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COMPANIES REGISTRY

The New Hong Kong Companies Ordinance Major Changes relating to Share Capital

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Topics to be considered to-day (1)

Modernizing the Law

- Retiring the concept of par for shares of **all** companies **(Part 4)**

Facilitating Business

- Introducing a new alternative court free procedure for reducing capital based upon a solvency test **(Part 5)**



Topics to be considered to-day (2)

- Allowing all types of companies (other than just private companies) to purchase their own shares out of capital, subject to a solvency test **(Part 5)**
- Allowing all types of companies (whether listed / unlisted) to provide financial assistance to another party to acquire shares in the company or its holding company, subject to a solvency test **(Part 5)**

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Retiring the concept of par (1)

Background

- Nominal value (also known as "par value") of shares is the minimum price at which shares can generally be issued
- It is generally accepted that par value does not serve its original purpose of protecting creditors and shareholders, and in fact may even be misleading because the par value does not necessarily give an indication of the real value of the shares
- The new CO adopts a mandatory system of no-par for all local companies having a share capital and retires the concept of par value for all shares **(section 135)**

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Retiring the concept of par (2)

- This is in line with international trends to provide companies with greater flexibility in structuring their share capital. In other comparable common law jurisdictions, there is also growing acceptance of no-par value shares. Jurisdictions that have adopted mandatory no-par value shares include Australia, New Zealand and Singapore
- There is no essential difference between a share of no par value and one having a par value. Both represent a share, being a fraction of the equity, but par value share has attached to it a fixed face value, and share without par value does not
- It is considered that retiring the concept of par creates an environment with greater clarity and simplicity and is more desirable for the business community generally

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Retiring the concept of par (3)

Major changes

- Under the old CO companies incorporated in Hong Kong and having a share capital were required to have a par value ascribed to their shares (**section 5(4)(a)**). This represented the minimum amount at which a share can be issued
- Companies must also declare in their Memorandum of Association the maximum amount of share capital that might be issued by the company (the requirement for "authorized share capital") (**section 5(4)(a)**)
- The amount of the excess of the issue price of the share over its par value was designated as "share premium". Under the old CO, there were restrictions on how a company could deal with share premium and how it must be accounted for (**section 48B**)

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Retiring the concept of par (4)

- Under the new CO, as a result of migration to mandatory no-par, relevant concepts such as par value, share premium, and requirement for authorised share capital are no longer necessary and are abolished
- **Authorised share capital**
 - Upon commencement of the new CO, the provisions in the Memorandum of Association of a company incorporated under the old CO (deemed to be provisions in the Articles of Association after commencement of the new CO) relating to authorised share capital and par value of the shares are for all purposes to be regarded as deleted (**section 98(4)**). The share capital of a company would be its issued share capital

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Retiring the concept of par (5)

- **Share capital**
 - The full proceeds of a share issue are credited to share capital under the new regime and become the company's share capital. The notion of issued or paid capital continue to be relevant even after the abolition of par value, and it then includes the amount previously credited to the share premium account. In other words, it represents the total amount that the company actually receives from its shareholders as capital contribution.
- **Share premium account**
 - With the abolition of par value, "share premium" no longer exists. There is a deeming provision in the new CO to provide for the amalgamation of the existing share capital amount with the amount in the company's share premium account (**section 37 of Schedule 11**).

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Retiring the concept of par (6)

- The permitted uses of share premium existing on the date of commencement of the new CO are preserved, e.g., to pay up shares which are issued as bonus shares (**section 38 of Schedule 11**). For this purpose, the company should continue to maintain records of the balance of the former share premium account
- **Capital redemption reserve**
 - On the commencement date of the new CO, any amount standing to the credit of the company's capital redemption reserve becomes part of the company's share capital (**section 37 of Schedule 11**)

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Retiring the concept of par (7)

Alteration of share capital

- A company has greater flexibility to alter its share capital in a no-par environment, e.g. a company is able to capitalise its profits without issuing new shares and to allot and issue bonus shares without increasing its share capital (**section 170**)
- Companies continue to be able to effectively consolidate and subdivide shares. Whilst there is no nominal amount to be divided for no-par shares, a similar result to subdivision can be achieved by increasing the number of shares. The process of consolidating shares into a smaller number should be considerably simplified where there are no par values to contend with. The number of shares will just reduce with no visible effect on the share capital (**section 170(2)(e)**)

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Retiring the concept of par (8)

- Bonus shares can continue to be issued notwithstanding that there is no longer a share premium account since in a no-par environment, shares can be issued without transferring an amount to the share capital account (**section 170(2)(d)**)



Retiring the concept of par (9)

Transitional arrangements

- The new CO commenced operation on 3 March 2014. The abolition of par value for the shares of all Hong Kong companies took effect immediately upon commencement of the new CO
- The new regime applies to all local companies regardless of whether the companies are formed before or after the commencement date of the new CO. All shares issued, before, on and after the commencement date of the new CO shall have no par value. The law deems all shares issued before the abolition to have no par value (**section 135**). There is no conversion process required from the companies



Retiring the concept of par (10)

- The new CO contains transitional and deeming provisions relating to the move from par value shares to no-par value shares (**sections 35 to 41 of Schedule 11**). The provisions are intended to provide legislative safeguards to ensure that contractual rights defined by reference to par value and related concepts are not affected by the abolition of par. The transitional and deeming provisions can save considerable work, expense and time for companies and reduce the possibility of disputes
- For example, the statutory deeming provision in the new CO (**section 40 of Schedule 11**) provides that for the purpose of interpreting and applying (i) a resolution of a company made and (ii) a trust deed or other document executed before the commencement of the new CO, a reference to the par or nominal value of a share (whether made expressly or by implication) is a reference to the nominal value of the shares immediately before that commencement date

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Retiring the concept of par (11)

- Nonetheless, individual companies may wish to review their particular situation to determine if they need to introduce more specific changes to their documents having regard to their own unique circumstances, e.g. the company's constitutional documents, contracts entered into by the company, trust deed involving the company and share certificates for use under the no-par regime by the company
- ▶ *The Companies Registry has issued an External Circular on this topic which can be accessed at:*

http://www.cr.gov.hk/en/publications/guidelines_01.htm

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Transactions in relation to Share Capital (1)

Court-free reduction of capital

- The old CO only allows a reduction of share capital if it is approved by the shareholders via a special resolution and if the reduction is confirmed by the court (**sections 58 to 63**). Court confirmation is not required if the sole purpose of the reduction is to re-designate the nominal value of shares to a lower amount (**section 58(3)**)
- The new CO introduces, as an alternative procedure, a general court-free procedure based on a solvency test which should be faster and cheaper and can be utilised by all companies
- **Sections 215 to 225** provide for the said court-free procedure, subject to compliance with the solvency test. The key features of the procedure include –

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Transactions in relation to Share Capital (2)

- (a) all the directors need to sign the solvency statement;
- (b) members' approval by a special resolution;
- (c) notices in the Gazette and newspapers;
- (d) register the solvency statement with the CR;
- (e) any creditor or non-approving member of the company may, within five weeks after the special resolution is passed, apply to the court for cancellation of the resolution; and
- (f) register the relevant return with the CR after the expiry of objection period.

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Transactions in relation to Share Capital (3)

Shares buy-back out of capital

- Under the old CO, the general rule was that a company can only buy back its shares using distributable profits or using the proceeds of a fresh issue of shares (**sections 49A and 49B**). This rule was derived from the capital maintenance doctrine. There was an exception for private companies which might fund a buy-back by payment out of capital based on a solvency test (**sections 49I to 49N**)
- Under the new CO, all companies are allowed to fund buy-backs out of capital, subject to a solvency requirement

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Transactions in relation to Share Capital (4)

- **Sections 258 to 266** retain most of the old CO requirements and procedures applicable to buy-backs by a private company out of capital, and extend them to all companies. The requirements and procedures are similar to the new court-free procedure for reduction of capital

Financial assistance to acquire shares

- **Section 47A** of the old CO prohibited a company and its subsidiaries from giving financial assistance for the purpose of acquiring shares in the company. The broad prohibition was subject to certain exceptions

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Transactions in relation to Share Capital (5)

- The main change under the new CO is to allow all types of companies (listed or unlisted) to provide financial assistance, subject to satisfaction of the solvency test and one of the three procedures set out in **sections 283 to 289**
- The first procedure, set out in **section 283**, provides that a company may give financial assistance if the assistance, and all other financial assistance previously given and not repaid, is in aggregate less than 5% of the shareholders' funds (paid up share capital and reserves of the company (as disclosed in the most recent audited financial statements of the company))

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Transactions in relation to Share Capital (6)

- The second procedure, set out in **section 284**, provides that a company may give financial assistance if it is approved by written resolution of **all** members of the company
- The third procedure, set out in **sections 285 to 288**, provides that a company may give financial assistance if it is approved by an ordinary resolution. Shareholders holding at least 5% of the total voting rights or members representing at least 5% of the total members of the company may apply to the court to restrain the giving of the assistance

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Transactions in relation to Share Capital (7)

Uniform solvency test

- Under Part II of the old CO, a solvency test was provided for in respect of (a) buy-backs of its own shares out of capital by a private company (**section 49K(3), (4) and (5)**); and (b) financial assistance to acquire shares given by an unlisted company (**section 47F(1)(d) and (2)**)
- Both solvency tests were based on cash flow alone, but there were minor differences between them, as follows –
 - (a) for buy-backs, under **section 49K(5)**, the solvency statement had to be accompanied by an auditors' report; and
 - (b) for financial assistance, under **section 47F(1)(d)(i)**, there was an additional requirement for the solvency statement to provide for the situation where the company intended to commence winding up within 12 months of the date of the proposed financial assistance

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Transactions in relation to Share Capital (8)

- It is desirable to adopt a uniform solvency test for buy-backs and financial assistance, and extend its application to the court-free procedure for reduction of capital, for consistency in the law. The new CO adopts the solvency test for financial assistance set out in **section 47F(1)(d)**, as it gives clarity and certainty on how the solvency test may apply in different scenarios
- There is therefore no need for an auditor's report and provision is made in the statement for the scenario where winding up commenced within 12 months
- **Section 204** of the new CO provides that a uniform solvency test is applicable to reduction of capital, buy-backs and financial assistance

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Transactions in relation to Share Capital (9)

- **Section 205** sets out the content of the uniform solvency test
- A company satisfies a solvency test in relation to a transaction if:
 - (a) immediately after the transaction there will be no ground on which the company could be found to be unable to pay its debts; and
 - (b) either (i) if it is intended to commence winding up within 12 months, the company will be able to pay its debts in full within 12 months of the commencement of the winding up; or (ii) in any other case the company will be able to pay its debts as they become due during 12 months after transaction

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Transactions in relation to Share Capital (10)

- A solvency statement must be made and signed by all directors for buy-backs and reductions of capital, and made and signed by a majority of directors for financial assistance
- There is no need for an auditor's report

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Thank you