of the proposals on the asset securitisation market in Hong Kong, in particular, whether we would be competitively disadvantaged when compared with other financial centres. We appreciate their concerns and would watch international developments, in particular, in relation to the IASs closely. Where necessary and justified, refinements will be made to the Bill before its enactment to ensure that our market development and corporate governance needs are adequately catered for and that the disclosure regime is in line with international standards and practices.

Improving the registration regime for oversea companies

10. Part XI of the CO provides for the registration regime for oversea companies. The Registrar of Companies (R of C), with the SCCLR's blessing, has chaired a Sub-Committee under the SCCLR to undertake a comprehensive review of this Part XI and all the other provisions of the CO which apply to oversea companies, with a view to simplifying the filing requirements. The provisions in Schedule 3 of the Bill aim to -

(a) replace the existing term "oversea company" by "non-Hong Kong company";

(b) shorten the period where a non-Hong Kong company is required to have an authorized representative after it ceases to have a place of business in Hong Kong from three years to one year;

(c) clarify the circumstances under which the company is required to register charges on its properties in Hong Kong;

(d) provide for the use of specified forms for the filing of documents, and allows certification of copies of documents required to be delivered to the R of C as true copies to be done in Hong Kong; and

(e) enhance the disclosure requirements for non-Hong Kong companies. For example, the Bill requires those companies which are obliged to publish accounts by the law in another jurisdiction or by a regulatory body to deliver annual returns together with their latest published accounts to the R of C.

11. The Sub-Committee is well represented by professionals in the legal and accounting sectors. In drawing up the proposals, the Sub-Committee has taken into account comments received from chambers of commerce and professional bodies on the existing registration regime.

12. When the Panel on Financial Affairs considered the legislative proposals in relation to oversea companies on 4 February 2002, Members suggested that other regulatory bodies be consulted on the possible impact of the proposals on anti-money laundering initiatives. The Commissioner for Narcotics, who oversees the policy on anti-money laundering, confirms that the proposed changes to the registration requirements for oversea companies do not have any particular implications from the anti-money laundering point of view.

Financial Services Branch
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