For Discussion
on 1 November 2010

Legislative Council
Panel on Financial Affairs

Companies Ordinance Rewrite

Consultation Conclusions of the Draft Companies Bill

PURPOSE

We last briefed the Legislative Council (LegCo) Panel on Financial Affairs (FA Panel) on 7 June 2010 on the exercise to rewrite the Companies Ordinance (Cap. 32) (CO). This paper briefs Members on the latest progress of the rewrite exercise and the conclusions of the two phases of consultation on the draft Companies Bill (CB).

BACKGROUND AND PROGRESS UPDATE

2. In mid-2006, the Government launched a major and comprehensive exercise to rewrite the CO, with a view to making it more user-friendly through suitable updates and modernisation. Given the length of the CO, we adopted a two-stage approach and opted to focus first on provisions relating to the operation of live companies.

3. Having considered views received from the three topical consultations held in 2007 and 2008 [1] and taking account of the recommendations and advice of the Standing Committee on Company Law Reform (SCCLR), the four dedicated Advisory Groups and the Joint Working Group between the Government and Hong Kong Institute of Certified Public Accountants, a draft CB was prepared for further public consultation in two phases in 2009 and 2010.

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[1] The three consultations conducted in 2007 and 2008 covered:-
(a) accounting and auditing provisions;
(b) company names, directors' duties, corporate directorship and registration of charges; and
(c) share capital, capital maintenance regime and statutory amalgamation procedure.

4. We have completed analysis of the feedback from both phases of the public consultations, and refined the draft CB as appropriate.

5. The draft CB now contains 21 parts, as follows:-

Part no.	**Part title**
1	Preliminary
2	Registrar of Companies and Companies Register
3	Company Formation and Related Matters, and Re-registration of Company
4	Share Capital
5	Transactions in relation to Share Capital
6	Distribution of Profits and Assets
7	Debentures
8	Registration of Charges
9	Accounts and Audit
10	Directors and Company Secretaries
11	Fair Dealing by Directors
12	Company Administration and Procedure
13	Arrangements, Amalgamation, and Compulsory Share Acquisition in Takeover and Share Buy-Back
14	Remedies for Protection of Companies' or Members' Interests
15	Dissolution by Striking off or Deregistration
16	Non-Hong Kong Companies
17	Companies not Formed, but Registrable, under this Ordinance
18	Communications to and by Companies
19	Investigations and Enquiries
20	Miscellaneous
21	Consequential Amendments, and Transitional and Saving Provisions

6. We are finalising the CB for introduction into LegCo in early 2011. The draft CB contains some 930 clauses, which are written in modern-day drafting language and are more user-friendly. There will be some footnotes and examples designed to assist the reader's understanding. The transitional and savings provisions will be set out in a stand-alone Schedule under Part 21 for ease of review. Consequential amendments on the existing CO and other Ordinances are being handled in a separate Bill, which will be introduced into LegCo in 2011[2].

7. For background reference, the sections in the CO which do not relate to live companies and therefore are not being dealt with under the CB, will be retained in Cap. 32, which will be renamed "Companies (Winding Up and Miscellaneous Provisions) Ordinance" (C(WUMP)O). When the CO rewrite exercise progresses to Phase II (i.e. winding up provisions), the provisions under C(WUMP)O (except provisions concerning prospectuses which will be moved to the Securities and Futures Ordinance (Cap. 571)) will be merged with the then-new Companies Ordinance.

CONSULTATION ON DRAFT CB

8. As mentioned above, we conducted two phases of public consultations on the draft CB. The First Phase Consultation, covering ten Parts of the CB, was conducted between 17 December 2009 and 16 March 2010. The Second Phase Consultation, covering the remaining ten Parts, was conducted from 7 May to 6 August 2010. Key issues raised in the two phases of consultation are set out in the ensuing paragraphs.

(A) First Phase Consultation

9. The First Phase Consultation covered ten Parts (namely, Parts 1 and 2, 10 to 12 and 14 to 18) of the draft CB.

10. We briefed the FA Panel on the reform proposals on 4 January 2010, and held a public consultative forum on 4 February 2010. We also

[2] While using a separate Bill to handle consequential amendments might be new in Hong Kong, it is a common practice in other common law jurisdictions such as the UK and Australia. The UK in the last Company Law reform has not included the consequential amendments in the main Bill.

attended eight meetings/forums convened by interested organisations. A total of 164 written submissions[3] were received. We have duly considered all the feedback, taking into account SCCLR's advice.

Key issues and conclusions

11. The conclusions to the issues highlighted for consultation are outlined below:-

(a) <u>"Headcount test"</u>[4]

We consider it desirable to retain the headcount test for members' schemes for listed companies, non-listed companies and creditors' schemes, for safeguarding the interests of minority shareholders and small creditors. Nevertheless, to strike a reasonable balance, the court will be given a new discretion to dispense with the test for members' schemes in special circumstances, such as where there is evidence that the result of the vote has been unfairly influenced by share splitting. This is similar to the approach adopted in Australia. We will keep this under review in the light of developments in other jurisdictions.

(b) <u>Disclosure of residential addresses of directors and identification numbers of directors and company secretaries</u>

To strike a reasonable balance between transparency and protection of personal data privacy, we plan to allow directors to provide a service address on the Companies Registry's (CR) public register, whereas their residential addresses will be kept on confidential record with access restricted to public and enforcement/regulatory authorities, liquidators, provisional liquidators and those who have obtained court orders for disclosure. Directors' residential

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[3] Among the 164 submissions, 104 were from companies/ law firms/ accounting firms, 30 from individuals and 30 from various organisations including some major chambers of commerce, professional and business organisations such as the Law Society of Hong Kong, Hong Kong Bar Association, Hong Kong Institute of Certified Public Accountants, Hong Kong Association of Banks, etc.

[4] "Headcount test" refers to the requirement under section 166 of the CO which provides that, for a compromise or arrangement between a company and its members or creditors (i.e. a scheme) to be approved, a majority in number of those who cast votes in person or by proxy at the meeting must have voted in favour of the scheme.

addresses currently on the public register will be purged upon application and payment of a fee.

For identification numbers, certain digits will be masked on the public register. Full identification numbers now on the public register will be purged upon application and payment of a fee.

(c) Regulating directors' fair dealings in respect of private companies associated with a listed or public company

We sought public views on whether private companies associated with a listed or public company should be subject to more stringent regulations, similar to public companies governing fair dealings by directors, such as a disinterested members' approval requirement for making a loan and similar transactions in favour of directors and their connected persons. Taking into account the majority view that the net should not be cast too wide, the concept of "relevant private company" will be modified to cover only private companies which are subsidiaries of a listed or public company.

(d) Common law derivative action

We agree with the majority view to preserve the common law derivative action as it may still be used by shareholders residing in Hong Kong to obtain remedies in respect of companies incorporated outside Hong Kong.

12. The consultation conclusions (**Annex A**) were released on 30 August 2010 and are available on the CO Rewrite website (http://www.fstb.gov.hk/fsb/co_write/) together with the responses received.

(B) Second Phase Consultation

13. The Second Phase Consultation covered the remaining parts (namely, Parts 3 to 9, 13 and 19 to 20) of the CB.

14. We briefed the FA Panel on the reform proposals on 7 June 2010. A public consultative forum was held on 22 June 2010 and we attended

ten meetings/forums convened by interested organisations. We received a total of 57 written submissions[5]. We have duly considered all the feedback, taking into account SCCLR's advice.

Key issues and conclusions

15. The conclusions to the issues highlighted for consultation are outlined below:-

(a) Financial assistance

From the viewpoint of protection of minority shareholders and creditors, we plan to retain certain restrictions on financial assistance by a company to another party for acquisition of its own shares for the time being, pending the introduction of directors' duty to prevent insolvent trading under the legislative proposals on corporate rescue procedure, though we agree that such restrictions for private companies could be abolished in the long run. Meanwhile, we also propose to streamline the "whitewash" procedures for giving financial assistance applicable to both private and public companies, as follows:-

(i) approval by board of directors if the aggregate amount of financial assistance does not exceed 5% of the shareholders' fund;

(ii) unanimous approval of the shareholders; or

(iii) approval by members by ordinary resolution, subject to the right of members holding at least 10% voting rights to petition to court for a restraining order.

To ensure that minority shareholders' interests would be sufficiently safeguarded, all the three scenarios above will also be subject to a solvency test.

[5] Among the 57 submissions, 24 were from business and professional organisations (including the Law Society of Hong Kong, Hong Kong Association of Banks, Hong Kong General Chamber of Commerce, Hong Kong Institute of Certified Public Accountants, Hong Kong Institute of Chartered Secretaries, Hong Kong Institute of Directors, etc.), 23 from companies/ law firms/ accounting firms and 10 from individuals.

(b) Directors' remuneration reports

Proposals pertaining to disclosure of directors' remunerations of listed companies should be better considered under the Listing Rules and/ or the Securities and Futures Ordinance (Cap. 571). With majority support from respondents, the CB will not require listed or unlisted companies incorporated in Hong Kong to prepare separate directors' remuneration report. Notwithstanding, we have invited the Securities and Futures Commission and the Hong Kong Exchanges and Clearing Limited to keep under review the compliance and effectiveness of the relevant requirements under the Listing Rules.

(c) Investigation and enquiries by the Financial Secretary (FS)

We will extend the right to apply to the FS for appointment of inspectors to members of registered non-Hong Kong companies. We will also enhance the investigatory power (e.g. by requiring a person under investigation to preserve records and verify statements made to the inspector) of an inspector appointed by the FS to investigate a company's affairs. As respondents considered that it would be impractical and rarely possible, if at all, to conduct effective investigation into affairs of non-Hong Kong companies that do not have a place of business in Hong Kong, we will not proceed with the proposal to subject those companies to investigation.

(d) Enquiries by the Registrar of Companies (Registrar)

To facilitate enforcement efforts of the CR and help safeguard the integrity of the public register, we will proceed with empowering the Registrar to obtain documents, etc. for the purpose of ascertaining whether there is misconduct which amounts to an offence concerning false or misleading information that relates to an application for deregistration of a company; and making of misleading or deceptive statements in any material particulars.

(e) Reasons for refusal to register a transfer of shares

To facilitate bona fide transactions, we plan to require companies to explain refusal to register a transfer of shares upon request by the transferor or transferee. The company must register the transfer if it fails to furnish reasons within 28 days after receipt of the request.

16. Apart from the above issues, the proposals in Part 9 (Accounts and Audit) also attracted considerable comments. Having considered the comments, and with the advice from SCCLR, we have fine-tuned our proposals, e.g. removing the option for large private companies to prepare simplified financial report even if they have members' approval. The proposed changes are set out in paragraphs 42 to 64 of the consultation conclusions.

17. The consultation conclusions (**Annex B**) were released on 25 October 2010 and are available on the CO Rewrite website (http://www.fstb.gov.hk/fsb/co_write/) together with the responses received.

WAY FORWARD

18. We are finalising the CB, taking into account the above consultation conclusions, as well as other comments on technical and drafting issues of the CB from the two phases of consultation. We aim to introduce the Bill into LegCo in early 2011.

Financial Services and the Treasury Bureau
25 October 2010

Rewrite of the Companies Ordinance

First Phase Consultation on the Draft Companies Bill

Consultation Conclusions

BACKGROUND

1. In mid-2006, the Government launched a major and comprehensive exercise to rewrite the Companies Ordinance (CO). By updating and modernising the CO, we aim to make it more user-friendly and facilitate the conduct of business to enhance Hong Kong's competitiveness and attractiveness as a major international business and financial centre.

2. Taking into account views collected during previous public consultation exercises in 2007 and 2008, we prepared a draft Companies Bill (CB) for further consultation. The first phase consultation covered 10 Parts of the CB and was launched on 17 December 2009. Besides seeking views on the draft provisions, the consultation paper highlighted several issues for consultation. These included –

   (a) whether the headcount test for approving a scheme of compromise or arrangement should be retained or abolished (*Questions 1 to 3 of the consultation paper*);

   (b) whether residential addresses of directors and identification numbers of directors and company secretaries should continue to be disclosed on the public register (*Questions 4 to 5 of the consultation paper*);

   (c) whether private companies associated with a listed or public company should be subject to more stringent regulation similar to public companies for the purposes of the provisions on fair dealings by directors (*Question 6 of the consultation paper*); and

(d) whether the common law derivative action should be abolished (*Question 7 of the consultation paper*).

3. The consultation paper and the draft clauses were widely circulated to various stakeholders including relevant professional bodies, business organisations, market practitioners, chambers of commerce, financial regulators, academics, etc. They were posted on the CO rewrite website of the Financial Services and the Treasury Bureau (FSTB) and hard copies were made available to the general public at a number of Government premises.

4. During the consultation period, we briefed the Legislative Council Panel on Financial Affairs on the reform proposals on 4 January 2010 and held a public consultative forum on 4 February 2010. We attended meetings/forums organised by other interested organisations to brief the participants on the proposals and listen to their views. A list of the forums and meetings we attended is at Appendix I. We have also sought the views of the Standing Committee on Company Law Reform (SCCLR).

OUTCOME OF CONSULTATION

5. The consultation ended on 16 March 2010. We received a total of 164 submissions (104 from companies; 30 from individuals; and 30 from business and professional organisations including the Hong Kong General Chamber of Commerce (HKGCC), Hong Kong Association of Banks (HKAB), Law Society of Hong Kong (LSHK), Hong Kong Bar Association (HKBA), Hong Kong Institute of Certified Public Accountants (HKICPA), Hong Kong Institute of Chartered Secretaries (HKICS), Hong Kong Institute of Directors (HKIoD), etc.), with some of them reaching us after the end of the consultation period. A list of the respondents is at Appendix II. A compendium of the submissions is also available at the FSTB's CO Rewrite website[1]. The respondents' comments and our responses are summarised below.

[1] Available at http://www.fstb.gov.hk/fsb/co_rewrite/.

Issues Highlighted for Consultation

A. Headcount test

6. Under section 166(2) of the CO, in order for a compromise or arrangement between a company and its members to be approved at a meeting ordered by the court under section 166(1), a majority in number of those who cast votes must have voted in favour of the compromise or arrangement (headcount test). The majority in number must also represent three-fourths in value of the members voting. In Chapter 6 of the consultation paper, we asked if the headcount test for members' schemes of listed companies, non-listed companies, and creditors' schemes should be retained, abolished, or retained but giving the court discretion to dispense with the test. We also asked whether there should be some forms of additional protection for small shareholders if the headcount test is to be abolished for non-listed companies.

Respondents' views

7. A total of 144 submissions commented on the subject focusing primarily on members' schemes of listed companies, including 101 from companies (most of which are listed companies), 26 from individuals and 17 from organisations. Views were diverse as to whether the headcount test should be retained or abolished.

Members' Schemes of Listed Companies

8. A total of 124 submissions opted for abolishing the test for members' schemes of listed companies, including those from business and professional bodies like HKGCC, LSHK, HKBA, HKICPA, HKICS, HKIoD and the Chamber of Hong Kong Listed Companies (CHKLC). There are also 91 submissions from listed companies supporting the abolition. The main arguments for abolition are –

   (a) the headcount test could not effectively reflect the preference/views of beneficial owners, particularly as a very

large proportion of shares in listed companies were held by nominees and custodians in the Central Clearing and Settlement System (CCASS). While beneficial owners can withdraw their shareholdings from CCASS and become registered shareholders, the process is cumbersome and involves cost;

(b) the headcount test might attract attempts for vote manipulation; and

(c) it is against the one share one vote principle, i.e. giving disproportionate weight to minority shareholders in the scheme approval process.

9. On safeguarding the interests of minority shareholders, most of the above submissions considered that the Code on Takeovers and Mergers[2] (Takeovers Code) issued by the Securities and Futures Commission (SFC) already provided sufficient safeguards and that any additional safeguards should be dealt with by the SFC through amendments to the Code. Some respondents, including LSHK and HKIoD, highlighted that notwithstanding the abolition, the court still retains the discretion not to approve a scheme in the event of irregularities or where the rights of minority shareholders are at stake.

10. At the same time, some 20 submissions, including those from the SFC, the Chinese General Chamber of Commerce (CGCC), the British Chamber of Commerce (BCC), the Association of Chartered Certified Accountants (Hong Kong) (ACCA), the HK Securities Association (HKSA) and HKAB, supported retaining the headcount test. They believed that the headcount test serves as an essential check on the share value test. The existing problem of

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[2] Under the Takeovers Code, there are additional requirements to protect the interests of minority shareholders, including:
(a) under Rule 2 of the Takeovers Code, an independent board committee comprising all non-executive directors who have no conflict of interest in the scheme has to be established to give advice to disinterested shareholders and the committee would seek advice from an independent financial adviser; and
(b) Rule 2.10(b) of the Takeovers Code stipulates that the number of votes cast against the resolution shall not be more than 10% of the voting rights attached to all disinterested shares, i.e. shares not held by the controlling shareholders or their connected parties.

the headcount test mentioned in paragraph 8(a) above could be overcome by the proposal to pursue a scripless market and that there was no credible evidence indicating that vote manipulation was common. Among these respondents, a majority saw merit in the option of giving the court a discretion to dispense with the test. They considered that it would be a fairer option which allowed the court to intervene in the event of possible abuses of the process. They also considered that it would strike a reasonable balance between protecting the right of the minority shareholders and avoiding giving too much veto power to the minority shareholders.

Members' Schemes of Non-listed Companies

11. Only 49 respondents commented on how to deal with the headcount test for members' schemes of non-listed companies. In general, those who supported the abolition of the headcount test for members' schemes of listed companies tended to support the same for non-listed companies, except for a few like HKBA, which argued that the headcount test should be retained for non-listed companies given that they were not affected by the problems relating to CCASS.

Creditors' Schemes

12. Some 48 respondents commented on the headcount test for creditors' schemes. The majority (33 submissions) preferred abolishing the test. Some of them argued that minority creditors would be able to petition for winding up. On the other hand, 10 submissions including the HK Confederation of Trade Unions, LSHK, HKBA, HKICPA and several accounting/legal firms supported retaining the headcount test for creditors' schemes, arguing that the test served to protect the interests of small creditors. There are arguments that the position of creditors bore little resemblance to that of shareholders in the context of schemes of arrangement and that the interests of large creditors did not usually align with small creditors.

Our response

Members' Schemes of Listed Companies and Non-Listed Companies

13. We note the divergent views expressed by the respondents on the abolition or retention of the headcount test for members' schemes. In particular, we note the market concern that the abolition may undermine the protection of the interests of minority shareholders. For public and listed companies, while the Takeovers Code offers some protection for minority shareholders, we agree that the Code is intended to supplement, but not substitute, the statutory protection in the CO. As a scheme will bind all members and permit the compulsory acquisition of the shares of dissenting shareholders, it would be important to ensure that the interests of minority shareholders are sufficiently safeguarded.

14. The criticism that the headcount test fails to reflect the decisions of beneficial owners of shares under CCASS can be addressed by the proposed introduction of a scripless market in Hong Kong. The proposal will reduce significantly the processing time and cost for beneficial owners of shares held under CCASS to become registered shareholders with voting rights. As regards the concern that the headcount test attracts vote manipulation, we note the SFC's advice that there has been no credible evidence to support the suggestion that attempts to manipulate the vote are common.[3]

15. We have reviewed the latest overseas development in this regard. The headcount test has been retained in other common law jurisdictions including the UK[4], Australia[5], Singapore, Bermuda, and the Cayman Islands. Australia has amended its legislation in late 2007 to give the court a discretion to dispense with the

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3 See para. 15 of SFC's submission on the Draft Companies Bill – First Phase Consultation dated 28 January 2010, available at http://www.fstb.gov.hk/fsb/co_rewrite/.

4 In the UK, the Company Law Review Steering Group (CLRSG) reviewed the headcount test and recommended its abolition as the widespread use of nominees had made it an irrelevant test, and no other meeting of members contained such a test. However, the UK government did not adopt the recommendation the UK Companies Act 2006 as it considered that the test was still an important investor safeguard.

5 The Australian Corporations and Markets Advisory Committee (CAMAC) has conducted a review and published a report on 28 January 2010 recommending, among other things, that the headcount test for companies with share capital be abolished. The Australian government has yet to take a view on whether to adopt the recommendation.

headcount test in circumstances where there is evidence that the result of the vote has been unfairly influenced by activities such as share splitting or in other extraordinary circumstances.[6]

16. On balance, we are inclined to believe that there are merits in retaining the headcount test for members' schemes while giving the court a discretion to dispense with the test so as to tackle the problem of share splitting by parties opposing a scheme. This is similar to the approach being adopted in Australia. We will keep this under review in the light of developments in other jurisdictions.

Creditors' Schemes

17. Views are even more diverse as to whether the headcount test should be retained or abolished for creditors' schemes. The concern for vote manipulation and problems arising from CCASS do not exist for creditors' schemes. We consider it desirable to retain the headcount test to protect small creditors. In fact, the headcount test was originally introduced to protect the interests of small creditors in creditors' schemes. As it is unlikely for small creditors who oppose a proposed scheme to manipulate the outcome of voting by assigning part of their debts to other persons, we see no need to extend the court's discretion to dispense the headcount test to cover creditors' schemes.

B. Disclosure of Directors' Residential Addresses and the Identification Numbers of Directors and Company Secretaries

18. At present, directors and secretaries of companies incorporated or registered in Hong Kong (including non-Hong Kong companies) are required by the CO to provide their residential addresses and identity card or passport numbers ("identification numbers") to the Companies Registry ("CR") for incorporation and registration purposes. As such information is available on the CR's register

[6] One possible "extraordinary circumstance" may be where a single shareholder holds shares on behalf of a large number of beneficial owners. In *pSivida Ltd v New pSivida, Inc* [2008] FCA 624, the Court observed, at [11]-[12].

or can be inspected and copied by members of the public, there may be concerns over data privacy and possible abuses. While we consider that there is no longer a need to require company secretaries to disclose their residential address, we asked in Chapter 7 of the consultation paper whether directors' residential addresses and directors/secretaries' identification numbers should continue to be displayed on the public register without restriction. We also asked the public that, if residential addresses are not going to be disclosed on the public register, whether we should follow the Australian approach (i.e. a director allowed to substitute his usual residential address by a service address if his or his family members' personal safety is at risk) or the UK approach (i.e. a director given the option to show his service address on the public register while keeping his residential address on a separate record with restricted access mainly to public bodies).

Respondents' views

19. A total of 68 submissions (30 from companies, 21 from individuals and 17 from organisations) have expressed views on the subject matter.

Directors' Residential Addresses

20. The majority (46) including the CHKLC, CGCC, HKIoD, HKICS and HKSA opined that directors' residential addresses should not be disclosed on the public register, mainly for reasons of privacy and risk of abuse. Most of them suggested that the service address of directors would be sufficient for contacting the directors and service of documents. Some respondents also noted that given Hong Kong did not have a residency requirement for directors, the foreign residential addresses provided by non-Hong Kong directors did not serve any meaningful purpose.

21. As regards whether the UK approach or the Australian model should be adopted to restrict access to directors' residential addresses, more respondents (32), including the CHKLC, HKICS, HKIoD and LSHK, preferred the UK model.

22. Some 20 respondents including HKBA, HKICPA, HKAB and some trade unions preferred maintaining the status quo. They did not see any strong grounds for changing the current regime given that cases of abuse were rare in Hong Kong and that neither the UK nor the Australian model could be easily administered. They also cited reasons like the need for law enforcement authorities and creditors to access information on directors' residential addresses.

Identification Numbers

23. Some 53 submissions expressed views on whether directors/secretaries' identification numbers should continue to be displayed on the register. The majority (43) considered that certain digits of the identification numbers should be masked. These include some chambers of commerce such as the CHKLC, CGCC and BCC, and professional bodies like HKICS, HKIoD, ACCA and CPA Australia. They considered that masking some digits of the identification numbers would give better protection to personal privacy without affecting the identification of individual persons. On the other hand, 10 submissions from the labour/trade unions, professional/business bodies like HKBA, LSHK, HKICPA and HKAB as well as a few accountancy/law firms objected to the proposal to mask certain digits of the identification numbers, arguing that such information provide a unique and effective identifier for individuals and that the disclosure on the public register so far has not created a major problem of abuse.

Our response

Directors' Residential Addresses

24. While there is little evidence that the current disclosure of directors' residential addresses on the public register has caused any major personal safety problems, we note the rising concerns over the protection of personal privacy and information as reflected in the views of the majority of respondents. We agree that access to directors' residential addresses should be restricted. After consulting the SCCLR, we also agree with the views of the majority of the respondents that the UK approach in maintaining

separate records for directors' service addresses and residential addresses would be preferred. We note that the Australian approach would offer less effective protection to directors' personal information as directors may only apply for substitution of residential addresses after the risks in relation to their or their family's personal safety are established.

25. Under the proposed approach, every director will be given the option of providing a service address for the public register of the CR while the residential address may be kept on the confidential record to which access will be restricted to public authorities, specified regulators, liquidators and provisional liquidators. Any other person can only access the residential address pursuant to a court order or by inspection of the register of directors kept by the company. There are provisions in Part 12 of the CB to the effect that if the company fails to allow inspection of its register, the court may on application order an inspection, but the court must not make such an order if the right of inspection is being abused. This would strike a balance between protecting directors' personal information and access to such information on bona fide grounds.

26. Regarding the directors' residential addresses already on the public register kept by CR, in view of the huge volume of information involved, the existing records containing the residential addresses of directors would only be purged upon application in accordance with specified procedures and upon payment of a fee. This is also in line with the practice in the UK.

Identification Numbers

27. In view of the overwhelming support for better protection of personal data, we will mask certain digits of the identification numbers in new records of individuals on the public register. It is a common and acceptable practice for masking certain digits of the identification numbers and the remaining digits (together with the name) should be sufficient to identify the individual persons.

28. Like directors' residential addresses, access to the full identification numbers of individuals will be limited to public

authorities, specified regulators, liquidators and provisional liquidators, and other persons pursuant to a court order. Existing records of identification numbers on the register will be purged upon application and payment of a fee, similar to the treatment of existing residential addresses on the register.

C. Regulating Directors' Fair dealings in respect of Private Companies Associated with a Listed or Public Company

29. Currently, a private company that is a member of a group of companies which includes a listed company (a "relevant private company"[7]) is in essence treated in the same manner as a public or listed company in the CO in respect of prohibitions on loans, quasi-loans and credit transactions in favour of directors or directors of its holding company or another company controlled by one or more of its directors.[8] The relevant private companies are thereby subject to more stringent restrictions than other private companies. In Part 11 of the CB, we propose relaxing the prohibitions on public companies in respect of these transactions. A new exemption will be introduced to enable public companies to make a loan, a quasi-loan or enter into a credit transaction in favour of a director or connected entity subject to disinterested members' approval.[9] Private companies will generally continue to be subject to less stringent regulations. We asked the public in Chapter 8 of the consultation paper on whether relevant private companies should be subject to more stringent restrictions similar to a public company.

Respondents' views

30. Among the total of 44 submissions received which expressed views on the subject matter, more respondents (16) including HKAB, HKICS, HKLS and some law firms preferred option 4, suggesting that the concept of relevant private company should be modified to cover only private companies which are subsidiaries of a

7 See section 157H(10) of the CO.

8 The prohibitions are extended to cover certain connected persons (e.g. spouse, child and step-child) of the directors in the case of listed companies and relevant private companies.

9 See paragraphs 24 to 27 of Explanatory Note on Part 11.

listed/public company. There are suggestions that this option would keep the law simple. Some also suggested that the restrictions regarding the regulation of quasi-loans/credit transactions involving directors should be applicable to companies on a needs basis and companies caught under the definition of "relevant companies" should be clearly and easily identifiable.

Our response

31. The view of a majority of the respondents, to confine relevant private companies only to those private companies which are subsidiaries of a public company, whether listed or non-listed, avoids casting the net too wide. Other types of private companies in a group, such as those whose holding company is a private company but which is also a majority shareholder of a listed company, can be excluded from the concept of relevant private company. We have doubts as to whether such private companies should be subject to tighter restrictions since the public investors of the listed companies concerned generally have no interests in such private companies.

32. Taking into account the majority view and having consulted the SCCLR, we agree to modify the concept of relevant private company to cover only private companies which are subsidiaries of a public company.

D. Common Law Derivative Action

33. Shareholder remedies provisions were substantially revised by the Companies (Amendment) Ordinance 2004 with a view to enhancing legal remedies available to members of a company. One of the significant changes was to provide a new statutory derivative action (SDA) procedure that may be taken on behalf of a company by a member of the company in Part IVAA of the CO. By section 168BC(4), the right to take a common law derivative action (CDA) was specifically preserved.

34. The Legislative Council has recently passed the Companies (Amendment) Bill 2010, which includes the proposal to extend the scope of SDA to cover "multiple" derivative actions (i.e. members of an associated company of the specified corporation[10] would be able to take a SDA). In anticipation of the extension, we asked in Chapter 9 of the consultation paper whether the existing right to take a CDA as preserved under section 168BC(4) of the CO should be abolished.

Respondents' views

35. A total of 29 submissions commented on the proposal. Based on the submissions, more respondents, including major business and professional bodies such as HKBA, HKAB, HKICS and HKIoD, supported the retention of CDA for reasons that it would provide necessary protection to shareholders in Hong Kong for obtaining remedies in relation to non-Hong Kong companies. There are arguments that there would not be any confusion arising from the retention and litigants could select the appropriate route that suits their case.

Our response

36. Noting that more respondents including the major business and professional bodies supported the retention of the CDA for reasons that it would provide necessary protection to shareholders in Hong Kong for obtaining remedies in relation to non-Hong Kong companies, we agree to retain CDA in the CB.

E. Codification of Directors' Duty of Care, Skill and Diligence

37. In clause 10.13 of the CB, we suggest codifying directors' duty of care, along the lines of section 174 of the UK Companies Act 2006 (CA 2006), so that a director must exercise reasonable care, skill

[10] An "associated company" in relation to a specified corporation means any company that is the specified corporation's subsidiary or holding company, or a subsidiary of that specified corporation's holding company.

and diligence, meaning the care, skill and diligence that would be exercised by a reasonably diligent person with –

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (the "objective test"); and

(b) the general knowledge, skill and experience that the director has (the "subjective test").

Respondents' views

38. We received some comments from chambers of commerce, several professional organisations such as HKLS, HKBA, HKICS, HKAB and HKICPA as well as some listed companies on the proposal to codify directors' duty of care, skill and diligence. While most of the respondents supported the proposed codification in principle, some expressed reservation over the introduction of a "mixed objective/subjective test". The main concern was that the subjective test would set an even higher standard for those directors having special knowledge or experience. They considered that the subjective test would be onerous and problematic in operation and would discourage persons having good qualifications from taking up directorships in Hong Kong.

39. Some also suggested that in the event that the subjective test was included in the legislation, a set of clear statutory guidelines on the operation/application of the subjective test would be required and that a "safe harbour" should be developed to define the circumstances where the directors would be protected from liability arising from the subjective test due to their background and qualification, in particular as regards the duty of care, skill and diligence as required of a non-executive director who subjectively is well-qualified but objectively does not participate in the daily operations and affairs of the company. Some also suggested adopting a "business judgment rule" similar to that in jurisdictions like Australia to protect directors from liability for bona fide business decisions which subsequently turn out to be mistaken.

Our response

40. While the subjective element of the proposed mixed test has been interpreted as raising the standard where the particular director has special knowledge, skill and experience, it does not depart significantly from the common law position in Hong Kong of directors' duty of care, skill and diligence in this respect.[11] Also, it seems that the concerns of some respondents may arise from a misunderstanding that the minimum objective standard of conduct of all directors would necessarily raise the standard to be followed by non-executive directors to require them to use the same care, skill and diligence of executive directors. Indeed clause 10.13 makes it clear that the courts must also take into account the "functions carried out by the relevant director". This means that the courts should consider the different functions of executive and non-executive directors when determining whether a particular director has exercised reasonable care, skill and diligence.[12] Clause 20.10 (in the second phase consultation) provides that the court may relieve an officer of a company from liability for any misconduct if he has acted honestly and reasonably and ought fairly to be excused having regard to all the circumstances (including those connected with his appointment). There is no obvious need to introduce a "safe harbour" as suggested by some respondents.

41. As regards the proposed introduction of a statutory "business judgment rule", previous studies have considered the proposal and were of the view that the existing common law on review of management decisions was sound and that there was no need for a statutory formulation of the business judgment rule.[13] The

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11 The subjective test in Re City Equitable Fire Insurance Co Ltd [1925] Ch 407 was recognised as the applicable standard by Rogers JA in Law Wai Duen v Boldwin Construction Co Ltd [2001]3 HKLRD 430 as he stated in paragraph 10 of the judgement that "Perhaps the classic exposition of the duty of care required of a director was given by Romer J in the case of Re City Equitable Fire Insurance Co Ltd [1925] Ch 407. The standard which he described as being required of a director is, if anything, open to review in present day circumstances as, perhaps, being too low.

12 See Gower and Davies *"Principles of Modern Company Law"* 8th ed. p.491.

13 Recommendation 6.15, p.124 of *the Consultancy Report of the Review of Hong Kong Companies Ordinance* undertaken by Ermanno Pascutto in 1997 and p.84 of the SCCLR's *Report on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance* (2000).

SCCLR also revisited the issue in 2007 and came to the same conclusion. We consider that there is no compelling need for a statutory business judgment rule at this juncture.

42. In the light of the above, we consider that there is no need to modify the proposal of codifying directors' duty of care with a "mixed objective/subjective test".

CONCLUSION

43. In summary, we are prepared to adopt the following proposals -

(a) The headcount test for members' schemes for listed/non-listed companies and creditors' schemes under section 166 of the CO will be retained but the court will be given a discretion to dispense with the test for members' schemes in special circumstances, such as where there is evidence that the result of the vote has been unfairly influenced by share splitting;

(b) Directors will be allowed to provide a service address for display on the public register of the CR whereas their residential addresses will be kept on the confidential record with access restricted to public and enforcement/regulatory authorities, liquidators, provisional liquidators and those who have obtained court orders for disclosure. Directors' residential addresses in the existing records will be purged upon application and payment of a fee;

(c) Certain digits in the identification numbers of individuals will be masked on the public register. The identification numbers in the existing records will be purged upon application and payment of a fee;

(d) On the assumption that a new disinterested members' approval exception to prohibitions on loan and similar transactions in favour of directors and their connected persons will be introduced in respect of public companies,

the concept of relevant private company will be modified to cover only private companies which are subsidiaries of a listed or public company;

(e) CDA currently preserved in section 168BC(4) of the CO will be retained in the CB; and

(f) No change will be made to clause 10.13 of the CB which seeks to codify directors' duty of care, skill and diligence along the lines of the UK CA 2006.

Other Issues

44. Apart from the issues discussed above, we have considered the comments on other aspects of the CB, mainly concerning technical or drafting issues. The comments and our responses are summarised in Appendix III[14].

WAY FORWARD

45. The Second Phase Consultation of the Draft CB was completed on 6 August 2010. We shall revise the CB taking into account the above proposals and views received. We aim to introduce the CB into the Legislative Council in late 2010.

Financial Services and the Treasury Bureau
30 August 2010

[14] Appendix III is not attached to this paper. Members who wish to peruse Appendix III may refer to the online version of the consultation conclusions at http://www.fstb.gov.hk/fsb/co_rewrite/.

Appendix I

List of Forums and Meetings Attended

Date	Organising Parties	Nature
7 January 2010	Small and Medium Enterprises Committee*	Meeting
12 January 2010	Labour Advisory Board*	Meeting
4 February 2010	Companies Bill Team, Financial Services and the Treasury Bureau	Forum
22 February 2010	Hong Kong General Chamber of Commerce*	Forum
1 March 2010	Federation of Hong Kong Industries*	Briefing
2 March 2010	The Hong Kong Institute of Directors*	Forum
8 March 2010	The Hong Kong Institute of Chartered Secretaries*	Meeting
15 March 2010	The Association of Chartered Certified Accountants*	Seminar

* We were invited by the organising parties to attend the forums and meetings to further introduce the proposals on the Draft Companies Bill – First Phase Consultation. Comments on the proposals were also received from members of the organising parties through discussions.

Appendix II

List of Respondents

1. Asia Satellite Telecommunications Holdings Limited
2. Asian Citrus Holdings Limited
3. Association of Chartered Certified Accountants, Hong Kong, The
4. British Chamber of Commerce in Hong Kong, The
5. CASH Financial Services Group Limited
6. Celestial Asia Securities Holdings Limited
7. Century Legend (Holdings) Limited
8. Chamber of Hong Kong Listed Companies, The
9. CHAN, Eric
10. CHAN, Raymond Wai Man
11. Cheung Kong (Holdings) Limited
12. Cheung Kong Infrastructure Holdings Limited
13. Chevalier International Holdings Limited
14. China Energy Development Holdings Limited
15. China Haidian Holdings Limited
16. China Haisheng Juice Holdings Co., Ltd.
17. China Mandarin Holdings Limited
18. China Metal Recycling (Holdings) Limited
19. China Railway Group Limited
20. China Sci-Tech Holdings Limited
21. Chinasoft International Limited
22. CHOI, Ivan
23. Chu Kong Shipping Development Company Limited
24. Chun Wo Development Holdings Limited

25. Cinda International Holdings Limited
26. CK Life Sciences Int'l., (Holdings) Inc.
27. CLARK, Stephen J
28. Clifford Chance
29. CLP Holdings Limited
30. Computershare Hong Kong Investor Services Limited
31. Consumer Council
32. CPA Australia Limited
33. CSI Properties Ltd.
34. Eagle Asset Management (CP) Limited
35. Emperor Capital Group Limited
36. Emperor Entertainment Group Limited
37. Emperor Entertainment Hotel Limited
38. Emperor International Holdings Limited
39. Emperor Watch and Jewellery Limited
40. Far East Holdings International Limited
41. Far East Hotels And Entertainment Limited
42. Federation of Hong Kong Industries
43. Fountain Set (Holdings) Limited
44. Get Nice Holdings Limited
45. Global Consultants and Services Limited
46. Golden Resorts Group Limited
47. GOME Electrical Applicances Holding Limited
48. Great Eagle Holdings Limited
49. G-Rescources Group Limited
50. Group Sense (International) Limited
51. Guoco Group Limited

52. Hanny Holdings Limited

53. Henderson Land Development Company Limited

54. Heritage International Holdings Limited

55. Hermes Equity Ownership Services Limited

56. HO, Tak Wing

57. Hong Kong Aircraft Engineering Company Limited

58. Hong Kong Association of Banks, The

59. Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies

60. Hong Kong Bar Association

61. Hong Kong Federation of Insurers

62. Hong Kong General Chamber of Commerce

63. Hong Kong Institute of Certified Public Accountants

64. Hong Kong Institute of Chartered Secretaries

65. Hong Kong Institute of Directors, The

66. Hong Kong Public Key Infrastructure Forum Limited

67. Hong Kong Trustees' Association Limited

68. Hongkong and Shanghai Banking Corporation Limited, The

69. Hongkong Electric Holdings Ltd.

70. Hopewell Holdings Limited

71. HUI, L T

72. Hutchison Harbour Ring Limited

73. Hutchison Telecommunications Hong Kong Holdings Limited

74. Hutchison Telecommunications International Limited

75. Hutchison Whampoa Limited

76. iMerchants Asia Limited

77. International Chamber of Commerce - Hong Kong, China

78. International Trademark Association
79. ITC Corporation Limited
80. ITC Properties Group Limited
81. JONES, Gordon
82. K. Wah International Holdings Limited
83. Keck Seng Investments (Hong Kong) Limited
84. Kerry Properties Limited
85. KPMG
86. LAM, W H
87. Law Society of Hong Kong, The
88. Lee & Man Holding Limited
89. Linklaters
90. Luk Fook Holdings (International) Limited
91. Lung Cheong International Holdings Ltd.
92. Mandatory Provident Fund Schemes Authority
93. Melco International Development Limited
94. Mexan Limited
95. MOK Yun Lee Paul
96. MTR Corporation Limited
97. National Investments Fund Limited
98. New Media Group Holdings Limited
99. New World Development Company Limited
100. NG, Wing Chung Michael
101. Norton Rose Hong Kong
102. P. C. Woo & Co.
103. Paradise Entertainment Limited
104. Paul Y. Engineering Group Limited

105. Perennial International Limited

106. PricewaterhouseCoopers

107. Prosperity Investment Holdings Limited

108. PYI Corporation Limited

109. QPL International Holdings Limited

110. Recruit Holdings Limited

111. Securities and Futures Commission

112. See Corporation Limited

113. Shanghai Industrial Holdings Limited

114. Shun Tak Holdings Limited

115. Solomon Systech (International) Limited

116. Sparkle Roll Group Limited

117. STEP Hong Kong Limited (Society of Trust and Estate Practitioners)

118. Strong Petrochemical Holdings Limited

119. Sun Hung Kai & Co. Limited

120. Sun Hung Kai Properties Limited

121. Sundart International Holdings Limited

122. Superb Summit International Timber Company Limited

123. Techtronic Industries Company Limited

124. TOM Group Limited

125. Trasy Gold Ex Limited

126. TSAO, Simon Y. T.

127. Universe International Holdings Limited

128. Van Shung Chong Holdings Limited

129. Wai Chun Group Holdings Limited

130. Wai Chun Mining Industry Group Limited

131. Wang On Group Limited

132. Win Hanverky Holdings Limited

133. Wing On Travel (Holdings) Limited

134. 王文治

135. 香港工會聯合會

136. 香港中華廠商聯合會

137. 香港中華總商會

138. 香港玩具廠商會

139. 香港證券業協會

140. 香港職工會聯盟

141. 港九勞工社團聯會

142. 陳娟

143. 新婦女協進會

144. 廖甘樹

145. 趙大君

146. 劉玉嬌

147. 劉耀東

148. 魏瑩思

149. 魏樹光

150 - 164 There are 10 anonymous submissions, and five submissions whose respondents have requested their names not to be disclosed.

Rewrite of the Companies Ordinance

Second Phase Consultation on the Draft Companies Bill

Consultation Conclusions

BACKGROUND

1. In mid-2006, the Government launched a major and comprehensive exercise to rewrite the Companies Ordinance (Cap. 32) (CO). By updating and modernising the CO, we aim to make it more user-friendly and facilitate the conduct of business to enhance Hong Kong's competitiveness and attractiveness as a major international business and financial centre.

2. Taking into account views collected during previous public consultation exercises in 2007 and 2008, we prepared a draft Companies Bill (CB) for further consultation. The First Phase Consultation covering ten Parts (namely, Parts 1 to 2, 10 to 12 and 14 to 18) of the CB was conducted between 17 December 2009 and 16 March 2010. The First Phase Consultation Conclusions were released on 30 August 2010 and are available on the dedicated CO Rewrite website (http://www.fstb.gov.hk/fsb/co_rewrite/) of the Financial Services and the Treasury Bureau (FSTB), together with the responses received and other relevant materials.

3. We will proceed to introduce a number of proposals in the CB after the First Phase Consultation. In particular, there are a number of measures to enhance corporate governance. For example:-

   (a) codifying the standard of directors' duty of care, skill and diligence with a view to clarifying the duty under the law and providing guidance to directors;

   (b) enhancing shareholders' engagement in the decision-making process, such as reducing the threshold requirement for

shareholders to demand a poll from 10% to 5% of the total voting rights; and

(c) fostering shareholder protection, such as introducing more effective rules to deal with directors' conflicts of interest.

4. This Second Phase Consultation covering the remaining parts of the CB (namely, Parts 3 to 9, 13 and 19 to 20) was launched on 7 May 2010 and ended on 6 August 2010. Apart from seeking views on the draft provisions, the consultation document also highlighted several issues for consultation, including the following:-

(a) whether the restrictions on financial assistance should be abolished for private companies (*Question 1(a) and (c) of the consultation document*); and if in the affirmative, how to regulate listed and unlisted public companies (*Question1(b)*);

(b) whether the CB should not impose a requirement of preparing separate directors' remuneration reports on all listed companies incorporated in Hong Kong; and unlisted companies incorporated in Hong Kong where members holding not less than 5% of voting rights have so requested (*Question 2*);

(c) whether the proposed changes to the provisions concerning the investigation of and enquiry into a company's affairs that may be exercised by the Financial Secretary (FS) are acceptable (*Question 3*);

(d) whether the proposed new powers for the Registrar of Companies (the Registrar) to obtain documents, records and information are acceptable (*Question 4*); and

(e) whether the CB should make it obligatory for a company to give reasons explaining its refusal to register a transfer of shares (*Question 5(a)*); and if in the affirmative, the manner of giving the reasons (*Question 5(b)*).

5. The consultation document and the draft clauses were widely circulated to various stakeholders, including relevant professional bodies, business organisations, market practitioners, chambers of commerce, financial regulators, academics, etc. They were posted on the CO Rewrite website and hard copies were made available to the general public at a number of Government offices.

6. During the consultation period, we briefed the Legislative Council Panel on Financial Affairs on the Second Phase Consultation document and proposals on 7 June 2010 and held a public consultative forum on 22 June 2010. We attended ten meetings and forums convened by other interested organisations to brief the participants on the proposals and listen to their views. A list of the meetings and forums we attended is at Appendix I. We have also consulted the Standing Committee on Company Law Reform (SCCLR) and have incorporated their views into this Consultation Conclusions as appropriate.

OUTCOME OF CONSULTATION

7. The Second Phase Consultation period ended on 6 August 2010, during which we received a total of 57 submissions (among which 24 were from business and professional organisations including the Hong Kong Association of Banks (HKAB), Hong Kong General Chamber of Commerce (HKGCC), Hong Kong Institute of Certified Public Accountants (HKICPA), Hong Kong Institute of Chartered Secretaries (HKICS), Hong Kong Institute of Directors (HKIoD), Law Society of Hong Kong (LSHK), etc.; 23 from companies/law firms/accounting firms; and ten from individuals). Other than the above issues (in paragraph 4 above) highlighted for consultation, the proposals in Part 9 (Accounts and Audit) also attracted considerable feedback.

8. A list of the respondents is at Appendix II. A compendium of the submissions is also available at the FSTB's CO Rewrite website. The respondents' comments and our responses are summarised below.

Issues Highlighted for Consultation

A. Financial Assistance

9. Section 47A of the CO imposes a broad prohibition on a Hong Kong company (and its subsidiaries) giving financial assistance to a third party for the purpose of acquiring shares in that company. Certain exceptions are set out in section 47C while special restrictions apply to listed companies (section 47D). Unlisted companies are provided with an additional exception under which the company has to pass a solvency test and obtain approval from shareholders with a special resolution, while the assistance must be provided out of distributable profits to the extent that the net assets are reduced by the assistance (section 47E).

10. In Chapter 2 of the consultation paper, we asked if the restrictions on financial assistance should be abolished for private companies. We also asked, if the answer is in the affirmative, whether (a) the existing rules for listed and unlisted public companies in the CO should be retained; or (b) the rules for both listed and unlisted public companies should be streamlined as set out in Part 5 of the CB. Under Part 5, generally speaking, a company will be allowed to give financial assistance, regardless of the source of funds, subject to satisfaction of the solvency test and compliance with the requisite procedures in the following three scenarios:-

(a) Scenario (a): approval by the board of directors while the aggregate amount of financial assistance does not exceed 5% of the shareholders' fund (clause 5.79);

(b) Scenario (b): approval by the board of directors with unanimous approval of the shareholders obtained for the financial assistance (clause 5.80); or

(c) Scenario (c): approval by the board of directors with a notice to be given to shareholders regarding the financial assistance and allowing any shareholder to object to the court (clauses 5.81 to 5.85).

Respondents' views

Private Companies

11. Among the 39 submissions commented on the issue, 27 of them (ten were from companies, eight organisations, five individuals and four law firms and accounting firms) supported abolition of restrictions on financial assistance for private companies, including the Association of Chartered Certified Accountants, Hong Kong (ACCA), Chinese General Chamber of Commerce (CGCC), Chamber of Hong Kong Listed Companies (CHKLC), HKICS and HKIoD. The main arguments for abolition are that there have been difficulties in applying the rules to identify financial assistance; and that the current directors' fiduciary duties and duty of care, as well as the duty for directors to prevent insolvent trading proposed to be introduced under a separate Corporate Rescue Bill[1], would provide sufficient check.

12. Six submissions, including those from the Chinese Manufacturers' Association of Hong Kong (CMAHK), HKAB, HKICPA and LSHK objected to outright abolition of the prohibition. Some considered that the underlying principle supporting the financial assistance restrictions remains valid, in that financial assistance from the resources of a company or its subsidiaries to purchase the company's shares could be prejudicial to the interests of creditors or minority shareholders in some cases. They considered that the provisions in Part 5 of the CB based on a solvency test would strike a right balance and offer certainty to financial institutions in financing leveraged buyouts. Some others considered that since one of the major safeguards mentioned in the consultation document, i.e. the duty on directors to prevent insolvent trading had yet to be enacted, it would be premature to abolish the restrictions in respect of private companies altogether at this stage.

13. For those who considered that private companies should still be subject to certain restrictions on financial assistance, some opined

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[1] See Consultation Conclusions on Review of Corporate Rescue Procedure Legislative Proposals, issued by FSTB in July 2010; available at http://www.fstb.gov.hk/fsb/ppr/consult/review_crplp.htm.

that private companies should be subject to a solvency test, as well as restrictions set out in scenarios (a) and (c) (paragraph 10 above) with such modifications that the 5% threshold be increased under scenario (a) and that the right for a member to contest the giving of financial assistance to the court should be subject to certain limitations thereby barring a member with a nominal shareholding from tactically holding up a commercially viable transaction.

14. Six submissions offered other comments. Some did not have a clear stance while others considered that the rules should only be abolished if the safeguards including the proposed directors' duty to prevent insolvent trading could serve as a more robust regulatory scheme to tackle the risks currently dealt with by the financial assistance rules.

Listed and Unlisted Public Companies

15. Fourteen submissions, including those of CGCC and CHKLC, considered that the rules for both listed and unlisted public companies should be streamlined in accordance with the rules set out in Part 5 of the CB (paragraph 10 above), with four out of the 14 submissions favouring abolition of the restrictions altogether.

16. Six submissions, including that of ACCA, considered that the existing rules in the CO should be retained (paragraph 9 above) as a regulatory tool to protect the interests of minority shareholders.

17. The remaining respondents made other suggestions. Some suggested codifying the directors' fiduciary duties while having in place the streamlined rules as set out in Part 5; others considered it sufficient to solely rely on the solvency test. The Securities and Futures Commission (SFC) pointed out that although the Listing Rules do not specifically deal with financial assistance *per se*, listed companies are subject to notification and disclosure requirements under Chapter 14 (Notifiable Transactions) and Chapter 14A (Connected Transactions) of the Main Board Listing Rules for transactions relating to giving of financial assistance, thus providing additional safeguards for minority shareholders' interests.

18. Some respondents provided specific comments on the three scenarios under Part 5 of the CB (paragraph 10 above), mainly considering that scenario (b) which requires an unanimous written resolution could not be applicable to listed companies; and that scenario (c) allowing any shareholder to petition to the court for restraining order would create uncertainty for listed companies and might not be effective in protecting minority shareholders' interests for they might not have the knowledge and/or means to apply to the court.

19. One respondent considered that the rules in Part 5 of the CB would impose additional burdens on listed companies incorporated in Hong Kong. This was a misunderstanding. We would like to clarify that Part 5 is intended to relax the broad prohibition against financial assistance under the existing CO. Such relaxation is applicable to listed companies alongside other companies incorporated in Hong Kong.

Our response

Private Companies

20. While many respondents supported the proposal to abolish the restrictions on financial assistance for private companies, others had grave concerns over outright abolition from the viewpoint of protection of minority shareholders and creditors. We also note that a number of respondents supported abolition *subject to* the introduction of the directors' duty to prevent insolvent trading which is currently under study. SCCLR also considers it prudent to retain certain restrictions on financial assistance for private companies, pending the introduction of insolvent trading provisions.

21. On balance, therefore, while abolition of financial assistance restrictions in the long run is supported in principle, for the purpose of the CB, safeguards should be laid down against giving of financial assistance pending the actual enactment of the directors' duty to prevent insolvent trading. In the meantime, the intended abolition

of financial assistance restrictions on private companies would not be featured in the CB.

22. To simplify the law, we would recommend that the safeguards against financial assistance be streamlined as detailed in paragraph 23 below, having regard to the current CO provisions and the proposed provisions in Part 5 of the CB. For the same reason and given the common goal to accord protection to minority shareholders, we also recommend that the same provisions be applicable to both private and public companies.

Listed and Unlisted Public Companies

23. Under the current CO, listed companies are basically prevented from giving financial assistance. This is considered by many as draconian. Many respondents supported the proposed relaxation of the prohibition. We will adopt the provisions in Part 5 of the CB with the following modifications:-

(a) scenarios (a) and (b) as set out in paragraph 10 above will remain as is;

(b) scenario (c) will be modified to require a company to obtain shareholders' or members' approval by an ordinary resolution (which is less stringent than the special resolution required of unlisted companies under section 47E of the CO) prior to the giving of financial assistance; and

(c) the right of shareholders or members under scenario (c) to petition to the court will remain, but the petition will have to be lodged by not less than 10% of the members (if the company is not limited by shares) or members having not less than 10% voting rights in total. A similar threshold is present in section 47G of the CO, mainly to minimise frivolous claims.

24. For reasons mentioned in paragraph 22 above, the three scenarios (namely, scenarios (a) and (b) and the modified scenario (c) in paragraph 23 above) will be equally applicable to private companies.

Companies giving financial assistance may invoke the provisions as appropriate to suit their needs.

B. Directors' Remuneration Reports

25. Section 161 of the CO requires all companies to set out the aggregate amount of the emoluments and pensions of, and compensation paid in relation to loss of office to directors and past directors in the account of the company. Currently, all listed companies in Hong Kong are required under the Listing Rules to disclose in their financial statements, on a named basis, details of directors' and past directors' emoluments.

26. In Chapter 3 of the consultation document, we have asked whether there is no need for the CB to require (a) all listed companies incorporated in Hong Kong; and (b) unlisted companies incorporated in Hong Kong where members holding not less than 5% of the total voting rights have so requested, to prepare separate directors' remuneration reports.

Respondents' views

27. A total of 35 submissions have expressed views on the subject, with the majority (26) including those from CGCC, CHKLC, HKAB, HKGCC, HKICPA, HKICS, LSHK and the Society of Chinese Accountants & Auditors (SCAA) considering that the requirement is unnecessary. Two submissions considered that the requirement is necessary while seven submissions expressed other opinions such as suggesting carving out all listed companies in Hong Kong (i.e. (a) in paragraph 26) from the requirement given the sufficient disclosure under the Listing Rules; and allowing a company to waive the requirement where there is support from at least 75% of its shareholders.

Our response

28. It is considered that any improvements to the disclosure of the remuneration of directors of listed companies should be better considered under the Listing Rules and/or the Securities and Futures Ordinance (Cap. 571). In this regard, we have invited the SFC and the Hong Kong Exchanges and Clearing Limited (HKEx) to keep under review the compliance and effectiveness of the relevant Listing Rules. The requirement of directors' remuneration reports would also be too onerous for unlisted companies. With the majority of the respondents supporting not to introduce the requirement of separate directors' remuneration reports in the CB, after consulting the SCCLR, we will proceed accordingly.

C. Investigations and Enquiries by the Financial Secretary (FS)

29. Sections 142 to 151 of the CO provide for power for the FS to appoint an inspector to conduct an investigation into the affairs of a company. The appointment may be made under section 142 on members' application; or under section 143 on the FS' own initiative (a) where there is fraud or mismanagement; (b) upon a court order mandating such appointment; or (c) upon application by a company which has passed a special resolution to make such a request. Under (a) and (c), the FS would consider, *inter alia*, whether there is significant public interest at stake that warrants invoking the power.

30. Sections 152A to 152F of the CO provide for the power for the FS or a person authorised by him to enquire into the books and papers of a company in assessing whether an investigation is warranted upon application from members under section 142 of the CO.

31. In Chapter 4 of the consultation document, we asked for views on the proposed changes to the provisions governing the investigation or enquiry that may be initiated by the FS as detailed in paragraphs 29 and 30 above. The key proposals include the following:-

(a) enhancing the investigatory powers of an inspector;

(b) extending the categories of companies that may be subject to investigation to include also companies incorporated outside Hong Kong but doing business in Hong Kong (even if not having a place of business in Hong Kong); as well as any other companies, wherever incorporated, within a group. The latter extension is also applicable to enquiry; and

(c) improving safeguards for confidentiality of information and protection of informers.

Respondents' views

32. We have received 28 submissions on the subject, out of which 12 agreed or had no objection to the proposals, while 16 had other comments, including questioning the practicability of covering companies that had no place of business in Hong Kong.

Our response

33. We will proceed with the proposal to extend the right to apply to the FS for appointment of inspectors to members of registered non-Hong Kong companies (i.e. non-Hong Kong companies having a place of business in Hong Kong and registered under Part 16 of the CB), so as to align the treatment of Hong Kong and non-Hong Kong companies. However, taking into account respondents' views that it would be impractical and rarely possible, if at all, to conduct effective investigation into the affairs of overseas companies that do not have a place of business in Hong Kong, we will not adopt the proposal to subject those companies to investigation.

D. Enquiries by the Registrar

34. In Chapter 4 of the consultation document, we proposed new but limited powers for the Registrar to obtain documents, records and information for the purposes of ascertaining whether any conduct that would constitute certain offences under the CB has taken place.

As a start, the offences will be confined to clause 15.7(7) concerning the giving of false or misleading information in connection with an application for deregistration of a company; and clause 20.1(1) concerning the making of a statement that is misleading, false or deceptive in any material particulars.

Respondents' views

35. The majority (16) out of a total of 25 respondents supported or did not object to the proposed new powers. A few respondents (such as LSHK and CMAHK) disagreed with the proposal and were concerned about allegedly excessive powers (such as criminal sanctions for non-compliance and the right to delegate power to any public officer).

Our response

36. The proposed new powers would facilitate the enforcement effort of the Companies Registry and help safeguard the integrity of the public register. In view of the majority support, we will take forward the proposal. In response to the concern about "excessive powers", we would like to clarify that the Registrar may invoke the enquiry powers only if she has reason to believe, and certifies such in writing, that an offence has been committed; the record, document, information or explanation is relevant to the enquiry; and the person is in possession of the record or document (clause 19.36(2)). The new powers are, therefore, appropriately restrained.

E. Providing Reasons to Explain Refusal to Register a Transfer of Shares

37. Section 69(1) of the CO requires a company which refuses to register transfer of shares or debentures to send a notice of such refusal to the transferor and transferee within two months after the transfer was lodged with the company. There is no requirement for the notice to be accompanied by the reasons for the refusal.

38. In Chapter 5 of the consultation document, we asked if a new requirement should be introduced in the CB to require companies to give reasons explaining their refusal. We also asked, if the answer is in the affirmative, whether the reasons should be given in a manner similar to that prescribed under the UK Companies Act 2006 (UKCA 2006), viz. mandatory where there is a refusal; or similar to the case of transmissions by operation of law under section 69(1A) of the CO, viz. the prospective transferee is entitled to call on the company to provide reasons for the refusal to register him as a member while the company is required to register the transfer if it fails to furnish reasons within 28 days after receipt of the request.

Respondents' views

39. A total of 36 submissions commented on this subject, among which 21 submissions, including those from CGCC, CHKLC, HKAB, HKICPA, HKIoD and LSHK, agreed that reasons should be provided; while 13 submissions, including those from HKGCC and SCAA, disagreed; and two offered other comments. The arguments both for and against the proposal are similar to those set out in the consultation document. Particularly, those agreed to the new proposal saw there is need to enhance transparency and to ensure proper exercise of the directors' duties to the benefit of the company. Those disagreed were mainly of the view that it has been established common law position to permit directors not to give reasons for their acceptance or rejection of transfer, and that currently there are already sufficient grounds (e.g. breach of fiduciary duties, etc.) to sanction against directors' wrongful refusals.

40. If reasons are to be given, among those who agreed, 11 (including CGCC, CHKLC, HKAB, HKICPA and LSHK) preferred arrangements similar to transmission by operation of law (i.e. upon request); while ten (including the HKIoD) preferred the UKCA 2006 approach (i.e. mandatory).

Our response

41. Given the majority support, we will require companies to give reasons explaining its refusal to register a transfer of shares. While views were divided on whether giving of reasons should be mandatory or upon request, as there is slightly more support for the latter and the approach has been adopted in the CO with respect to transmission of shares by operation of law, we recommend its adoption.

Proposed Changes to Provisions in Part 9 (Accounts and Audit)

42. Apart from comments on the above highlighted issues, we have also received a significant number of comments on the draft clauses of Part 9 (Accounts and Audit) of the CB. In the light of the feedback received and the SCCLR's advice, we propose a number of substantive changes to Part 9, as elaborated below:-

(I) Qualifying Criteria for Private Companies to Prepare Simplified Financial and Directors' Reports

43. Section 141D of the CO provides that a private company (other than a company which is a member of a corporate group and certain companies specifically excluded, such as insurance and stock-broking companies) may, with the written agreement of all the shareholders, prepare simplified accounts and simplified directors' reports in respect of one financial year at a time. According to the SME-Financial Reporting Framework issued by HKICPA, a company qualifies for reporting based on the SME-Financial Reporting Standards (SME-FRS) if it satisfies the requirement under section 141D. The Joint Government/HKICPA Working Group to Review the Accounting and Auditing Provisions of the CO (JWG) recommended to relax the qualifying criteria to enable more private companies to prepare simplified financial and directors' reports (referred to as reporting exemption in the draft CB) along the following lines:-

(a) a private company (except for a banking/deposit-taking company, an insurance company, or a stock-broking company), will automatically be qualified for simplified reporting, if it is a "small private company" that satisfies certain conditions[2];

(b) a private company that does not qualify as a "small private company" can also enjoy the benefit of simplified financial and directors' reports if members holding at least 75 % of the voting rights so resolve and no other member objects;

(c) a group of companies that qualifies as a "group of small private companies"[3] can also prepare simplified financial and directors' reports; and

(d) a group of private companies that is not qualified as a "group of small private companies" can elect for simplified reporting with the approval of members holding at least 75% of the voting rights and no member objects in the holding company or in the non-small private companies, depending on the circumstances.

44. As noted in the consultation document[4], the Hong Kong Financial Reporting Standard for Private Entities (HKFRS for PEs) was adopted on 30 April 2010. Eligible private entities which do not have public accountability now have a reporting option that is less onerous in terms of disclosure requirements than the full HKFRSs. In that regard, we welcomed views of the accounting profession on whether and, if so, how the above proposals should be modified.

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2 Satisfying any two of the following conditions:-
- Total annual revenue of not more than HK$50 million.
- Total assets of not more than HK$50 million.
- No more than 50 employees.

3 Satisfying any two of the following conditions:-
- Aggregate total annual revenue of not more than HK$50 million net.
- Aggregate total assets of not more than HK$50 million net.
- No more than 50 employees.

4 See Explanatory Notes on Part 9, paragraph 10.

Respondents' views

45. HKICPA and most major accounting firms have reservations about the proposal to extend the possible use of SME-FRS to private companies/groups of any size, where members holding 75% of the voting rights so resolve and no member objects (i.e. paragraph 43(b) and (d) above). Their reservation mainly stemmed from the fact that SME-FRS was developed essentially for SMEs as an alternative to the full HKFRSs and generally has much simpler accounting requirements. Therefore, SME-FRS might not be able to reflect, with the degree of transparency that would be expected, the state of affairs of sizeable companies/groups with more complex accounts.

Our response

46. In the light of the above concern and the fact that a simpler HKFRS for PEs is now available as a reporting option for "large" private companies/groups, we recommend keeping only the proposed option for "small" private companies/groups to prepare simplified financial and directors' reports (i.e. paragraph 43(a) and (c) above) and not to introduce the option for other private companies/groups to opt for simplified reporting requirements based on approval by members holding 75% voting rights and no objection from the remaining members (i.e. paragraph 43 (b) and (d) above).

(II) "True and Fair View"

47. Clause 9.25 of the CB requires that annual financial statements and annual consolidated financial statements must give a true and fair view of the financial position and financial performance of the company and the subsidiary undertakings (if applicable).

Respondents' views

48. HKICPA does not support the proposal that all companies incorporated in Hong Kong should be required to present their financial statements in accordance with a "true and fair view".

According to HKICPA, currently, auditors are not permitted to express a "true and fair" opinion on financial statements prepared under SME-FRS, as SME-FRS is considered a compliance framework, as defined in the Hong Kong Standard on Auditing (HKSA) 200 (Clarified). Instead, for financial statements prepared under SME-FRS, auditors should express an opinion as to whether the relevant financial statements are prepared, in all material respects, in accordance with the framework.

Our response

49. In view of HKICPA's comments, we will exempt the financial statements of those companies preparing simplified financial reports from the "true and fair view" requirement.

(III) Preparation of Financial Statements by a Holding Company

50. JWG recommended that a holding company should only be required to prepare consolidated financial statements for the group and there is no need to prepare separate financial statements for the holding company itself. We have accordingly provided in clause 9.24(1) and (2) of the CB that directors must prepare for each financial year financial statements (for non-holding companies) or consolidated financial statements (for holding companies) for the group.

Respondents' views

51. As noted by an accounting firm, a holding company that intends to change its status from a private to a public company (under Part 3 of the CB) or to distribute its profits and assets (under Part 6 of the CB) is required to prepare its own financial statements in addition to the consolidated financial statements for the group.

Our response

52. Upon closer examination, we note that since holding companies must prepare annual consolidated financial statements in the manner as

prescribed under Subdivision 3 of Division 4 of Part 9, in particular clause 9.25 and the Schedule to Part 9, the annual consolidated financial statements (with the balance sheet of the holding company shown in the notes to accounts) could also be used for the purpose of clauses 3.33 and 6.13 to save the companies' efforts.

53. To standardise the disclosure requirements in Part 6, we will also require the interim financial statements under clause 6.14 and the initial financial statements under clause 6.15 to be prepared in the same manner as the financial statements or consolidated financial statements under Part 9, except for such matters which are not material for determining the distributable profit and that the financial statements may not cover a full financial year. This will be consistent with the current requirements under the CO.

(IV) Remuneration of Auditors

54. Clause 9.25(3) and Part 2 of the Schedule to Part 9 require the financial statements of a company (not falling within the reporting exemption) to disclose, amongst other things, the audit and non-audit services provided by the auditor or its associates and related remuneration, in accordance with JWG's recommendation.

Respondents' views

55. HKICPA and some major accounting firms expressed concern on the requirement as it was unclear as to the scope of "associate" and "service" to be covered. There is also concern that if the definition of "associate" follows the UK's regulations, the scope may be so wide that the cost of obtaining such information, particularly for a sizable group with operations in many countries, may outweigh the benefits.

Our response

56. We note that the proposal to extend the disclosure of the auditor's remuneration to cover non-audit services undertaken by the auditor

and its associates involves complex issues. As far as listed companies are concerned, Paragraph 2(h) of Appendix 23 to the Listing Rules already provides for the mandatory disclosure of the remuneration of the auditor and related entities for audit and non-audit services in the corporate governance report of listed issuers [5]. For unlisted companies, the existing disclosure requirement in relation to auditor's remuneration under Paragraph 15 of the Tenth Schedule of CO[6] would seem to be sufficient. In the light of the comments received and after consulting the SCCLR, we will preserve the existing CO requirement in the CB. We have also invited SFC and HKEx to keep under review the compliance and effectiveness of the relevant provision of the Listing Rules.

(V) Requiring Directors to Make a Declaration as to Whether the Financial Statements Give a True and Fair View of the Financial Position and Financial Performance of the Company

57. Section 129B of the CO requires every balance sheet of a company to be approved and signed on behalf of the board of directors. In clause 9.28 of the CB, based on JWG's recommendation, we propose to replace it by a requirement for the financial statements to be accompanied by a directors' declaration which states whether, in the directors' opinion, the financial statements or consolidated financial statements, give a true and fair view of the company or the group's financial position and financial performance. The purpose is to remind the directors of their obligation to prepare financial statements that give a "true and fair view".

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[5] It requires an "analysis of remuneration in respect of audit and non-audit services provided by the auditors (including any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as part of the audit firm nationally or internationally) to the listed issuer. Such analysis must include, in respect of each significant non-audit service assignment, details of the nature of the services and the fees paid."

[6] Paragraph 15 of the Tenth Schedule to the CO provides that the amount of the remuneration of the auditors shall be shown under a separate heading, and for the purposes of this paragraph, any sums paid by the company in respect of the auditors' expenses shall be deemed to be included in the expression "remuneration".

Respondents' views

58. Some respondents considered the proposed directors' declaration unnecessary and were concerned that directors who were not accountants might have difficulty opining on the financial statements. HKICPA and SCAA also noted that complications would arise in a situation where the directors made a declaration that, in their opinion, the financial statements gave a true and fair view of the financial position and the financial performance of the company, but the auditor held a different view. Moreover, as a result of the change suggested in paragraph 49 above, the financial statements of those companies preparing simplified financial reports would be exempted from the "true and fair view" requirement.

Our response

59. In view of the above concern, we will not introduce the proposal of requiring directors' declaration regarding financial statements. This will not detract from the directors' duty to prepare financial statements that give a true and fair view or are properly prepared in accordance with the applicable accounting standards. We will preserve the existing requirement under section 129B of the CO in the CB.

(VI) Business Review

60. To enhance transparency, the JWG recommended that all public companies and "large" (i.e. other than those qualified to apply the simplified accounting and reporting requirements) private and guarantee companies should be required to prepare as part of the directors' report, a business review which is more analytical and forward-looking than the information currently required under the CO. This proposal is included in the CB. The proposal has drawn a number of comments as summarised below: -

(a) some respondents did not see the need for private companies to prepare a business review and were concerned about the

additional cost. For listed companies, the content of such a review would be better dealt with through the Listing Rules. LSHK suggested that an "opt-in" arrangement would be more appropriate, particularly in the context of private and guarantee companies;

(b) some considered the requirement an unnecessary burden for wholly-owned subsidiary companies (public or private). The position of wholly-owned subsidiary companies is similar to that of owner-managed companies;

(c) some were concerned about the wording in clause 9.31 regarding the contents of business review. For example, a major accounting firm commented that the lack of objective measure to judge the meaning of "comprehensive" in clause 9.31(2)[7] rendered this requirement unduly burdensome on directors;

(d) HKICPA and a few other respondents considered it important that directors should feel comfortable with making forward-looking statements that were meaningful. They suggested that a "safe harbour" clause be included in the CB, which would provide directors with protection from civil liability for statements or omissions in the directors' report. Reference was made to section 463 of the UKCA 2006 which provides that directors are liable solely to the company, and no other person, for a loss suffered by the company if statements are untrue or misleading or there is an omission of anything required to be in the report. The directors are liable if they knew a statement was made in bad faith or recklessly, or an omission was made for deliberate and dishonest concealment of material facts. The protection does not affect any other liability for a civil penalty or criminal offence; and

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[7] Clause 9.31(2) stipulates that a business review must be a balanced and comprehensive analysis, consistent with the size and complexity of the company's business, of:-
(a) the development and performance of the company's business during the financial year; and
(b) the position of the company's business at the end of the financial year.

(e) some queried that prohibiting disclosure by cross-referring to the directors' report under clause 9.32 was unnecessarily restrictive. Currently, for listed companies, a business review is normally included as a separate section from the directors' report in the annual report. For presentation purposes, listed companies should have the flexibility to cross-refer to information in the annual report.

Our response

61. In response to the above concerns, we recommend that the following modifications be made to the "business review" proposal:-

(a) in addition to those SMEs that are already eligible for reporting exemption, private companies can opt out of the business review requirement by special resolution. We consider that this would address the concern about the requirement being too onerous for private companies;

(b) wholly-owned subsidiary companies will be exempted from the business review requirement. The holding company will prepare the business review if it is not exempted under (a) above;

(c) clause 9.31(2) requiring a business review to be "comprehensive analysis" will be deleted, for we agree with the comments that the contents of the business review are adequately covered by clause 9.31(1) which requires that, amongst other things, the business review must contain "a fair review of the company's business", together with clause 9.31(3) which sets out that "to the extent necessary for an understanding of the development, performance or position of the company's business, a business review must include…an analysis using financial key performance indicators";

(d) a "safe harbour" provision along the lines of section 463 of the UKCA 2006 (paragraph 60(d) above) will be inserted; and

(e) clause 9.32 which prohibits disclosure by cross-reference will be deleted to provide more flexibility for companies in preparing the business review and directors' report.

(VII) Auditor's Rights to Information

62. Clause 9.56 of the CB provides that auditors will be empowered to require a wider range of persons, including the employees of the company and the officers and employees of its Hong Kong subsidiary undertakings, and any person holding or accountable for any of the company's or the subsidiary undertakings' accounting records, to provide them with information, explanations or assistance without delay, as they think necessary for the performance of their duties as auditors. Failure to comply with the requirement to provide information, etc. to auditors will be liable to criminal sanctions.

Respondents' views

63. A number of respondents, including CHKLC, HKGCC, HKICPA, HKICS and HKIoD, have expressed the following concerns:-

(a) the scope of persons is too wide and subjecting employees or ex-employees to criminal sanctions for failing to provide information, etc. to auditors is potentially unfair and oppressive. It may cause hassles for companies to fill in-house finance positions and necessitates changes to the companies' recruitment policies and employment contracts thus unnecessarily increasing the costs of doing business. The proposed requirement for holding companies to obtain information, etc. from individual employees at any level, currently or formerly associated with those subsidiaries, could also be impracticable;

(b) requiring the provision of "assistance" (in addition to information and explanations) is too broad and over-reaching.

Terms such as "without delay" could also be too vague and should be more clearly defined; and

(c) the requirement should not be based on what "the auditor thinks necessary for the performance of his duties as auditor of the company", but rather on what, objectively, is reasonably necessary for the performance of his duties.

Our response

64. In the light of the above concerns and after considering the views of the SCCLR, we recommend the following modifications to the proposal:-

(a) removing "employee" and ex-employees of companies or their subsidiary undertakings from the scope of persons liable to give information etc. to the auditor. We will however continue to require officers of a company's Hong Kong subsidiary undertakings and any person holding or accountable for any of the company's or the subsidiary undertakings' accounting records to give information etc. to the auditor;

(b) removing the requirement to give "assistance" to the auditor. Substitute "as soon as practicable" for "without delay" to address the concern about vagueness of the term; and

(c) substituting "that the auditor reasonably requires" for "that the auditor thinks necessary" to address the concern about the lack of an objective test in the requirement.

CONCLUSION

65. In summary, we are prepared to adopt the following proposals in the CB:-

(a) the restrictions on financial assistance to a third party to purchase a company (or its holding company)'s shares will be relaxed and applicable to both private and public (listed or unlisted) companies. The relaxed restrictions will include three scenarios, namely (a) approval by the board of directors if the aggregate amount of financial assistance does not exceed 5% of the shareholders' fund; (b) approval by the board of directors with unanimous approval of the shareholders; and (c) approval by the board of directors with approval by members or shareholders by ordinary resolution, subject to the right of at least 10% of members (if the company is not limited by shares) or members holding at least 10% voting rights (if the company is limited by shares) to petition to the court for a restraining order. All the three scenarios will be subject to a solvency test;

(b) the power of an inspector appointed by the FS to investigate a company's affairs will be enhanced by requiring that, e.g. a person under investigation to preserve records and verify statements made to the inspector. Companies eligible to apply to the FS for appointment of inspectors will be extended to cover registered non-Hong Kong companies. In addition, confidentiality of matters or information obtained in an investigation, and protection of persons who volunteered information to facilitate an investigation will be enhanced;

(c) the Registrar will be empowered to obtain documents, etc. for the purpose of ascertaining whether there is misconduct, which amounts to an offence, concerning false or misleading information that relates to an application for deregistration of a company; and making of misleading or deceptive statements in any material particulars;

(d) companies will be obliged to explain a refusal to register a transfer of shares upon request by the transferor or transferee, and to register the transfer if it fails to furnish reasons within 28 days after receipt of the request;

(e) a private company (except for a banking/ deposit-taking company, an insurance company, or a stock-broking company) will automatically be qualified for simplified reporting if it is a "small private company"[8]. Similarly, a group of companies which qualifies as a "group of small private companies"[9] can also choose to prepare simplified financial and directors' reports;

(f) companies that prepare simplified financial reports will be exempted from the "true and fair view" requirement in annual financial statements or annual consolidated financial statements (as the case may be), to align with HKSA 200 (Clarified) as explained in paragraph 48 above;

(g) to save companies' efforts, the annual consolidated financial statements that must be prepared by a holding company in accordance with Subdivision 3 of Division 4 of Part 9 will also be taken as the financial statements required under clause 3.33 for the re-registration of a company that converts from a private to public company and under clause 6.13(1) for distribution of profits and assets. For the same reason and to remove asymmetrical disclosure requirements under Part 6, the interim and initial financial statements under clauses 6.14 and 6.15 respectively will also be prepared in accordance with Subdivision 3 of Division 4 of Part 9, except for such matters which are not material for determining the distributable profit and that the financial statements may not cover a full financial year;

(h) the existing disclosure requirement in relation to auditor's remuneration under Paragraph 15 of the Tenth Schedule to the CO will be preserved in the CB;

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[8] Satisfying any two of the following conditions:
- Total annual revenue of not more than HK$50 million.
- Total assets of not more than HK$50 million.
- No more than 50 employees.

[9] Satisfying any two of the following conditions:
- Aggregate total annual revenue of not more than HK$50 million net.
- Aggregate total assets of not more than HK$50 million net.
- No more than 50 employees.

(i) all public companies and "large" (i.e. other than those qualified to apply the simplified accounting and reporting requirements) private and guarantee companies will be required to prepare an analytical business review in the directors' report (though "large" private companies may opt out if approved by a special resolution). To limit directors' liability, a "safe harbour" clause along the lines of section 463 of the UKCA 2006 will be provided; and

(j) in addition to the existing rights to request information from the officers of a company (i.e. directors, managers and company secretary), auditors will be empowered to require information and explanations that the auditors reasonably require for the performance of their duties as auditors from a wider range of persons, including officers of a company's Hong Kong subsidiary undertakings and any person holding or accountable for any of the company's or the subsidiary undertaking's accounting records. Failure to comply with the requirement to provide information, etc. to auditors will be subject to criminal sanctions.

Other Issues

66. Apart from the issues discussed above, we have considered the comments on other aspects of the CB, mainly concerning technical and drafting issues. Major comments and our responses are set out in Appendix III[10].

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[10] Appendix III is not attached to this paper. Members who wish to peruse Appendix III may refer to the online version of the consultation conclusions (at http://www.fstb.gov.hk/fsb/co_rewrite/).

WAY FORWARD

67. We are finalising the CB, taking into account the views received from the First and Second Phase Consultations of the Draft CB and the Consultation Conclusions. We aim to introduce the CB into the Legislative Council in early 2011.

Financial Services and the Treasury Bureau
25 October 2010

Appendix I

List of Forums and Meetings Attended

Date	Organising Parties	Nature
14 May 2010	Small and Medium Enterprises Committee*	Meeting
10 June 2010	Hong Kong Legal Professionals Association*	Seminar
22 June 2010	Companies Bill Team, Financial Services and the Treasury Bureau	Forum
26 June 2010	Democratic Alliance for the Betterment and Progress of Hong Kong*	Seminar
28 June 2010	Society of Chinese Accountants & Auditors*	Seminar
12 July 2010	Hong Kong Institute of Certified Public Accountants*	Forum
13 July 2010	The Hong Kong Institute of Directors*	Meeting
15 July 2010	Federation of Hong Kong Industries*	Meeting
19 July 2010	Hong Kong Brands Protection Alliance*	Seminar
21 July 2010	Hong Kong Institute of Certified Public Accountants (Small and Medium Practitioners)*	Forum
26 July 2010	The Association of Chartered Certified Accountants*	Seminar

* We were invited by the organising parties to attend the forum/meeting to further introduce the proposals on the Draft Companies Bill – Second Phase Consultation. Comments on the proposals were also received from members of the organising parties through discussions.

Appendix II

List of Respondents

1. Association of Chartered Certified Accountants, Hong Kong, The
2. BEST, Roger
3. British Chamber of Commerce in Hong Kong, The
4. Chamber of Hong Kong Listed Companies, The
5. CHAN, Frances
6. Chinese General Chamber of Commerce, The
7. Chinese Manufacturers' Association of Hong Kong, The
8. Cheung Kong (Holdings) Limited
9. Clifford Chance
10. CLP Holdings Limited
11. Computershare Hong Kong Investor Services Limited
12. Consumer Council
13. CPA Australia
14. Deloitte Touche Tohmatsu
15. Ernst & Young Advisory Services Limited
16. Federation of Share Registrars Limited
17. Great Eagle Holdings Limited
18. Henderson Land Development Company Limited
19. HO, Tak Wing
20. Hong Kong Aircraft Engineering Company Limited
21. Hong Kong Association of Banks, The
22. Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies, The

23. Hong Kong Federation of Insurers, The
24. Hong Kong General Chamber of Commerce
25. Hong Kong Institute of Certified Public Accountants
26. Hong Kong Institute of Chartered Secretaries, The
27. Hong Kong Institute of Directors, The
28. Hong Kong Institute of Trade Mark Practitioners, The
29. Hong Kong Securities Association Ltd
30. Hong Kong Trustees' Association Ltd
31. Hongkong and Shanghai Banking Corporation Limited, The
32. Hutchison Harbour Ring Limited
33. Hutchison Telecommunications Hong Kong Holdings Limited
34. Hutchison Telecommunications International Limited
35. Hutchison Whampoa Limited
36. Intel Corporation
37. JONES, Gordon
38. KPMG
39. LAM, Kin Kun Arthur
40. Law Society of Hong Kong, The
41. Linklaters
42. Liway Charm Limited
43. Mandatory Provident Fund Schemes Authority
44. MOK, Yun Lee Paul
45. NG, S M Karen
46. Norton Rose Hong Kong
47. Oxfam Hong Kong

48. PricewaterhouseCoopers

49. Securities and Futures Commission

50. Slaughter and May

51. Society of Chinese Accountants & Auditors, The

52. Stock Exchange of Hong Kong Limited, The

53. SUEN, Chi Wai

54. TSAO, Yea Tann Simon

55. 日昇實業有限公司

56. 廖甘樹

57. One respondent has requested his name not to be disclosed