

CHAPTER 3

ENSURING BETTER REGULATION

- 3.1 To ensure that the regulatory regime is effective and business-friendly, the Government will introduce a number of improvements to the company incorporation and name registration procedures, the filing of information, and the registration of charges. Many of these will focus on encouraging and exploiting new forms of e-communication. We will also enhance enforcement against “shadow companies”³⁴ by empowering the Registrar to act on court orders by directing a “shadow company” to change its name and to substitute its name with the company registration number if the company fails to comply with the direction. Meanwhile, we will also improve the effectiveness of the enforcement regime by giving the Registrar power to obtain documents, records and information for enforcement of certain provisions in the CB and the power to compound certain offences under the CB, and refining the definition of “officer who is in default”.

Electronic Company Incorporation

Introducing electronic incorporation and expediting company name approval process

- 3.2 Starting from late 2010/early 2011, the CR will introduce in phases new services for electronic incorporation of companies and delivery of documents. As noted in paragraph 1.12 above, legislative amendments will be introduced into the LegCo in early 2010 to tie in with the implementation of the new electronic services. Such amendments will cover, among other things, the use of digital signatures and passwords, and signing of the incorporation form and issuance of the certificate of incorporation by electronic means.

Company Name Registration

Expediting company name approval process

- 3.3 As part and parcel of the company incorporation process, we will introduce changes to the company name registration system with a view to expediting the company name approval process. At present, the performance pledge for incorporation of companies is four working days. Most of the

³⁴ These refer to those companies incorporated in Hong Kong at the CR with names which are very similar to existing and established trademarks or trade names of other companies and pose themselves as representatives of the owners of such trademarks and/or trade names or produce counterfeit products bearing such trademarks or trade names.

processing time is spent on scrutinising proposed company names to ensure that they are not objectionable for various reasons.³⁵ To expedite the company name registration system, we will bring forth the approval of company names prior to the company incorporation process, whereby a company name would be accepted for registration if it satisfies certain preliminary requirements, namely, that it is not identical to another name on the register and does not contain words or expressions on a specified list.³⁶ Thereafter, if the company's name is found to be objectionable as being offensive, likely to give the impression of a government connection or contrary to the public interest upon further checking, the Registrar will be empowered to direct within a specified period the company in question to change its name and to substitute its name with the company registration number if the company fails to comply with the direction. The revised procedures would shorten the company incorporation processing time from four to one working day. The legislative changes will be incorporated into the CB.

Empowering the Registrar to act on a court order requiring an infringing company to change its name

3.4 At present, the Registrar has only very limited power under the CO to deal with “shadow companies”. There have been strong requests in recent years from the business community especially trademark/brand name owners in Hong Kong to strengthen our company name registration system to tackle possible abuses by “shadow companies”. A proposal to enhance enforcement against “shadow companies” was put forward for public consultation in the second quarter of 2008.³⁷ Under the proposal, the Registrar would be empowered to act on a court order requiring a company to change its name by directing the “shadow company” to change its name, or substituting its name with the company registration number if the company fails to comply with the direction. The proposal received overwhelming support from the respondents. The amendments will be incorporated into the amendment Bill to be introduced into the LegCo in early 2010.

³⁵ For example, a proposed company name must not be identical to the name of an existing company, its use must not constitute a criminal offence nor be offensive or contrary to the public interest. In addition, names that would be likely to give the impression that the company is connected with the Central People's Government or with the Hong Kong Government or any department of either Government or that contain certain words or expressions such as “Chamber of Commerce” and “Trust” require official approval.

³⁶ Separately, we will review the list of words and expressions in the Companies (Specification of Names) Order in consultation with relevant Bureaux as some of the words may be outdated and should no longer be regulated (e.g. “Municipal” and “Building Society”).

³⁷ The consultation conclusions were issued in December 2008 and are available at www.fstb.gov.hk/fsb/co_rewrite.

Ensuring Accuracy of Information on the Public Register

Clarifying and enhancing the Registrar's powers in relation to registration of documents and keeping of the register

3.5 We will clarify and enhance the Registrar's powers to help ensure the accuracy and timeliness of information on the public register.³⁸ The new measures will include:

- (a) clarifying that the Registrar's powers to specify the form of documents and the form of delivery include requirements as to authentication and the manner of delivery of documents;
- (b) giving the Registrar a power to refuse registration of documents if the document is not properly delivered or is unsatisfactory;
- (c) empowering the Registrar to withhold the registration of an unsatisfactory document and request the person who delivered the document to take certain remedial actions, such as producing further information or evidence;
- (d) empowering the Registrar to require a company or its officers to resolve inconsistencies in information on the register or to provide updated information; and
- (e) empowering the Registrar to annotate information on the register to provide supplementary information, such as the fact that the document in question has been replaced or corrected.

Introducing a new court-based procedure for removing from the register information that is inaccurate, forged or derived from anything invalid, ineffective or done without the authority of the company

3.6 At present, it is unclear if the court has general inherent jurisdiction to order the Registrar to remove information which has been provided in compliance with statutory requirements. There is no clear means for a company to remove from the register information which has been placed on the register but subsequently proves to be inaccurate and misleading. As the Registrar is not in a position to determine whether a piece of information is inaccurate or forged, we will introduce a new court-based procedure for the removal of such information. The Registrar will, upon an order of the court, rectify or remove any material on the register that derives from anything invalid or ineffective or that is done without the authority of the company.³⁹

³⁸ See paragraphs 2 to 9 and 12 to 13 of Explanatory Notes on Part 2.

³⁹ See paragraphs 10 to 11 of Explanatory Notes on Part 2.

Streamlining Regulation

- 3.7 We have looked for ways to streamline existing regulatory requirements in the CO which no longer serve any practical purpose or overlap with other regulatory measures. Some examples are cited below.

Abolishing the licence system for keeping a branch register of members outside Hong Kong

- 3.8 Under section 103 of the CO, a company is required to apply and pay for an annual licence if it wishes to keep its register of members in a place at or near which it transacts its business outside Hong Kong. This licence system will be abolished. Instead, if a company transacts business outside Hong Kong, it may keep at such a place a branch register of its members resident there provided that a notice is given to the Registrar of the address where the branch register is kept.

Removing the share qualification requirement for directors

- 3.9 Section 155 of the CO requires that a director who has not satisfied his share qualification provision in accordance with the company's articles shall do so within a prescribed period. If he does not do so or if a director ceases to retain his share qualification, the director is deemed to have vacated his office. Any unqualified person who acts as a director after the expiration of the prescribed period is liable to criminal sanction.⁴⁰
- 3.10 The share qualification requirement was originally designed to ensure that directors would act in the interests of the company. However, it is now uncommon for companies to require directors to have or obtain a number of qualifying shares. The criminal penalty provision is also outmoded. The similar requirement in the UK has been repealed.⁴¹ We will remove the requirement in the CB.

Removing disclosure requirements in the Tenth and Eleventh Schedules of the CO that duplicate with financial reporting standards

- 3.11 The Tenth Schedule of the CO comprises a detailed list of disclosure requirements as to the contents of the balance sheet and profit and loss account. The schedule is now out of date as a result of the significant developments in financial reporting, which are reflected in the Hong Kong Financial Reporting Standards. The Eleventh Schedule of the CO comprises a list of relatively simple disclosure requirements regarding the contents of the balance sheet of companies applying section 141D of the CO.

⁴⁰ The maximum penalty is a Level 3 fine and a daily default fine of \$200.

⁴¹ Section 291 of the UK Companies Act 1985 was repealed by section 1295 of the UKCA 2006.

There is an overlap between the Eleventh Schedule and the SME-Financial Reporting Standard.

- 3.12 In order to avoid any potential conflicts between the applicable financial reporting standards and the Tenth and Eleventh Schedules respectively, the Tenth and Eleventh Schedules will be repealed except for a small number of public interest or corporate governance disclosure requirements which are not covered by the applicable financial reporting standards.⁴² Companies will be required to continue to follow the overriding principle that their accounts must give a true and fair view of their state of affairs and will be required to state in their accounts as to whether the accounts have been prepared in accordance with the applicable accounting standards, and the particulars of and the reasons for any departure from those standards.

Registration of Charges

- 3.13 Taking into account the public's views received during the consultation conducted in the second quarter of 2008⁴³, we will introduce a number of changes to the registration of charges regime in the CB.⁴⁴ These will include:

- (a) updating the list of registrable charges, including expressly providing that a charge on an aircraft or any share in an aircraft is registrable and removing the requirement for registration of a charge for the purpose of securing any issue of debentures;
- (b) replacing the automatic statutory acceleration of repayment in section 80(1) of the CO with a right for the lender to demand immediate repayment of the amount secured by the charge, should a company fail to register a charge within the prescribed time;
- (c) making both the prescribed particulars of the charge and the instrument creating or evidencing a charge registrable and open to public inspection, in order to streamline the registration process and enhance transparency; the same also applies to the application for registration of repayment / release and the supporting evidence thereof; and
- (d) shortening the period to register a charge from 5 weeks to 21 days.

⁴² Such disclosures include auditors' remuneration (which applies to companies other than those preparing simplified accounts), the aggregate amount of any outstanding loans to directors and employees to acquire shares in the employing company made under the authority of sections 47C(4)(b) and (c) of the CO and information regarding a company's ultimate parent undertaking required under section 129A of the CO.

⁴³ See footnote 37 above.

⁴⁴ Provisions will be included in Part 8 of the CB to be covered in the second phase consultation paper.

Improving the Enforcement Regime

Giving the Registrar powers to obtain documents, records and information for the enforcement of certain provisions

3.14 Currently, the CR has limited investigatory powers under the CO and has encountered difficulty in performing its regulatory role. In the interest of promoting compliance with provisions under the CB and enhancing the enforcement regime, we intend to empower the CR to obtain documents, records and information to ascertain whether certain acts or omissions by a company or its officers would give rise to the following offences in the CB:

- (a) giving the CR false or misleading information in connection with an application for the deregistration of a company; and
- (b) making a false, misleading or deceptive statement knowingly or recklessly in any return, report, certificate, balance sheet or other document, required by or for the purposes of any provision of the CB.⁴⁵

The provisions have a strong public interest dimension because any default would impair the integrity of the CR's register and adversely affect the interests of third parties.

3.15 The powers include requiring the company, its officers and any other person who is reasonably believed to be in possession of the relevant documents or records, to produce the documents and records and to provide information and explanation on them.⁴⁶

Updating provisions on company investigations

3.16 Currently, the CO provides for two forms of investigation into the affairs of a company authorised by the Financial Secretary:

- (a) formal investigations (known as "inspections") where the Financial Secretary appoints an inspector with extensive powers to conduct the investigation (sections 142 to 150); and
- (b) preliminary fact finding, where the Financial Secretary or a person authorised by him may require a company and its present or past directors and employees etc. to produce the company's books and papers and provide explanation of them (sections 152A to 152F).

⁴⁵ Based on the offences under section 291AA(14) and section 349 of the CO.

⁴⁶ Provisions will be included in Part 19 of the CB to be covered in the second phase consultation paper.

3.17 Over the past 38 years, there have been 38 appointments of inspectors under the CO, the most recent one was *Peregrine Investments Holdings Ltd* and *Peregrine Fixed Income Ltd* case in 1999-2000 where the Financial Secretary appointed the inspector upon the recommendation of the SFC for an investigation, having regard to the narrow scope of SFC's powers prevailing at that time. Since the SFO came into operation in 2003, the SFC has greater investigatory powers and is able to impose a broader range of sanctions under the SFO. The need for invoking the CO to investigate a listed company has greatly diminished. No preliminary enquiry under section 152A has ever been undertaken since the relevant sections were added in 1984.

3.18 Although the CO investigation regime is now very rarely used, we believe that the two forms of investigation should be retained to give the Financial Secretary "reserve" powers to investigate into the affairs of a company formed or operating in Hong Kong in case there are appropriate grounds to do so in the future. Some updating of the provisions will be made, mainly in the light of similar provisions in the SFO and the Financial Reporting Council Ordinance which are more modern. The significant changes include:

- (a) giving the Financial Secretary express powers to define the terms of the appointment of an inspector, limit or expand the scope of an inspection and suspend an inspection at his discretion pending criminal proceedings or otherwise. Provisions will also be added to deal with situations like the resignation or replacement of an inspector and the revocation of an inspector's appointment by the Financial Secretary;
- (b) providing an express obligation to inform or remind a person required to assist of the limitations on the use of self-incriminating evidence in proceedings;
- (c) giving protection to persons who volunteered information to facilitate investigation by granting immunity from liability for disclosure; and
- (d) enhancing the confidentiality of information obtained from an investigation and defining more clearly how such information might be disclosed to other regulatory authorities.⁴⁷

Empowering the Registrar to compound specified offences

3.19 The majority of companies in Hong Kong are SMEs. In many cases, filing defaults may be due to oversight. Nevertheless, we believe that criminal

⁴⁷ Provisions will be included in Part 19 of the CB to be covered in the second phase consultation paper.

sanctions should be retained as the last resort.

- 3.20 To enhance compliance, the Registrar will be given a new power to compound, at her discretion, certain offences under the CB. This means that the Registrar may offer a person who is reasonably suspected of having committed an offence an opportunity to avoid prosecution of that offence by paying an amount to the Registrar as a compounding fee and, where appropriate, remedying the breach constituting the offence within a specified period. If that person accepts such an offer and complies with the terms of such offer, no prosecution will be initiated against him for that offence.
- 3.21 Compoundable offences will be set out in a Schedule to the CB and generally confined to those offences which are:
- (a) related to non-compliance with filing obligations and with obligations for affixture of names or the like;
 - (b) punishable only by a fine or a fine and a daily default fine (i.e. not by imprisonment); and
 - (c) triable summarily only.⁴⁸

Replacing the phrase “officer who is in default” with “responsible person” and refining the definition to strengthen the enforcement regime

- 3.22 Many offence provisions under the CO punish not only a company but also those officers⁴⁹ of the company who are in default. An “officer who is in default” is currently defined under section 351(2) of the CO as “any officer of the company, or any shadow director of the company, who knowingly and wilfully authorizes or permits the default, refusal or contravention mentioned in such provision”.
- 3.23 To strengthen the enforcement regime, the following changes will be made to the definition:
- (a) replacing the reference to “knowingly and wilfully authorizes or permits the default, refusal or contravention” with “authorizes or permits, participates in, or fails to take all reasonable steps to prevent, the contravention”, thus lowering the threshold for a breach or contravention and extending it to negligent acts or omission;

⁴⁸ Provisions will be included in Part 20 of the CB to be covered in the second phase consultation paper.

⁴⁹ Under section 2(1) of the CO, “officer”, in relation to a body corporate, includes a director, manager or secretary.

- (b) extending the punishment to an officer of a corporate officer which commits an offence as an officer who is in default, where the first mentioned officer has caused the corporate officer to be in default; and
- (c) using the term “responsible person” in place of “officer who is in default”⁵⁰.

Adjusting the penalties for offences

3.24 There are three types of penalties provided in the CO, namely, imprisonment, fines and daily default fines⁵¹. Where appropriate, adjustments will be made to the maximum penalties as prescribed for offences under the CO to ensure consistency and adequate deterrent effect. For instance, the maximum penalties of similar offences applicable to Hong Kong companies and non-Hong Kong companies will be aligned.

3.25 Currently, offences which are punishable by the same level of fine may be subject to different daily default fines. For example, the daily default fines for offences which are punishable by a Level 3 fine range from \$200 to \$700. Adjustments will be made so that each applicable level of fine will only carry one corresponding amount of daily default fine in the CB as follows⁵²:

Level of fine	Maximum fine amount	Proposed daily default fine
Level 3	\$10,000	\$300
Level 4	\$25,000	\$700
Level 5	\$50,000	\$1,000
Level 6	\$100,000	\$2,000
Maximum fine amount above \$100,000		\$2,000

⁵⁰ See paragraphs 7 to 12 of Explanatory Notes on Part 1.

⁵¹ A daily default fine is applicable to certain offences where the offender is liable, in addition to a lump sum fine and imprisonment (if any), to a fine each day on which the default, refusal or contravention continues. See section 351(1A)(d) of the CO.

⁵² Please note that the amount of daily default fine is only a maximum amount that may be imposed for continued contravention of an offence. The court has discretion to order an amount of such fine well below the maximum in the light of the circumstances of the case.