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## **Companies Registry External Circular No. 11 / 2014**

### **The New Companies Ordinance (Cap. 622) Companies (Directors' Report) Regulation (Cap. 622D)**

#### **Disclosure of Information in Directors' Report - equity-linked agreements and reasons for resignation or refusal to stand for re-election of a director**

This circular seeks to set out the requirements for a directors' report to contain information on equity-linked agreements entered into by the company and the reasons for resignation or refusal to stand for re-election of a director under the Companies (Directors' Report) Regulation (Cap. 622D) ("the Regulation").

### **Background**

2. The Regulation is one of the 12 pieces of subsidiary legislation made under the new Companies Ordinance, Chapter 622 of the Laws of Hong Kong ("the new CO"). The new CO and its subsidiary legislation will come into operation on 3 March 2014.

3. In the new CO, the requirements relating to a directors' report are provided in sections 388 to 391. The Regulation is made under section 452(3) of the new CO to prescribe information that is required to be contained in a directors' report.

### **The new requirements**

4. The Regulation introduces a new requirement for a directors' report to contain information on equity-linked agreements. As it is common nowadays for companies to enter into agreements that will or may result in the companies issuing shares, and as the issuance of shares has a potential to dilute existing shareholders' interests, the disclosure of such information will enhance transparency and the protection of shareholders' interests.

5. Another new requirement introduced in the Regulation is in relation to the disclosure of the reasons for resignation or refusal to stand for re-election of a director. Under the Regulation, a directors' report must contain a summary of the reasons relating to the affairs of the company. The requirement, which does not apply to companies falling within the reporting exemption under Division 2 of Part 9 of the new CO ("reporting exemption"), seeks to enhance transparency without unnecessarily increasing the burden or compliance costs for companies.

### **Disclosure of information on equity-linked agreements**

6. The new requirement to disclose information on equity-linked agreements is set out in section 6 of the Regulation. Under section 6, a company is required to disclose in the directors' report for a financial year all equity-linked agreements entered into by the company in that financial year, and all equity-linked agreements entered into by the company in the past which still subsisted in that financial year. No disclosure is required if the directors had resolved to enter into an equity-linked agreement before the end of a financial year of the company if the agreement in respect of which had not yet been entered into by the parties.

7. Section 6(1) of the Regulation provides that if, in any financial year of a company, the company has entered into an equity-linked agreement, a directors' report for the financial year must state the reason for entering into the agreement, the nature and terms of the agreement, the classes of shares issued under the agreement and the number of shares that have been issued for each class. The information to be disclosed in respect of an equity-linked agreement subsisting at the end of a financial year is set out in section 6(2).

8. The term "equity-linked agreement" is defined in section 6(3) to mean an agreement that will or may result in the company issuing shares, or an agreement requiring the company to enter into such an agreement, and specifically includes:

- (a) an option to subscribe for shares;
- (b) an agreement for the issue of securities that are convertible into, or entitle the holder to subscribe for, shares in the company;
- (c) an employee share scheme; and
- (d) a share option scheme.

9. The new requirement will cover any agreement that gives a third party the power and right to require a company to issue shares even if there are conditions that have to be met, and will include any such agreement notwithstanding that the company has an option on settlement to either issue shares or pay cash or other consideration.

10. The following agreements are specifically excluded from the definition of an equity-linked agreement under section 6(3) of the Regulation:

- (a) an agreement to subscribe for shares in a company that is entered into pursuant to the company's offer of its shares to the public; and
- (b) an agreement to subscribe for shares in a company that is entered into pursuant to an offer made to the members of the company in proportion to their shareholdings.

These agreements are required to be disclosed in the directors' report under section 5 of the Regulation, which is a restatement of the requirement under section 129D(3)(g) of the Companies Ordinance, Cap. 32 ("Cap. 32").

### **Disclosure of reasons for resignation or refusal to stand for re-election of a director**

11. Section 8 of the Regulation provides that if:

- (a) a director of a company has in a financial year resigned from the office or refused to stand for re-election to the office; and
- (b) the company has received a notice in writing from the director specifying that the resignation or refusal is due to reasons relating to the affairs of the company (whether or not other reasons are specified),

a directors' report for the financial year must contain a summary of the reasons relating to the affairs of the company. The requirement does not apply in respect of a company that falls within the reporting exemption for the financial year.

12. Companies which fall within the reporting exemption include, among others, small private companies which meet the specified size criteria (namely, those that satisfy two of the following conditions: total revenue not exceeding \$100 million, total assets not exceeding \$100 million and no more than 100 employees). Particulars of the criteria for the reporting exemption are contained in Division 2 of Part 9 and Schedule 3 to the new CO.

13. If a company has received a written notice from a director specifying that his resignation or refusal to stand for re-election is due to reasons relating to the affairs of the company, section 8 requires the company to summarize those reasons in the directors' report, so as to enhance transparency. A summary is a shortened version of the reasons given by the director. The summary must be prepared in an objective manner with the contents derived from the reasons stated in the written notice given by the director. It must include all the reasons that relate to the affairs of the company. If the director has also specified reasons that do not relate to the affairs of the company (e.g. personal reasons), only those reasons relating to the company's affairs are required to be contained in the summary.

## **Failure to comply with the Regulation**

14. A director who fails to take all reasonable steps to secure compliance with the Regulation commits an offence and is liable to a maximum fine of \$150,000 under section 388(6) of the new CO. A director who commits a wilful default is liable to a term of imprisonment of up to 6 months, other than a maximum fine of \$150,000 (section 388(7)).

## **Transitional arrangements for existing companies**

15. The provisions in the new CO and the Regulation on directors' report apply to a financial year of a company that begins on or after the commencement date of the new CO, and they apply to all Hong Kong companies regardless of whether the companies are formed before or after the commencement date of the new CO. Sections 129D and 141D of Cap. 32 continue to apply in relation to a directors' report for a financial year beginning before the commencement date of the new CO and ending on or after that date.

## **Enquiries**

16. Further information relating to the requirements of a directors' report under the new CO are available in the Briefing Notes on Companies (Directors' Reports) Regulation in the "New Companies Ordinance" section of the Companies Registry's website ([www.cr.gov.hk](http://www.cr.gov.hk)). Enquiries concerning this circular should be directed to Mr YU Kwok-kuen, Assistant Registry Manager (Registration) 2, at (852) 2867 5365 / [kkyu@cr.gov.hk](mailto:kkyu@cr.gov.hk).

17. This circular is intended to provide a general guide to the new requirements as set out in paragraphs 4 and 5 above. You are advised to seek independent legal advice in case of doubt.

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**Registrar of Companies**

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