Standing Committee on Company Law Reform (SCCLR)

The Eleventh Annual Report

1994/95

Standing Committee on Company Law Reform (SCCLR)

Eleventh Report to His Excellency the Governor in Council

Subjects considered by the

Standing Committee during 1994/95

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Terms of Reference of the Standing Committee on Company Law Reform

(1) To advise the Financial Secretary on amendments to the Companies Ordinance as and when experience shows them to be necessary.

(2) To report annually through the Secretary for Monetary Affairs to the Governor in Council on those amendments to the Companies Ordinance that are under consideration from time to time by the Standing Committee.

(3) To advise the Financial Secretary on amendments required to the Securities Ordinance and the Protection of Investors Ordinance with the objective of providing support to the Securities and Futures Commission in its role of administering those Ordinances.

(ii)

Membership of the Standing Committee for 1994/95

Chairman : The Hon Mr Justice Rogers

Members : Mr Richard E T Bennett

Mr Christopher M de Boer

Mr John R Brewer

Mr Dennis G D Cassidy

The Hon Marvin Cheung Kin-Tung, OBE, JP

Mr CHOW Man Yiu, Paul

Mr Henry FAN Hung-ling

Mr David W Gairns, JP

Mr Robert G Kotewall, Q.C.

Mrs Angelina P L Lee

Mr Alan Smith, JP

Professor Ted Tyler

Mr J T Allen

Ex-officio Members :

Mr A R Hearder, JP
The Official Receiver

Mr Gordon Jones, JP
The Registrar of Companies

Mr David T R Carse, OBE, JP
Deputy Chief Executive
(Banking)

Mr TAM Wing-pong
Deputy Secretary for Financial Services

Mr Gerard McMahon
Securities & Futures
Commission

Secretary : Mr E T O'Connell

Meetings held during 1994/95

One Hundredth Meeting	-	5th May
One Hundredth and First Meeting	-	2nd July
One Hundredth and Second Meeting	-	24th September
One Hundredth and Third Meeting	-	26th November
One Hundredth and Fourth Meeting	-	14th January

Summary of Recommendations/Remarks

Chapter	Subject Matter	Recommendations/Remarks
1	Auditing & accounting requirements for small companies.	No change to the mandatory audit requirement for small companies.
2	Priority payments for small depositors.	Amend the Companies Ordinance to provide that all eligible depositors should be granted preferential status up to $100,000.00 net in the event of a winding-up of a licensed bank.
3	Section 16(1) of the Companies Ordinance.	Amend to allow for the use of pre-printed signatures on certificates of incorporation.
4	The decision of Houldsworth V City of Glasgow Bank : Section 111A of the 1985 UK Companies Act.	Adopt Section 111A of the 1985 UK Companies Act to allow shareholders who have subscribed for shares on the basis of misleading information in a prospectus to sue the company itself without having to rescind ownership of their shares.
5	Use of the English Language in the Companies Ordinance.	Amend the Companies Ordinance to allow for the use of the Chinese Language as well as the English Language.
6	Abolition of the disclosure exemption enjoyed by shipping companies.	Amend the Tenth Schedule by the abolition of the exemption enjoyed by shipping companies with regard to financial disclosure in their accounts.
7	Section 239 of the Companies Ordinance - Certificates of dissolution.	No change to the present wording of the section.
8	Financial disclosure by authorised institutions.	Information paper tabled by Hong Kong Monetary Authority. It recommended greater financial disclosure by authorised institutions. Review and consultation exercise still ongoing.

Chapter	Subject Matter	Recommendations/Remarks
9	Changes to the listing rules of the Stock Exchange.	A number of changes to the listing rules of the Stock Exchange recommended by the working party, including greater financial transparency in the accounts of listed companies.
10	Overall Review of the Companies Ordinance.	Administration's proposal to undertake a review supported by the Standing Committee.
11	Registration of Company Charges.	No change to the current legislative provisions.
12	Alternate Directors.	Papers referred to the Administration for further consideration. Little point in codifying the duties of Alternate Directors when those of primary directors remain subject to the rules of common law.
13	Execution of a company's documents.	No change to the current legal requirements.
14	Accounts preparation & audit requirement.	Amend Sections 122(1) & 122(2) of the Companies Ordinance along the lines of Sections 224 to 227 and 236 of the 1985 UK Companies Act.
15	Charitable & other donations: Section 129D(3)(d) & (e) of the Companies Ordinance.	Revise the amounts upwards from $1,000.00 to $10,000.00 before disclosure must be made in the directors report.
16	Amendment to the 1988 Capital Accord for bilateral netting.	Information paper tabled by the Hong Kong Monetary Authority recommending change to capital adequacy framework.
17	Company Inspections.	No change to the existing legislative regime.
18	Amendments to the Companies Ordinance.	A range of proposed changes to Hong Kong's companies legislation have been submitted for the Standing Committee's consideration.
19	Recommended practice on independent non-executive directors.	Guidelines issued by the Stock Exchange of Hong Kong for the boards of listed companies to improve corporate governance and raise business ethics.

Chapter	Subject Matter	Recommendations/Remarks
20	Tenth Annual Report.	Queries/recommendations raised by HKSA and HKAB.

Chapter 1

Auditing And Accounting Requirements For Small Companies

1. Summary of Recommendations

1.1 At the 104th meeting of the Standing Committee, members voted in favour of the retention of the present mandatory audit requirement set out in Section 141 of the Companies Ordinance (CO), for all 'small' companies. In view of the objection in principle to the proposal the question of what would constitute a 'small company' was never addressed.

Background

1.2 Section 121 of the CO requires every company to keep proper books of account with regard to :

(a) all sums of money received and expended and the matters in respect of which the receipt and expenditure takes place;

(b) all sales and purchases of goods; and

(c) the assets and liabilities.

Section 121 also provides that the books of account must give a true and fair view of the state of the company's affairs and that they must also explain its transactions.

1.3 Section 122 of the CO requires the directors to lay before the company at its AGM the profit and loss account for the financial year together with the balance sheet. The auditors of the company, who are appointed pursuant to the provisions of Section 131 of the CO, are required pursuant to Section 141(1) of the CO to report to the members on the accounts examined by them and on every balance sheet, profit and loss account and all group accounts laid before the company in general meeting. The auditors report must be read before the company in general meeting and shall say whether or not in their opinion proper books of account have been kept and whether or not the company's balance sheet and profit and loss account are in agreement with the books of account and returns.

1.4 In November 1993, the UK Chancellor of the Exchequer announced that there would be a relaxation of the audit requirement for certain categories of companies under UK companies legislation. The measures announced provided for the complete abolition of the audit requirement for companies with a turnover below £90,000.00 p.a. and the replacement of the audit report with a compilation report for those companies with a turnover between £90,000.00 p.a. and £350,000.00. For those companies with turnovers exceeding £350,000.00 the audit requirement would remain. The reasons underlying these changes are set out in a consultation report issued by the DTI in London in April

1993, and which was tabled before members during discussions.

1.5 It was against this background that the Standing Committee decided to consider whether similar proposals were appropriate for Hong Kong. As a starting point, a consultation exercise was undertaken to elicit the views and opinions of the business, commercial and professional sectors of Hong Kong. In addition, the views of the Inland Revenue Department (IRD) were also sought as, it was felt, any proposed changes to the current legislative requirements would need their approval.

1.6 The issue was debated at considerable length at the 100th, 102nd and 104th meetings. Discussions were wide-ranging but the majority concluded that the audit should be retained for all small companies. Those members in favour of retention emphasised the following points :

(a) In Hong Kong, in respect of small companies, it was usual for the accounting and auditing exercise to be undertaken at the same time. There would therefore be minimal 'add on' costs for an audit certificate;

(b) The costs of an audit, even for small companies, were insignificant compared to the UK;

(c) At a time when Government and The Hong Kong Society of Accountants were committed to improving accounting standards, the proposal would be a retrograde step;

(d) The price of limited liability was the requirement to have the accounts audited. This was a necessary protection for both shareholders and creditors of the company;

(e) The retention of the requirement went a considerable way in ensuring that proper books of account were maintained by companies. In fact, and as the IRD had pointed out, the quality of books of companies were generally far superior to unincorporated associations, whose accounts were not audited. It also allayed the fears of investors who had left the control and management of those companies to others;

(f) It would be very difficult to categorise companies into 'big' or small as the proposal envisaged; and

(g) The IRD required the comfort of an audit certificate to ensure that a company's financial returns were accurate and reliable. Unless an audit was undertaken there would be no way of knowing what the turnover of a company amounted to. If the audit requirement were to be modified, it was thought

probable that the IRD would seek a substantial increase in funding from Government to enable it to undertake the task of critically examining financial returns of companies granted an exemption. Hitherto, the mandatory audit certificate had provided that same degree of comfort.

1.7 Members who felt that the proposals merited further consideration or possible adoption in Hong Kong opined that :

(a) The costs of an audit for small companies were a significant 'add on' cost of business;

(b) Many companies were incorporated to hold title to property because of existing tax advantages. Such companies were not trading and the financial relief which the proposals offered would be welcomed. The same individuals were usually the directors and shareholders;

(c) Most foreign companies registered under Pt. XI of the ordinance were not required to have their accounts audited in Hong Kong. In many foreign jurisdictions there was no audit requirement. As the IRD accepted the unaudited accounts of such companies, the

accounts of very small locally incorporated companies should also be acceptable without an audit certificate;

(d) The accounts of wholly owned subsidiaries should be exempted on the grounds that their accounts would come within the audit of their parent companies;

(e) Where all the shareholders of small companies unanimously consented to the waiver of the audit requirement and this was done on an annual basis, an exemption should be granted. The vast majority of the shareholders of such companies carried on their business activities without rancour or dissent and they should be given the commercial option of seeking an exemption;

(f) Small companies should be treated in a similar manner to unincorporated enterprises which were not burdened with a mandatory audit; and

(g) Banks, finance houses and other creditors did not usually rely on an auditor's certificate preferring instead the safety and comfort of personal guarantees from directors when deciding whether to provide loans and overdraft facilities to small companies.

1.8 Although members voted in favour of the retention of the mandatory audit, it was agreed to review the workings of the amending legislation in the UK after a reasonable period of time.

Chapter 2

Priority Payment for Small Depositors of Licensed Banks: Proposed Amendments to Section 265 of the Companies Ordinance

2. Summary of Recommendations

2.1 At the 104th meeting of the Standing Committee, the Administration's proposal to confer preferential status upon eligible depositors of Licensed Banks up to the first HK$100,000.00 of their net eligible deposits in the event of the Banks's liquidation was approved by members.

Background

2.2 Following the liquidation of the Bank of Credit and Commerce Hong Kong Ltd. (BCCHK), the question of how best to protect the interests of small depositors of licensed banks was considered by the Administration. In this regard, Government conducted a public consultation exercise in February 1992 on the feasibility of a Deposit Protection Scheme (DPS) along the lines of the one introduced some years before in the UK. It was eventually concluded that any attempt to introduce such a scheme in Hong Kong would encounter stiff resistance and eventually the proposal was allowed to lapse.

2.3 Nevertheless, it was believed that there were strong arguments for providing some protection to small depositors if this could be achieved in a way that was widely acceptable and which would not jeopardise the integrity of the banking system. This was because :

(a) most people placed a large percentage of their savings in bank deposits for reasons both of security and accessibility. Any threat to individuals savings in bank deposits could have a knock on effect on the confidence of the community as a whole;

(b) small depositors were not in a position to judge the risks when placing deposits with banks; and

(c) banking was a very important integral part of the modern market economy. It was also a business of confidence. The conversion of people's savings into productive capital and investment for commerce and industry was a fundamentally important role undertaken by banks. If that confidence were to be shaken, not only depositors but the whole economy could suffer.

2.4 In January 1993, the Governor in Council approved in principle the proposal to introduce legislation whereby claims from small depositors were afforded preferential

status in the event of the liquidation of a bank.

Proposal

2.5 Section 265 of the Companies Ordinance sets out the existing hierarchy of preferential payments in a winding-up i.e. claims from employees up to certain defined limits for arrears of wages and severance pay etc., followed by claims from the crown, followed by claims under certain insurance contracts etc. It was proposed that in the event of a winding up of a licensed bank, an eligible depositor's first $100,000.00 net eligible deposit should receive priority payment after the payment of all statutory debts.

2.6 The definitions of 'deposit' and 'depositor' set out in the Banking Ordinance would be adopted. Certain categories of deposit, in view of the spirit of the proposal to protect the 'small depositor', would be excluded from the scheme. These would include :

(a) deposits by the Hong Kong Monetary Authority, authorised institutions, money lenders, persons registered under the Commodity Trading Ordinance, and the Securities Ordinance and insurers within the meaning of the Insurance Companies Ordinance;

(b) deposits by public bodies, agents of overseas Governments and multilateral development banks;

(c) deposits by the bank's directors, controllers, managers, holding companies and subsidiaries;

(d) deposits with maturities of five years and more; and

(e) deposits made after the bank ceased to be a licensed bank.

2.7 It was intended that all the accounts of a person with a bank would be aggregated for the purpose of determining the amount eligible for preferential status. However, all the existing rules with regard to set-off would continue to apply. As against that the principle of 'Pari Passu' in a liquidation would be further eroded by the proposal. However the Administration considered the proposal justified given the unique and vitally important role of banks in the financial system. By giving a measure of comfort to small depositors, it was thought that this would help to enhance the stability of the banking system and benefit the economy as a whole.

2.8 It was also thought that by substantially reducing the

creditor population (an analysis of BCCHK disclosed that the vast majority in number of depositors had net deposits of less than $100,000.00) this would lead to substantial savings in administration costs and it would also enable the liquidator to concentrate on the larger creditors thus providing them with the opportunity cost of receiving dividends earlier.

2.9 During the course of the meeting held on 7 May 1994, members were very concerned to ensure that, the 'small man in the street' should be protected in the event of another bank collapse. This meant that a liquidator should be able to identify and pay off the small depositors as speedily as possible, within days or weeks. The current legal requirements on set off which obliged the liquidator to work out the depositors net position was a very exacting task which experience had shown took a long time to achieve. A possible solution to the problem was to provide depositors the opportunity of opening a specially designated account of up to HK$100,000.00 which would not be subject to the usual legal requirement of aggregation and set-off. In view of these concerns the Administration agreed to reconsider the proposal and to revert to the Standing Committee at a later date.

2.10 A further discussion paper was tabled at 104th Meeting. An important objective of the scheme was to provide a measure

of protection to small depositors but this should not be done in a way which would unduly impact on the existing operation of banks as well as compromise established principles of liquidation law. The proposal to set up a specially designated account would have this effect, as immunity from set-off would confer a greater advantage upon small depositors than available to other existing classes of preferential creditors who would still be subject to set-off. In addition, it could disrupt a bank's existing operations which the Administration was keen to avoid. Members endorsed this approach.

2.11 Certain members expressed concern that yet another class of preferential creditors was being established under Hong Kong law which could be ultimately to the detriment of the ordinary unsecured creditors of the bank. They thought this proposal was counter to a perceptible trend in other comparable common law jurisdictions which was to reduce the number of preferential classes of creditors in a liquidation for the benefit of the ordinary creditors. As against that, however, 'small depositors' deserved priority payment status in the event of another liquidation of a licensed bank in Hong Kong, and the policy initiative underlying the proposal was supported by members.

Chapter 3

Amendments to Section 16(1) of the Companies Ordinance (CO) Certificates of Incorporation

3. Summary of Recommendations

3.1 At 100th Meeting of the Standing Committee, members unanimously endorsed the Registrar of Companies proposal to amend Section 16(1) of the CO to permit the Registrar to issue pre-signed certificates of incorporation.

Background

3.2 At present, certificates of incorporation and change of name of companies were personally signed by the Registrar of Companies or Senior Companies Registration Officers under delegated authority. The actual signing was cumbersome because of the large number of certificates involved. On average over 5,000 certificates in respect of new companies incorporated and 1,000 certificates in respect of change of company name were issued each month. The Efficiency Unit, in a review of the operation systems in the Companies Registry, recommended that certificates with pre-printed signatures should be introduced as this would enable signatory officers to make better use of their time.

3.3 The current provisions of section 16(1) of the CO provided that the Registrar was obliged to certify under his hand that each company was incorporated and, in the case of a limited company, that the company was limited. Therefore the use of pre-printed certificates was disallowed under current legislation.

Chapter 4

The Adoption of Section 111A of the 1985 UK Companies Act to Reverse the Effects of the English Decision : Houldsworth V City of Glasgow Bank 1880, 5AC 317

4. Summary of Recommendations

4.1 At the 103rd Meeting of the Standing Committee, members unanimously endorsed the proposal of the Hong Kong Association of Banks to enact provisions similar to Section 111A of the 1985 UK Companies Act to enable a person who wished to claim compensation with regard to the issue of shares or securities by an issuing company the right to do so without having to first rescind his shares or acquisition of securities to which listing particulars relate.

Background

4.2 Because of the English decision of Houldsworth v City of Glasgow Bank 5AC 317 which limited the availability of a claim for damages against the company itself even if misrepresentation or a breach of contract could be established by the shareholders, shareholders had to rescind their contract for the subscription of their shares

before being able to claim damages from the company itself. By virtue of Section 3(1) of the Application of English Law Ordinance, the common law and rules of equity in the UK, in so far as they were applicable, were in force in Hong Kong. The decision would be applicable in Hong Kong.

4.3 The brief facts of the case in question were as follows :

" H purchased stock in the bank and was entered in the register of members and received dividends. The bank commenced winding-up and H was placed on the list of contributors. The directors had made various fraudulent misstatements. H then sued the bank which was in liquidation. It was held that H must first rescind the contract because it was inconsistent with membership of a company to sue it for fraud. If recission had become impossible, as it had in this case because of the winding-up, the action for damages could not be maintained. "

4.4 As the third edition of Farrar's company law has stated (page 570):

" The precise reason for the rule has never been clear. The City of Glasgow Bank was an unlimited liability company and there is an obvious practical

difficulty in allowing shareholders to claim damages from the company in such circumstances. Allowing their claims would add to the liabilities of the company to which they, as shareholders, have to contribute. That increases their loss and thus their claim against the company, which adds to the liabilities of the company, and so on, ad infinitum. But in Re Addlestone Linoleum Co. Ltd (1887) 37 Ch D 191, CA, the rule was held to apply to a shareholder in a limited liability company as well. The justification here may have been a fear that allowing shareholders to claim money from their company involved the risk of payment being made to the shareholders out of capital. Whatever its justification, the rule has now been abrogated by Section 111A of the Companies Act 1985. However, the issue of capital maintenance is likely still to be a concern of the courts in any case in which the question of the company paying compensation to a shareholder arises. "

4.5 Section 111A of the 1985 UK Companies Act provides as follows :

" A person is not debarred from obtaining damages or other compensation from a company by reason only of his holding or having held shares in the company or any right to apply or subscribe for shares or to be included in the company's register in respect of shares. "

4.6 Members agreed it was necessary to adopt a similar provision in Hong Kong. The reasons underlying the development of the principle in the UK were arcane. There should be no reason in principle disallowing a subscriber for shares from suing the issuing company for damages if misled by information in a prospectus without having to first rescind his membership of the company. The 'reduction of capital' argument advanced by the legal academics to justify the rule was debatable. A company may have surplus of capital in excess of the paid up capital and would therefore be able to pay any damages that the courts may award. Shareholders were entitled to sue promoters of company for misleading statements in prospectuses. They should also be entitled to sue the company itself. The implementation of a provision similar to Section 111A of the 1985 UK Companies Act in Hong Kong was to be welcomed.

Chapter 5

The Use of the English Language in the Companies Ordinance

5. Summary of Recommendations

5.1 At the 104th Meeting of the Standing Committee, members endorsed the Registrar of Companies proposal to amend all sections, rules and regulations in the Companies Ordinance and subsidiary legislation to allow for the use of the Chinese Language (in addition to the English Language) in company doucments without an English translation. In future, for example, the memorandum and articles of a company could be printed in the Chinese language and filed with the Registrar of Companies without an English translation. However Sections 38(1) and 342(1)(b) were exempted from this proposal. Instead it was recommended that the publication of prospectuses and the prospectuses themselves must, if they were printed in either language, be accompanied by a translation into the other language.

Background

5.2 For some time, the Registrar of Companies had been considering the need to 'localise' the Companies Ordinance to comply with the requirements of the 'Basic Law'. Article 9 of the Basic Law provides as follows :

" In addition to the Chinese language, English may also be used as an official language by the executive

authorities, legislature and judiciary of the Hong Kong Special Administrative Region. "

Article 8 provides :

" The laws previously in force in Hong Kong, that is, the common law, rules of equity, ordinances, subordinate legislation and customary law shall be maintained, except for any that contravene this law, and subject to any amendment by the legislature of the Hong Kong Special Administrative Region. "

5.3 In late 1993, the Commissioner for Chinese Language (CCL) pointed out that there could be a conflict between the mandatory English language provisions of the CO and the Official Languages Ordinance (OLO). The OLO which has been part of the laws of Hong Kong since February 1974 was promulgated to :

" provide for the official languages of Hong Kong and for their status and use. "

Section 3 of the OLO declares English and Chinese to be the official languages of Hong Kong for the purposes of communication between the Government or any public officer and members of the public and it also accords equal primacy to both languages.

5.4 The Attorney General's Chamber subsequently advised that the principal language for post 1997 communications between Government and the public would have to be in Chinese, though English could also be used as an alternative. The present 'English only' provisions set out in the Companies Ordinance would therefore be a breach of the Basic Law after 1997.

5.5 During the course of discussions, many members were concerned to ensure that the use of the English language remained widespread in the commercial life of Hong Kong. As far as the financial markets were concerned it was very important that the use of English remained as the dominant language for Hong Kong, even more so if Hong Kong was to retain and enhance its reputation as a leading regional and world financial centre. With regard to listed companies it was vital that their public records were in both English and Chinese to enable people e.g. company analysts, to critically examine its future financial prospects. This would be for the benefit of both domestic and international investors.

5.6 In view of the serious concerns expressed by members at the 103rd Meeting with regard to the possible adverse impact the proposal could have on the affairs and documentation of listed companies, further discussion was deferred until 104th Meeting to enable the Securities & Futures Commission to consider the proposal and its possible impact on listed

companies in greater detail. As for private companies, the proposal was unanimously endorsed.

5.7 At the 104th Meeting, members were advised that the issue had been examined previously by a discussion panel of the Financial Services Liaison Committee within the context of the adaptation of laws. The advice that had been tendered was that the 'either/or' approach should be adopted in any amending legislation to comply with the future requirements of the basic law. In addition, the Registrar of Companies had also been advised that the 'either/or' approach would not be incompatible with the provisions of the basic law. The Registrar of Companies had ruled out the 'both English and Chinese' option because of :

(a) the anticipated very high cost to the business community of having documentation translated into both languages; and

(b) the inevitable delays to the commercial sector by requiring documentation in both languages.

These two factors would simply make the 'both/and' option unsustainable in the long run. In view of this consideration would have to be given to amending the listing rules of the Stock Exchange with regard to listed companies to provide for the mandatory use of English. The proposal was therefore supported.

Chapter 6

The Abolition of the Exemption enjoyed by Shipping Companies in respect of some of the General Provisions as to the Balance Sheet and Profit & Loss Account contained in Part I to the Tenth Schedule of the Companies Ordinance (CO)

6. Summary of Recommendations

6.1 At the 105th Meeting of the Standing Committee, members endorsed the proposal of the Hong Kong Society of Accountants (HKSA) to abolish the current exemption enjoyed by shipping companies under item 28 of Part III to the Tenth Schedule of the CO. These provisions exempt shipping companies, banks and insurance companies from complying with certain of the financial disclosure provisions provided for in the Tenth Schedule of the CO.

Background

6.2 Section 123(1) of the CO provides that every balance sheet must give a true and fair view of the state of affairs of the company as at the end of its financial year and every profit and loss account must give a true and fair view of the profit or loss of the company for the financial year.

6.3 Under Section 123(2), the balance sheet and profit and loss account must comply with the requirements of Schedule 10 to the CO. Part I of the Schedule 10 specifies the content of the balance sheet and the profit and loss account.

6.4 Part III of Schedule 10 makes special provision for the accounts of banking, insurance and shipping companies, and exempts those categories of companies from many of the disclosure requirements applicable to all other companies. In support of its submission, the HKSA stated :

" In pre-war Britain the operation of ships carried certain national secrets. For this historic reason, shipping companies in Britain have been treated as special category companies and were entitled to certain accounts disclosure requirements.

This exemption is no longer compatible with the operation of shipping companies today. The UK Companies Act 1985 has removed shipping companies as special category companies. We believe that the disclosure exemptions afforded to shipping companies in the Companies Ordinance should be removed. "

6.5 A paper was tabled at the 103rd Meeting of the Standing Committee. The Chairman directed the Secretary to canvass the views of the Hong Kong Shipowners Association and to

bring the matter back before the Standing Committee when a response was available. In a written response dated 25 January 1995, the Hong Kong shipowners advised that they had no objection to the proposal.

Chapter 7

Certificates of Dissolution following the winding-up of Companies - Section 239 of the Companies Ordinance (CO)

7. Summary of Recommendations

7.1 At the 104th Meeting of the Standing Committee, members recommended that there should be no amendments to Section 239 of the CO to provide for the issue of a certificate of dissolution either automatically or upon request once the winding-up of a company had been completed. The proposal had been suggested by the Hong Kong Society of Accountants (HKSA) in its submission to the Standing Committee on amendments to the CO.

Background

7.2 Under Section 239 of the CO and which is only applicable in respect of a member's voluntary winding-up, when the affairs of a company are fully wound up, the liquidator is obliged to table accounts before a general meeting of the company and to provide explanations in relation to those accounts.

7.3 Within one week of the meeting, the liquidator must send a copy of the account to the Registrar of Companies and must

make a return, including details of the holding of the meeting and its date. The Registrar must register the account and the return and three months later the company will be dissolved.

7.4 In comparison the dissolution of a company being wound up by order of the court may be achieved with or without a court order :

(a) Section 226A of the CO provides for the dissolution of a company when its affairs have been completely wound up and the liquidator granted his release by order of the court. The Official Receiver may then sign a certificate of compliance with Section 226A and deliver it to the Registrar of Companies for registration. Two years thereafter the company will be dissolved;

(b) When the affairs of the company have been completely wound up, the liquidator may apply to the court for an order that the company may be dissolved from the date of such order (Section 227(1)). The liquidator must deliver a copy of the order to the Registrar of Companies.

7.5 In support of its proposal the HKSA had stated :

" In company liquidation under Section 239, a company is dissolved after filing the relevant returns. There is no provision for a certificate of dissolution. Such a certificate is available in many jurisdictions. As such certificates are often requested by shareholders, can the legislation so provide, either automatically or on request, whichever is administratively more convenient. "

7.6 The position in the UK and Australia is broadly similar to that pertaining in Hong Kong. It was pointed out in the paper tabled for discussion that in Hong Kong it was the practice of the Registrar of Companies to stamp the word dissolved on those documents filed with him when dissolution had been effected under Section 239. A simple search of the Register would reveal this. Furthermore, the registry very rarely received requests for certificates of dissolution. A simple search of the public register retained by the Companies Registry would disclose whether or not a company had been dissolved. As a member's voluntary winding up constituted the single largest number of the three types of winding up available in Hong Kong (the other two being creditors winding up and winding up by the court) and could only be undertaken when a company was solvent, the members of such companies should be aware of the position and would not need a certificate of dissolution.

7.7 Members were not therefore satisfied of the need to effect statutory changes and accordingly recommended that the existing provisions should remain undisturbed.

Chapter 8

8. Financial Disclosure by Authorised Institutions (AIS)

8.1 At the 101st Meeting of the Standing Committee, a paper was tabled by the Hong Kong Monetary Authority (HKMA) on the question of financial disclosure by AIS. A HKMA working party had issued a consultation paper to all locally AIS, the Hong Kong Association of Banks, the Deposit-taking Companies Association, the Hong Kong Society of Accountants and certain audit firms. This set out the recommendations of the working party on the level of greater financial disclosure by AIS. A copy of the recommendations set out in the paper is at Appendix 1.

8.2 It was widely accepted that the general trend in financial reporting was towards greater transparency and accountability and that the level of financial disclosure by AIS in Hong Kong was somewhat limited. As a consequence, the HKMA had become increasingly aware of the concerns and worries of regulators in other countries and also those of the financial rating agencies about this lack of financial information contained in the accounts of AIS. This was because under the Companies Ordinance locally incorporated companies were required to prepare their accounts in accordance with the Tenth Schedule, and licensed banks were exempted from most of the disclosure requirements set out in that schedule.

8.3 Both the HKMA and AIS accepted the need for greater financial disclosure than there had been hitherto. Hong Kong as a world financial centre had to look to the international trend which was for more financial information. The present level of limited disclosure by banks on Hong Kong could become counterproductive as it might lead to a lower than justified perception of authorised institutions in Hong Kong by depositors, counterparties, overseas regulators and rating agencies. This might affect their ability to conduct international business or to raise capital.

8.4 During the discussion members stressed the importance of the HKMA working in tandem with the other regulatory agencies such as the Securities & Futures Commission and the Stock Exchange which were also evaluating the need for the accounts of listed companies to contain much more financial information and be more financially transparent. Members believed that if there were to be widespread changes to the rules on financial disclosure, the HKMA should issue industry wide guidelines. In addition, the Stock Exchange should consider amending its listing rules to accommodate the changes and the Hong Kong Society of Accountants should consider issuing new 'Statements of Standard Accounting Practice' to reflect those changes. Such an approach would allow for maximum flexibility to be built into the new disclosure requirements which would more

easily reflect the dynamic state of financial markets. The more inflexible legislative approach was not desirable.

8.5 On 28 September 1994 the HKMA issued a Best Practice Guide on Financial Disclosure by Authorised Institutions based on recommendations jointly developed by the HKMA, the Stock Exchange and the SFC. These were incorporated in the Stock Exchange's listing rules.

8.6 On 19 December 1994 the HKMA issued the initial package on Financial Disclosure (Phase I) for 1995 accounts of Authorised Institutions. The Stock Exchange has also updated its Listing Rules in April to incorporate the package. A further package of disclosures will be released for consultation in 1995.

BEST PRACTICE GUIDE ON FINANCIAL DISCLOSURE BY AUTHORISED INSTITUTIONS

I. Introduction

1.1 This Best Practice Guide ("the Guide") is issued by the Hong Kong Monetary Authority (HKMA) to set out the minimum standards which the HKMA recommends authorised institutions to adopt in respect of information to be disclosed in their annual accounts for financial years ending on or after 31 December 1994.

1.2 The recommendations in this Guide are supplementary to and do not supplant any other disclosures required under relevant legislation, accounting standards, or which are necessary to show a true and fair view. Hence, in addition to the disclosures recommended in this Guide, authorised institutions will need to take account of the other existing disclosure requirements under the Companies Ordinance, the Stock Exchange Listing Rules, and the applicable Statements of Standard Accounting Practice where relevant.

II. Background

2.1 Banks and deposit-taking institutions play a significant and influential role in the efficient running of an economy and its monetary system. Most individuals and corporate bodies have an interest in such institutions either as depositors, borrowers or investors. There is considerable public interest in their well-being and in the adequacy of the financial information which institutions disclose in their published annual accounts i.e. whether such information sufficiently reflects the performance and financial strength of the institution during and at the end of the reporting period.

Present position

2.2 By virtue of an exemption from the disclosure requirements set out in the Tenth Schedule of the Companies Ordinance, banks incorporated in Hong Kong are permitted to disclose less information than other companies. In essence, the exemption means that :

(a) banks need only provide limited balance sheet information;

(b) banks do not need to provide a breakdown of income, operating expenses and charge for bad and doubtful debts in their profit and loss

account; and

(c) banks are able to maintain inner reserves and can make undisclosed transfers to or from them.

2.3 The exemptions do not apply to restricted licence banks (RLBs) and deposit-taking companies (DTCs). Nonetheless, the disclosure made by these companies is still modest relative to most other international financial centres.

2.4 The exemption under the Companies Ordinance was originally introduced in recognition of the special nature of banks. They are heavily reliant on external funding from customer deposits or interbank borrowing and their capital and earnings are vulnerable to fluctuations in asset values, creditworthiness of their borrowers, the business cycle and monetary conditions. The exposure of banks to such fluctuations means that they are vulnerable to a loss of confidence on the part of depositors. Banking problems can quickly spread, calling into question the stability of the system as a whole. This led to the view, in a number of countries including Hong Kong, that it was preferable for banks not to disclose full information about their performance and business so as to prevent bad news from causing a loss of confidence.

The need for change

2.5 The need to maintain the stability of the banking system should be given considerable weight in considering the appropriate extent of financial disclosure by banks. However, the Hong Kong banking system is now well-capitalised and profitable, and the supervisory regime has been strengthened. Moreover, the international trend is towards greater transparency and accountability, and the present level of disclosure by banks in Hong Kong is very limited. This could become counterproductive as it may lead to a lower than justified perception of authorised institutions in Hong Kong by depositors, counterparties, overseas regulators and rating agencies. This may affect their ability to conduct international business or to raise capital.

The new approach

2.6 The HKMA has been working closely with the banking industry since December 1993 to develop proposals to increase the scope of financial disclosure by authorised institutions in Hong Kong. A Working Party on Financial Disclosure

chaired by the HKMA and comprising representatives of authorised institutions formulated a set of recommendations which were embodied in a consultation paper issued in mid-May to the banking industry and the accounting profession.

2.7 The Stock Exchange of Hong Kong (SEHK), which has a locus in relation to listed banks, presented its own proposals for greater financial disclosure by listed banks in a discussion paper issued in March 1994 to the public.

2.8 Comments from the banking industry and the accounting profession reflected a general support for a common disclosure framework for both listed and non-listed authorised institutions. A joint technical working group comprising representatives from the HKMA, SEHK and the Securities and Futures Commission (SFC) developed by end August 1994 joint recommendations in respect of additional information to be disclosed in authorised institutions' 1994 accounts. The recommendations, which have been endorsed in principle by the Hong Kong Association of Banks, the Deposit-taking Companies Association and the Hong Kong Society of Accountants, are set out in section III below.

III. Recommendations of the Joint Technical Working Group

Profit and Loss Statement

3.1 An authorised institution should include the following information in the profit and loss statement or the notes to the financial statements. Institutions should exercise judgement in deciding on the relative prominence given to each disclosure item, having regard to the overall clarity of the financial statements.

Interest income
Interest expense
Other operating income
- Gains less losses arising from dealing in foreign currencies
- Gains less losses from other dealing activities
- Net fees and commission income (see paragraph 3)
- Dividend income (Analyse into listed and unlisted)
- Others

Operating expenses
- Staff costs
- Premises and equipment expense, excluding depreciation (Analyse where material)
- Depreciation charge
- Other operating expenses

Charge for bad and doubtful debts
Gains less losses from disposal of tangible fixed assets and long-term investments (Analyse where material)
Exceptional item (In accordance with HK SSAP 2)
Taxation charge
Extraordinary item (In accordance with HK SSAP 2)
As an appropriation :
Transfers to or from inner reserves
Transfers to or from reserves

3.2 In relation to the taxation charge, the basis on which the Hong Kong profits tax is computed should be disclosed.

3.3 In relation to the net fees and commission income, the gross figures should be disclosed where they are material and are necessary for the appreciation of the true extent of fee-based activities engaged in by the institution.

3.4 An authorised institution should disclose any material amount set aside to provisions other than those for depreciation, renewals or diminution in value of assets or any material amount withdrawn from such provisions and not applied for the purposes thereof.

Balance Sheet

3.5 An authorised institution should disclose the following information in the balance sheet or in the notes to the financial statements. Again, institutions should exercise judgement in deciding on the relative prominence given to each disclosure item, having regard to the overall clarity of the financial statements.

Assets
Cash and short-term funds
- Cash and balances with other banks and financial institutions
- Money at call and short notice
- Treasury bills (including Exchange Fund Bills)

Placements with banks and financial institutions maturing between one and twelve months
Trade bills (provisions should be shown if material)
Certificates of deposit
Securities held for dealing purposes (Analyse into listed and unlisted)
Advances and other accounts
- Advances to customers
- Advances to banks and financial institutions
- Accrued interest and other accounts (Analyse where material)
- Provisions for bad and doubtful debts (Analyse between those against advances to customers, advances to banks and financial institutions, accrued interest and other accounts if material)
  - general
  - specific

Investment securities (Analyse into listed and unlisted and disclose market values of listed securities)
Investments in associated companies
Tangible fixed assets (for each major class of assets including investment properties disclose the information as set out below)
- cost or valuation
- the additions, revaluations and disposals made during the period
- the amount provided or written off for depreciation or diminution in value of these assets during the period
- the accumulated depreciation, and
- the net book value

Liabilities
Deposits and balances of other banks and financial institutions
Current, fixed, savings and other deposits of customers
Certificates of deposits
Issued debt securities
Other accounts and provisions including inner reserves

Capital Resources
Loan capital (Types, coupon rates and maturities should be disclosed)
Minority interests
Share capital
Reserves (Analyse into the various material types of reserves including property and other revaluation reserves, where maintained)

3.6 The gross amount (before accumulated depreciation) of tangible fixed assets included in the financial statements should be analysed between those included

at cost and those included at valuation, if any. For those fixed assets that have been included at valuation, the years in which those assets were valued and the values should be disclosed and in the case of assets that have been valued during the financial period, the following should be disclosed:

the names of the persons who valued them and particulars of their qualifications for doing so, and
the bases of valuation used by such persons.

3.7 Of the premises (including investment properties) which are contained in tangible fixed assets how much is ascribable to those held freehold and those held on a lease (categorised into long lease, medium-term lease and short lease) should be disclosed. A distinction should also be made between those held on lease in Hong Kong and those held outside Hong Kong.

3.8 An institution should disclose details of the movements in reserves during the period, including the surplus or deficit on revaluation of properties.

Transactions with Group Companies

3.9 Where an authorised institution has entered into transactions with group companies, it should disclose the nature of the relationship and analyse the balances due to or from the various categories of group companies as at balance sheet date.

Principal Accounting Policies

3.10 The principal accounting policies adopted in determining the profit or loss for the period and in stating the financial position should be disclosed by way of note to the accounts.

Comparative Figures

3.11 The corresponding amounts for the immediately preceding financial year should be given for the above disclosures.

Terminology

3.12 Institutions should consider the guidance note on terminology at Annex

A in determining the classification of items within the disclosures contained in the Guide. Institutions should provide sufficient descriptions in their accounting policy notes or other notes on the accounts to enable the users of the financial statements to understand how material items have been dealt with.

Presentation and layout

3.13 The above recommendations present a broad framework of financial disclosure by authorised institutions. The precise method of presentation in the accounts and the layout is a matter for individual institutions to agree with their auditors.

IV. Implementation

Applicability

4.1 The recommendations in section III are intended to apply to all licensed banks and the larger RLBs and DTCs incorporated in Hong Kong in respect of the annual accounts for their financial years ending on or after 31 December 1994.

4.2 Larger RLBs and DTCs are defined for this purpose as those which currently have total assets of HK$1 billion or more or total customer deposits of HK$300 million or more (for further details see Annex B). The HKMA will contact individually those RLBs and DTCs which it considers fall within this category. To maintain consistency in reporting, RLBs and DTCs which adopt the disclosure recommendations in their 1994 accounts are expected to continue reporting on that basis notwithstanding that they may fall below the exemption thresholds in subsequent financial years. The HKMA will hold discussions with the Deposit-taking Companies Association on the applicability of the recommendations to the smaller RLBs and DTCs in respect of their 1995 accounts.

4.3 The recommendations set out in Section III are intended as a minimum standard of disclosure. Institutions which wish to disclose information in addition to that recommended in this Guide, and RLBs and DTCs below the exemption thresholds which intend to adopt the recommendations in their 1994 accounts are welcome to do so.

Compliance

4.4 The SEHK intends to require listed banks to comply with the recommendations in Section III starting with their 1994 accounts. The Listing Rules will be amended to apply the recommendations to listed banks.

4.5 While it is recognised that this Guide is not statutory, the HKMA expects non-listed locally incorporated authorised institutions to which this Guide is applicable to adopt the recommendations on a voluntary basis in drawing up their accounts for their financial years ending on or after 31 December 1994.

4.6 The HKMA is considering an amendment to the Banking Ordinance to include adequate disclosure of financial information in the annual audited accounts as a condition of authorisation.

Statement of Compliance

4.7 It is recommended that authorised institutions to which the recommendations in section III apply should include a statement in their directors' report on the extent of compliance with the Guide and the reason for any non-compliance. In cases of full compliance, a general statement that the annual accounts have complied with the recommendations of this Guide would suffice. In cases of partial compliance, the statement in the directors' report should specify the areas of, and reasons for, non-compliance.

Hong Kong Monetary Authority

September 1994

Annex A

Financial Disclosure Package for the 1994 Accounts
Guidance note on Terminology

"Banks and financial institutions" refer to institutions authorised under the Banking Ordinance and similar overseas institutions.

"Cash & balances with other banks and financial institutions" means cash in the till and demand deposits with other banks and financial institutions.

"Money at call and short notice" refers to deposits which have a fixed period of maturity of up to one month or those with a notice period of one month or less.

"Treasury bills (including Exchange Fund Bills) include all such bills regardless of maturity and including those held for dealing purposes.

"Trade bills" refer to all purchased bills of exchange in relation to trade transactions.

"Certificates of Deposit" include all Certificates of Deposit regardless of maturity (including those held for dealing purposes).

"Securities held for dealing purposes" are defined as all other money market or capital market securities held for trading.

"Advances to banks and financial institutions" include placements with banks and financial institutions of more than one year.

"Investment securities" include all other money market or capital market securities held for purposes other than dealing purposes.

"Loan Capital" refers to subordinated liabilities such as loans, debentures, floating rate notes, etc.

"Deposits & balances of other banks and financial institutions" refer to all amounts (excluding those in the form of debt securities and certificates of deposits) arising out of banking transactions owed to other banks and financial institutions.

"Issued debt securities" refer to all negotiable securities other than stocks, shares, and Certificates of Deposit.

"Gains less losses arising from dealing in foreign currencies" refer to the profits less losses from foreign exchange transactions including those from foreign exchange derivatives.

"Gains less losses from other dealing activities" include profits less losses from dealing in instruments such as securities, commodities, precious metals, derivatives based on these items and other derivatives such as interest-rate derivatives.

"Premises and equipment expense" include rents and rates, insurance of premises and equipment, lighting, heating, maintenance costs and Electronic Data Processing expenses.

"Charge for bad and doubtful debts" refers to the net amount charged or credited to the profit and loss account in respect of provisions for bad and doubtful debts and bad debt recoveries.

"Long-term investments" include investment securities and investments in associated companies.

"Group companies" refer to the following categories : the ultimate holding company, any subsidiary of the ultimate holding company (including any intermediate holding company of the institution) and any subsidiary of the institution.

Annex B

Application of the recommendations to RLBs and DTCs

Paragraph 4.1 and 4.2 of the Best Practice Guide indicate that the recommendations in the Guide are intended to apply to RLBs and DTCs which currently have total assets of HK$1 billion or more or total customer deposits of HK$300 million or more. Any RLB or DTC which meets either one of the size criteria is recommended to adopt the recommendations in the Best Practice Guide.

The HKMA intends to use the figures which RLBs and DTCs report in respect of item 21 (Total assets less provisions) and item 5.4 (Total deposits from customers) of the Return of Assets and Liabilities of an Authorised Institution (Form MA(BS)I) to determine whether a RLB or DTC meets the above size criteria. To ensure that institutions know in advance whether or not they should adopt the recommendations in the Best Practice Guide and to avoid the effects of one-off fluctuations at the end of financial year, the average of the relevant figures reported in the twelve month period up to end-August 1994 will be adopted for this purpose.

Chapter 9

Proposed Changes to the Listing Rules of the Stock Exchange

9. Summary of Recommendations

9.1 At the 100th Meeting of the Standing Committee, a discussion paper drawn up by the Stock Exchange titled : 'Proposed Changes to the Listing Rules arising from the report of the Working Group on Financial Disclosure' was tabled for information purposes only.

Background

9.2 In November 1992, the Working Group on Financial Disclosure was established. Its terms of reference were :

" (a) to review the financial disclosure requirements and identify deficiencies in the laws, rules, and regulations governing financial disclosures of listed companies in Hong Kong; and

(b) to recommend such changes to the requirements as are within the jurisdiction of the SFC and the Exchange. "

9.3 The Stock Exchange had reviewed the working group's report and was now proposing to amend its rules to adopt the

recommendations contained therein. The principle changes recommended were :

(a) more detailed information on directors enrolments and senior management compensation;

(b) more information on directors and senior management;

(c) more information on Companies Pension Schemes and costs;

(d) details of any restrictions on subsidiaries reserves or, if there are none, an express negative statement to that effect should be contained in the accounts;

(e) where candidates for listing on the Stock Exchange include valuations of property and other assets in their prospectus at the time of listing, such valuations should continue to be reflected in the issuer's financial statements;

(f) further information on the shareholder base of a company should be disclosed;

(g) more information on a company's or group's principal customers and suppliers.

(h) to phase in, over a three year period, and within a uniform framework, greater detailed analysis of a company's operations and financing;

(i) changes of auditors to be set out in the accounts;

(j) a clear statement in the accounts which accounting standards have been followed in the preparation of financial statements; and

(k) to bring the disclosure requirements of overseas companies into line with those applicable to Hong Kong companies.

9.4 Members welcomed the report and the recommendations contained in it. It was clearly a step in the right direction.

Chapter 10

Overall Review of the Companies Ordinance

10. Summary of Recommendations

10.1 At the 100th Meeting of the Standing Committee, members supported the Administration's proposal to undertake an overall review of the Companies Ordinance.

Background

10.2 In his budget speech for 1994, the Financial Secretary announced :

> " We have tried in the past to respond to developments in the corporate world through piecemeal amendment of the Companies Ordinance. I believe we have reached a stage when a thorough review has become essential. We now need an ordinance for the 21st century. I have therefore asked the Secretary for Financial Services to take this forward. "

10.3 A paper prepared by the Financial Services Branch was tabled for discussion. At Appendix 1 is a copy of the terms of reference the overall review is expected to operate within. A brief history of Hong Kong's company legislation up until the setting-up of the Company Law

Revision Committee is copied at Appendix 2. The Company Law Revision Committee presented its reports in 1971 and 1973. Many of its recommendations were included in the Companies (Amendment) Ordinance of 1984 which broadly speaking brought the Hong Kong legislation into line with the 1948 UK Companies Act. Amongst the recommendations of the CLRC was that there should be a permanent Standing Committee to advise on amendments to the Companies Ordinance as and when necessary. As a consequence the Standing Committee on Company Law Reform was set up in 1984 and has met regularly since presenting its annual report to the Governor in Council.

10.4 In support of its proposal to undertake an overall review of the companies legislation, the Administration pointed out that a number of significant changes and developments have taken place since the inception of the Standing Committee. These included :

(a) the setting up of the Securities & Futures Commission;

(b) the more prominent role played by the Stock Exchange as a regulator in the Securities sector;

(c) the dramatic increase in the numbers of private companies and the consequential difficulties of

enforcing the companies legislation against them in the event of a breach;

(d) the large numbers of listed companies which had redomiciled;

(e) the development of Hong Kong as an international financial centre;

(f) the growing numbers of Chinese enterprises seeking a listing on the Stock Exchange;

(g) the growth in trade between HK and China; and

(h) the requirement for UK to harmonise its laws, including company law which had hitherto been the model for the Hong Kong legislation, with other EC countries.

10.5 All of these factors had persuaded the Administration that an overall review was necessary. It was thought that the Standing Committee would be an inappropriate body to undertake the task given that it was a part-time committee, whose members had their own very busy work schedules. Rather, the review should be conducted on a full time and concentrated basis, by a specially appointed person or persons.

10.6 During discussion members stressed the following points :

(a) it was vital that the person tasked with the responsibility for the review should keep the Standing Committee abreast of developments to avoid duplication of work;

(b) the Standing Committee would continue to examine 'micro' issues of the Companies Ordinance rather than take a 'macro' approach which the review appeared to envision;

(c) other jurisdictions such as Australia and New Zealand had recently announced general and far reaching reviews of their companies legislation. It was timely for Hong Kong to do the same because its legislation was still largely modelled on the 1948 UK Companies Act. It was archaic and needed streamlining;

(d) the Administration had to be very wary of any politically motivated 'social engineering' which many comparable common law jurisdictions had undergone, particularly under socialist rule. Hong Kong had not thrived and become a great trading territory with its legal and commercial infrastructure defective and flawed.

10.7 When the announcement was made that Mr. Ermanno Pascutto had been appointed to undertake the task, it was agreed that he should be invited to attend all future meetings of the Standing Committee. This was to ensure that there was regular interface between his work and that of the Standing Committee and that there was no duplication of work.

10.8 The Administration advised members that it was hoped to complete the review within two years.

[CD3004]

Appendix 1

Proposed Terms of Reference for Review of the Companies Ordinance

Having regard to -

1. (1) The HKG's policy of minimum interference in the market;
   (2) the economic and legal systems in HK;
   (3) HK's status as an international financial and business centre;
   (4) the particular and unique aspects of the corporate culture in Hong Kong;
   (5) recent developments in companies law and regulation in other comparable jurisdictions; and
   (6) the existing framework of securities-related law and regulation in Hong Kong,

to consider and make recommendations on the following matters -

2. (1) The proper aims and objectives of the Companies Ordinance.

   (2) Whether private and public (and, in particular, listed) companies should continue to be subject to the same regulatory regime, under the Ordinance, in relation for example to requirements for accounts, or whether they should be the subject of distinct and separate regulation in the light of, inter alia,

      (i) developments in the role and responsibilities of the SFC since its establishment in 1989; and

(ii) the fact that 50% or more of the companies listed on the Hong Kong Stock Exchange are incorporated overseas,

and if the latter course of action is proposed, to make recommendations as to the nature of the respective regulatory regimes for private and public/listed companies;

(3) the scope for and desirability of -

(a) rationalising and simplifying the Ordinance, including a greater use of subsidiary legislation and/or administrative arrangements.

(b) streamlining and simplifying the procedures prescribed under the Ordinance, including in relation to,

(i) the incorporation of a company,

(ii) the submission of returns,

(iii) the winding-up of a company (taking into account the recommendations of the Law Reform Commission on the reform of the law relating to insolvency);

(c) codifying duties and responsibilities and stipulating minimum qualifications and capacities for company directors;

(d) including more specific statutory assistance for minority shareholders, and other persons who deal with companies, who wish to forestall, or to seek redress against, misconduct or abuses by a company and/or its directors (including through easier access to the judicial process);

(e) extending financial and other disclosure requirements, having regard also to existing non-statutory rules in respect of listed companies;

(f) rationalising and making more effective the enforcement provisions and sanctions under the Ordinance;

(g) extending regulatory powers in relation to the investigation and inspection of a company's affairs; and

(h) providing alternative forms for the constitution of a company.

(4) Whether Part XI of the Ordinance is sufficient to regulate the activities of companies incorporated overseas with a place of business in Hong Kong.

(5) The relevance with respect to Hong Kong of the development of International Business Companies.

(6) Such other matters as the Secretary for Financial Services may from time to time specify.

Appendix 2

CHAPTER 1

BACKGROUND, PRINCIPLES AND GENERAL SUMMARY

(For explanation of references see paragraphs 1.13—16 of Introduction)

I BACKGROUND

Historical survey

1.1 Until 1948 the company law of Hong Kong could, due allowance being made for a few years time lag, be said to be almost identical with that of Great Britain. The original Companies Ordinance 1865 followed closely the original Companies Act, 1862, and (leaving aside amending Ordinances) the Companies Ordinance, 1911, followed the Companies (Consolidation) Act, 1908, and the Companies Ordinance, 1932, the Companies Act, 1929.—However, since the passing of the Companies Acts of 1948 and 1967, the provisions of which, except for a few adopted in 1965 and 1972, have not been adopted in Hong Kong, a great gap has opened between our company law and that in force in Britain.

1.2 The changes made in Britain in 1948 and 1967 were almost entirely based on recommendations made in the Comprehensive Reports of two important committees, the Company Law Amendment Committee headed by Mr Justice (later Lord) COHEN, which submitted its Report in 1945, and the Company Law Committee headed by Lord Jenkins, which submitted its Report in 1962. The Companies Act 1967 did not, however, by any means implement all of the Jenkins Committee's recommendations—indeed, the greater number were left over for consideration in connection with a new comprehensive Companies Bill. This has long been expected, but owing no doubt to its length and complexity and the amount of Parliamentary time required to consider it, it has been put off from time to time. However, it has now been promised within the life of the present Parliament (i.e. before June 1975), and should therefore be presented in the fairly near future. In view of Britain's entry into the European Economic Community, it is probable that the Bill will include provisions to conform with general requirements in the Community and therefore not relevant in Hong Kong.

Australian law

1.3 In Australia, where until recent years the company law also followed closely the British law, many of the Jenkins Committee's recommendations not yet implemented in Britain have been adopted. Since 1967 Australia has had a three-member Company Law Advisory Committee, headed by Sir Richard EGGLESTON, charged with the duty of reporting to the Standing Committee of Attorneys General on provisions considered necessary to increase the protection afforded to the investing public by the Companies Acts. The Advisory Committee has submitted seven separate Reports dealing respectively with accounts and audit; disclosure of substantial shareholdings and takeovers; special investigations; insider dealings; the control of fund raising, share capital and debentures; share hawking; and the registration of charges. A large number of the recommendations in these have been adopted by the States, and there are therefore many subjects in which Australian company law now differs substantially from the British law.

Local conditions

1.4 In 1948, when the last complete revision and consolidation of British company legislation was effected, there were in Hong Kong only about 2,000 companies on the register, and until 1957 new incorporations were running at the rate of only two or three hundred a year. From then on, as the industrial and commercial development of the Colony gained pace, the numbers of incorporations have risen steeply, and with 1972 seeing a record number of 4,310 new companies the grand total of companies on the register at the end of that year was over 26,000. In the immediate post-war years there were only just over 40 companies quoted on the Hong Kong Stock Exchange, and there were few among them which had important trading subsidiaries. This situation continued until well into the 1960s, and as late as 1968 there were only about 60 companies quoted on the Stock Exchange. However, following upon the rapid expansion and diversification of their businesses, more and more companies have 'gone public', with the result that there are now some 260 local companies quoted on the Colony's four stock exchanges. It has moreover become increasingly common for such companies, in addition to carrying on their original business in the Colony, to operate other businesses through subsidiaries or in association with other companies.

1.5 From the foregoing it will be gathered that for several years after the enactment in Britain of the Companies Act, 1948, the provisions of the Companies Ordinance, 1932, based on those of the 1929 Act, were reasonably adequate under local conditions. These conditions have, however, since undergone great changes, and it has been clear for many years that the relatively simple provisions of the

Ordinance are no longer adequate, especially in view of the vastly increased participation by members of all classes of the population in the ownership of public companies. There are therefore a great many changes which must now be made in company law in order to provide a sound basis for the proper management of the Colony's corporate enterprises, and effective safeguards for the protection of all those who invest in them.

Chapter 11

Registration of Company Charges

11. Summary of Recommendations

11.1 At the 101st and 104th Meetings of the Standing Committee, members agreed that no legislative changes should be effected to Part III of the Companies Ordinance which dealt with the Registration of Company Charges. However, members agreed to keep the matter under review and to await the outcome of a further consultation exercise currently being undertaken in the UK by the Department of Trade and Industry (DTI) on the same subject.

Background

11.2 In 1991, the Standing Committee agreed in principle that provisions similar to Part IV of the 1989 UK Companies Act which have yet to be brought into force should be enacted in Hong Kong. However, many difficulties have since been identified in the draft legislation which must be overcome before a new system of registration of charges for companies can be introduced. These difficulties include :

(a) the amount of detail to be included in the charge particulars delivered for registration (having regard

to the need to computerise the registration facilities and the amount of information required by searchers);

(b) the transitional and savings provisions for charges registered under the present registration scheme;

(c) how the new provisions should apply to overseas companies; and

(d) the interrelationship between the company charges and the land registration system.

11.3 The report of the working party commissioned by the Department of Trade and Industry to undertake a review of the new system was before members during discussions. One of the main stumbling blocks to the implementation of the new registration system was the potentially adverse impact the proposal to abolish the conclusive nature of the Registrar of Companies Certificate, would have upon the integrity of the land registration system. This was because the Land Registrars relied upon that certificate where it related to company charges over land requiring registration under the Land Registration Acts. The disappearance of the certificate, coupled with the sanction of partial avoidance (this was one of the other proposals in the draft legislation) would mean that the

Land Registrars could no longer assume that company charges over land presented to them for registration were guaranteed against avoidance under the Companies Act. As Hong Kong was about to introduce a Land Titles Bill setting up a land registration system those same difficulties would have to be addressed.

11.4 During the debate, members felt that any new legislation had to be a demonstrable improvement on the existing provisions. Given the importance of land and the role it played in the economy of Hong Kong, it was vital that the problems referred to in the DTI report should be resolved before proceeding further.

11.5 Other members felt that the present system was now working well. The Registrar of Companies had introduced a whole series of administrative procedures which had greatly reduced the length of time necessary to complete registration formalities - from 6 to 7 weeks down to 10 workings days.

11.6 A further discussion paper was tabled at the 104th Meeting. The proposals for reform were still being considered by the DTI. The position would therefore be kept under review.

Chapter 12

Alternate Directors

12. Summary of Recommendations

12.1 This subject was discussed at the 103rd and 104th Meetings of the Standing Committee when, in view of the differing views and opinions of members on whether the role and activities of Alternate Directors needed to be regulated in law, it was decided to refer the matter to the Financial Services Branch for further consideration.

Background

12.2 At the request of a member, the Standing Committee considered the role of Alternate Directors in companies, with particular regard to the disclosure of directors remuneration and loans provided to them. It was thought that the word 'director' as defined in the Companies Ordinance left in doubt whether an alternate director was a director for all purposes under the ordinance.

12.3 Section 2 of the Companies Ordinance defines a director as any person occupying the position of director by whatever name called. Unlike the UK or Australia there are no provisions in the ordinance or its subsidiary legislation

governing the appointment of alternate directors. Pennington on Company law, sixth edition page 553 has described the position of alternate directors as follows :

" It would appear that an alternate director is a director of the Company for all purposes of the Companies Act 1985 and that all its provisions apply to him accordingly. Consequently, an alternate director may become disqualified from being or acting as a director in the same way and for the same causes as a director appointed in the normal manner and he is subject to the same prohibitions and restrictions as are imposed by the Companies Act 1985 on normally appointed directors. It is also certain that the fiduciary and other duties toward their company which are imposed on directors at common law and in equity are also imposed on alternate directors which they are acting in that capacity. "

12.4 During the course of discussions, it was pointed out that alternate directors were frequently appointed in Hong Kong. It was also common to include specific provisions for their appointment in the Articles of Association notwithstanding the fact that Table A of the First Schedule was silent on the subject. Certain members considered that when alternate directors were appointed, all the normal common law duties of care and fiduciary

duties owed to the company were equally applicable to them. This included for alternate directors of listed companies questions such as the obligation to disclose their shareholdings and their duties with regard to insider trading. It was pointed out, however, that it was rare to find alternate directors who had signed those documents which had to be filed with the stock exchange. Only when a company had been listed for some time did the question of the appointment of alternate directors arise. Even then it was usually in connection with their appointment as nominees for significant shareholders of the company.

12.5 Other members believed that unless and until the role and duties of primary directors were codified and defined, there was little point in seeking to do so for alternate directors, whose role and duties hitherto, like those for primary directors, had been developed by the courts. Although codification of directors duties had been rejected by LegCo in 1991, the Institute of Directors had agreed at the request of the Administration to prepare and circulate to its members guidelines for directors concerning the conduct of a company's affairs. Some members expressed concern that those guidelines were still unavailable and proposed that the issue of codification of directors duties should be revisited if they were not published by the end of the year.

Chapter 13

Execution of a Company's Documents

13. Summary of Recommendations

13.1 At the 101st Meeting of the Standing Committee, members recommended that there should be no changes to the current legislative regime governing the execution of a company's contracts provided for by Section 32 of the Companies Ordinance (CO)

Background

13.2 Section 32 of the CO provides that contracts on behalf of a company may only be made in the following manner :

" (a) a contract, which if made between private persons would be required by law to be in writing and under seal, may only be made on behalf of the company in writing under the common seal of the company;

(b) a contract, which if made between private persons would be by law required to be in writing, signed by the parties to be charged therewith, may be made on behalf of the company in writing signed by any person acting under its authority, express or impled;

(c) a contract which if made between private persons would by law be valid although made by parol only, and not reduced into writing, may be made by parol on behalf of the company acting under its authority, express or implied. "

These provisions are largely modelled on Section 36 of the 1985 UK Companies Act which had its genesis in similar provisions contained in the 1929 and 1948 UK Companies Acts.

13.3 The 1989 UK Companies Act replaced Section 36 of the 1985 Act with a new Section 36A. The major change brought about by this amendment was to permit two directors (or a director and a secretary) of the company to execute a document on behalf of the company by signature alone provided it was expressed in the document that it was done for and on behalf of the company. No seal was necessary.

13.4 During the course of discussion members felt that the present system of execution of a company's documents in Hong Kong was working well. The execution of documents under seal was considered an important ritual in corporate life, more so than in the UK, and which should therefore remain undisturbed. A further consideration was that, Hong Kong unlike the UK was geographically compact, and

therefore the problems of having to possibly despatch documents to far away destinations did not arise. In addition modern company seals were now compact and easy to handle in sharp contrast to their predecessors.

13.5 Further enquiries with the DTI in London disclosed that the new system for the execution of documents was working well though, with regard to the sealing of share transfers, company seals were still required. This was because the 1963 UK Stock Transfer Act which mandated the use of company seals had not been amended in conjunction with the 1989 UK Companies Act.

Chapter 14

Accounts Preparation and Audit Requirement : Amendments to Sections 122(1) & 122(2) of the Companies Ordinance (CO)

14. Summary of Recommendations

14.1 At the 103rd Meeting of the Standing Committee, members endorsed the proposal to amend Sections 122(1) and 122(2) of the CO along the lines of Sections 224 to 227 and Section 236 of the 1985 UK Companies Act to include firstly the imposition of an accounting reference period and secondly to provide that a company's accounts could be laid at any general meeting of the company, not just the annual general meeting. Public companies would be required to file notice of their accounting reference date with the Registrar of Companies whilst private companies, because there was no obligation to file their accounts with the Registrar of Companies, should be obliged to notify their shareholders of the accounting reference date.

Background

14.2 Under Section 122(1) of the CO directors were obliged to lay before the company at its AGM a profit and loss account. The court was empowered, upon application, to direct that they could be laid before some other meeting

of the company if there were appropriate reasons. The accounting period, in respect of the first set of accounts, dated from incorporation and subsequent accounts dated from the preceding accounts. They must be made up to a date not earlier than 6 months before the date of the AGM or, in the case of a private company and a company limited by guarantee not more than 9 months before the date of the meeting. Similar provisions applied in respect of the preparation of the balance sheet which had the same accounting period as the profit and loss account.

14.3 In the UK, a company is permitted to give notice to the Registrar of Companies within 9 months of incorporation specifying a date on which, in each calendar year, the accounting reference period of the company is to end. If the company gives such a notice, then the specified date becomes the accounting reference date. If no notice is given, the accounting reference date is 31 March. There are provisions which enable a company to alter its current and all subsequent accounting reference periods by giving notice to the Registrar of Companies at any time in the course of a period specifying a new reference date.

14.4 The member who suggested the amendment made the following submission :

" The account requirement of a company should be

independent of whether an Annual General Meeting is held, which is purely a secretarial matter. Consideration should be given to having the accounts preparation and audit requirements into a separate section in the Companies Ordinance following a set-up similar to the 'UKCA' 1985 (Sections 224 to 227 and Section 236) including imposing a requirement of accounting reference period. Further the accounts may be laid at any general meeting instead of the Annual General Meeting. "

14.5 Members felt that the proposals would be more flexible than the existing statutory regime and should therefore be supported.

Chapter 15

Charitable and other Donations : Sections 129D(3)(d) and (e) of the Companies Ordinance (CO)

15. Summary of Recommendations

15.1 At the 102nd Meeting of the Standing Committee, members supported the proposal to upwardly revise the amounts of charitable and other donations a company and its subsidiaries should be entitled to make from HK$1,000.00 to HK$10,000.00 without having to stipulate the fact in the directors report which had to be attached to a company's accounts when laid at its AGM.

Background

15.2 Section 129D(1) of the CO requires that a report by the directors dealing with the profit and loss of the company and the state of affairs of the company as at the end of the financial year must be attached to every balance sheet laid before the company in general meeting. 129D(3) stipulates that the report must include donations for charitable or other purposes in excess of HK$1,000.00. A proposal was submitted by the Hong Kong Society of Accountants to upwardly revise this sum to HK$10,000.00 given the high rates of inflation which have been a

feature of Hong Kong's economic life for some time.

15.3 Some members thought that the directors report was an important tool to ensure that a company's money was being properly expended. Very many companies had turnovers in billions of dollars and whilst charitable donations, small by comparison, would be recorded in the books of account, they would not be itemised in the balance sheet. Other members expressed concern at the phrase 'other purposes' contained in Section 129D(3) and wondered if it could be used to justify the payment of bribes. It was pointed out however that a company's money could only be expended for a lawful purpose and that the payment of bribes, being a criminal offence, would be 'ultra vires' the company.

15.4 The question of whether to include a provision in the Companies Ordinance which would automatically trigger a rise in the fees and fines provided for in line with the rise in inflation was also considered. After discussion it was thought appropriate to leave this question to the person who was to be responsible for the overall review of the Companies Ordinance.

Chapter 16

Amendment to the 1988 Capital Accord for Bilateral Netting

16.1 At the 102nd Meeting of the Standing Committee, a paper was tabled by the Hong Kong Monetary Authority (HKMA) setting out its views on the amendments to the 1988 capital accord for bilateral netting. Under the present capital accord, there was only limited recognition of bilateral netting for the purposes of calculating capital requirements on off-balance sheet interest rate and exchange rate contracts. The Basle Committee on Banking Supervision had issued an amendment (copy at Appendix 1) that broadened the recognition of bilateral netting for capital adequacy purposes. In view of this the HKMA intended to amend its capital adequacy framework.

16.2 The Company & Financial Law Committee of the Law Society of Hong Kong had confirmed that for authorised institutions Hong Kong law on the netting of counterparty exposure was the same as the statement of law issued by the Financial Law Panel in London in November 1993. This meant that :

(a) in an insolvent liquidation of a company where there have been mutual debits and credits or other mutual dealings between the company and another party, set-off applies; and

(b) only the net balance is required to be paid to the liquidator or proved for in the liquidation.

16.3 The HKMA was therefore proposing to introduce a wider recognition of bilateral netting into the capital adequacy framework provided certain conditions were met. These included :

(a) that the contract was in writing;

(b) that the contract created either a single claim or obligation to receive or pay a sum certain following a default or insolvency in respect of those off-balance sheet transactions;

(c) that the authorised institution obtained a confirmatory legal opinion that its netting agreements were enforceable not only in Hong Kong but also in the jurisdiction where the counterparty is chartered or, if a branch, in the jurisdiction where the branch was located.

(d) that the authorised institution continually monitored changes in the relevant law to ensure that their netting contract continued to be enforceable;

(e) that the contract was not subject to a walk away clause; and

(f) that adequate file documentation was kept to support the netting of an off-balance sheet rate contract.

16.4 If bilateral netting was permissible under Hong Kong law (and this appeared to be the position), this would clearly benefit Hong Kong as a financial centre given that business would gravitate to those centres where it was permitted. Members were supportive of these developments. A confirmatory legal opinion that netting was permissible under Hong Kong law was necessary to reassure not only the HKMA but also overseas regulators. In the USA, for example, specific legislation had been enacted to deal with off balance sheet transactions. A similar legislative approach was not ruled out in Hong Kong but at the moment this did not appear necessary given the confirmatory legal opinion received by the HKMA from the Hong Kong Law Society.

Appendix 1

Amendment to the 1988 Capital Accord for bilateral netting

In the last sentence of the first paragraph on page 28 (Annex 3) of the 1988 Capital Accord the word "are" is replaced with "may be".

The language below replaces page 30 (Annex 3) of the 1988 Capital Accord in respect of the recognition of bilateral netting for the purpose of calculating capital requirements. The footnote numbers are as they would appear in the revised Capital Accord.

"Careful consideration has been given to the issue of bilateral netting, i.e., weighting the net rather than the gross claims with the same counterparties arising out of the full range of forwards, swaps, options and similar derivative contracts.[6] The Committee is concerned that if a liquidator of a failed counterparty has (or may have) the right to unbundle netted contracts, demanding performance on those contracts favourable to the failed counterparty and defaulting on unfavourable contracts, there is no reduction in counterparty risk.

Accordingly, it has been agreed for capital adequacy purposes that:

(a) Banks may net transactions subject to novation under which any obligation between a bank and its counterparty to deliver a given currency on a given value date is automatically amalgamated with all other obligations for the same currency and value date, legally substituting one single amount for the previous gross obligations.

(b) Banks may also net transactions subject to any legally valid form of bilateral netting not covered in (a), including other forms of novation.

(c) In both cases (a) and (b), a bank will need to satisfy its national supervisor that it has:[7]

(1) a netting contract or agreement with the counterparty which creates a single legal obligation, covering all included transactions, such that the bank would have either a claim to receive or obligation to pay only the net sum of the positive and negative mark-to-market values of included individual

6 Payments netting, which is designed to reduce the operational costs of daily settlements, will not be recognised in the capital framework since the counterparty's gross obligations are not in any way affected.

7 In cases where an agreement as described in (a) has been recognised prior to July 1994, the supervisor will determine whether any additional steps are necessary to satisfy itself that the agreement meets the requirements set out below.

transactions in the event a counterparty fails to perform due to any of the following: default, bankruptcy, liquidation or similar circumstances;

(2) written and reasoned legal opinions that, in the event of a legal challenge, the relevant courts and administrative authorities would find the bank's exposure to be such a net amount under:

- the law of the jurisdiction in which the counterparty is chartered and, if the foreign branch of a counterparty is involved, then also under the law of the jurisdiction in which the branch is located;
- the law that governs the individual transactions; and
- the law that governs any contract or agreement necessary to effect the netting.

The national supervisor, after consultation when necessary with other relevant supervisors, must be satisfied that the netting is enforceable under the laws of each of the relevant jurisdictions;[8]

(3) procedures in place to ensure that the legal characteristics of netting arrangements are kept under review in the light of possible changes in relevant law.

Contracts containing walkaway clauses will not be eligible for netting for the purpose of calculating capital requirements pursuant to this Accord. A walkaway clause is a provision which permits a non-defaulting counterparty to make only limited payments, or no payment at all, to the estate of a defaulter, even if the defaulter is a net creditor.

For banks using the current exposure method, credit exposure on bilaterally netted forward transactions will be calculated as the sum of the net mark-to-market replacement cost, if positive, plus an add-on based on the notional underlying principal.[9] The scale of add-ons to apply will be the same as those for non-netted transactions as set out in this Annex. The Committee will continue to review the scale of add-ons to make sure they are appropriate. For purposes of calculating potential future credit exposure to a netting counterparty for forward foreign exchange contracts and other similar contracts in which notional principal is equivalent to cash flows, notional principal is defined as the net receipts falling due on each value date in each currency. The reason for this is that offsetting contracts in the same currency maturing on the same date will have lower potential future exposure as well as lower current exposure.

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8 Thus, if any of these supervisors is dissatisfied about enforceability under its laws, the netting contract or agreement will not meet this condition and neither counterparty could obtain supervisory benefit.

9 Supervisors will take care to ensure that the add-ons are based on effective rather than apparent notional amounts.

The original exposure method may also be used for transactions subject to netting agreements which meet the above legal requirements until market risk-related capital requirements are implemented, at which time the original exposure method will cease to be available for banks supervised according to this Accord[10]. The conversion factors to be used during the transitional period when calculating the credit exposure of bilaterally netted transactions will be as follows:

Maturity	Interest rate contracts	Exchange rate contracts
Less than one year	0.35%	1.5%
One year and less than two years	0.75%	3.75% (*i.e.* 1.5% + 2.25%)
For each additional year	0.75%	2.25%

These factors represent a reduction of approximately 25% from those on page 29 of the Accord. For purposes of calculating the credit exposure to a netting counterparty during the transitional period for forward foreign exchange contracts and other similar contracts in which notional principal is equivalent to cash flows, the credit conversion factors on page 29 of the Accord could be applied to the notional principal, which would be defined as the net receipts falling due on each value date in each currency. In no case could the reduced factors above be applied to net notional amounts."

10 Where appropriate, national supervisors may allow an additional transition period, but in no case longer than 12 months.

Chapter 17

Company Inspections :
Sections 142 to 152F of the Companies Ordinance (CO)

17. Summary of Recommendations

17.1 At the 101st Meeting of the Standing Committee members concluded that the existing legislative framework governing the appointment of Inspectors by the Financial Secretary to undertake Company Inspections was adequate and did not require alteration. In addition members believed that the current procedures under which inspectors operated were fair and reasonable.

Background

17.2 The powers conferred on the Financial Secretary under the CO to appoint inspectors have several purposes including the protection of shareholders and others from the fraudulent misconduct by directors of a company. Under Section 143(1)(a) of the CO the Financial Secretary is required to appoint one or more Inspectors if a court declares that a company's affairs ought to be investigated. Other provisions also govern their appointment either on application by the shareholders or indeed on the Financial Secretary's own initiative if the circumstances warrant it.

17.3 On the conclusion of the investigation the Inspector is obliged to report to the Financial Secretary with his findings. As Palmer on Company law, 22nd edition, pages 74-12 has put it :

" The report is not itself a legal decision, nor are the opinions of the inspector expressed therein binding upon any person in the manner that a judgement of the court is. It is merely an expression of the findings and opinions of the inspector. "

17.4 Arising out of the report the Financial Secretary may decide to :

" (a) prosecute any wrongdoers under the criminal law if there are grounds to do so; or

(b) wind up the company in the public interest; or

(c) bring civil proceedings in the name of the company. "

17.5 Mr. David Pannick, Q.C., an eminent UK lawyer, has called for legislation to curb the powers of Inspectors appointed under equivalent UK provisions. (Please refer to his article in the 29 March 1994 issue of the Times

Newspaper.) Of major concern to Mr. Pannick was the way in which evidence was collected by Inspectors - they can rely on hearsay evidence; the person being investigated has no right to see all the material relied on or to cross-examine those who make allegations but only to know the substance of the changes. He thought this was wrong and that there was a case for the reform of the law to confine the discretionary powers of inspectors and to impose higher standards of procedural fairness.

17.6 During discussions, members considered that the issue was extremely important given that regulators in Hong Kong were becoming increasingly strict about the way in which the affairs of companies were being conducted. However, a balance had to be struck between, on the one hand, giving inspectors the power to properly investigate and, on the other, ensuring that the rights of those directly affected by the investigation were respected. Concerns were expressed that if new procedural requirements (as Mr. Pannick proposed) were enacted, they would provide those with the motive of obstructing inspectors with the additional means of doing so. This would prevent Inspectors from completing their work in a timely manner and at a reasonable cost. Experience had taught that company investigations were already large, complex and very expensive and new procedural requirements would add to them all.

17.7 Members who had been involved in inspections in Hong Kong were of the view that hitherto inspectors had not acted oppressively. Great care had been taken in the use of 'hearsay evidence' and invariably reference was made to its use in the inspectors reports. In addition if an inspector intended to criticise somebody in his report, that person was first given an opportunity of responding. As a result, there was a general reluctance to curb the present powers of inspectors. Rather, given the history of inspections and the difficulties of obtaining evidence especially in insider dealing cases, several members believed that there was a case for widening their powers.

Chapter 18

Amendments to the Companies Ordinance

18. Background

18.1 At the 100th Meeting of the Standing Committee, members supported the Chairman's suggestion that the professional, commercial and business sectors of Hong Kong should be invited to submit a list of possible amendments to Hong Kong's company's legislation. The Chairman believed, and members agreed, that the business community should be invited to adopt a more pro-active role in initiating legislative changes to the current legal framework.

18.2 At Appendix 1 is a list of suggested topics for discussion put forward by some of those consulted. Some of these subjects have already been discussed at meetings and recommendations have been made. The remaining items will be tabled for discussion at future meetings.

Suggested amendments to the Companies Ordinance

Item No.	Subject Matter	Proposed by
1.	The harmonisation of Sections 140A(2)(a) and 140A(3)(b) to enable creditors as well as members to receive the auditors resignation statement.	Marvin K.T. Cheung
2.	To clarify whether the profit and loss on the disposal of investments constitute income under paragraph 13(1)(g) of the Tenth Schedule.	Marvin K.T. Cheung
3.	To consider the repeal of Sections 141A and 141B which contain special provisions for financial accounts for the years ending before 30.9.75 and for the first final year ending after 29.9.75 respectively.	Marvin K.T. Cheung

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Item No.	Subject Matter	Proposed by
4.	To amend Section 157H (prohibition of loans to and guarantees on behalf of directors by companies) to allow for shareholders in private companies to ratify retrospectively the provision of security.	HKAB
5.	To simplify the procedures for corporate authorisation with regard to the execution of documents. To modernise company administration by e.g. allowing for the execution of minutes by fax, holding meetings by telephone etc.	HKAB
6.	To provide for "migration provisions" to permit the change of a company's incorporation to another jurisdiction whilst remaining the same legal entity.	HKAB

Item No.	Subject Matter	Proposed by
7.	Reviewing the provisions of 'Table A' and in particular regulation 81 which contains restrictions on borrowing and the creation of security by companies.	HKAB
8.	To update the financial disclosure requirements set out in the Tenth Schedule and in Section 161.	SEHK
9.	With regard to the issue of Prospectuses, to harmonise the provisions set out in the Third Schedule with those contained in the listing rules.	SEHK
10.	To consider a separate ordinance for public or listed companies which would include provisions to regulate financial advisers with regard to public offerings.	SEHK

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Item No.	Subject Matter	Proposed by
11.	To consider the repeal of Sections 123(4) and 126(3) which empower the Financial Secretary to override statutory accounts disclosure requirements.	HKSA
12.	To amend Section 126(2) to allow for the consolidation of the financial statements of a subsidiary drawn up to the same date as the holding company.	HKSA
13.	To amend Section 141 to require an auditor to consider whether the information given in the directors report is consistent with the audited accounts.	HKSA
14.	To amend Section 141C to confine the Auditors Report to the audited financial statements and not, in addition, to the directors report.	HKSA

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Item No.	Subject Matter	Proposed by
15.	To modify the audit report requirements with regard to exempt companies under Part III of the Tenth Schedule and Section 141D.	HKSA
16.	To consider reducing the minimum number of shareholders required by a company from 2 to 1.	HKSA
17.	To consider the definition of a 'Private company' with regard to overseas companies under Section 336(6).	HKSA
18.	To amend Section 239 to provide for a certificate of dissolution either automatically or upon request, once the liquidation process is complete.	HKSA
19.	To amend 33A to provide for a shorter period with regard to the retention of an authorised representative once an overseas company has been de-registered.	HKSA

Item No.	Subject Matter	Proposed by
20.	To introduce statutory backing for accounting standards.	HKSA
21.	To update and revise Schedule 10 and other accounts disclosure requirements.	HKSA
22.	To review the position of overseas incorporated companies whose operations are undertaken within Hong Kong.	HKSA
23.	To amend Section 209B(b) by deleting the references to Sections 182, 183 and 186.	Bar Association
24.	To consider the harmonisation of Sections 157I(3)(b) and 157I(2) - the former negatives the effect of the latter.	Bar Association
25.	To extend the provisions of Section 168A (the alternative remedy to winding-up in cases of prejudice) to companies incorporated	Bar Association

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Item No.	Subject Matter	Proposed by
	overseas.	
26.	To consider amending the definition of 'place of business' in Section 341.	Bar Association
27.	In respect of listed companies, and with the advent of a central clearing system, to amend Section 71A by providing for a simple letter of indemnity to replace the current procedural regime.	ICSA
28.	To allow for subsequent alterations to a company's Articles of Association to be registered by way of reprinted articles.	ICSA
29.	To amend Section 158(5) to repeal the reference to the minimum age requirement for a director which is already contained in Section 157C.	ICSA

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Item No.	Subject Matter	Proposed by
30.	To consider the repeal of Section 157D(3) - the filing of notice of a director's resignation.	ICSA
31.	To extend the requirements of Form III of the Companies (Forms) regulations (pursuant to Section 55) to all alterations of capital provided for under Section 53.	ICSA
32.	To amend the reporting requirements on the allotment of shares and to extend the general meeting consent with regard thereto.	ICSA
33.	To alter Section 18(2) to provide that all statutory declarations be made by professional company secretaries, solicitors or professional accountants.	ICSA
34.	To amend Section 233 to allow for the statutory declaration regarding solvency to be sanctioned by way of a board resolution.	ICSA

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Item No.	Subject Matter	Proposed by
35.	To disallow Articles of Association from providing that the business of a company can be undertaken by the resolution of the majority of directors, in lieu of a properly convened meeting.	ICSA
36.	To consider amendments to Section 111 to enable private companies to dispense with AGMs or to introduce provisions to enable the business of an AGM to be undertaken by way of written resolutions.	ICSA
37.	To clarify the statutory meaning of Section 116B which provides that resolutions signed by all the members are deemed to have been passed at duly convened meetings of the company.	ICSA

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Chapter 19

Recommended Practice on Independent Non-Executive Directors (ID)

19. Background

19.1 At the 104th Meeting of the Standing Committee a paper titled : Recommended practice on ID was tabled for discussion. This had been drawn up by the Stock Exchange of Hong Kong to offer basic guidance on the qualifications, appointment and the role of ID to the boards of listed companies. A copy of the paper is at Appendix 1.

19.2 The objective underlying the recommendation by the Stock Exchange for the appointment of such directors was to enhance the effectiveness and professionalism of the boards of listed companies in Hong Kong. Improved corporate governance would assist in maintaining Hong Kong's position as a respected financial centre.

19.3 During the course of the discussions members were advised that another objective of the recommendations was to tackle the difficult and thorny issue of 'connected transactions'. When a listed company was involved in such transactions, ID were expected to act as independent watchdogs to ensure that the interests of the company and its shareholders were protected.

19.4 Some members pointed out that in the USA and certain other western countries, it was common to have more ID than executive directors on the main board. They provided real supervision over a company's affairs and whilst Hong Kong lagged behind many other countries in this regard, the proposals of the Stock Exchange were clearly a step in the right direction. Their recommended tenure should be for at least two and not more than four years duration. ID could be removed by the board for the same reasons as any other director e.g. breach of fiduciary duty.

19.5 Members endorsed the recommendations set out in the paper. They hoped it would help to improve the standards of corporate governance and business ethics in Hong Kong.

Standing Committee on Company Law Reform

THE STOCK EXCHANGE OF HONG KONG LIMITED

RECOMMENDED PRACTICE ON INDEPENDENT NON-EXECUTIVE DIRECTORS

In the commentary that follows, basic guidance on qualifications, appointment and the role of independent non-executive directors is provided to help boards of listed companies approach the requirement for appointing independent non-executive directors with greater clarity and assurance.

Please note at the outset, as a matter of importance, that this commentary does not amend or supersede and is not part of the Listing Rules nor does it displace the general law applying to directors of companies nor is it a substitute for legal advice.

1. QUALIFICATIONS

1.1 Character and Integrity

Each director, whether executive or non-executive and, in the latter case, whether independent or not, has a fiduciary duty to the company. The duty requires the director to display the utmost good faith and honesty in all his dealings with the Company or on its behalf and prohibits the director from putting his or her personal or business interests, or those of others, above the interests of the company.

Prior to appointing a candidate to the directorship, the board must be satisfied that the candidate has the high degree of character and integrity that would reasonably be expected of one who must meet a fiduciary's duty.

1.2 Independence

Generally, any relationship with the company or others, or any personal interests, that could prevent directors from objectively exercising their informed judgment will bring into question their independence. Thus, independence is more likely to be questioned if the director:-

- owes allegiance to a particular shareholder or group of shareholders;
- is on the board specifically to protect the interests of a third party;
- is or was connected to a director, the chief executive or substantial shareholders;
- holds more than one percent of the total issued share capital;

- relies for his or her livelihood on his or her remuneration as a director;
- is a current or former executive of the listed company; or
- has or had a financial or other interest in the business of the company or its subsidiaries.

This list should not be considered exhaustive as other factors affecting one's independence may certainly arise.

1.3 Experience

Each director, including a non-executive director, has a duty to act with reasonable skill, care and diligence in the affairs of the company. Relevant experience, which may be experience gained in a different industry or business, and a mature sense of judgment help to ensure that the director will be able to discharge this duty. Complementary skills and experience balancing those of the overall board would be particularly valuable. Moreover, in order to be effective during board deliberations a director should possess the experience and judgment needed to gain the confidence and respect of fellow board members.

2. APPOINTMENT

Independent non-executive directors should be recruited against a full specification, be formally appointed by a formal and objective process and enjoy fixed tenure. This guards against appointment by a faction and against arbitrary removal from office. Conditions of appointment, including as regards tenure and remuneration, should be set out in a written appointment letter.

Reappointment should not be automatic. Termination by the company of a non-executive director's appointment during tenure should only be possible by decision of the full board and in the event of a material breach of contract. Tenure should not be overlengthy, as it might become difficult for the non-executive director to sustain full independence and objectivity over time. A period of two to four years is generally recommended.

Before accepting appointment, an intending independent non-executive director should understand the commitment that will be required in terms of time, effort and responsibility. Acceptance should not be lightly considered. It must be understood by all that independent non-executive directors, regardless of whether they are appointed for their expertise or professional skills in a particular area, must actively participate and contribute substantively to the overall work of the board.

3. ROLE OF THE INDEPENDENT NON-EXECUTIVE DIRECTOR

The law does not distinguish between executive directors and non-executive directors. All directors bear the same principal responsibility to promote the best interests of the company and its shareholders in directing the company's business and affairs. All directors have the duty to act honestly and in good faith exercising due skill, care and diligence. An essential role of the independent non-executive director is to help ensure that the interests of all shareholders, and not only the interests of a particular faction or group, are indeed taken into account by the board.

A second important role of the independent non-executive director is to help ensure that the relevant issues are subjected to objective and dispassionate consideration by the board. To assist the director in this role he or she must receive the same quality and level of information as any executive director. The independent non-executive director is entitled to ask for relevant information and to receive the same in sufficient time to enable him or herself to make a fully informed contribution to discussions at board meetings.

A third important role, again shared by all directors alike, is supervision of management. Generally, supervision of management involves formulating and establishing policies and procedures covering significant areas of the company's operations, monitoring the implementation by management of those policies and procedures and when prudent or necessary providing for independent third party review and testing of compliance with board policies and procedures, applicable laws and regulations and the completeness and accuracy of information provided by management. This is not to say that the non-executive director will be involved in day-to-day operational matters, but he should be expected and encouraged to speak out firmly on these issues from a supervisory perspective and one independent of management.

In light of the above, you may wish to consider whether your existing arrangements with any independent non-executive director already on your board should be altered or otherwise formalised.

It is hoped that by their presence, independent non-executive directors will add to the effectiveness and professionalism of the boards of listed companies in Hong Kong, and that improved standards of corporate governance will aid in maintaining Hong Kong's position as a respected international financial centre.

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Hong Kong, 22nd November, 1994

Chapter 20

Tenth Annual Report of the Standing Committee on Company Law Reform

20. Background

20.1 The Tenth Annual Report was tabled before ExCo on 26 July 1994 and before LegCo on 28 July 1994. It was circulated to the professional, business and commercial bodies of Hong Kong on 9 September 1994, following on from which a number of responses had been received and which were tabled for discussion at 103rd Meeting of the Standing Committee.

20.2 The Hong Kong Association of Banks (HKAB) was requesting the Standing Committee to reconsider its decision not to include in the Disqualification of Directors legislation provisions similar to Section 600 of the Australian Companies Code. Broadly speaking, this provision applied to a person who had been a director of two or more companies which had been wound up as insolvent within 7 years of each other and where the ordinary unsecured creditors had received less than a 50% dividend. During discussions, the Official Receiver advised that HKAB had possibly overlooked Part IVA of the Companies Ordinance which came into effect on 30 May 1994. A director could be reported as being unfit even if he was involved with only one insolvent company and this could include the

level of a company's insolvency. The position was being monitored by the Official Receiver and a report would be tabled before the Standing Committee on how the disqualification of directors provisions were being interpreted by the courts.

20.3 The Hong Kong Society of Accountants (HKSA) requested that the Stock Exchange should implement the recommendations of the Cadbury Report on Audit Committees. However, the listing committee of the Stock Exchange had reviewed the recommendations and concluded that it would be inappropriate for them to be adopted in full. The commercial climate in Hong Kong was different from that of the UK.

20.4 The HKSA had asked the Standing Committee to review the twin questions of the inner reserves of banks and the disclosure requirements set out in the Tenth Schedule. However, the Hong Kong Monetary Authority hoped to be in a position to come to a view on the issue once it had completed a review and consultation exercise.

20.5 The HKSA disagreed with the Administration's proposal to raise the limits for preferential payments of wages etc. to former employees to the levels set out in the Protection of Wages on Insolvency Ordinance. However, the question was still under consideration within Government.

20.6 The HKSA has suggested that the financial disclosure requirements set out in the Companies Ordinance should be updated in line with the best practice guide issued by the HKMA to authorised institutions on financial disclosure. As the listing rules were also being updated to demand greater financial transparency in the accounts of listed companies, it was sensible to bring the Tenth Schedule into line.