

CHAPTER 5

MODERNISING THE LAW

5.1 Some of the provisions in the CO are based on old concepts that no longer meet the needs of modern business. An obvious example is the underlying assumption of paper-based communications between a company and its members. As noted in paragraph 2.20 above, the CB will facilitate communications between a company and its members by electronic means. In addition, we will take the opportunity of the rewrite to retire some antiquated concepts that no longer serve any useful purposes such as par value of shares and authorised capital. Moreover, we will modernise the language and re-arrange the sequence of some of the provisions in a more logical and user-friendly order so as to make the CB more readable and comprehensible.⁶⁶ We will also introduce technical changes to provide for the enabling framework for scripless trading by removing, or providing exceptions to, the limitations arising from the provisions on scrip-based shares presently found in the CO.

Share Capital

*Retiring the concept of par value*⁶⁷

5.2 The current rules relating to share capital require companies having a share capital to have a par value ascribed to their shares. Par value is an antiquated concept which may arguably give rise to one or more of the following practical problems:

- (a) unnecessarily complex accounting system;
- (b) inhibits raising of new capital;
- (c) unnecessary work for share registries and added costs; and
- (d) being misleading to the unsophisticated investor.⁶⁸

⁶⁶ See footnote 5 above.

⁶⁷ Provisions will be included in Part 4 of the CB to be covered in the second phase consultation paper.

⁶⁸ See FSTB, *Consultation Paper on Share Capital, the Capital Maintenance Regime and Statutory Amalgamation Procedure* (June 2008), paragraphs 2.1 to 2.8 (available at http://www.fstb.gov.hk/fsb/co_rewrite).

- 5.3 In a public consultation conducted in the third quarter of 2008, the majority of the respondents supported the proposal to abolish the par value regime and to adopt a mandatory system of no-par.⁶⁹ We will adopt a mandatory system of no-par for all companies with a share capital, subject to a transition period (tentatively 24 months from the date the CB is passed by the LegCo) in case companies wish to review their documents before the conversion is effected.
- 5.4 Other changes arising from the move to a no-par environment include:
- (a) to provide a legislative deeming provision for the amalgamation of the existing share capital amount with the amount of share premium (and also capital redemption reserve) immediately outstanding in a company's account before the migration to no-par share capital;
 - (b) to preserve substantially the currently permitted uses of the share premium for the amount standing to the credit of the share premium account before the migration to no-par, so as to avoid hardship to companies arising from any loss of the permitted uses of share premium that they enjoyed prior to the migration to no-par;
 - (c) to provide a statutory deeming provision to preserve contractual rights defined by reference to par value;
 - (d) to repeal the power of a company to convert shares into "stock"⁷⁰ which no longer serves any practical purpose while allowing stock created before the commencement of the CB to be reconverted into paid-up shares;
 - (e) to apply the merger relief to the amount in excess of the subscribed capital of the acquired company attributable to the shares acquired or cancelled. Group reconstruction relief will apply to the excess of the consideration for the shares over the base value of the assets transferred; and
 - (f) to allow capitalisation of profits with or without an issue of shares, issuance of bonus shares without the need to transfer amounts to share capital, consolidation and subdivision of shares, and make appropriate provisions in relation to redeemable shares.

⁶⁹ The consultation conclusions were issued in February 2009 and are available at www.fstb.gov.hk/fsb/co_rewrite.

⁷⁰ 'Stock' is a fund that has a nominal value equivalent to that of the total of the shares so that a member, instead of holding particular identified shares of 100 shares of \$10 each numbered 1 to 100, holds \$1000 stock.

*Removing the requirement for authorised capital*⁷¹

- 5.5 Authorised capital is the maximum amount, usually specified in monetary terms, that a company is permitted by its constitutional document⁷² to raise by issuing shares. The protection against dilution which authorised capital is thought to provide is far from absolute as most companies are able to increase the authorised capital by an ordinary resolution.
- 5.6 We will remove the requirement for authorised capital as it no longer serves any useful purpose. Nevertheless, companies can still be given the option to retain the provision for authorised capital in the company's Articles of Association, or to delete or amend it by resolution. If retained, the authorised capital will be deemed to be specified in terms of number of shares to be issued instead of monetary value. The companies may vary or abolish the restriction by ordinary resolution.

Removing the power of company to issue share warrants

- 5.7 Companies are permitted to issue share warrants to bearer under section 73 of the CO, provided the same is authorised by the company's articles. Share warrants are rarely issued by companies nowadays and are considered to be undesirable from the perspective of anti-money laundering. Consequently, the ability for a company to issue share warrants will be removed in the CB. Nevertheless, existing share warrants should be grandfathered, without setting any time limit for surrender of the warrants.⁷³

Enabling Scripless Securities Trading

- 5.8 The SFC is currently working with the SEHK and the Federation of Share Registrars on the operational model for the proposed scripless environment, with a view to putting forward proposals for public consultation in late 2009. The limitations arising from the provisions on scrip-based shares in the CO will have to be removed to enable the scripless holding and trading of shares and debentures issued by, among others, Hong Kong incorporated listed companies.
- 5.9 To tie in with the scripless securities market reform, technical amendments to the CO will be introduced into the LegCo in early 2010. The proposed amendments will be commenced only when the market has agreed to, and is

⁷¹ Provisions will be included in Part 4 of the CB to be covered in the second phase consultation paper.

⁷² Under the CO, the constitutional document of a company formed in Hong Kong are the Memorandum of Association and Articles of Association. A company's authorised capital is set out in its Memorandum of Association. We will propose in the CB that a company incorporated in Hong Kong will only be required to have Articles of Association. The Memorandum of Association will be abolished and essential information contained in a Memorandum of Association can be set out in the Articles of Association.

⁷³ Provisions will be included in Part 4 of the CB to be covered in the second phase consultation paper.

ready to implement, an operational model for a scripless securities market. The CB will also incorporate those technical amendments.⁷⁴ Further legislative amendments including amendments to the SFO would be pursued as necessary as the operational model takes shape.

⁷⁴ Provisions will be included in Part 4 of the CB to be covered in the second phase consultation paper.