

HONG KONG COMPANIES ORDINANCE: THE SIGNIFICANT CONTROLLERS REGISTER REGIME

From 1 March 2018, Hong Kong incorporated companies (unless exempt) will be required to maintain a register of individuals and/or certain legal entities with significant control over them, namely the significant controllers register (SC register). Non-compliance with the SC register requirements is a criminal offence.

This means corporate groups with Hong Kong entities should carry out a "SC register analysis" for each applicable Hong Kong company in their group structure. This briefing will share some practical tips to help you carry out the analysis. It also discusses the consequences for M&A and banking transactions.

WHICH COMPANY HAS TO KEEP A SC REGISTER?

The SC register requirements, which are contained in a new Division 2A of Part 12 of the Companies Ordinance (CO), apply to all companies formed and registered under the CO, namely, companies limited by shares, companies limited by guarantee and unlimited companies. The requirements do not apply to overseas companies or their registered branches in Hong Kong. Companies which have their shares listed on the Stock Exchange of Hong Kong (SEHK) are also exempted.

The SC register is not open to public inspection. However, the following categories of persons have inspection rights:

- an officer of the prescribed agencies (i.e. Companies Registry, Customs and Excise Department, HKMA, the Police, Immigration Department, Inland Revenue, Insurance Authority, ICAC and SFC) for the purpose of the officer's performance under the law of Hong Kong of a function relating to the prevention, detection or investigation of money laundering or terrorist financing;
- an officer of the Companies Registry for ascertaining whether the SC register requirements have been complied with; and
- any person whose name is entered in the SC register as a significant controller.

Key issues

From 1 March 2018, a Hong Kong company must:

- take reasonable steps to identify its significant controllers.
- enter the required particulars of its significant controllers in the SC register and keep them up-to-date.
- keep the SC register at its registered office or another place in Hong Kong and make it available for inspection and taking of copies by authorities.

Failure to comply with the above requirements is a criminal offence.

WHAT CONSTITUTES A PERSON WITH "SIGNIFICANT CONTROL"?

A person has significant control over a company limited by shares if the person meets one or more of the following conditions (SC Conditions) in relation to the company:

Condition 1 – holds, directly or indirectly, more than 25% of the issued shares in the company.

Condition 2 – holds, directly or indirectly, more than 25% of the voting rights in the company.

Condition 3 – holds the right, directly or indirectly, to appoint or remove a majority of the board of directors of the company.

Condition 4 – has the right to exercise, or actually exercises, significant influence or control over the company.

Condition 5 – has the right to exercise, or actually exercises, significant influence or control over the activities of a trust or a firm that is not a legal person, but whose trustees or members satisfy any of conditions 1 to 4 (in their capacity as such) in relation to the company.

WHO SHOULD BE RECORDED IN THE SC REGISTER?

Not all legal entities that satisfy one or more of the five SC Conditions are required to be registered on a company's SC register. The SC register only records:

- a registrable person - a natural person or a specified entity who has significant control over the company. A specified entity includes a corporation sole (i.e. a legal entity consisting of a single incorporated office occupied by a single natural person e.g. the Financial Secretary of the Hong Kong Government), a government of a country or territory (or part of a country or territory), a local authority or local government in a country or territory, or an international organization whose members include 2 or more countries or territories (e.g. the United Nations).
- a registrable legal entity (RLE) - a legal entity who is a member (recorded as such in the register of members) of the company and has significant control over the company. This concept only captures the legal entity immediately above the company in the latter's ownership chain, but not the other entities in the chain.

WHAT PARTICULARS ARE REQUIRED TO BE RECORDED FOR A REGISTRABLE PERSON OR RLE?

The SC register must record the basic information of each registrable person and RLE eg the name, address, (if an individual) Hong Kong ID number (or the number and issuing country of passport), date on which the significant controller became registrable, and nature of the control over the company by specifying which SC Condition is satisfied.

The company must ensure the particulars on the SC register are up-to-date. Any person who knowingly or recklessly makes a statement which is misleading, false or deceptive in any material particular in the SC register commits a criminal offence which can lead to fine and imprisonment.

The SC register must never be empty. If you are not in a position to enter details in a SC register, including because:

- there are no registrable persons or RLEs;
- investigations are still ongoing to determine registrable persons or RLEs;
- the particulars of an identified registrable person have not yet been confirmed; or
- a notice has been sent but the notice addressee has not complied with the requirements (or the notice addressee has only complied with all the requirements after the specified period),

the relevant fact must be entered in the SC register.

STATUTORY DUTY TO IDENTIFY SIGNIFICANT CONTROLLERS

The CO requires a company to take reasonable steps to identify its significant controllers. The significant controllers owe no statutory duty to proactively identify themselves or inform the company of the relevant required particulars.

If a company knows or has reasonable cause to believe that a person is a significant controller (or such person knows the identity of another person who is a significant controller), the company must give notice to the person within 7 days. The company commits a criminal offence punishable by a fine if it fails to do so.

The recipient of the notice must comply with the requirements stated in the notice within one month from the date of the notice. Failure to do so constitutes a criminal offence which leads to a fine.

What sort of actions would constitute reasonable steps to fulfil a company's obligation to identify the significant controllers would depend on the factual circumstances of each individual company. In straightforward cases, that would mean reviewing the statutory books of the company and other relevant company(ies), articles of association or other constitutive documents, statement of capital required to be filed under the CO, etc.

If a joint venture is involved (say, the company is set up by a number of joint venture partners), the shareholders' agreement or other relevant covenant or agreements (such as voting undertaking, side letters, power of attorney) must be reviewed.

For instance, a minority shareholder (X) holding or controlling less than 25% of the joint venture company's share or voting rights will still be considered as a significant controller if it enjoys a contractual right in the joint venture agreement to appoint or remove a majority of the board of directors of the company (SC Condition 3 satisfied). If X has veto rights over certain decisions in the running of the company's business e.g. changing the nature of the company's business, making any additional borrowing from lenders or appointing / removing the CEO, it will be considered as a significant controller because it has the right to exercise significant influence or control over the company (SC Condition 4 satisfied).

THE UK REGIME COMPARED

There are two major differences between the Hong Kong SC register regime and its equivalent under the Companies Act 2006 of the UK:

- the UK registers are open to public inspection and information from the registers must be filed with Companies House, whereas the Hong Kong SC registers are only available for inspection by certain categories of person (as mentioned above); and
- Hong Kong did **not** adopt the "restrictions notice" procedure under the UK legislation where failure to comply with a request for information can lead to the issue of a restrictions notice which has the effect of "freezing" the relevant interest in the affected shares so that any transaction relating to them is void and no rights are exercisable in respect of the frozen interest (this would include taking or enforcing security over such shares).

PURCHASING A HONG KONG COMPANY

In an acquisition transaction where Hong Kong companies are in the target group, each Hong Kong company's SC register must be reviewed and warranties should be broad enough to cover that their SC registers (as with other statutory books and records) are properly kept and accurate. A "SC register analysis" must be carried out in respect of each Hong Kong company in light of the acquisition and, if applicable, their SC registers must be updated at closing.

TAKING SECURITY OVER HONG KONG COMPANY SHARES

Turning to taking security over shares of a Hong Kong company:

- there are no SC register regime implications if security is taken over the shares of a SEHK listed company (the regime does not apply to such companies).
- for security over shares of a company to which the SC register regime applies (an applicable company):
 - (A) if the security is in the form of a legal mortgage (i.e. legal title to the shares is transferred to the mortgagee on day one) over more than 25% of the issued shares of an applicable company, the mortgagee will be a RLE of that applicable company and will be subject to the SC register regime; and
 - (B) if the security is in the form of an equitable charge, then, absent any unusual provisions (or provisions to the contrary) in the charging document, the chargee will have the benefit of the security exemption which provides that the rights attached to shares subject to security will be treated as being held by the chargor if those rights are exercisable only in accordance with the chargor's instructions or in the chargor's interest until the chargee exercises its rights for the purpose of preserving the value of the security or for realising the security.

If you need any further information or would like help carrying out your SC register analysis, please contact your Clifford Chance relationship partner.

CONTACTS

Neeraj Budhwani
Partner
T +852 2826 2428
E neeraj.budhwani
@cliffordchance.com

Emma Davies
Partner
T +852 2825 8828
E emma.davies
@cliffordchance.com

Francis Edwards
Partner
T +852 2826 3453
E francis.edwards
@cliffordchance.com

Matthew Fairclough
Partner
T +852 2825 8927
E matt.fairclough
@cliffordchance.com

Matthias Feldmann
Partner
T +852 2825 8859
E matthias.feldmann
@cliffordchance.com

Connie Heng
Partner
T +852 2826 2457
E connie.heng
@cliffordchance.com

Amy Ho
Partner
T +852 2825 8993
E amy.ho
@cliffordchance.com

Virginia Lee
Partner
T +852 2826 3451
E virginia.lee
@cliffordchance.com

Edith Leung
Partner
T +852 2825 8929
E edith.leung
@cliffordchance.com

Amy Lo
Partner
T +852 2826 3420
E amy.lo
@cliffordchance.com

Maggie Lo
Partner
T +852 2826 3568
E Maggie.lo
@cliffordchance.com

Dauwood Malik
Partner
T +852 2826 3485
E dauwood.malik
@cliffordchance.com

Mark Shipman
Partner
T +852 2825 8992
E mark.shipman
@cliffordchance.com

Matthew Truman
Partner
T +852 2826 3497
E matthew.truman
@cliffordchance.com

Anthony Wang
Partner
T +852 2826 3434
E anthony.wang
@cliffordchance.com

Andrew Whan
Partner
T +852 2825 8903
E andrew.whan
@cliffordchance.com

Frank Yuen
Partner
T +852 2825 8084
E frank.yuen
@cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 27th Floor, Jardine House,
One Connaught Place, Hong Kong

© Clifford Chance 2018

Clifford Chance

Abu Dhabi • Amsterdam • Bangkok •
Barcelona • Beijing • Brussels • Bucharest •
Casablanca • Dubai • Düsseldorf • Frankfurt •
Hong Kong • Istanbul • London • Luxembourg •
Madrid • Milan • Moscow • Munich • New
York • Paris • Perth • Prague • Rome • São
Paulo • Seoul • Shanghai • Singapore •
Sydney • Tokyo • Warsaw • Washington, D.C.

Clifford Chance has a co-operation agreement
with Abuhimed Alsheikh Alhagbani Law Firm
in Riyadh.

Clifford Chance has a best friends relationship
with Redcliffe Partners in Ukraine.