# Consultation Study Concerning the Implications of Adopting a No-Par Value Share Regime in Hong Kong

## Final Report

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## 1. INTRODUCTION

1.1 Freshfields Bruckhaus Deringer has been commissioned by the Government of Hong Kong SAR to conduct a consultancy study on the implications of adopting a system of no-par value shares in Hong Kong.

1.2 We are delighted to present to you this Final Report on the consultation. The proposals herein (on which we were assisted in relation to accounting and tax by PricewaterhouseCoopers) have been developed through research, consultation and discussion.

## 2. EXECUTIVE SUMMARY

2.1 Currently the shares of all companies incorporated in Hong Kong and having a share capital are required to have a par value ascribed to them. This was also the position in most other jurisdictions, whether of the common or civil law tradition. A significant number of these jurisdictions have however moved to a system of no-par, particularly in recent years.

2.2 No-par shares are therefore not new. Belgium and Luxembourg introduced them in the nineteenth century, and the United States[1] and Canada[2], from the early twentieth century. More recently a number of Continental European jurisdictions such as Germany and Austria have followed suit. The United Kingdom has not yet adopted a system of no-par, but only because a European Directive[3] is said to stand in the way of that. New Zealand and Australia, jurisdictions with a similar legal tradition to Hong Kong, have moved to a full no-par system, as Singapore is likely to do soon.

2.3 Whilst the Continental European jurisdictions may have been prompted to adopt no-par shares to facilitate the Euro denomination, the reason for abandoning the requirement for par values in the case of most jurisdictions is more fundamental. Current thinking is mostly that the original reasons for requiring par were mistaken or are not applicable today. Retiring the concept of par, it was largely felt, would not just purge a historical *faux pas*, it would also create an environment of greater clarity and simplicity that would be desirable for the business community generally. Largely these were the reasons for these jurisdictions adopting a system of no-par.

2.4 Whilst the reasons for change were fairly uniform the manner in which the change was effected was far less so. Australia and New Zealand made an immediate and complete change to a no-par system (the mandatory system of no-par), but in rather different ways. The variations are even greater where jurisdictions made no-par shares optional (the optional system of no-par). Theoretically it is also possible to have a hybrid system comprising a combination of the mandatory system (for example, for new companies only) and the optional system (for example, for existing companies only), even though these do not yet seem to have been adopted in practice. In particular, we found no practical example of the "hybrid" model (of mandatory no-par for new companies and optional for existing companies) suggested by the task force of the Standing Committee on Company Law Reform when the Standing Committee previously considered the subject in the context of its overall review of the Companies Ordinance. Clearly whether Hong Kong should move to a no-par system and the implication of such a move can only be properly considered by reference to a particular model of no-par. Our terms of reference were to consider all systems of no-par.

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1 New York being the first to introduce it in 1914.

2 The possibility of issuing no-par shares was introduced by an amendment to the federal Companies Act in 1924.

3 Second Company Law Directive.

2.5 We have sought to make our recommendations based on a combination of the following:

(a) Identification of issues.

(b) Consultations.

(c) Consideration of the experience of other jurisdictions.

(d) Consideration of the position under Hong Kong legislation and rules.

2.6 In practice the no-par systems in other jurisdictions seem to have worked satisfactorily, at least we have not heard of any abuses peculiar to, or facilitated by, no-par systems. In most respects it seems that the practical operation of the no-par system can be very similar to that of the par value system so that a comparison between the two is largely theoretical.

2.7 We have considered the desirability of migrating to a no-par system giving particular attention to the operation of the no-par system in practice, the matters in respect to which safeguards are necessary, the interest of investors, creditors and the wider public. Our conclusion is that the principle of the no-par system is desirable, and that it should be introduced in Hong Kong on a mandatory basis for all companies incorporated in Hong Kong with a share capital. There is however no pressing need to effect the change presently, save that it would be efficient and preferable to have it in consideration in any review of the capital maintenance rules, and for the changes to be made together.

## 3. BACKGROUND

3.1 This section provides a brief overview of the requirement for par value, as seen in its historical perspective, and as it applies today. It also describes the more significant issues that requiring par value and retiring the concept give rise to.

3.2 It is important to emphasise from the outset that 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 or an aliquot part of the equity, but the par value share has attached to it a label of value, and the share without par value does not. In a par value system, it is usual to state the share capital this way:

*"The share capital is $x divided into y shares of $z each"*

The share therefore has a label proclaiming that its par value is $z. On the other hand a no-par system would simply represent the capital as:

*"$x divided into y shares"*.

3.3 Par value (or nominal value, as it is also called) is the minimum price at which shares can generally be issued. Where shares are issued above the par value, the amount in excess of the par value is called the share premium, and is separately accounted for. All shares of a class have the same par value, and this generally remains unchanged in the life of the company.

3.4 The par value is shown on the financial statements as the share capital of the company. These were the statements that were said to be relied on by customers and financial institutions that extended credit to the company and potential subscribers to shares in the company. The theory is that par value and the statutory framework in which it operates is necessary in order to protect creditors and shareholders.

3.5 The way in which the concept of "par" is said to protect creditors' interests is principally as follows:

(a) The par value of a company's shares provides a base of subscribed share capital that cannot be repaid to shareholders except with the sanction of the court - or, in the case of a liability to pay the unpaid part of the par value, cannot be released by the company without the sanction of the court. It was therefore regarded as a cushion of solvency for the trading activities of the company.

(b) Par value assists creditors to assess whether a company has adequate capital by showing the minimum amount that an applicant for a share has to contribute to the company.

3.6 It is said to protect shareholders in these ways:

(a) It protects existing shareholders by ensuring that companies do not issue new shares below the floor price (par value) of existing ones, thereby reducing the

possibility of dilution of the fractions of ownership held by earlier allottees (called "share watering").[4]

(b) It fixes the maximum amount that a shareholder in a company limited by shares is statutorily obliged to pay for new shares. The actual share price, and the amount of any premium over par, would be a matter for agreement between the parties.

3.7 The weight of legal opinion is that the theory of par value is not borne out in practice. On the contrary, the par label is said to stand in the way of recognising the ordinary share in a company for what it really is: a fraction of the equity of the company. Conceivably it is potentially deceptive, and can be used to mislead the less sophisticated investor. The object of a change to no-par is not to add any suggestion of a value that is more true or real, but to remove a label that has little to do with the intrinsic value of the share.

3.8 The concept of par value is also said to add unnecessary complexity to company accounting and the financial statements of companies. The increasing use in loan agreements and other creditors' agreements of financial covenants on the company, including limitation on the circumstances under which the company could use its funds to pay dividends or other distributions to shareholders or to repurchase its own shares, means that the division of the company's equity between "capital" and "surplus" has become for such creditors a matter of academic interest only.

3.9 The expression of a dividend as a percentage of the par value is also said to illustrate the unreality of the par value system. For example, if a 5% dividend is declared in respect of a share of $1.00 par value, the dividend that an investor who has paid $10 for the share is 5 cents (ie 0.5% of his investment), not 50 cents. A dividend declared as a percentage of par value (in the example 5%) can be deceptive, while a declaration in terms of money (5 cents) makes obvious the real position.

3.10 There is a clear growing recognition and acceptance of the validity of no-par value shares, and a move towards its adoption in place of par value shares.

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[4] Any issuance of shares other than to existing shareholders in the proportion of their shareholding will also have a "diluting" effect. This is often avoided by the shareholders securing rights of pre-emption for themselves. In the case of share-watering an existing shareholder may likewise have his shareholding diluted by reason alone that additional shares are issued (to others), but the main objection to share-watering is that new shares would be issued at less than what the existing shareholder had been obliged to pay for them.

## 4. ANALYSIS OF THE EXPERIENCE OF OTHER JURISDICTIONS

4.1 The comparative part of the study encompassed the following:

(a) A consideration of the experiences of other jurisdictions in their consideration and/or adoption of the various permutations of the no-par regime.

(b) Considerations (legal, economic, accounting and taxation) underlying their preferences for one and rejection of others.

(c) The implementation processes adopted to achieve the no-par regime.

(d) Investigation into whether in practice the different systems have worked satisfactorily (or, on the contrary, have given scope for abuses such as manipulation of accounts).

(e) Investigation of the extent to which no-par value shares are used in those jurisdictions which have introduced it on an optional basis.

(f) Consideration of the factors which underlie the demand (or rejection) of no-par, e.g. type (or size) of companies, listed, public or private and industry.

(g) Investigation of whether investors have shown any reluctance to buy shares of no-par value which are dealt with on the London and New York Stock Exchanges.

4.2 This was done through research into and analysis of published material comprising legislation, commission reports and secondary material and was supplemented with consultations with the law and securities commissions, stock exchanges and professional associations (law and accountancy) of relevant jurisdictions. We also consulted law firms in jurisdictions of particular interest.

4.3 The no-par value system is by no means a revolutionary matter. Most of the major jurisdictions, save for the United Kingdom, have migrated to a system of no-par, or are in the process of so doing. In the United Kingdom, the issue has been separately considered by no less than three committees, all favourably, but with variations as to the model to be adopted.[5] Most recently the Company Law Reform Steering Committee in their Final Report on Modern Company Law for a Competitive Economy concluded that the change should not be effected in this round of reform, but could be implemented when the restriction thought to exist in the Second European Company Law Directive was lifted. A number of the tax havens (British Virgin Islands, Cayman Islands, Guernsey and Jersey) have also migrated to no-par, although Bermuda remains on the par value system.

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[5] This has never been legislated. In 1967 a Companies Bill that included provisions of no-par value shares was passed by the House of Lords. When the Bill was introduced in the House of Commons the provisions in regard to no-par shares had been omitted, but it seemed that the opposition to the no-par system did not reflect upon the merits of the system.

4.4 Singapore was set to migrate to a mandatory no-par system this year when concerns about details of the migration prompted the withholding from the Companies (Amendment) Bill No 3/2004 of provisions intended to effect the change. The intention appears to be to allow time for a further consideration of certain issues, not a reconsideration of the merits of the no-par system.

4.5 The issue of no-par is not one within the sole domain of common law jurisdictions, as a number of civil law jurisdictions (like Belgium, Luxembourg, Germany, Austria and Japan) have also migrated to a system of no-par. It seems that legal tradition is not a factor that has particular relevance in deciding whether to adopt a system of no-par, but it does seem to have influenced the type of no-par system that is adopted.

4.6 Table A sets out (in alphabetical order) some of the jurisdictions which have migrated to a no-par system and gives a brief description of the type of no-par system adopted. Appendix A sets out in relation to 6 of these jurisdictions[6] further details of their systems of no-par.

**TABLE A**

| JURISDICTIONS | TYPE OF NO-PAR SYSTEM |
|---|---|
| Australia | Mandatory<br><br>Shares of any company having a share capital must have no par value (s254C, Schedule 5, Company Law Review Act 1998). |
| Austria | Optional<br><br>But companies must have one or the other, and not a mix of par and no-par. The system is taken from the German no-par system (as to which, please see below). |
| Belgium | Optional<br><br>In the Belgian no-par system (probably one of the earliest in the world) shares are either issued "having a mention of value" or "without mention of value" (as they are respectively described in the law). The first issue of shares establishes the original "accountancy parity", so that an initial issue of 1,000 shares at 500 trances |

[6] These jurisdictions are Australia, Cayman Islands, Germany, Guernsey, New Zealand and South Africa. They reflect a range of different models of the no-par system.

| | |
|---|---|
| | per share establishes an "accountancy parity" of 500 trances. Where a subsequent issue is made at a higher price the "accountancy parity" for all shares is automatically raised to a figure that is equal to the total amount in capital account (less reserves), divided by the number of shares in issue. A subsequent issue can only be issued at a lower price if the company in general meeting has first written down its issued capital such that each share in issue has an "accountancy parity" equal to the proposed price of issue of the new shares. |
| British Columbia | Optional<br><br>The authorized capital of a company consists of shares with a par value, or shares without par value, or both kinds of shares (s19(1) Company Act 1996).<br><br>If shares in a company are of both kinds, the shares with par value must be a class or classes of shares distinct from the shares without par value (s19(3) Company Act 1996).<br><br>Every company may by special resolution alter its memorandum to change all or any of its unissued, or fully paid issued, shares with par value into shares without par value; or change all or any of its unissued shares without par value into shares with par value (s231(1)(e) Company Act 1996). There is no provision allowing for issued shares without par value to be converted into shares with par value. |
| British Virgin Islands | Optional<br><br>Extended to international business companies only which are separately incorporated under the International Business Companies Act, 1984 (companies incorporated under the Companies Act 1990 still have par values). Can have a mix of par and no- |

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|---|---|
| | par. |
| California | Optional, on the face of it<br><br>The California General Corporation Law does not prohibit the use of par value shares (so that a company can choose to retain them) but it does remove the legal significance of par save for very limited purposes. The legal effect of par value with respect to dividends, redemption of stock and payments for stock is eliminated, whether or not the corporate charter documents continue to contain references to it. Companies can retain references to par value in their charter documents to enable them to be qualified in foreign jurisdictions in which the franchise or other taxes are computed on the basis of par value, and to have (and therefore use) par value for those purposes. Effectively however, shares of Californian companies regardless of their label are no-par value shares. |
| Cayman Islands | Optional<br><br>Extended to exempted companies only (being companies with businesses outside Cayman).<br><br>The capital with which an exempted company proposes to be registered may be divided into shares without par value. Companies must have one or the other, and not a mix of par and no-par. |
| Germany | Optional – for *Aktiengesellschaften*, stock corporations whose shares may be listed on stock exchanges. (*Gesellschaft mit beschränkter Haftung* or *GmbHs*, which are comparable to the US close corporation and in part the limited liability company are excluded)<br><br>It is possible for a company to have either par or no-par value shares (but not both). The German no-par value system (called |

| | |
|---|---|
| | "*Stückaktie*") is generally regarded as falling short of a true no-par system. Companies that choose to have no-par value shares nevertheless retain the concept of a fixed nominal share capital. This is divided into shares. As the total number of shares is fixed in the articles of association, it is possible to determine the capital underlying each share (which must not be less than 1 euro). This arguably effectively retains a par value, but a less visible one, particularly since the par value is no longer printed on the share certificate. |
| Ghana | Mandatory |
| Guernsey | Optional<br><br>Extended to all companies with a share capital. A company can have a mix of par and no-par. |
| Japan | Mandatory with effect from 1 October 2001.<br><br>Prior to this Japan had an optional system of no-par. Amendments were made with effect from 1 October 2001 to abolish the legal concept of par so that all companies currently have only no-par value shares. |
| Jersey | Optional<br><br>Extended to all companies. Any company may register as a company with or without shares having a nominal value (ss 3E, 3F Companies (Jersey) Law 1991).<br><br>A company can have a mix. Companies (both existing and new) can convert from par to no-par and vice versa on more than one occasion, but can have only one type at any time for the same class of shares. |
| New Zealand | Mandatory<br><br>Extended to all companies with a share |

| | |
|---|---|
| | capital and all classes of shares. |
| Ontario | Mandatory |
| South Africa | Optional<br><br>Extended to all companies and all shares, but shares must be all par or no-par within a class. Companies can convert from par to no-par and vice versa on more than one occasion, but only if they are fully paid. |

4.7 United Kingdom, Singapore and Uganda have not, at the time of this report implemented a system of no-par, but have each indicated a preference for the mandatory system when they do. It may be significant to note that in the United Kingdom, the earlier committees which considered the issue (Gedge – 1954 and Jenkins – 1962) considered an optional system, but the Company Law Review Steering Group which considered the issue recently preferred the mandatory system.

4.8 Continental Europe aside (the considerations underpinning their choice being relevant only to Europe), there are probably more jurisdictions that have adopted (or are in the process of adopting) the mandatory system of no-par in recent years than an optional one. Australia and New Zealand are amongst the jurisdictions which migrated from a par value system to a fully no-par one. Japan moved from an optional no-par to a mandatory no-par system in October 2001.

4.9 Jurisdictions that have selected the mandatory system of no-par have generally felt that an optional system would be an inadequate treatment of the ills of the par value system. It was also felt that the retention of par value as an option involves unacceptable complication. The New Zealand Law Commission concluded that "to retain par value as an option would be unacceptably complicated and would serve no useful purpose" (para 384, Company Law Reform and Restatement, Report No 9, June 1989). In Australia, the Companies and Securities Law Review Committee on Shares of No Par Value and Partly Paid Shares (Report No 11-1990) recommended giving companies the option of issuing shares with par or no-par value (para 36), but it was a mandatory system that was finally legislated because it was felt that a system that permitted both par and no par value shares would unnecessarily complicate the law and its administration (Company Law Review Bill 1997, para 11.24). Japan, which first introduced no-par shares optionally, abandoned that for a fully no-par system when it found that companies, whilst not denying the merits of the no-par system, were nevertheless slow to make the change.

4.10 The reasons for jurisdictions adopting an optional approach have been more difficult to discern. In South Africa, which has one of the most liberal optional no-par systems, the Report of the Commission of Enquiry into the Companies Act[7] which

[7] Published on 15 April 1970.

recommended the introduction in South African Company Law of a no-par system on an optional basis (para 34.12), considered the ways in which confusion arising from an optional system may be reduced, but did not suggest that the Commission considered mandatory no-par as the way forward. In California, companies have the option of retaining references to par in their charter documents, but this is principally to enable them to be qualified in foreign jurisdictions where taxes are computed on the basis of par value. The legal significance of par is otherwise mostly removed, so that it is probably not representative of a true optional system. This is the model of the Revised Model Business Corporation Act, which California adopted, as did a number of other US states.

4.11 Table A shows that the optional regime is implemented in different ways by different jurisdictions. These variations are even more extensive when the models are looked at in detail. We have not come across any literature that explains the considerations underlying preferences for the diverse models of optional no-par adopted.

4.12 Whilst less obvious, variations exist even with the fully mandatory models. Australia and New Zealand both passed legislation prohibiting par values, but each placed the no-par regime within very different legal frameworks. Australia largely preserved the capital maintenance rules of the par value system by reclassifying as stated capital that which the par value system distinguished as share capital and premium. New Zealand, on the other hand implemented no-par without the concomitant concept of stated capital, legislating instead a solvency test for the protection of creditors.

4.13 Appendix A provides in greater detail the position of the no-par regimes adopted in Australia, New Zealand, South Africa, Guernsey, Cayman Islands and Germany, including the implementation processes used to put them in place.

4.14 The details of these variations, to the extent that they aid in the discussion and analysis will be considered in greater depth and detail in the following sections of this report when we consider the issues raised in the two rounds of consultation, particularly the second.

4.15 Generally all these systems appear to have worked satisfactorily, based on the responses received from the bodies we consulted in the relevant jurisdictions (the stock exchanges, law societies, accounting bodies, and in some cases, law firms). No study appears to have been done in those jurisdictions on the degree to which no-par is working, and to that extent, these are “impressions” rather than empirical evidence. However, we have not come across any evidence of abuse peculiar to, or more prevalent in, the no-par system.

4.16 The Continental European countries that adopted no-par shares on an optional basis reported substantial uptake of no-par shares, but these, we believe, were largely driven by the conversion to Euro (which no-par shares were said to facilitate). Japan, on the other hand, found it necessary to move more decisively into a no-par system (by abolishing the concept of par) when companies dawdled in the conversion when it was optional.

4.17 Companies have similarly been slow in South Africa to convert their shares, with no-par shares issued mainly by newly incorporated companies. We do not know of any published statistics of the ratio of par to no-par shares in South Africa (after 30 years of optional no-par), but the impression of a local law firm[8] is that it remains overwhelmingly (possibly 90%) par.

4.18 In the Cayman Islands, where companies can be incorporated with either par or no-par value shares (formally since 1989)[9], it seems that the preference is still to incorporate with par value shares. A firm that advises on Cayman law[10] thinks that this is from a combination of factors, including lack of familiarity with no-par shares, the unsatisfactory nature of Cayman law on no-par shares, and the fact that a court order is still required to effect a reduction in share capital whereas share premium may be freely used without court sanction. There are as yet no Cayman shares without par value listed on the Hong Kong Stock Exchange.[11]

4.19 We have not come across any literature which has considered whether there was any correlation between the demand for no-par and the nature and size of the company.

4.20 We have also not come across any evidence that investors have shown reluctance to buy shares of no-par value which are dealt with on the London or New York stock exchanges.

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8 Webber Wentzel Bowens.

9 Prior to 1989, it appears that some companies were incorporated with no-par value shares, but the legal sanction for this was unclear until the Companies (Amendment) Law 1989.

10 Conyers Dill & Pearman.

11 As of 5 February 2004, the date of the Exchange's email confirmation as to this. Neither the PRC nor Bermuda (the other jurisdictions whose shares may be listed on the HKSE) allow no-par value shares.

## 5. RESPONSES FROM CONSULTATIONS

5.1 We undertook two rounds of consultation in Hong Kong with a view to achieving effective reflection of a wide range of points of view.

5.2 The first was launched towards the end of January 2003 and sought to gauge the extent to which significance is still attached to the par value of shares in Hong Kong. We received responses from 62 individuals or organisations, mainly investment banks, financial institutions, listed companies, law firms, company secretarial firms, chambers of commerce and academic institutions.

5.3 The results of this consultation indicated that a significant proportion of the public in Hong Kong do place some significance on the par value of shares in their decisions on investment and extending credit. As none of the respondents were unsophisticated investors or lenders, this proportion is likely to be higher amongst the wider public. There appeared to be significant confusion in the understanding of the concept of par values, even among those respondents who had said that par value was not important to their investment and lending decisions.

5.4 A copy of the first stage consultation document is annexed as Appendix B. The report on and analysis of the responses from the first stage consultation is annexed as Appendix C. The list of responses in the order in which they were received is annexed as Appendix D

5.5 The second stage consultation document was published in June 2003. A copy of this is annexed as Appendix E. This was a much larger document, and more technical than the first. The consultation, whilst well received, drew fewer responses, possibly because of the technical nature of the subject, and the timing of the consultation. We received responses from twenty five individuals or organisations. Fifteen of these provided full responses whilst ten gave general comments and/or selected responses to particular issues of interest to them. The list of responses in the order in which they were received is annexed as Appendix F.

5.6 In the next section we provide a review of the responses to the issues raised in the second consultation. In many cases the responses are not, in our view, representative of a wider position on the issue given that they reflect the views of a very small (albeit important) segment of the community in Hong Kong.

## 6. ANALYSIS OF SECOND STAGE CONSULTATION

6.1 What follows is a summary and analysis of the responses to the questions in the Section III of the second stage consultation document. The responses will be analysed in the segments adopted in the consultation document. These are:

1. General

2. Scope

3. Model of no-par

4. Legislative Changes

5. Accounting Considerations

6. Taxation Considerations

7. Other Considerations

8. Wider reform

6.2 The questions are reproduced for ease of reference (and where necessary for comprehension of the accompanying narrative), but not those that ask for observations or comments by way of extension of the principal question. The questions in a number of cases have not been reproduced verbatim, but modified to make them complete without the narrative that accompanied them in the consultation document.

6.3 Charts (pie charts, and where appropriate, bar charts) are to give the reader an 'at a glance' look at the spread of responses for each of the questions requiring selection of provided options. Generally pie charts are used where multiple options are provided (eg Question 3.1 and 3.3), and bar charts for Yes/No answers. Questions 1.1 and 1.3 ask several questions each, which require essentially Yes/No answers and are graphically represented in the form of bar charts.

6.4 A number of respondents (seven) did not answer the questions in the consultation document specifically but provided separate comments on areas of particular interest or concern to them. These have not, for the purposes of recording responses, been counted in the percentages of those who answered the questions specifically. They are however considered in the analysis insofar as they are relevant to any of the questions.

## 1. General

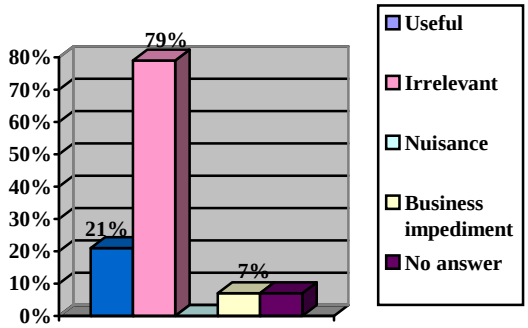
***Question 1.1*: *In your dealing with shares do you find the par value of shares.***

a) ***Irrelevant***

b) ***Useful***

c) ***Business impediment***

d) ***No Answer***




Most of the respondents thought par value to be irrelevant, a small percentage thought it a business impediment, but none considered it a nuisance. One respondent (which did not answer the specific questions in Question 1.1 but answered it more generally in Question 1.2) said that as a law firm they simply accept par value as a legal fact of life. In a corporate environment which has always been premised upon shares having a par value, this is wholly explicable and may in fact explain why (of the respondents who answered Question 1.1) so few found it a business impediment, and none, a nuisance.

A significant number (21%) thought par value useful, but their further comments (in Question 1.2) show that they do not see these functions as irreplaceable, as in the case of the respondent which said that the par value 'is useful as a point of reference, but if all shares were of no par value then a new benchmark/point of reference would emerge'. Another respondent which thought par value to be both useful and irrelevant explained its seemingly incongruent selections to Question 1.1 this way: 'The par value has its usefulness in differentiating different classes of share. However the roles outlined in points (1) to (3) are artificial and can be defeated nowadays by companies setting a very low par value". The reference to points (1) to (3) is to the three roles of par value in the narrative preceding Questions 1.1 and 1.2:

(1) fixing the amount a shareholder is statutorily obliged to pay for new shares

(2) setting a price limit below which directors may not issue shares

(3) creating a floor of subscribed share capital that cannot be repaid to shareholders except with the sanction of the court.

Of the respondents which did not answer the questions in the consultation document specifically, one thought that par value does provide some degree of protection to shareholders against dilution of their shareholdings, but did not consider that this stood in the way of legislating for no-par if the protection is otherwise provided for (or enhanced, the preference of the respondent in question). The two accounting bodies which also participated this way (Association of Chartered Certified Accountants and Hong Kong Society of Accountants) were both of the view that par value no longer serves the original purpose of protecting creditors and shareholders, and (one of them) that it may, to the extent that some are led to believe that it provides some protection, be misleading.

***Question 1.3: Are any of these problems associated with par in fact problems in practice?***

***a) Unnecessarily complex accounting system***

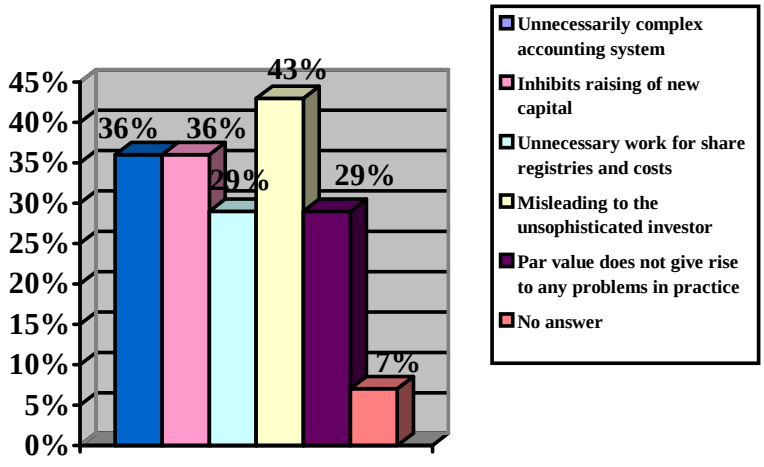
***b) Inhibits raising of new capital***

***c) Unnecessary work for share registries and costs***

***d) Misleading to the unsophisticated investor***

***e) Par value does not give rise to any problems in practice***

***f) No answer***



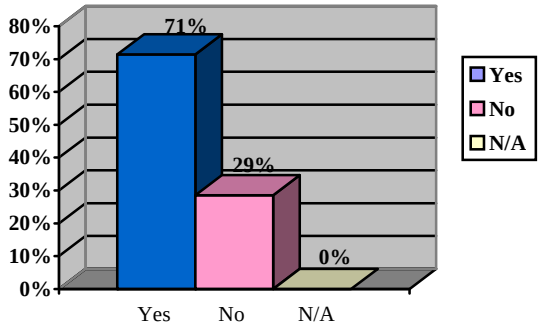

Most respondents thought that one or more of the problems associated with par were in fact problems in practice: 36% of respondents said that it gives rise to unnecessarily complex accounting systems, 36% that it inhibits raising of new capital, 43% that it is misleading to the unsophisticated investor, and 29% that it creates unnecessary work for share registries and costs. However, 29% of the respondents

thought that par value does not give rise to any problems in practice, and 7% made no selection. We do not think that the relatively large proportion of respondents regarding par value as not raising practical problems should be taken as a sign of support for maintaining the status quo, rather that the imperfections of the present system may simply be well understood and relatively easy to avoid in the most situations. Indeed, we regard the 43% of respondents who believe par is misleading to the unsophisticated invested, and the results of the first stage consultation which also bear this out, to be a telling statistic.

A need for no-par?

In Hong Kong there is no requirement for a minimum par value of shares (as there is in some jurisdictions) and shares can be issued with very low par values thereby avoiding some of the restrictions associated with the requirement of maintaining par. In light of this, it has been questioned whether there is a real need for no-par value shares if the same (or substantially the same) effect can be achieved by issuing shares with a very small par value.

***Question 1.5*: *Do you think this flexibility already avoids many of the problems caused by the requirement to have par value?***




71% of the respondents agreed that the ability to have shares of low par value does avoid some of the problems caused by the requirement to have par value, but it would seem (from their further comments) that most of them do not regard this as sufficient reason not to go ahead with removing par altogether.

***Question 1.7*: *The arguments against a no-par system centre in the main on the following:***

a. ***Par value is not misleading. Business people are not generally misled in assessing the value of shares by the existence of par value.***

b. ***Hong Kong company law concepts of maintenance of capital are constructed around the use of par value for share capital. Adopting a system of no-par will therefore require a fundamental change.***

c. ***Any new system would need to distinguish between existing share capital and shares issued without a par value, unless it was made compulsory to convert the existing share capital of all companies into shares of no-par value.***

d. ***Conversion of existing shares with a par value into shares of no-par value may affect or render ineffective provisions in share rights or in other contracts and documents that refer to or operate by reference to the par value.***[12]

e. ***If companies were to be permitted to create a new class of no-par value shares but retain the existing par value shares (that is, have both types of share capital), there may be scope for confusion. It might therefore be considered necessary only to permit no-par value shares in the case of new companies.***

f. ***Difficulties about issuing shares at a discount can be removed without abolishing par value. They can, for example, be largely side-stepped by issuing shares with low par values, or by simplifying the process (in section 50(1) of the Ordinance) for issuing share at a discount. Currently the discount has to be authorised by shareholders in general meeting and sanctioned by the court. One way of simplifying the process would be to dispense with the court approval, replacing that with a procedure that gives creditors an opportunity to object.***

g. ***Par value is needed to measure the statutory liability to pay any unpaid amount of the capital subscribed, ie in partly paid shares.***

h. ***Introduction of no-par value shares entails other technical problems, some of which are:***

(i) ***the treatment of the concept of partly paid shares, and of the liability to pay any unpaid amount on shares in a no-par value system;***

(ii) ***amendment of the accounting and tax requirements to take account of the absence of par values.***

i. ***It would take a large amount of Government and private sector time to put this into workable form, and for companies to understand the changes. The critics are not convinced that there are sufficient advantages to justify this cost.***

***Do you agree with the arguments listed above?***

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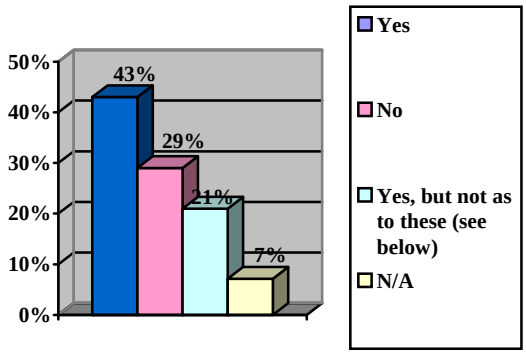
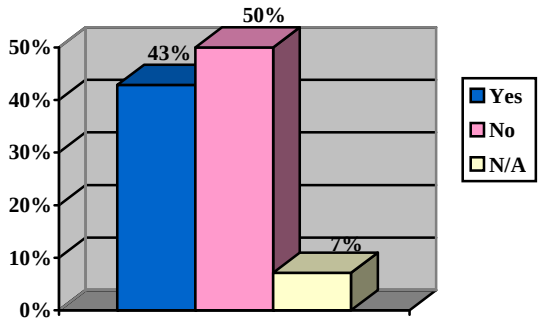
[12] A particular instance of this would be class rights in a company with more than one class of share capital, which are defined by reference to amounts paid up on the shares. Removal of the par value in such a case may constitute a variation of class rights.




A majority of the respondents (43%+21%) agreed with at least some of the arguments. 29% disagreed with all of the arguments whilst 7% did not indicate their position on this. The fact that more respondents agreed with the arguments (which were not all arguments against no-par systems) than not, does not of course suggest a rejection of the no-par system. Indeed, we do not think that the percentage of respondents answering affirmatively to this question should be interpreted as supporting the case against a no-par system, particularly when viewed with the endorsements reflected in the responses and comments given to questions 1.9 and 1.11 below. Rather this seems to us to be indicative of the view that the need to change the current system is not so overwhelming that it should be pushed forward as a priority.

***Question 1.9*: *Do you think that there is a real need for no-par value shares in Hong Kong?***




There appeared to be no real opposition to no-par on the merits of the system. However the responses were not unequivocal as to the present need to migrate to such a system. Of the respondents who replied to the questions in the consultation document and specifically Question 1.10, 43% answered "Yes", 50% "No" and 7% were ambivalent. The following reasons were given in support of why there was a real need for a no-par system:

- "Resolves the inhibition of raising fresh capital in the same class as discounts to par value. This is seen pertinent as the growing pace of globalisation is forcing businesses to rationalise and profit margins become thinner and harder to maintain."

- Hong Kong should endeavour to streamline the accounting and administrative work involved for the maintenance of registered companies in order to stay competitive in the world market.

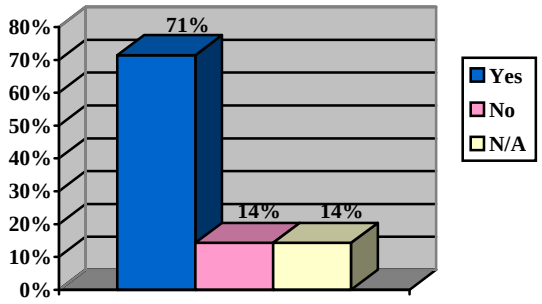
Those who answered "No" did not unfortunately give reasons for their choice. The comment of one of these in fact may be said to support a migration to no-par: 'Not a "real need" but it would be beneficial and a modernizing progression in the development of HK corporate law'. The respondent who did not answer Question 1.10 specifically said (under Question 1.11) that he had difficulty in answering this question as his practical experience in Hong Kong was limited, but was sympathetic to the views expressed in the memorandum in favour of no-par value shares.

A majority of those who answered more generally (7 respondents) were in favour of migration but one respondent questioned whether this (given the economic situation then) was an appropriate time to do it given the costs of effecting the change. Two were equivocal, with one respondent also questioning whether there was any overwhelming need to make the change at the time. Indeed, taken together with those responding on the consultation document itself, the percentage in support of moving to a no-par system increased to 52%, with 36% against and 12% indicating no preference.

The Financial Law Committee of the Law Society of Hong Kong decided against. This was not however a decision against the merits of a no-par system which the Committee acknowledged. In discussions with us following their written submissions, representative members of the Committee expressed the view that there was no real use for par today, and said that if the system was being designed again it would make more sense if it were a no par one. The Committee however did not think that the existing system was sufficiently problematic to justify costs and efforts to change it.

We agree that there is no pressing need for an immediate change to the current par value system. The no-par system is clearer and simpler to understand (and this does not seem in dispute) but the present par system is not so inherently flawed as to warrant an immediate change. A distinction should be drawn between deciding whether a no-par system is likely to be preferable over time and whether there is a current need or demand for change. Otherwise a decision may be made on what is unlikely to be an enduring consideration. The fact that public opinion has changed so substantially from the first stage consultation (where there were enthusiastic calls and even demands for a change to the present system) to the second (cost focused approach) is an indication of this.

***Question 1.11*: *If you were to incorporate a new company in Hong Kong, or are already in control of one, would you opt for no-par value shares for your company should the option (of par or no-par) be made available in Hong Kong?***



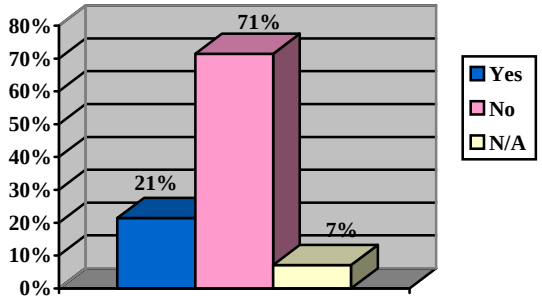

The response to this question bears out the proposition that there is no real opposition to no-par on the merits of the system. 71% of the respondents would not only opt for no-par value shares if they were to incorporate a new company, but would choose to convert the shares of an existing company to no-par value shares if the option was made available in Hong Kong. Those who answered 'No" did not provide reasons, but two respondents who did not select either Yes or No provided the following reasons for their ambivalence:

- "Depends on the purpose of setting up the company."
- "Whether we would incorporate companies with no per value shares is a question which cannot be answered hypothetically. It would depend on facts and circumstances at the time."

<u>Offshore incorporation</u>

Many companies choose to incorporate outside Hong Kong in places like the British Virgin Islands, the Cayman Islands and Bermuda that have a more flexible capital maintenance regime, whilst operating their business here.

***Question 1.13*: *Do you think that adopting a system of no-par may make it more attractive for companies to incorporate in Hong Kong?***



The respondents who answered 'Yes' said that it would only make it marginally more attractive. Those who answered 'No', being the majority of them (71%), were mainly of the view that the preference for places like the British Virgin Islands, the Cayman Islands and Bermuda are driven by considerations unrelated to no-par. These included a more flexible capital maintenance regime, but it must be said that a no-par regime can provide, and is often used, as the premise for a more flexible capital maintenance regime.

Implications of no-par regime on companies incorporated off-shore

Any amendment to the Companies Ordinance to legislate for no-par will not directly affect companies incorporated outside of Hong Kong, but the possibility cannot be dismissed that these companies, which have been operating against a background of par value, may be affected in some way by a change to a no-par regime. One possible effect is that these companies, which remain with par values under the laws of their incorporation, will no longer operate under the same regime as the rest of the companies in their group (which have shed their par values under Hong Kong laws). This may make it difficult to consolidate their accounts.

***Question 1.15: Please add any observations or comments on the possible implications on these companies of the implementation of a no-par regime in Hong Kong.***

The majority of respondents who responded to this were of the view that there should not be any accounting problems arising from companies in a group having par values and not.

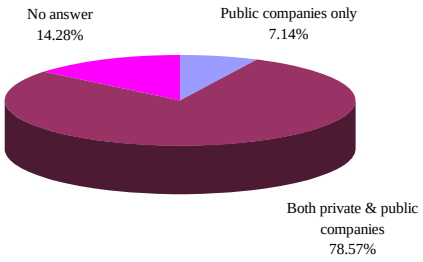
One respondent referred to the point made in the consultation document that the existence of different share capital structures among companies in the same group could cause problems with consolidated group accounts without expressly endorsing it.

## 2. Scope

**Types of companies**

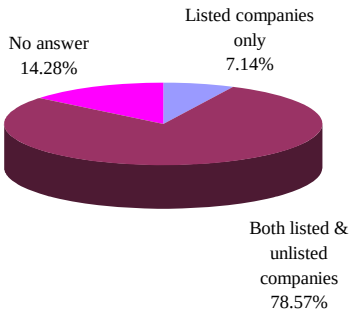
***Question 2.1 If a system of no-par is adopted for companies incorporated in Hong Kong it should apply to*:**

(a)



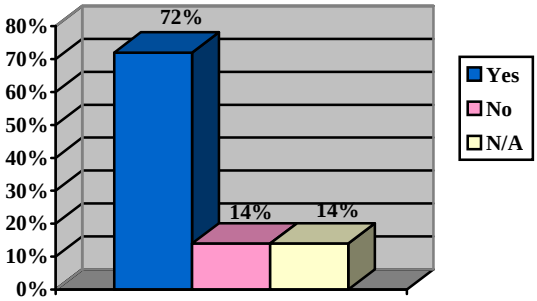

Private companies only: 0%

(b)




Unlisted companies only: 0%

**(c)** ***companies regardless of industry type?***




Two of the respondents whilst not making any selections in paragraphs (a) to (c) of Question 2.1 did in their response to Question 2.2 (invitation to supplement answers

to Question 2.1 with comments and observations) indicate a preference for no-par to be made available to all companies. For the purposes of recording responses to Question 2.1 however they count amongst those who provided no answer.

If a no-par system is adopted, an overwhelming majority is in favour of the system being extended to all companies. Some of these have provided the following reasons:

- "1. The need to maintain consistency and thus cause less confusion to non-sophisticated investors especially; 2. Potential for private companies to seek future listings as in the case of many listed companies in the past."

- "An universal approach should be adopted in order to avoid confusion – (but somewhat inconsistently answered "No" in relation to para (c) without providing a reason for the departure in relation to industry type)."

- "The same rules should apply to all companies to avoid confusion and to reduce complexity."

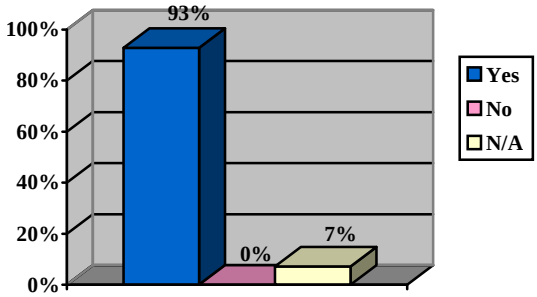
We would agree with this choice. It is also consistent with what most jurisdictions have done. The British Virgin Islands and Cayman Islands have applied the no-par system to international business companies (in the case of BVI) and exempt companies (in the case of Cayman) only. These are generally companies that are incorporated, but do not carry on businesses in those jurisdictions, and which are separately regulated from "local" companies. Hong Kong does not differentiate between companies this way so that any consideration that underlies the BVI and Cayman restrictive application of the no-par scheme (which we were not able to establish) should not apply here. There does not appear to be anything otherwise peculiar to Hong Kong incorporated companies that requires a departure from the general rule.

One respondent thought that the no-par system should be extended only to public companies whose shares are listed but provided no reasons for limiting it this way. We are of the view that there are no compelling reasons for limiting the no-par system to listed companies only. Indeed distinguishing its application this way may unnecessarily complicate the listing process. England decided recently to delay legislating for no-par until it was possible to apply it to both private and public companies (and the EU Second Company Law Directive was thought to stand in the way of legislating it for public companies). Equally we should apply it to both, if at all.

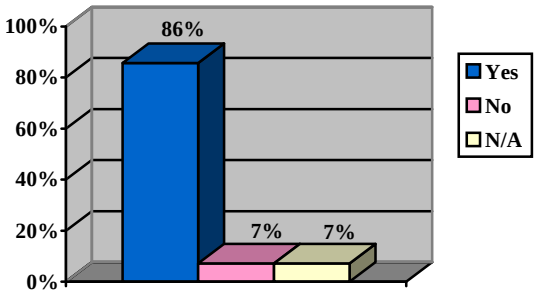
Types of shares

***Question 2.2.1: If a system of no-par is adopted, should this apply to:***

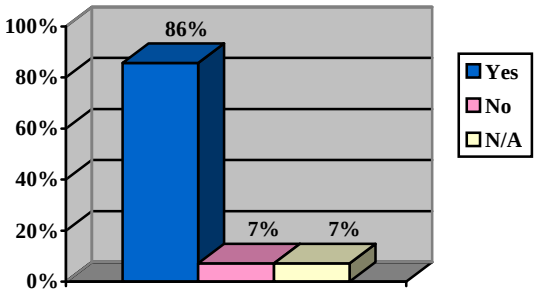
**(a) preference shares**




**(b) redeemable shares**




**(c) redeemable preference shares**




The same majority thought that, if adopted, the no-par system should be extended to all shares. The following reasons were given:

- "Same need expressed for consistency."

- "The significance of par in redeemable or preference shares is it being the reference point for the calculation of the dividends. We believe this purpose can be easily substituted by other means of reference."

- "If a no par value system is implemented, we see no reason why it should not be possible for all types of shares to have no par value on an optional basis."

One subjected this to a qualification on redeemable shares that it should only apply to new shares as the terms for redemption and dividend payment have already been prescribed at the time of issue. A consequence of applying no-par to new issues only whilst retaining par for existing shares is that companies will have a mix of par and no-par shares. The Guernsey no-par model (see Appendix A) has this structure – companies can issue no-par shares (or shares with par value), but cannot convert par value shares to no-par shares. In Guernsey the reason for this seems unrelated to the treatment of redeemable shares that have par value at the time of commencement of the no-par regime there. Under Guernsey law the consideration for no-par value shares is transferred to share premium[13], which can be used for redemption of any no-par value shares.[14] We have been told by Guernsey lawyers that the law enabling the no-par shares did not provide the facility for conversion of existing par value shares into no-par value shares probably to avoid abuse where shares are converted to release otherwise undistributable share capital.

It is possible to provide for redeemable par value shares even in a fully no-par environment. In Australia and New Zealand, all shares (including redeemable shares) were automatically converted to no-par value shares upon commencement of the no-par regime, with no apparent difficulty in relation to the redeemable shares. There is no reason why payment for these shares cannot continue to be computed by reference to the par value if that was the term of its issue. Australia legislated for this (s601BQ Corporation Act 2001 and s1449 of the Company Law Review Act 1998)[15] by providing that a reference to the par value of a share is to be taken to be a reference to the par value of the share immediately before registration/commencement, or the par value that the share would have had if it had been issued then.

The position is more complicated where the redeemable share in issue at the introduction of the no-par regime was issued on terms that a premium would be paid on redemption. This is because there may not be a share premium account from which this can be paid. One possibility is for the rules to provide that redeemable shares may be redeemed from distributable profits or from the proceeds of a new issue. Australia dealt with this issue by preserving the right of the company to use amounts standing to the credit of the share premium account immediately prior to commencement of the no-par regime to pay the premium payable on redemption of redeemable shares issued before commencement. Guernsey provides that the whole

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[13] Regulation 3(5) of the Companies (Shares of No Par Value) (Modification of Legislation) Regulations 2002. This departs from most other no-par systems.

[14] Regulation 3(6), *ibid.*

[15] S601BQ applies to companies that become registered under the Act after commencement of the no-par system, whilst s1449 applies to those registered under the Act before the commencement.

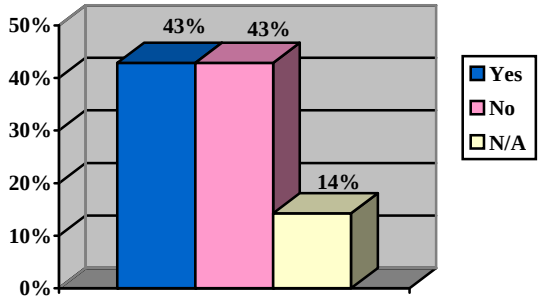
of the proceeds of an issue of no-par shares shall be transferred into share premium, which may be used for redemption purposes.

**Partly paid shares**

There are also conflicting views as to whether partly paid shares can or should be accommodated within the no-par regime. The concern is that there would be problems in the treatment of the concept of partly paid shares, and of the liability to pay any unpaid amount on shares in a no-par value system. This is because the Companies Ordinance regards as partly paid shares that are not fully paid as to their par value. Amounts outstanding on the premium are a matter of contract, not the Ordinance.

South Africa and Canada did not accommodate partly paid shares within their no-par regime. Australia did, but prohibited the redemption of no-par redeemable shares whilst partly paid. It was felt (in the case of Australia) that the complications involved in conversion of partly paid redeemable shares would outweigh any benefit to be derived.

***Question 2.4: If a system of no-par is adopted, should this apply to fully paid shares only?***




The respondents were equally divided on this (with 14% abstaining from making a choice). Two of those respondents who would extend the no-par regime to partly paid shares provided the following comments:

- "Provided adequate and comprehensive amendments are made to the companies Ordinance, there is no reason why no par value shares cannot be partly paid."

- "Partly paid shares can be treated as partly paid on issue price instead of par value."

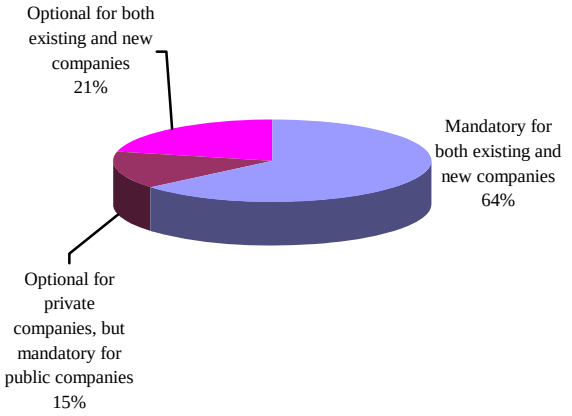
Amongst the respondents who felt that the system should not be extended to partly paid shares, one objected not because it thought that it could not be accommodated within the no-par regime, but on the more fundamental ground that like par value shares they are a relic of a Victorian notion of share capital which should be removed. The other respondents who felt that the no-par system should not be extended to partly paid shares did not provide reasons, and it is possible that at least some of them

may also have thought that partly paid shares should be abolished. This may explain the otherwise somewhat incongruent responses recorded for Question 3.13 in which 71% of the respondents said that it should be possible to convert shares that have not been fully paid to no-par value shares, suggesting that a majority of the respondents may not see any legal, accounting or tax issues as standing in the way of removing par values from partly paid shares. Indeed there appears not to be.

Whether partly paid shares should be abolished in any event is strictly an issue separate from that of abolition of par values and is dealt with under Question 8.6 as an issue of wider reform.

## 3. Model of no-par

***Question 3.1 If a system of no-par is adopted, which of these forms should it take?***




***Mandatory for new companies, but optional for existing ones: 0%***

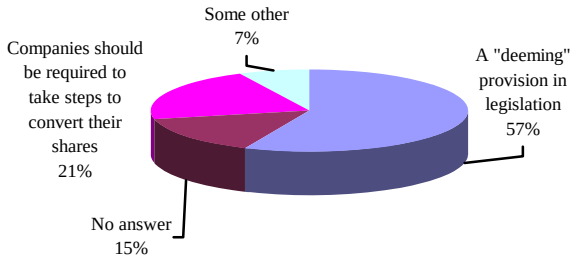
***Some other: 0%***

The weight of popular opinion was thrown in favour of a mandatory system for both existing and new companies, with uniformity and simplicity as the main reasons for this choice. There was also fairly substantial support (21%) for an optional system that would apply to all companies.

None of the respondents who answered the detailed questions in the consultation document were in favour of a hybrid system of mandatory no-par for new companies and optional for existing companies (the system preferred by the task force of the Standing Committee on Company Law Reform. One respondent (which answered generally) did indicate a preference for this model but for a reason which is not immediately obvious.

Another respondent (which also answered generally) on the other hand preferred a uniform application of no-par to all companies (and their shares) on the grounds that a situation where the shares of some listed companies have a par value while those of other listed companies do not, where a listed company has both par value and no-par value shares or where different companies within a listed group have different systems would probably not be conducive to an orderly market.

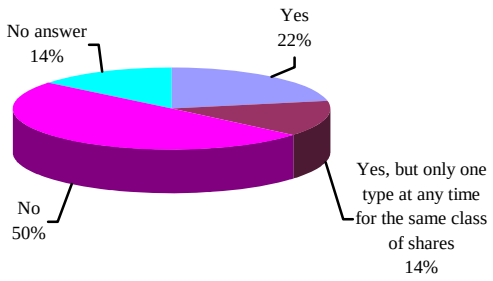
***Question 3.3 If a mandatory system of no-par is adopted, which of the following implementation methods do you consider should be used?***




The Companies Ordinance will have to be amended if no-par value shares are to be authorised or required, and the nature and extent of amendment will largely be a function of the model of no-par that is to be adopted. One way of achieving the change is by legislative provision deeming any reference to par value of a share in any ordinance, instrument or arrangement after conversion to be a reference to the par value of the share immediately before conversion, and the rights attached to the share to be the rights as defined by reference to that par value. There is a need however to consider whether this should be absolute, or whether it should be possible to exclude the application of the deeming provision by express provision in the instrument or arrangement. If the migration to no-par is mandatory, it should not be possible for companies to exclude the conversion, but it may be thought to be necessary to allow companies some flexibility in the details of the conversion.

A majority of respondents (57%) favoured a deeming provision in the legislation mainly on grounds of minimising disturbance and costs to the companies, with a number of respondents cautioning on the need to carefully consider ramifications on existing contracts.

***Question 3.5: If an optional system of no-par is adopted, should a company be able to have a mixture of par and no-par value shares?***




Half the respondents voted 'No' on this, largely on grounds that a system which allowed a mixture of par and no-par would be too complicated. A not insignificant number (22%) voted in favour but unfortunately provided no reasons for their choice. Presumably it was felt that a system that gives companies a choice (as to whether to convert their shares to no-par) should also allow them to decide whether all or some only of their shares should be of no-par. This is more than the 14% who would allow a mix but not within the same class of shares.

More jurisdictions migrating to no-par recently have adopted the mandatory than any other system. Indeed Ontario and a number of other Canadian provinces which had adopted the optional system much earlier have more recently converted to a fully mandatory system, suggesting that there are good practical reasons for the choice of the majority (of the respondents).

***Question 3.7: If the ability to issue shares of no-par value is to be accorded and companies are to have an option as to whether to have shares with par value or shares of no-par value, should it be possible for a company to convert shares having par value into shares of no-par value and vice versa?***

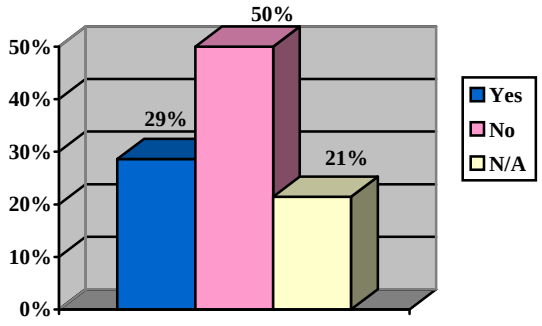
Yes: 57%

No: 29%

N/A: 14%

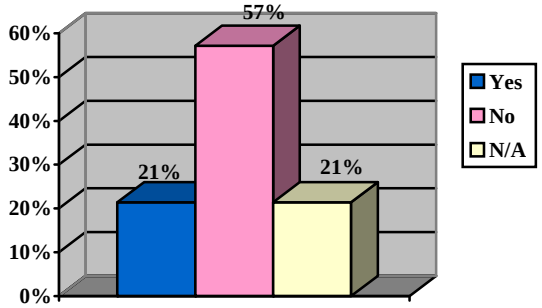
A majority (57%) of respondents thought that companies should be allowed to convert shares from one system to the other. Only one of these provided a reason for the preference which is that it will allow portability to a company crossing to another jurisdiction. Those who were against thought that this would be inconsistent with the overall objective of having a no-par system and that it might be confusing to shareholders.

***Question 3.9: If the ability to convert shares having par value into shares of no-par value and vice versa is accorded, should conversion be allowed on more than one occasion? Should a company that has converted its par value shares to no-par value shares be allowed to subsequently convert them back to par value shares for instance?***



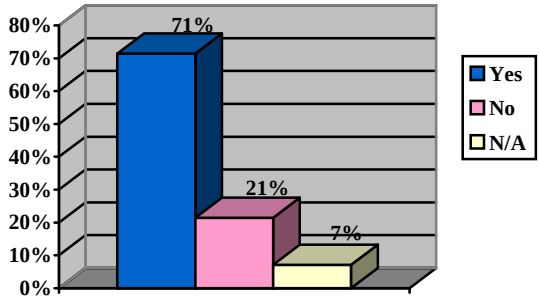

Far fewer thought that companies should be allowed to convert from one system to the other more than once. One of those who thought that it should said that an optional system should 'allow the widest practical freedom of choice' subject to caveats that there must be a clear system in place to ensure that the investing public are adequately informed of the dual systems. Another respondent felt that shares that had been converted to no-par should only be allowed to be converted back to par value shares under a court order.

***Question 3.11: Should it be possible to convert part only of these shares?***




Even fewer were in favour of this flexibility being extended to part only of the shares.

***Question 3.13: Should it be possible to convert shares that have not been fully paid?***




71% of the respondents thought that it should be possible to convert partly paid shares to share of no-par value, suggesting that a majority of the respondents may not see any legal, accounting or tax issues as standing in the way of removing par values from partly paid shares. The responses to this question appear at first blush to be at odds with that to Question 2.4 which basically asked the same question but in a more general context (and where 43% only thought that it should be possible to convert partly paid shares to no-par). As pointed out in the earlier analysis, the responses are not in fact inconsistent. The responses to Question 2.4 were skewed to a larger proportion of noes by those who felt that partly paid shares should be abolished together with par values.

<u>The Californian and German systems of optional no-par</u>

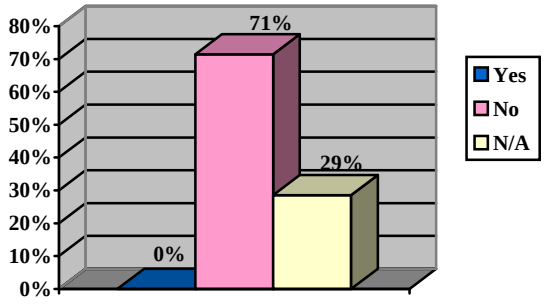
The Californian and German models are substantially different from the usual models of no-par and from each other, despite both being labelled "optional no-par" regimes. The California General Corporation Law does not prohibit the use of par value shares (so that a company can choose to retain them) but it does remove the legal significance of par, save for very limited purposes. The legal effect of par value with respect to dividends, redemption of stock and payments for stock is eliminated, whether or not the corporate charter documents continue to contain references to it. Companies can retain references to par value in their charter documents to enable them to be qualified in foreign jurisdictions in which the franchise or other taxes are computed on the basis of par value, and to have (and therefore use) par value for those purposes. Effectively however, shares of Californian companies regardless of their label are no-par value shares.

In Germany it is possible to have either par or no-par value shares (but not both). Companies that choose to have no-par value shares nevertheless retain the concept of an amount representing total issued share capital. This amount is divided into shares, each of which represents the shareholder's "participation" in the company. Take the case of a German company with a total issued share capital of 10M Euro. This amount is divided into shares, each of which must not be of a value less than 1 Euro. In this case let us assume that the 10M Euro is divided into one million shares. A shareholder who holds 10,000 shares has a proportional interest in the issued share capital represented by 10,000 out of 1,000,000 shares. Although it is possible to work out the "value" of each share, the shares are issued without mention of the value. In

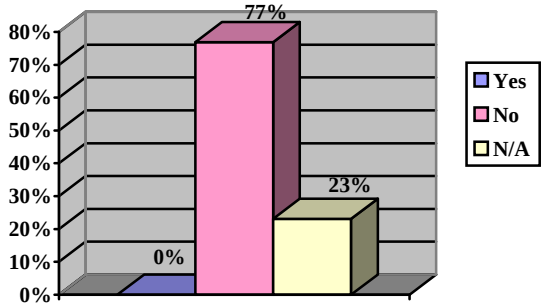
this case each share has on issue a monetary value of 10 Euro, referred to as the "accountable par". Unlike the par value, the accountable par is not fixed. A subsequent share issue at a higher price (subsequent issues cannot be made below the accountable par) automatically pushes up the accountable par value.

Critics say that this perpetuates the requirement that shares have a par value to create a "floor" price below which new shares cannot be issued. This clearly falls somewhat short of a true system of no-par value shares in that it appears to treat shares without a par value in almost the same way, for capital maintenance purposes, as shares with par values. No-par value shares in the strict sense of the term are in fact prohibited in Germany. This system of no-par does however mean that no amount is stated on the share certificate that may mislead the unsophisticated investor, and there is no "fixed" par value.

***Question 3.15: Is the Californian model of optional no-par suitable for Hong Kong?***




***Question 3.16: Is the German model of optional no-par suitable for Hong Kong?***



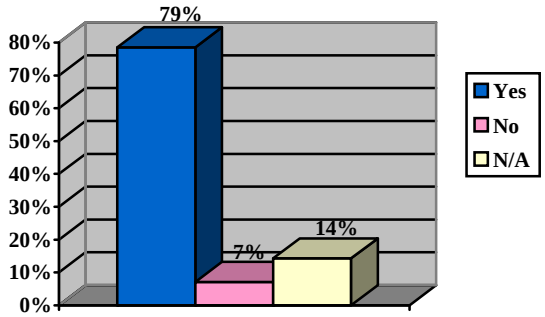

None of the respondents thought the Californian or German systems of no-par suited to Hong Kong. The reason is obvious for the German system but less so for the Californian one (and to an extent this may explain the slightly higher number of respondents who rejected the German system to the Californian one). Clearly having par value in substance but not in form is not the way forward if we are to move to a no-par system for the advantages that it is said to bring.

The Californian system (which in essence is a form of mandatory no-par) has all the advantages claimed for the no-par system and additionally enables companies (otherwise having no-par shares) to claim the advantages available to companies with par values in another jurisdiction. Logically there is much to be said for such a system. The legislative treatment will be more detailed, but not substantially so.

Unfortunately very few respondents have provided reasons for rejecting the Californian model and the few who did have appear not to have fully understood it, perhaps because of the brief treatment given to it in the consultation document.

## 4 Legislative Changes

***Question 4.1: Do you consider that a deeming provision with appropriate safeguards would be appropriate?***




Almost 80% of the respondents thought that a legislative provision (with appropriate safeguards) should be the way to effect a change to no-par. The reason for this choice (as reflected in the further comments) is that it will save considerable conversion work for the companies. One respondent (who agreed) subjected it to the caveat that the effect on overseas registered companies listed in Hong Kong should be fully addressed in any legislative amendment.

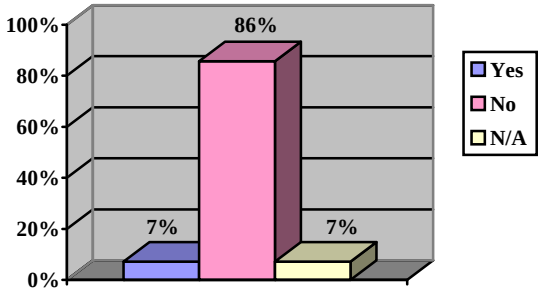
Question 4.3 which asked whether there were legislations, instruments and arrangements that the respondents anticipate may require special treatment (where the general deeming provision may not be sufficient) drew only two substantive responses. These said that:

- "The way to complete the proportional interest in a company with different classes of shares will have to be specified for purpose of the SFO."

- "The Hong Kong Society of Accountants should be fully consulted in this respect as accounting guideline or statement of standard accounting practices should reflect the change in legislation accordingly."

One respondent (which was consulted and provided a general response) agreed with the view expressed in the consultation document that care should be taken in the formulating of the deeming legislative provision and the illustration of a possible unintended result but provided no other specific areas of concern.

***Question 4.4: Do you anticipate any problems in relation to the listing or trading of shares of no-par value?***




Almost all the respondents did not anticipate any problems in relation to the listing or trading of shares of no-par value. That must be correct. No-par value shares have been listed on other stock exchanges without any apparent difficulty. There does not appear to be anything peculiar to the Hong Kong stock exchange for it to be any different here.

One respondent which had 'considered the issues raised in the Consultation Paper purely from a listing-related perspective' said in their general comment that in the event that Hong Kong moves to a no-par value regime, they would obviously need to make consequential changes to the Listing Rules, the nature and extent of which would depend on the nature and extent of the changes to the law. They highlighted the following (the comments are reproduced verbatim):

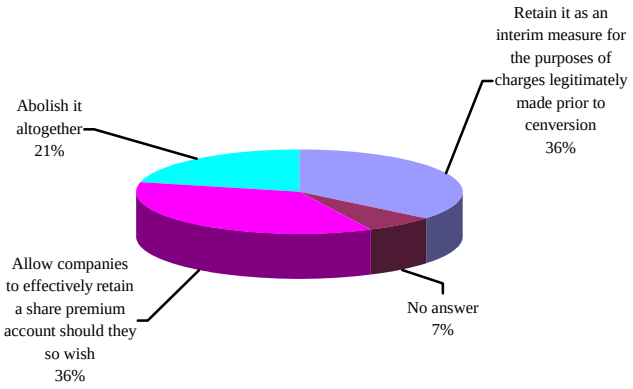
- As a general principle, the Listing Rules seek to protect the interests of shareholders by requiring certain acts to be made subject to shareholders' approval or, where there is less scope for corporate malfeasance, disclosure. Specifically as regards dilution of shareholders' interests, I would not expect a move to a no-par value regime, by itself, to have any major impact, if at all, on the Listing Rules in relation to protection against such dilution as par value has never been a consideration in this regard.

- As regards the return of share capital to shareholders in the winding-up of a company, I understand that shareholders rank after all other persons entitled to a distribution of the company's assets (in particular, creditors). Therefore, any protection afforded in this regard is in any event so remote as to be illusory. Thus, I would not expect the abolition of par value to make any major difference on this point either.

- The Listing Rules currently provide for annual listing fees to be calculated by reference to the nominal value of the company's listed equity securities. If the shares have no par value, we will obviously need to adopt an alternative method of determining the amount of such fees payable. This will probably be undertaken by one of the business units within the Exchange (i.e. not the Listing Unit).

- If a new regime is to be introduced, one should endeavour to keep any disruption to the market to a minimum. I would suggest that, upon enactment, the coming into force of any new regime be delayed for a reasonable period so as to allow time for companies to review their Memorandum and Articles of Association, contracts and other relevant documents. In our case, the time would be needed to make the necessary consequential changes to the Listing Rules.

***Question 4.6: Which of these options would you prefer in relation to the treatment of share premium?***

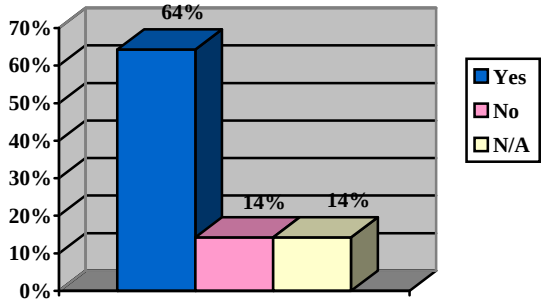



There is no one clear preference. Respondents are equally divided (36% each) amongst those who would retain the share premium as an interim measure and those who would allow companies to retain it effectively. A not much lower percentage (21%) thought that share premium should be abolished altogether.

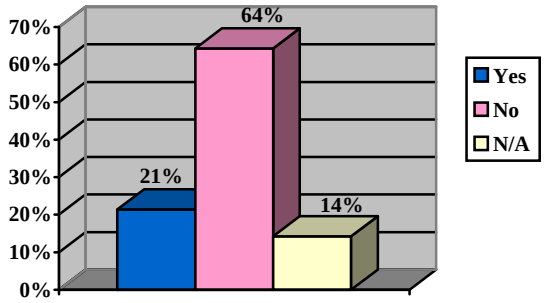
One respondent (which answered generally) said that allowing existing companies the use of a share premium account under the system of no-par, such that the share premium can be distributed subject to an overriding solvency test (applicable to all distributions), would obviate the need to take the radical step of requiring all existing companies to convert their par value shares to no-par value shares.

***Question 4.8: If a mandatory no-par regime is adopted, should the currently permitted applications of the share premium account***

**(a)** ***be extended to the whole of the subscribed share capital?***




**(b)** ***be removed completely?***




***(c) dealt with some other way?***

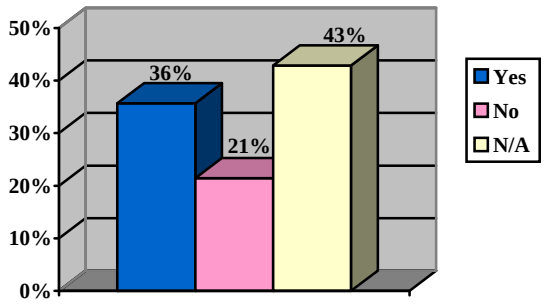
More respondents would prefer the currently permitted applications of the share premium account to be retained (by extension to the whole of share capital) than removed completely. None suggested that they should be dealt with in some other way.

One respondent which was in favour of retaining the currently permitted applications of the share premium account by way of its extension to the whole of share capital said that to retain a share premium account or a shadow share premium account would defeat the original purpose of having a no-par regime.

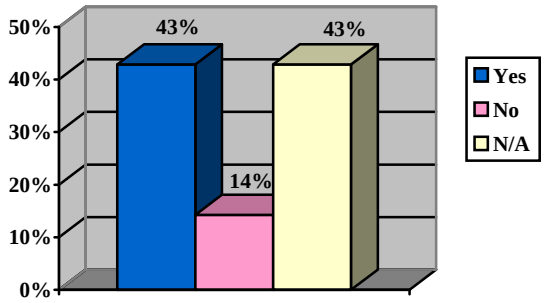
As under a no par value system, bonus shares can be issued without the need to charge the value to either the share premium account or the profit and loss account we can see no strong reason to retain a voluntary share premium account. Indeed we can see a benefit of a no par value scheme that a company with less cash may offer shareholders the choice of a cash dividend or bonus shares where the bonus shares have a higher value than the dividend. This would depend on the articles of the company.

***Question 4.9: If an optional no-par regime is adopted, should the currently permitted applications of the share premium account***

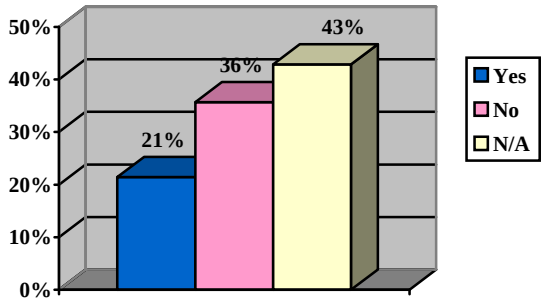
**(a)** ***be retained for the share premium account?***




**(b)** ***be extended to the whole of the subscribed share capital?***




**(c)** ***be removed completely?***




**(d)** ***be dealt with some other way?***

Question 4.9 asked a similar question to that in Question 4.8 but in the context of an optional no-par environment. Almost half (43%) of respondents did not make a selection for (a) to (c), whilst none took up the invitation in (d) to

suggest some other (better) treatment of the currently permitted applications of share premium if an optional no-par were to be adopted.

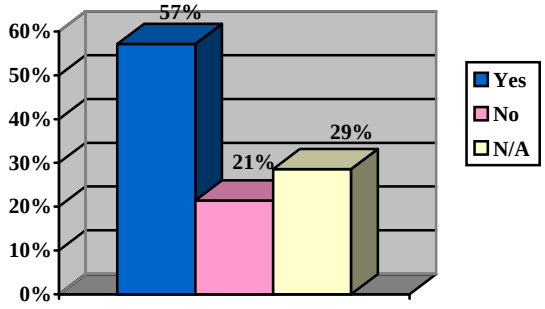
Slightly more respondents preferred the current application of share premium to be extended to the whole of the subscribed share capital (43%) than to be retained for the share premium (36%). 21% felt that it should be removed altogether. None suggested that they be dealt with in some other way.

Different classes of shares

Where a company with different classes of shares becomes part of a no-par regime it will be necessary to assess how the proceeds of a share issue will be recorded in the contributed capital account (ie the account to which the proceeds of the share issue are credited) where the shares have been issued with varying premiums. If those issues have been of shares of one class all with the same par value, the variation in premiums would not impede the merging of share capital and share premium accounts. Shares are not defined by the amount of their premium; the latter is normally a function of the market value of the share at the time of issue. Thus an ordinary share issued at par (say $1.00) carries the same rights as another share subsequently issued at a premium of 50 cents, or indeed any other premium.

But if there have been issues of different classes of shares, there may be special class rights to claim premium amounts in a winding up, which would need to be preserved.

**Question** ***4.10: Would a "shadow share premium" account as described in the consultation document be an adequate measure by which class rights that recognise a premium can be preserved?***




A majority of respondents answered in the affirmative. The choice is however undermined by the fairly substantial number of respondents who did not select either a "Yes" or "No" answer but who may have by that omission intended to disagree in substance, as indicated in the further comments of these two respondents (who were amongst those who did not select an answer:

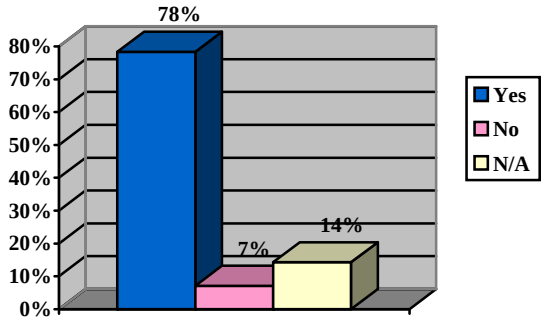
- "This sort of point underlines the necessity for the no par value system to be optional."

- "A shadow share premium account would imply the existence of a par value system and contradicts one of arguments advanced to support the case of no-par value shares: "the concept of 'par value' is potentially misleading."

Bonus shares

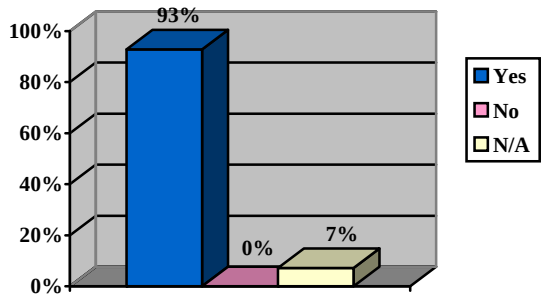
Companies are currently able to pay up new shares ("bonus issues") by transferring amounts from share premium account to share capital. In a no-par environment, where there would not be a distinction between share premium and share capital, the equivalent transaction would be that shares would be allotted to shareholders as bonus shares without transferring any amount to the share capital account. All that would occur is that the number of shares in issue increases. Such a transaction is, in a no-par value context, no different from a subdivision of shares under section 53(1)(d) of the Ordinance and no special provision in the legislation would be required for it.

***Question 4.12: Do you agree with the treatment of bonus shares outlined above?***




The treatment of bonus shares as outlined is an uncontroversial one, and the responses reflect that. One respondent added that the bonus share issues should be noted in the company financials for record.

***Question 4.14: Do you agree that preference shares of no-par value should be allowed?***

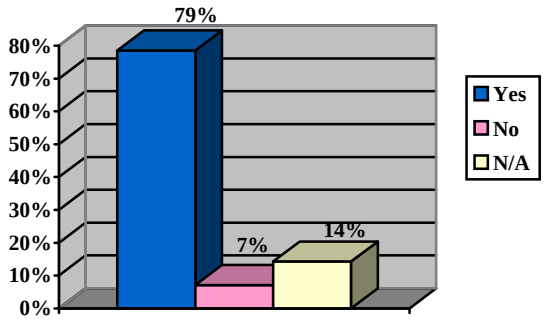



Overwhelmingly, and without qualifications, respondents agreed that preference shares of no-par value should be allowed.

Redeemable shares

Currently a company with redeemable shares that it is about to redeem has the power to issue new shares up to the nominal amount of the shares to be redeemed.

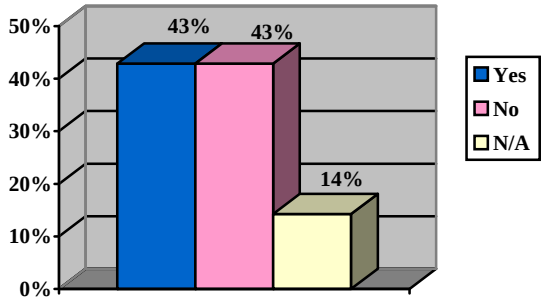
***Question 4.16: Should such shares be convertible to no-par value shares?***




Most respondents (79%) thought that redeemable shares should also be convertible to no-par value (redeemable) shares. This is consistent with the preference (reflected again in a further comment) that all classes or categories of shares should be allowed to convert to no-par value shares.

One respondent qualified its 'Yes' with the conditions that the converted shares remain redeemable and that redeemable no-par value shares must be capable of existence in a no-par regime.

***Question 4.18: If a no-par regime is adopted, should there be any restriction on the number of new shares a company is permitted to issue in these circumstances?***




Respondents were equally divided on this issue. An examination of the further comments suggest that some of the respondents may have overlooked the fact that the question was asked in the context of redeemable shares, and not generally:

- "The existing restriction on general mandate of 20% issued capital should be maintained."

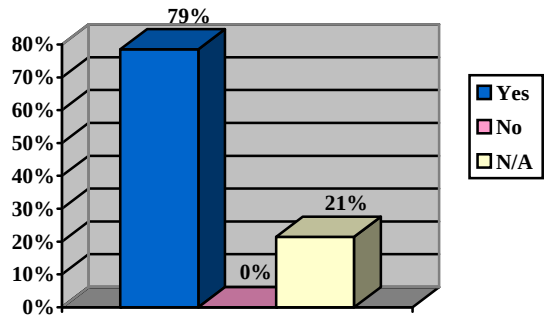
- "Any restriction on the number of new shares a company is permitted to issue will hinder any business expansion and fund raise exercise."

One respondent which answered 'Yes' said that it would presumably be necessary to have rules which will ensure that the number of new shares issuable will be fair both to the preference shareholders and to any other class of shareholders.

Redeemable shares issued at a premium

Redeemable shares which were issued at a premium to par value may, as to any premium payable on redemption, be redeemed out of the proceeds of a new issue and the company's share premium account may be used. In a no-par environment, one possibility for companies which have par value shares in issue at commencement of the no-par regime and for all newly formed companies with no-par value shares, is for the rules to provide that redeemable shares may be redeemed from distributable profits or from the proceeds of a new issue. Such shares will have no-par value at redemption, so there will be no way of replicating the present distribution between rules for the redemption of nominal value and rules relating to any redemption of premium.

***Question 4.20: Do you agree with the treatment of redeemable shares issued at a premium outlined above?***




All those who answered this question agreed to the suggested treatment.

Merger and Group reconstruction relief

Relief from the obligation to transfer amounts to the share premium account is currently provided in the Ordinance:

(a) where shares are issued at a premium as consideration for the transfer or cancellation of another company's shares in the context of a merger (section 48C); and

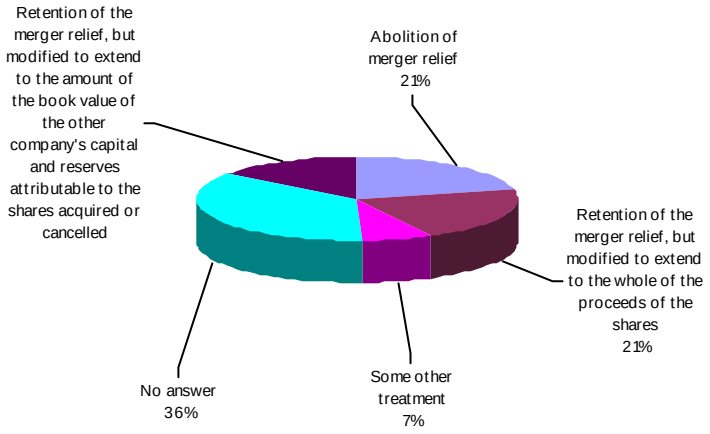
(b) where shares are issued at a premium as consideration for the transfer of assets in the context of a group reconstruction (section 48D).

In the case of mergers, the relief extends to the whole of the premium. For group reconstructions, it is limited to any excess over the base value of the assets transferred.

For companies with no-par value shares, the choice is whether to extend the relief in each case to the whole of the proceeds of the shares, withdraw it completely, or apply it to some part of the proceeds of the shares. In the case of mergers, the relief if extended to the whole of the proceeds could risk serious erosion of the subscribed capital of the new company compared with the merging companies. This is because nothing is recorded within subscribed capital on issuance of the shares. This does not argue completely for withdrawal of the relief, as the provision might be modified for no-par value shares so that the amount to be transferred to subscribed capital is, for example, the amount of the book value of the other company's capital and reserves attributable to the shares acquired or cancelled.

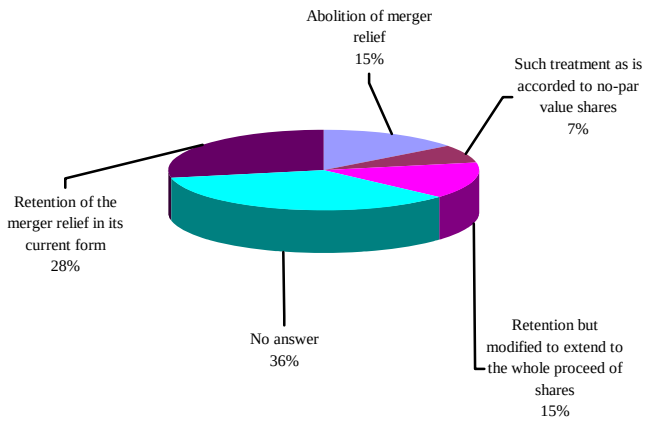
For companies with par value shares the amount to be transferred could, as at present, be the par value of the shares issued. However this will result in companies with shares with par and no-par values being treated differently in respect of the relief. Whether they should be is an issue that requires consideration.

***Question 4.22: Assuming the abolition of par value shares, which of those do you favour?***




There was no clear preference from the respondents. An equal number of respondents thought the relief should be abolished altogether as those who thought that it should be retained and extended to the whole of the proceeds of the shares.

***Question 4.24: For companies that retain par value shares which of these do you favour?***



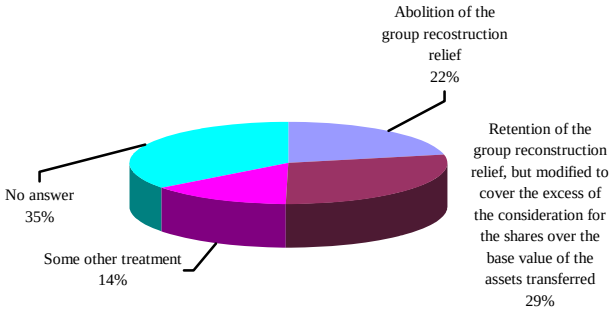

***Retention of the merger relief, but modified to extend to the amount of the book value of the other company's capital and reserves attributable to the share acquired or cancelled: 0%***

Apart from those who did not answer (the largest majority), more respondents thought that the merger relief should be retained in its current form for companies that retain par value shares than any of the other options suggested in the question. This will result in companies with shares with par and no-par values being treated differently in respect of the relief.

Group reconstruction relief

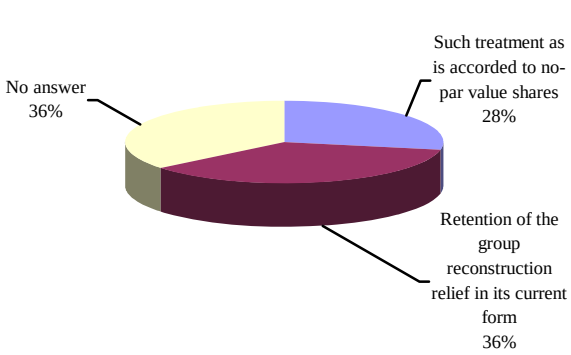
In the case of group reconstructions, the relief is currently limited to the excess of the premium over the base value of the assets transferred. The danger of erosion of capital is therefore substantially less. For companies with no-par value shares, relief from transfer to subscribed capital could cover the excess of the consideration for the shares over the base value of the assets transferred. For companies with par value shares the substance of section 48D of the Ordinance could remain. Alternatively the modified form of the relief suggested for no-par value shares could be extended to shares with par value in order not to distinguish between them in the application of the group reconstruction relief.

***Question 4.26 Assuming the abolition of par value shares, which of those do you favour?***




Of those who responded, more preferred the retention of the relief, modified to cover the excess of the consideration for the shares over the base value of assets transferred to any other option. Abolition of the relief was the second most popular choice, with one of those making it explaining that since the significance of a premium account will be substantially reduced if a no-par system is adopted, the significance of group reconstruction relief will be reduced as well.

***Question 4.28 For companies that retain par value shares, which of these do you favour?***



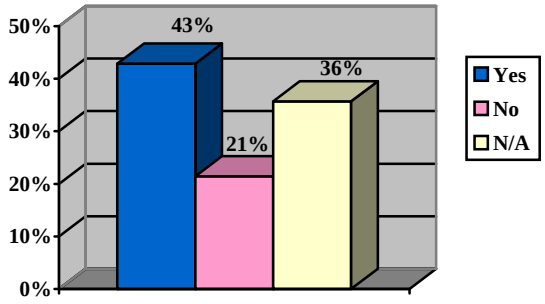

Some other treatment: 0%

Apart from those who did not answer, more respondents thought that the group reconstruction relief should be retained in its current form for companies that retain par value shares than any of the other options suggested in the question. This will result in companies with shares with par and no-par values being treated differently in respect of the relief.

Section 48E

Section 48E of the Ordinance sets out the consequences for the asset side of the balance sheet where merger relief or group reconstruction relief is available. For companies with no-par value shares, an appropriately modified provision would be needed under which, where all or part of the consideration for the shares is not transferred to subscribed capital, that amount may also be disregarded in determining the amount at which any shares or consideration for shares are included in the balance sheet. For companies with par value shares, the substance of section 48E could remain, or the provision as modified for no-par value shares could apply where each relief would apply to par and no-par value shares in the same way.

***Question 4.30: Do you agree that if merger relief and reconstruction relief are available, the substance of section 48E of the Ordinance should be retained with appropriate modifications to accommodate any changes to those reliefs?***




More respondents agreed than not but the number of respondents who did not take a position was significant.

There was no clear majority for any of the questions related to merger and group reconstruction relief, and the numbers who did not answer at all were large. This is not surprising as this is an area that is highly technical and of some complexity. It would seem that any recommendation here should be from accounting experts.

Distributions rules

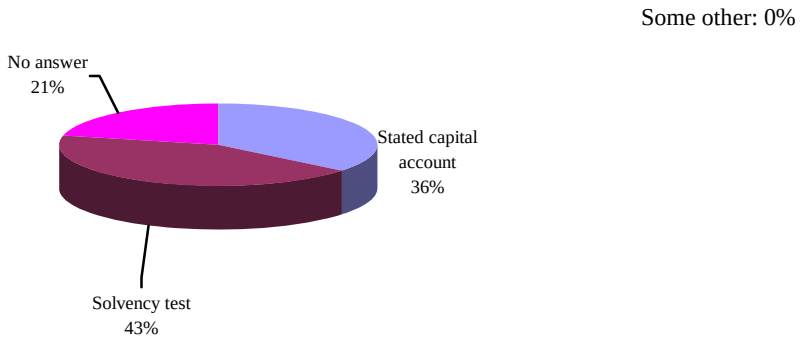
There are at least two contrasting formulations for rules on capital distribution. The first is to carry the whole of the proceeds to a "stated capital account" which would take the place of the paid-up capital and share premium account, with distribution rules similar to that for share capital. This is applied in Canada and was the recommended approach by the Gedge Committee in the UK.

The second is a "solvency test" which New Zealand preferred and implemented. The New Zealand Law Commission when recommending the abolition of par value recommended against having a stated capital account. The Law Commission adopted a broad principle that the propriety of any distribution by a company to its shareholders, whether by way of share re-purchase or dividend, should be governed by a solvency test. All directors who vote in favour of a distribution must sign a

certificate that in their opinion the company will, after the distribution, satisfy the solvency test. If reasonable grounds did not exist for the opinion set out in the certificate, those directors who signed the certificate would be personally liable to the company to restore the distribution, except in so far as it may be recoverable from shareholders. The solvency test is a "two-pronged one to ensure both 'balance sheet' solvency and 'cash flow' solvency."

The New Zealand Law Commission felt that the stated capital account merely reinstates under a different name the concept of nominal capital for the purposes of distributions and provides insufficient protection for creditors at risk.

***Question 4.32: If par value shares are abolished, which of these distribution rules do you think should be adopted in Hong Kong?***




The solvency test had a slightly higher vote to the stated capital account. None of those who chose the solvency test gave reasons for their choice but two of those who preferred the stated capital account did. Both of these were companies:

- "In order to provide sufficient protection for creditors, stated capital account should not be distributed easily. We consider the current distribution rules for share capital has already served that purpose."

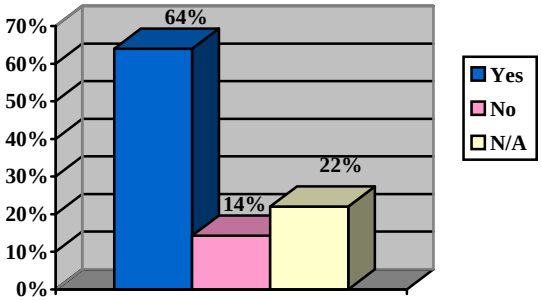
- "It is unreasonable that directors are asked to certify solvency on the distribution of distributable reserves."

More significantly the Hong Kong Society of Accountants has thrown its weight behind the solvency test method, in fact making it a pre-condition to the adoption of a no-par regime:

We would favour the adoption of a no-par regime subject to clear rules being formulated on capital distribution by way of share repurchase or dividend, including a "solvency test". It is not clear from the consultation paper how the solvency test is to be defined and implemented. The solvency test should be clearly defined with proper benchmarks, for example, by reference to balance sheet solvency, covering both

current and total assets/liabilities, and income statement and cash flow solvency, to ensure objectivity in the assessment of solvency. In the event that professional advisers are called upon to give an assurance in relation to solvency, the lack of proper benchmarks could impose an unacceptable degree of risk upon them as well as potentially creating an expectation gap between the level of assurance that professionals are in reality in a position to give and the public perception of that assurance. There would need to be a firmly established procedure with an agreed reporting format and terms of reference for this proposal to be practicable. There seems to be no clear indication in the consultation paper whether this has been the outcome in the jurisdictions where a solvency test now operates.

***Question 4.34: If par value shares continue to be permitted, should the equivalent regime be applied to share capital and share premium accounts?***

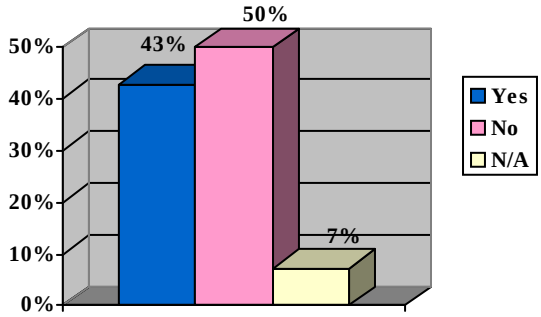



A majority of the respondents (64%) would prefer the same regime (or equivalent) to be applied to shares of par and no-par should they co-exist. A major law firm (which did not select an answer to Question 4.34) however disagreed stating that if par value shares continue to be permitted, they could see no reason to change the present distribution rules (as applied to companies with par value shares). This must be correct in the case of stated capital as the distribution rules are the same. However where the solvency test is adopted much more can be said for applying the same test for distribution to types of share capital.

Issue at a discount

If shares no longer have a par value, the rule against allotment at a discount to par value loses its relevance.

***Question 4.36: Is there a need for a rule to replace the rule against allotment at a discount?***



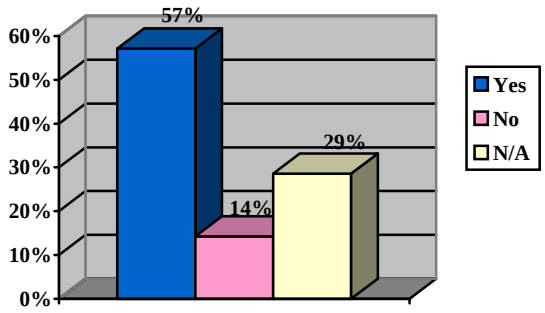

There was a marginally higher vote against replacing the rule. One respondent which felt otherwise said that they believed some sort of mechanism should be set up to protect the existing shareholders' interest in the company and to avoid unjust material dilution.

We agree with the majority. Replacing the rule against discount would effectively be re-enacting par value in a different way. Dilution of shareholders' interest is however a valid concern but is addressed a different way, as the discussion that follows show.

Replacement measures/Additional safeguards

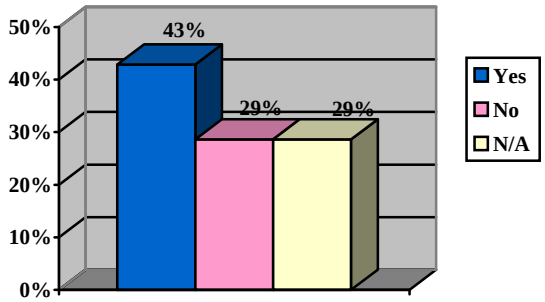
If the concepts of "par" and "authorised capital" are abolished other measures may need to be put in place to prevent directors from diluting shareholders' interests in the company or bringing new members into the company without the consent of existing shareholders. Par value protects existing shareholders by preventing companies from issuing new shares below the floor price (being the par value) of the existing ones, thereby reducing the possibility of dilution of the fractions of proprietorship held by them (the earlier allottees). The authorised capital assures the shareholder that his holding would represent at least a minimum proportion of the company, since the company will not be able to issue shares in excess of the authorised share capital without the approval of the shareholders. Most companies are able to increase the authorised capital by an ordinary resolution so the protection against dilution is far from absolute.

***Question 4.38: Do you agree that there should be replacement measure(s) against dilution of shareholders' interest if "par" and "authorised capital" are no longer mandatory?***



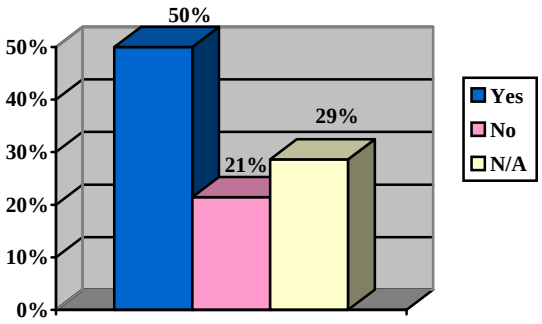

A majority of the respondents agreed that there should be replacement measures against dilution.

***Question 4.39: One alternative would be to require companies to state the maximum number of no-par shares that it can issue. This would work the same way as stating the authorised capital in terms of number of shares rather than in monetary value. Do you favour such an approach?***




More respondents were in favour of the approach than against.

***Question 4.40: In addition, a special resolution could be required to approve the issue price in the case where it is less than the immediately preceding issue price of the shares of the company. Do you favour such an approach?***




Again more respondents were in favour of the approach than against.

Two of the respondents who were in favour of the approaches added that they resemble the existing approach in preventing improper dilution of shares familiar to shareholders. One of them also commented that 'the existing measures against dilution of shareholders' interest by 'authorised capital' and 'par' are not effective any way since the former can easily be increased by an ordinary resolution and the latter can be avoided by setting a low par value'. The former can be addressed in a no-par environment in the manner suggested by another respondent, which is to require a special resolution to approve the number of new shares to be issued if the dilution effect is larger than a pre-determined percentage. This will be consistent with the suggested requirement for special resolution for dilution to the price.

One respondent (which agreed with the approaches) would however exclude from the rule on maximum number of shares the issuance of bonus shares to all shareholders in proportion to their shareholdings, as this would not result in a dilution. We are of the view that since bonus shares are not excluded from the current authorised capital rule they should not be treated differently in a no-par environment.

Two respondents who disagreed provided the following reasons:

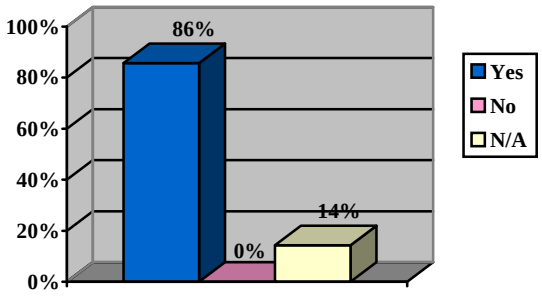
- "In our view, constraints on dilution are best left to listing rules (in the case of listed companies) and to directors' duties (in the case of unlisted companies)."

- "The listing rules already have minority shareholder protection measures in place by preventing companies from issuing shares at a significant discount to market value. An evaluation should be made to determine whether these measures provide sufficient protection for shareholders as a whole. Private companies' articles of association normally provide protection of existing shareholders' interests. However, transitional provisions need to be carefully considered and the additional cost and effort imposed on existing companies need to be carefully evaluated."

***Question 4.42:*** *<u>Subdivision</u>*

At present a company can subdivide its issued shares without any change in the total amount of the company's issued share capital. In a subdivision it is the nominal amount of the share that is divided. In the case of shares of no-par value there is no nominal amount to be divided. A similar result can however be achieved by increasing the number of no-par value shares. In either case the shareholder's fractional share in the equity is exactly the same as before.

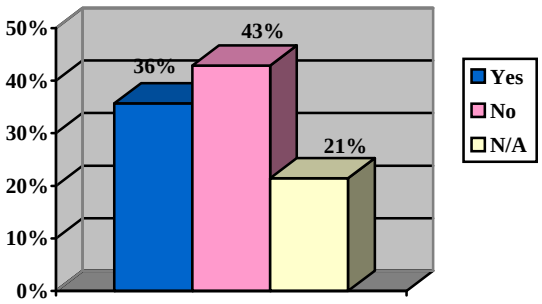
***Do you agree that the power of a company to subdivide its share capital should be retained with the modifications described above?***




This is not a controversial point and the responses reflect that. The additional comment made by one of the respondents does not derogate from this:

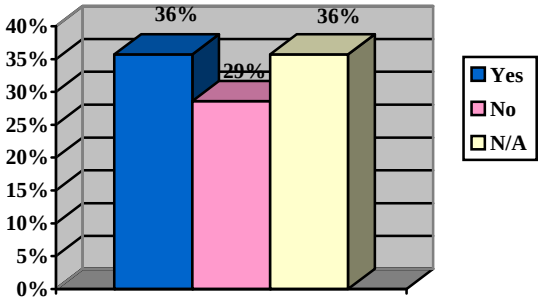
"We believe it is essential for a company to subdivide its share whenever there is a need in order to enhance the liquidity of the shares in the market."

***Question 4.44: If subdivision is to be permitted for no-par value shares, should it be available for partly paid shares?***



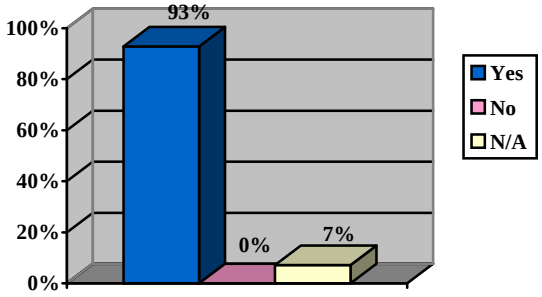

More respondents would not permit the subdivision of partly paid shares, probably for the reason that Australia thought it inappropriate.

***Question 4.45: Should this be the case only if the proportion between the amount paid and unpaid remains constant?***



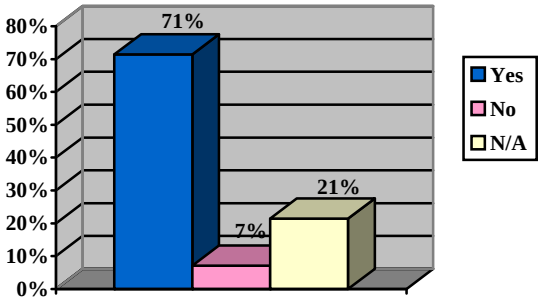

There does not appear to be reason to depart from current rule for subdivision of partly paid shares, that the proportion between the amount paid and unpaid remains constant. The subdivision process when applied to no-par shares involves the creation of new shares, and the splitting of the outstanding liability to the new no-par share. The process should maintain the pre-existing ratios. More respondents agreed with this view than those who did not, but the difference was not large. Unfortunately those who disagreed did not provide reasons for their preference.

***Question 4.47: Do you agree that the power of a company to consolidate its share capital should be retained in a no-par regime?***




Overwhelmingly the response to this was in the affirmative, with one respondent elaborating that a mechanism like consolidation of share capital should be maintained in order to facilitate trading of penny stocks.

***Question 4.49: Do you agree that the power to convert shares into stock and vice versa becomes obsolete in a no-par environment and should be removed?***



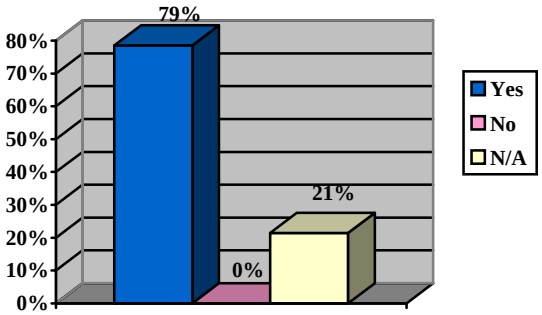

A substantial majority (71%) of respondents agreed that the ability to convert shares into stock can be removed in a no-par environment. One of the respondents excluded from this the par value part of an optional regime. This must be right unless it is thought that (as a wider reform) stocks should also be prohibited for par value shares.

One of the respondents who disagreed advanced the argument that stock can be expressed in number of shares or percentage of participation in a particular company or class of shares. Theoretically there does not appear to be reason why stocks cannot be redefined this way but given that most respondents see no need for retention of the ability to convert to stock, this will not be explored further.

**Part 5 Accounting Considerations**

***Question 5.1: Do you agree with the following statement:***

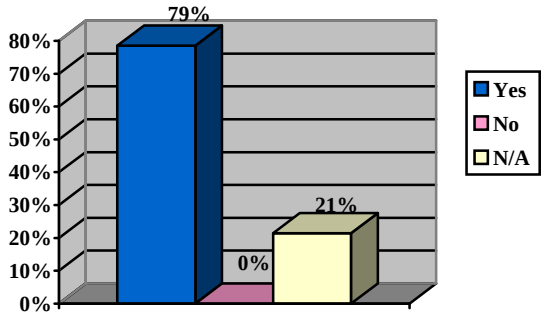
***"In a no-par value share regime the issuance of shares should be accounted for by crediting to share capital the cash received or receivable; or in the case of shares issued other than for cash, the fair value of the consideration received or the fair value of the shares issued. Quoted market prices in active markets provide the best evidence of fair value and are often used as the basis for measurement. If quoted market prices are not available, the estimate of fair value is based on the best information available in the circumstances, which may be the fair value of the consideration received. This is no different to the existing par value regime except there is no share premium."***



A majority of respondents (79%) agreed with this statement. In no-par value share regimes the issuance of shares is typically accounted for by crediting to share capital the cash received/ receivable, or in the case of shares issued other than for cash the fair value of the consideration received or the fair value of the shares issued. This is no different to the existing treatment under Hong Kong GAAP, with the exception that the removal of par value means that shares will no longer be issued at a premium to par, thus removing the requirement to differentiate proceeds received between share capital and share premium.

One respondent commented that in the current par value share regime, the number of shares issued is clearly identified and the participation in the company can be determined. It should be noted that it is a requirement under the Companies Ordinance if a company has issued any shares during the financial year to disclose the reason for making the issue, the classes of shares issued and, for each class of shares, the number issued and the consideration received by the company for the issue. We do not foresee any reason why this requirement will cease to be relevant upon the move to a no-par value regime, however it should be noted that financial statement disclosures in relation to this matter are driven by legal requirements (Companies Ordinance), not accounting standards.

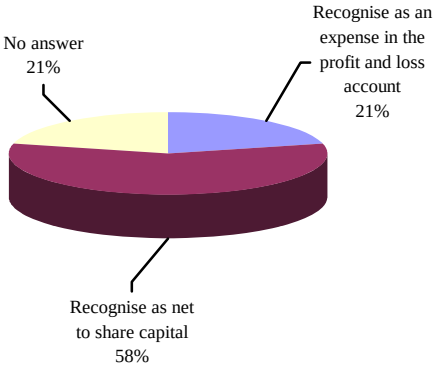
***Question 5.2: Should the existing share premium reserve be treated as share capital after the introduction of a no-par value regime?***




Most respondents (79%) favoured an accounting treatment whereby the share premium reserve is treated as share capital upon the introduction of a no-par value regime.

At present in Hong Kong the establishment and application of the share premium reserve is driven by legal requirements. We note that most existing no par value regimes have "in substance" treated the share premium reserve as part of share capital on commencement of a no par value regime. One respondent stated that the existing uses of the share premium reserve should be extended to the entire share capital in a no par value regime. In this regard the accounting in Hong Kong will be largely determined by the legal requirements on the introduction of a no par value regime. To the extent that a revised Companies Ordinance requires the share premium reserve to be treated as part of permanent capital, and depending on any transitional provisions, the accounting will follow suit.

***Question 5.3: How should issue costs or share issue expenses be recognised in a no-par value share regime if these were previously recorded against share premium?***

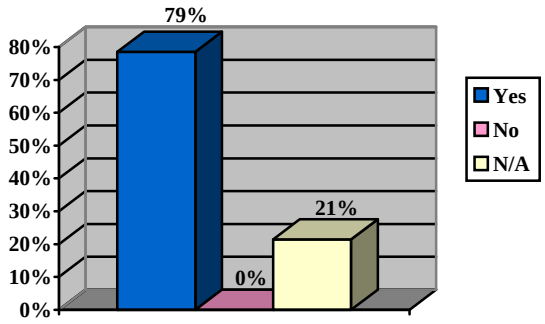



***Some other treatment: 0%***

Most respondents (58%) favoured a continuation of the existing treatment in Hong Kong whereby it is common for share issue expenses to be recorded as a reduction against proceeds received in arriving at the amount of share capital and share premium to be recorded. A minority of the respondents (21%) favoured recognising share issuance costs in the profit and loss account although no reasons for the suggested treatment was given.

We note that issue costs on share issue expenses in no par value regimes are typically recognised at net (to share capital) to reflect the substance of the transaction, and depending on the legal requirements on implementation of a no par value regime, specifically any changes to the Companies Ordinance that prescribe the treatment of issue costs, we see no reason why transaction costs arising on the issue of equity instruments should not continue to be recognised as a reduction of the proceeds of the equity instruments to which they relate. This is consistent with the existing accounting treatment in Hong Kong in addition to being an allowable Companies Ordinance use of the share premium reserve.

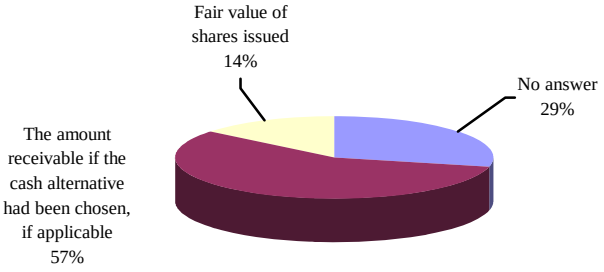
***Question 5.4: Do you consider that the reinvestment method will continue to be appropriate in a no-par value regime where shares are issued in consideration for the dividend foregone?***




Most respondents (79%) held the view that the reinvestment method will continue to be appropriate in a no-par value regime where shares are issued in consideration for the dividend foregone. A minority of the respondents (21%) did not consider that the reinvestment method would continue to be appropriate in a no par value regime where shares are issued in consideration for the dividend foregone

Where shares are issued in lieu of cash dividends, the method currently used in Hong Kong depends on the substance of the transaction: if the shareholders have formally agreed in advance that they will take the share alternative, then the capitalisation method is appropriate (akin to a bonus share issue). Alternatively if shareholders have not formally agreed to receive shares prior to the dividend being declared and they are provided with an option to receive cash or shares then the reinvestment method is more appropriate, whereby an amount equivalent to the full cash alternative is recognised as a liability. Under the capitalisation method an amount equal to the nominal value of the shares issued is credited to share capital and debited to any reserve that can fund a bonus share issue. Under the reinvestment method the transaction is treated as if it were a payment of a cash dividend that is immediately reinvested in shares. We do not envisage any reason why these methods will not continue to be appropriate under a no par value regime with the exception that no premium will be recorded on issuance of new shares in lieu of cash dividends, and depending on any transitional legal arrangements the share premium account if it does not exist, will no longer be able to be used to fund the issue (capitalisation method). The impact on total shareholders' equity should be identical under both par and no-par regimes.

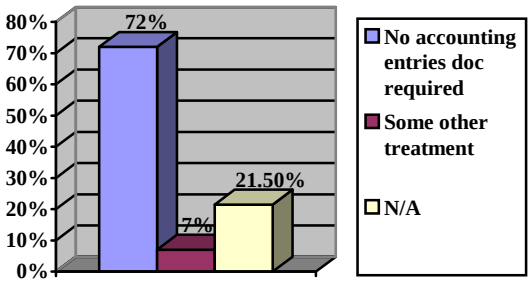
***Question 5.5: How should consideration be measured for shares issued in lieu of dividends in a no-par value regime?***




***Nil value: 0%***
***Some other treatment: 0%***

A majority of respondents (57%) held the view that consideration for shares issued in lieu of dividends should be measured at the amount of dividend receivable by the shareholders if the cash alternative had been chosen. Under existing Hong Kong GAAP this is the appropriate treatment when a cash alternative is given to the shareholders. If no cash alternative is provided, then the fair value of shares issued is an appropriate measurement basis, as identified by 14% of respondents.

***Question 5.6: With the abolition of the share premium reserve in a no-par value share regime, how will bonus shares be accounted for where shares are issued on a pro-rata basis to all existing members?***

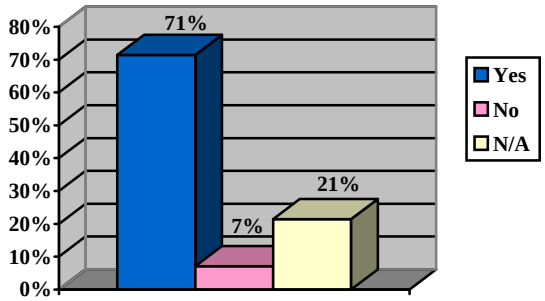



Most respondents (72%) were of the view that no accounting entries would be required if bonus shares are issued on a pro-rata basis to existing members in a no-par value regime. A minority of respondents (21.5%) disagreed that no accounting entries would be required for a bonus issue in a no par value regime although there was no indication of what accounting entries should be made where the bonus shares are issued on a pro rata basis to all existing members.

In accordance with current Hong Kong law it is not uncommon practice in par value regimes such as Hong Kong to fund bonus share issues out of the share premium reserve. In this situation the share premium reserve is debited with the nominal value

of the shares issued and the share capital is credited with an equivalent amount. In no par value regimes, however, it is common for there to be no accounting entry reflected within shareholders' equity in the financial statements for such a transaction although appropriate disclosures are made for the bonus issue in the notes to the financial statements. Depending on transitional arrangements there is typically no longer a share premium reserve. Total equity is not changing; it is simply divisible by a larger number of shares. The company has received no present cash value, and accordingly there is no need for an accounting entry recording a credit to equity. There is a requirement, however, for note disclosure of the number of shares on issue.

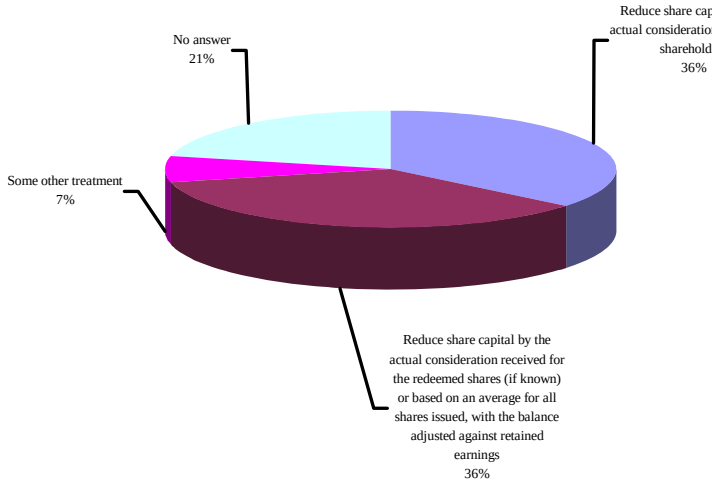
***Question 5.7: Should transitional accounting provisions be required? For example, should there be transitional provisions to allow the company to use the balance existing in the share premium account immediately prior to commencement of the regime to fund a redemption of redeemable preference shares already on issue or to write-off preliminary company expenses or share issue expenses incurred before that date?***




Most respondents (71%) agreed that transitional accounting provisions should be put in place upon any move to a no-par value regime.

In Hong Kong, the Companies Ordinance restricts the application of the share premium account to certain purposes, including providing for premiums payable on the redemption of redeemable preference shares. Transitional provisions to allow a company to use the balance existing in the share premium account immediately prior to the commencement of a no par value regime need to be considered. To avoid confusion and alternate accounting treatments we recommend that any transitional provisions adopted are documented clearly in the revised Companies Ordinance.

***Question 5.8: How should the buy back of shares be accounted for in a no-par value regime?***




Where a company repurchases or redeems its own shares, the cost will usually be different from their par, stated or assigned values. It has been noted that jurisdictions that have implemented no par value regimes have different methods of accounting for such repurchases/ redemptions. For example, in Australia such buy-backs are generally allocated against share capital, whilst in the US and Canada an allocation is made between share capital and retained earnings if the purchase price exceeds the stated value of the shares bought back. 36% of respondents stated that share buy backs in a no-par value regime should be accounted for by reducing share capital by the actual consideration paid to the shareholders, whilst the same number of respondents stated that share buy backs should be accounted for by reducing share capital by the actual consideration received by the company for the redeemed shares at the time of the shares' original issuance (if known) or based on an average for all shares issued, with the balance adjusted against retained earnings. One respondent stated that they saw no reason why a company should be prevented from repurchasing and cancelling any of its equity provided the funding comes out of profits. It was not clear if this was referring to current year profits or retained profits of the company.

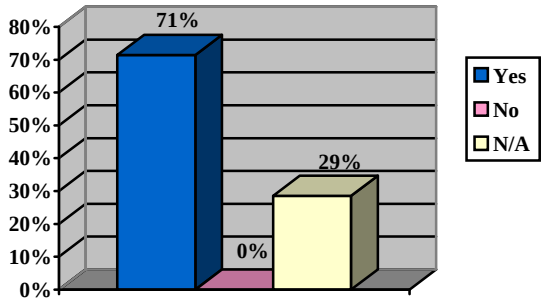
From a Hong Kong perspective the accounting for the purchase or redemption of own shares may be simplified on the introduction of a no par value regime, depending on the type of no-par regime introduced, as there will be no requirement to allocate part of the purchase consideration to share premium reserve (or capital redemption reserve, depending on legal changes) though this is contingent on legal changes to the Companies Ordinance including clear transitional arrangements. There will, however, be an issue in relation to the allocation of the purchase consideration across the various components of shareholders equity, namely share capital, retained earnings and other reserves.

The options for allocating the cost of share repurchases to shareholders' equity are generally as follows:

- Allocate the entire amount to share capital;
- Allocate to share capital based on the specific amount attributable to the proceeds on the original shares, with the difference to reserves (including retained earnings); or
- Allocate to share capital and reserves (including retained earnings) based on the average per share value (share capital divided by issued shares), whereby share capital is reduced by the average per share value and the premium paid above the aggregate of the average per share value of shares repurchased/ redeemed is allocated to reserves.

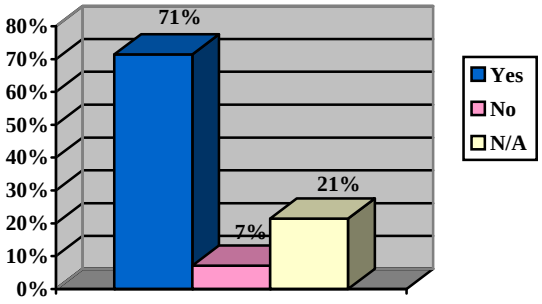
Depending on changes made to the Hong Kong Companies Ordinance, accounting standard setters in Hong Kong will need to be clear as to the guidelines issued in relation to accounting for equity share repurchases and redemptions, particularly in cases where share capital is reduced to nil and a negative buyback reserve may need to be created in the absence of the ability to use other available reserves including retained earnings.

***Question 5.9: Do you agree that there will be no difference in the accounting treatment for issuances of shares without par values aside from that stated above?***




All respondents that answered this question agreed with the above statement, reflecting the view that most accounting changes will be driven by relevant legal amendments on the introduction of a no-par regime.

***Question 5.10: Do you agree that no accounting entry is required to record a share split where shares have no par values as there would be no change to equity?***

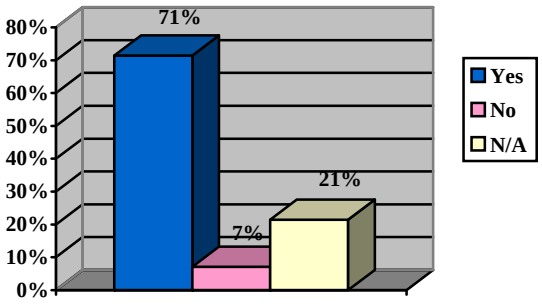



71% of respondents agreed with this assertion. 7% of those that responded indicated that an accounting entry would be required although there was no indication as to what the entry should be.

A share split is when a company issues a new number of shares for all its existing shares outstanding. There is no need for an accounting entry in the books of the company to record a share split, as there is no movement between reserves and issued share capital. If the shares involved have a par value, the par is decreased in proportion to the split. The only change in a no par value is therefore to the description of capital as there is no longer a distinction between share capital and share premium.

***Question 5.11: Do you agree with the following statement:***

***"If shares in a no-par value regime are issued partly paid, the unpaid element will be the difference between the issue price and the value actually contributed by the shareholder. The accounting entry to reflect this is to credit the value of the paid and unpaid portion of the shares to share capital and record a receivable for the unpaid portion and a receipt for the paid portion."***




The majority (71%) of respondents agreed with this statement.

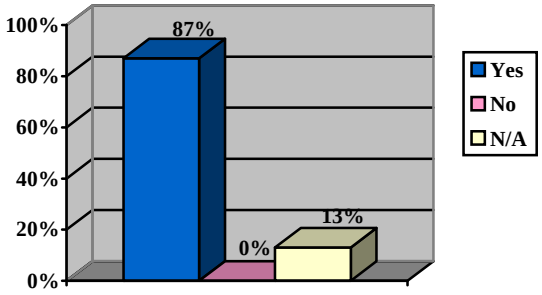
Under HK GAAP where partly paid shares are issued, the accounting treatment is the same as for fully paid shares, except that a receivable is recognised for the value of

the unpaid portion of the shares. If the partly paid shares are issued at a premium to par value then a credit is also required to the share premium account.

If shares in a no par value regime are issued partly paid, the unpaid element will be the difference between the issue price and the value actually contributed by the shareholder. The accounting entry to reflect this is to credit the value of the paid and unpaid portion of the shares to share capital and record a receivable for the unpaid portion and a receipt for the paid portion. There is consequently little difference with a par value regime, with the exception that there is no need to differentiate issue proceeds between share capital and share premium.

## Part 6 Taxation Considerations[16]

***Question 6.1: Do you agree that the analysis in the consultation document of the Hong Kong profits tax implications with respect to gains derived from the transfer/disposal of shares with par values should apply equally where shares have no par values?***




There is no capital gains tax in Hong Kong and whether a gain derived from the transfer/disposal of shares is taxable or not depends on whether the gain is regarded as a revenue/capital gain. The current tax law does not distinguish par or no-par share investment. Most respondents (87%) agree that the profits tax implications on the gains derived from the transfer/disposal of shares with par values should equally apply to those with no par values.

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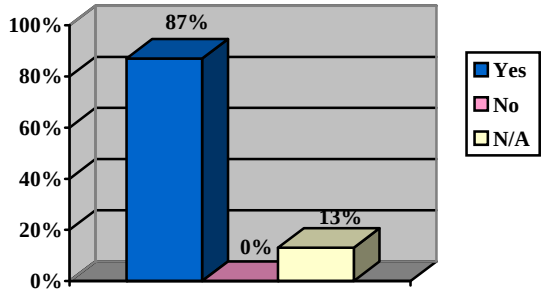
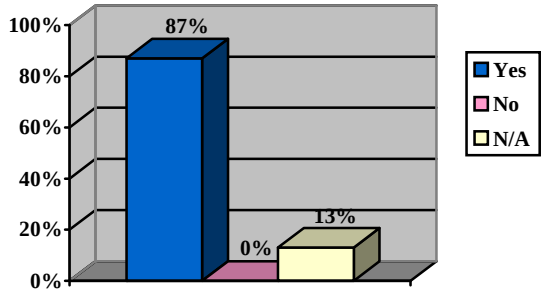
16 Please note that the data in this section is based on 15 full responses (includes the I.R.D who responded solely to this section).

***Question 6.2: Do you agree that the calculation of the resulting gain/loss from the transfer/disposal of shares with par values as described above should apply equally to shares with no par values?***




Again, most respondents (87%) agree that the calculation of the resulting gain/loss from the transfer/disposal of shares with par values should equally apply to those with no par values. The respondents are of the opinion that the change of par system will not alter either the cost or disposal proceeds.

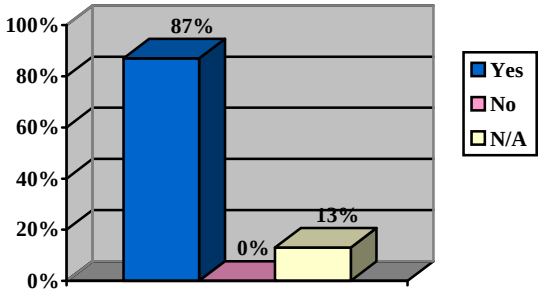
***Question 6.3: Do you agree that the current tax treatment of dividends derived from shares with par values should apply equally to dividends derived from shares with no par values?***



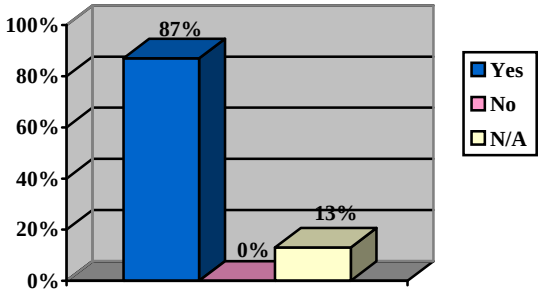

Most respondents agree that the tax treatment of dividends derived from shares with par value should equally apply to those with no par value.

***Question 6.4: Do you agree that the tax consequences of a buy-back of shares with no par values should be the same as that described above in respect of shares with par values, for the:***

**(a) Company?**

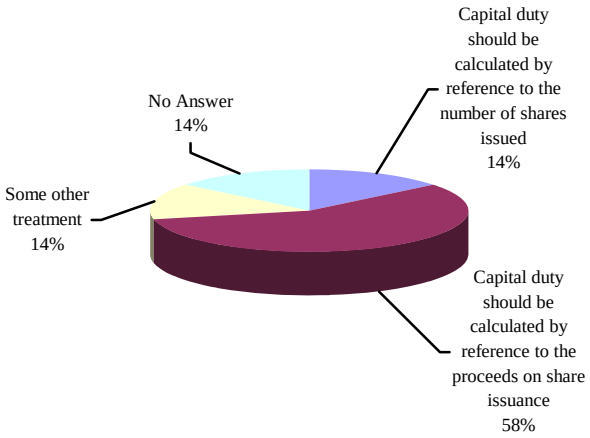



**(b) Shareholder?**




Most respondents agree that the buy-back of shares by the issuer should not constitute a taxable transaction and from the seller's perspective, the profits tax implications would depend on whether the transaction is a revenue or capital transaction. Those respondents who agree to the above statement also agree that the tax consequences should equally apply to shares with and with no par values.

***Question 6.5: What should be the treatment of capital duty in a no-par value regime?***

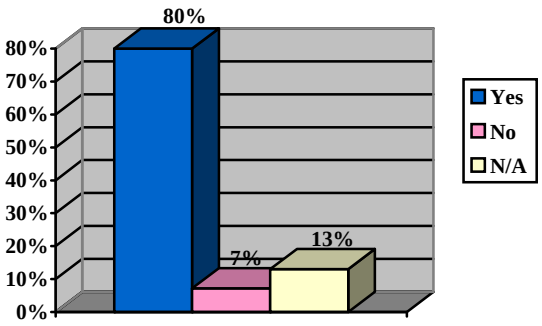



Under the current practice applicable to shares with par value, capital duty is imposed on the first registration of share capital and on any subsequent increase in nominal share capital, which is imposed on the nominal share capital/amount of value of the share premium capped at HK$30,000 per issuance.

Most respondents agree that capital duty should be calculated by reference to the proceeds of the share issue. Some respondents believe that the capital duty may be exploited if it is levied by reference to the number of shares issued by means of issuing only a few of very high value shares and some respondents also suggested that capital duty should be abolished.

***Question 6.6: Do you agree with the following statement:***

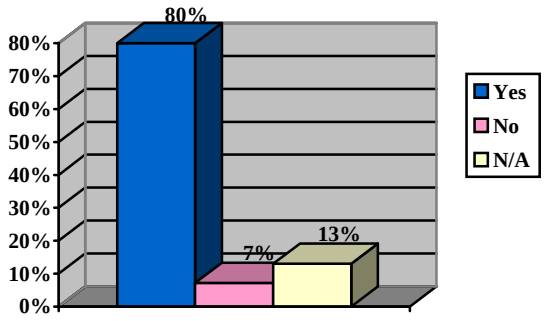
***"Given that stamp duty is assessed based on the transaction consideration or market value where no reference is made to the par value of the shares, the stamp duty implications for shares with no par values should be the same as that described above for shares with par values."***




Most respondents agree that the stamp duty implications for shares with no par value should be the same as that for those with par value but some have commented that stamp duty should be abolished.

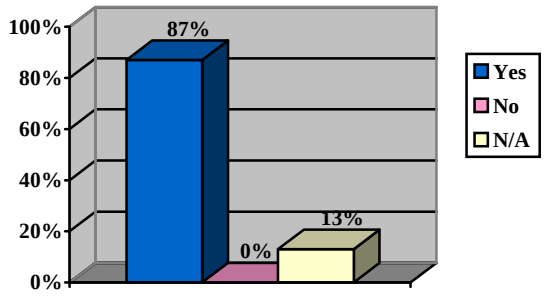
***Question 6.7: Do you agree with the following statement:***

***"Given that estate duty is assessed for quoted shares by reference to the last closing price of the shares in public stock exchanges and for unquoted shares by the value of the share as ascertained from the latest accounts of the company, the estate duty implications for shares with no par values should be the same as that described above for shares with par values."***



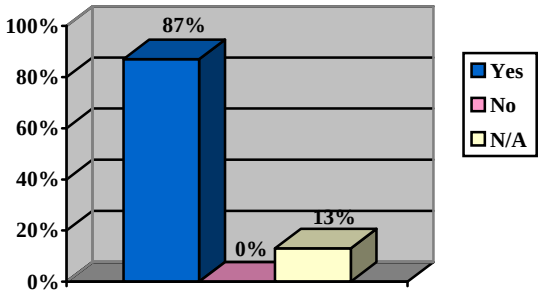

Most respondents agree that the estate duty implications for shares with no par value should be the same as that for those with par value but some have commented that estate duty should be abolished.

***Question 6.8: Do you agree that the analysis in the consultation document with respect to the Hong Kong salaries tax implications to individuals should apply equally in a no-par value regime?***

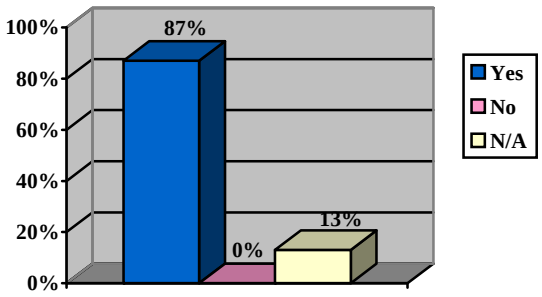


***Question 6.9: Do you agree with the following statement:***

***"Since the taxable gain to the employee would be computed based on the market value of the shares less the consideration paid by the employee for obtaining the share options, the salaries tax impact to the employee of options over shares with no par values should be the same as that described above for shares with par values."***



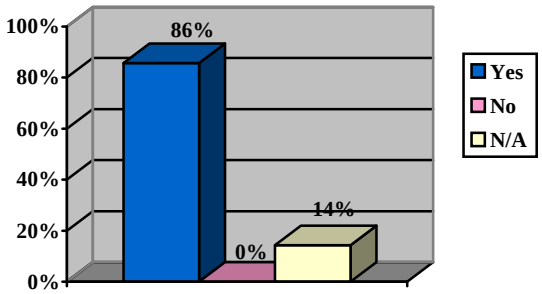

***Question 6.10: Do you agree that the computation of the gain from options over shares with no par values should be the same as that described above in relation to shares with par values?***




For questions 6.8 – 6.10, most respondents agree that the prevailing Hong Kong salaries tax implications applicable to transactions involving shares with par value should equally apply to shares with no par value.

## Part 7 Other considerations

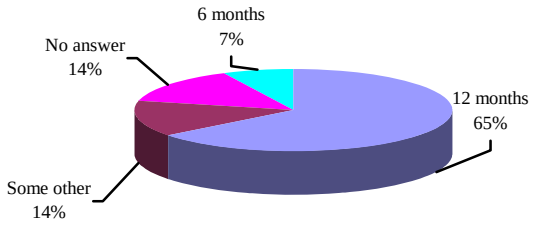
***Question 7.1: Do you see the need for a transitional period before any change to the par regime is made effective?***




The vote is clearly for a transitional period. One respondent (which responded generally) referred specifically to the need for the coming into force of any new regime to be delayed for a reasonable period so as to allow time for companies to review their memorandum and articles of association, contracts and other relevant documents.

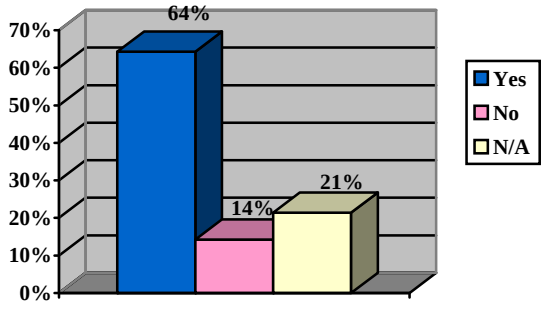
One of the respondents which participated in the detailed questions but chose not to answer this one stated by way of additional comment that there should be no need for a transitional period if the no par value regime is optional. The rationale for this could be that a company that is considering a conversion to no-par could always delay the conversion until such time as it has reviewed its documents to its satisfaction. This does not argue for an optional system but a sufficient transition period.

***Question 7.3: Question 7.3 What would be an appropriate transitional period if one were to be adopted?***




12 months appears to be the most favoured period of transition.

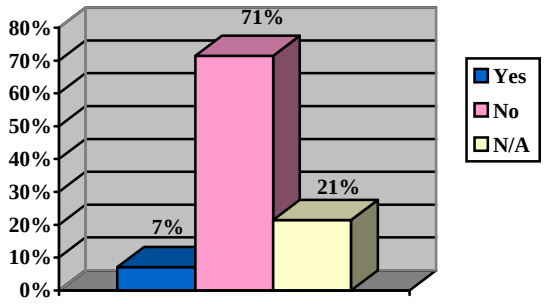
***Question 7.4: Should there be delayed operation of the provisions implementing no-par to allow time for consequential amendments to other legislation?***




Most respondents were in favour of delaying implementation of the provisions effecting the no-par regime. One respondent, which did not, argued that all necessary legislative changes should be made at once.

We are of the view that a decision whether to migrate to a no-par system should preferably be made with knowledge of the extent of legislative change required (and the report extends to this), but there does not appear to be reason to require all legislative changes to be made at the same time if that is not administratively convenient.

***Question 7.6: Do you anticipate any other types of significant costs?***




We found no evidence that a change to a no-par system would result in significant costs to companies converting. The types of costs would be a function of the model of no-par to be implemented and the manner in which it would be effected. The costs identified could include the costs of convening a general meeting to approve the conversion and consequential amendments to the constitutional documents, the costs of registration of the resolution(s) and of reissuing share certificates and costs of professional advice on the conversion and its effect on the contractual and other arrangements of the company. Over time costs could even be reduced as a result of more straight forward accounting treatment.

Most respondents (71%) did not anticipate any other types of significant costs. Those who did listed the following:

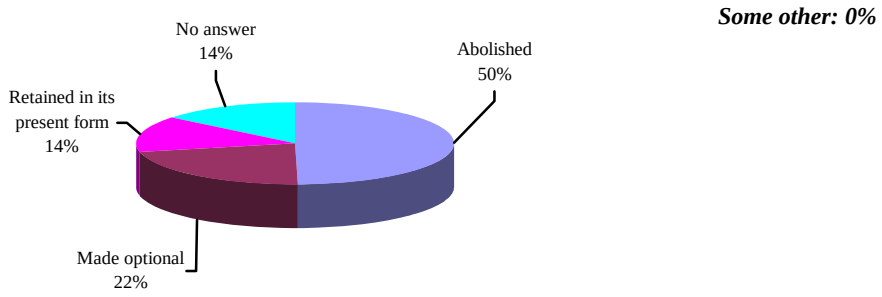
- "For public listed companies, charges by the share registrars, advertising costs, administrative costs of dealing with re-issue of share certificates and additional auditors' fees."

- "Internal costs to review, assess and implement changes."

Conceivably these costs could be incurred but whether it would be necessary to incur any or all of them would depend on the model of no-par to be implemented and the manner in which it would be effected. PricewaterhouseCoopers are of the view that any additional auditing costs would not be significant, and is likely to be one-off.

## Part 8 Wider reform?

***Question 8.1: Which of these do you think should be the treatment of the notion of "authorised share capital" if a no-par regime is adopted?***

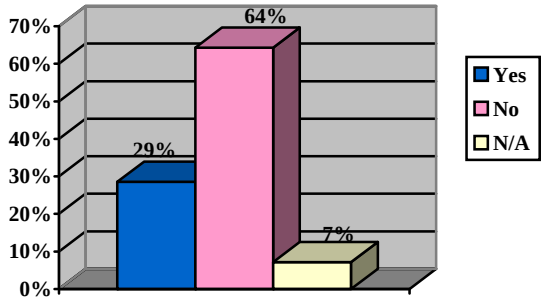



Half the respondents thought that the notion of authorised capital should be abolished if a no-par regime is adopted. Clearly authorised capital in its present required form cannot operate in a no-par environment. The real issue is whether an alternative measure, possibly analogous to the current requirement, is required. We deal with this further below.

This may in substance be the concern of one respondent which said that the requirement for authorised capital should be made optional. As a further comment the respondent stated that authorised share capital is an effective mechanism to balance the power of directors to issue shares for the principal purpose of diluting the existing shareholders.

This contrasts sharply with the view of another respondent which thought that there is a case for abolition of authorised share capital irrespective of the adoption of a no par value regime on a voluntary or mandatory basis. This in fact answers the next question and the comments will be more fully considered in relation to that.

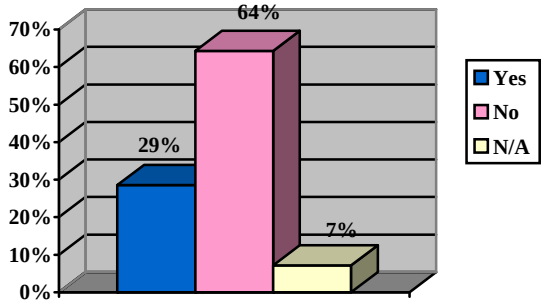
***Question 8.3: Should the notion of "authorised share capital" be abolished regardless of whether we move to a no-par regime?***




The majority of respondents would not retire the notion of authorised capital unless par value was also retired. One of the respondents which felt that a wider reform was called for wrote (but in relation to the earlier question) as follows:

"It seems to us that there is a case for abolition of authorised share capital irrespective of the adoption of a no par value regime on a voluntary or mandatory basis. It seems to us that the right to issue new shares is best controlled through the listing rules, where the relevant companies are listed. Where the companies are not listed, it seems to us that there is a little necessity for such control".

***Question 8.5: If "authorised share capital" is abolished do you see a need for alternative measures?***



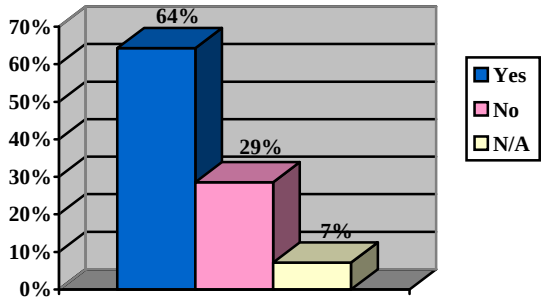

Most respondents see no need to replace authorised capital, suggesting perhaps that many do not see authorised capital as providing a meaningful measure or effective form of protection. Those who felt otherwise have suggested the following:

- "We suggest a specific mandate should be obtained from the shareholders to issue any new shares which have a significant dilution effect, e.g. over 20%."

- "An alternative measure to determine the maximum number of shares or participation in the company should be established."

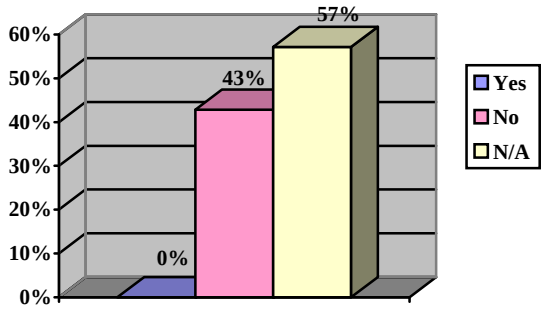
Clearly however only some of those who questioned the efficacy of authorised capital as a form of protection thought that it should be abolished in any event (from responses to the earlier question).

***Question 8.7: As a wider reform, should provision for partly paid shares be discarded?***




A majority of respondents would do away with partly paid shares as a wider reform, one on the basis that not many companies make such issues. Another stated that there will be circumstances where partly paid shares are required e.g. capital or asset injection by phases, which appears at odds with its preference to do away with partly paid shares.

***Question 8.9: Will the abolition of the power to issue partly paid shares have taxation consequences?***




All of those who answered this question thought that there would be no tax consequences to abolishing partly paid shares or that taxation would not be a relevant issue. One of the respondents who did not make a Yes/No selection stated as an additional observation that there could be potential commercial implications.

Other implications

***Question 8.11: Are there any other implications (legal, tax, accounting, economic, financial) that you think are likely to arise or have a significant bearing on the issue of no-par that you would like considered? Please specify or add any observations or comments in the space below***

Only one responded to this, but only to state “None Known”, which is also likely to be the (unexpressed) position of the other respondents.

## 7. GENERAL CONCLUSIONS AND RECOMMENDATIONS

7.1 Desirability of no-par shares (see questions 1.1 – 1.15 in Section 6)

Our conclusion is that it would be desirable to introduce a no-par system into Hong Kong. It is uncontrovertibly the normal and logical method of stating the division of the capital of a company into shares. The par value system, whilst not inherently flawed, is not. The responses to the consultations (and in particular the first) indicate a significant confusion in the understanding of the concept of par values, even amongst sophisticated investors and lenders. It is conceivable that the less sophisticated investor and lender can be misled. The comparative analysis and study of other jurisdictions that have migrated to no-par, as well as the responses to the more technical sections of the consultation, highlight the greater clarity and simplicity of the no-par system over the one in place today.

We do not however make our recommendation on the basis that the par value system is so misleading that a change is required. The system has been in place for more than a century, and there is no evidence of that. Our recommendation instead is based on our conclusion that the no-par system is a clearer, simpler and more flexible system (and this in essence is the reason so many jurisdictions have, or are in the process of adopting it), and it can be introduced into the Hong Kong system of company law without excessive interruption or cost to businesses, and without compromising on investor and creditor safeguards or the wider public interest. The system appears to have worked (and well) in the jurisdictions that have adopted it – we have received no evidence that it will not in Hong Kong. Furthermore, we found no evidence in those jurisdictions that costs associated with a switch to no-par were either significant in their own right or represented a material consideration in the debate as to whether migration should occur. Except for the few points dealt with below in respect to which safeguards appear to be necessary, we do not expect that any abuse or malpractice will result from converting to a no-par system.

Whilst a migration to no-par will involve changes to certain legislation and rules (identified below in Appendix G), we see no reason why such changes should be difficult to accommodate within the framework of Hong Kong's body of laws given proper review and preparation. Moreover, since changes to the Listing Rules would largely be to accommodate companies with no-par rather than to seek to apply the Rules exclusively to them, we would not anticipate making such amendments should be especially burdensome.

The only matter on which significant differences of opinion have been expressed by respondents is whether or not there is a real need to introduce no-par shares now, concerns about costs and other more pressing economic issues being principally the reasons for the noes. The results of the consultation indicate a majority of those responding (whether in the consultation document or more generally) supported a migration to no par, and that more than 70%

would opt for no-par value shares on incorporating a new company were the option to be available in Hong Kong (see above pages 20 and 21).

However, a number of respondents argued that there is no need to rush into a no-par system. We agree there is no pressing need for that. Nonetheless, we believe it would be efficient and preferable to have it in consideration in any review of the capital maintenance rules, and for the changes to be made together. Australia and New Zealand introduced their no-par system this way and Singapore is likely to go this route too (see also questions 4.6 – 4.10 in section 6 and paragraph 7.6 on page 80 below).

Abolition of the requirement for par values may not in itself significantly improve the competitiveness of Hong Kong securities in the international financial markets, but it is integral to achieving a more simplified and modern capital regime that will.

7.2 Model of no-par (see questions 3.1 – 3.16 in Section 6)

We recommend a mandatory system for both existing and new companies. This is consistent with the preference of the majority of respondents and of jurisdictions that have more recently migrated to no-par (or where it is in contemplation). The latter includes those jurisdictions (United Kingdom, some provinces in Canada and states in the US, and Japan) which had earlier considered or adopted an optional system.

Jurisdictions have opted (or changed) to the mandatory system because it is much simpler for all concerned. An optional system requires legislating for and administering two parallel regimes, which can add to costs, complexity, and confusion for all involved. This was recognised by the Financial Law Committee of the Law Society, which nevertheless thought that companies must be given some freedom of choice. Underpinning that was the belief that it would not be proper or realistic to compel a change to or use of no-par shares. The results of the consultation on this issue suggest that this may not in fact be an issue. 67% of respondents (comprising also companies) preferred a mandatory system.

Japan, which initially allowed no-par shares on an optional basis, found that a significant number of companies chose to continue to have par value shares (by default and because this was the system which they were more familiar with), thereby defeating largely the migration to a no-par system. The optional no-par system in South Africa has also not been very successful in migrating companies to no-par, apparently for the same reason.

One respondent (a major international law firm) questioned whether article 105 of the Basic Law would be breached if a mandatory regime were to deprive shareholders of benefits that they had previously enjoyed. There is no essential difference between a share of no-par value and one having a nominal

value, or in the practical operation of the no-par and par systems.[17] We are therefore unable to see any shareholder benefit as being affected aversely by a change to no-par, or if there is (which we doubt), that it cannot be remedied. Some changes will be necessary in the computation of capital duty, but this need not be more onerous under the no-par system. There is no reason why the incidence of any other Hong Kong tax or duty should be different for companies with no-par shares.

7.3 Types of companies (see question 2.1 in Section 6)

Our conclusion is that there is no reason to exclude any particular form or type of company having a share capital from the no-par system. The Cayman Islands and British Virgin Islands made no-par shares available to certain types of companies only, but for reasons not relevant to Hong Kong. We would recommend that no-par be applied to all companies, as the majority of respondents want.

7.4 Classes of shares (see questions 2.2 – 2.4 and 4.14 in Section 6)

The Gedge Committee's (UK) objection to extending no-par to preference shares has fallen away, with most jurisdictions applying it to all classes of shares. Our view is that the features of preference and redeemable shares can, and should be accommodated in shares having no-par values with appropriate changes to the law. The submissions we received were decisively in favour of extending no-par to all classes of shares, and we agree with them.

7.5 Partly paid shares (see questions 2.4 and 8.7 – 8.9 in Section 6)

Partly paid shares can be accommodated within the no-par regime, the practical working of this in Australia[18] and New Zealand bears this out. There does not appear to be reason why this should not be possible in Hong Kong. The Companies Ordinance can be amended to regard as partly paid shares that are not fully paid as to their issue price.

If shares of no-par value are not permitted to be partly paid the perceived difficulties in respect of shares of no par value that are not fully paid up will not arise. There will however be a need to require existing partly paid shares to be fully paid up prior to the conversion to no-par.

The majority of respondents are in favour of permitting the conversion to no-par of partly paid shares, but would prefer to abolish partly paid shares altogether, as a wider reform.

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[17] Aside from the par and no-par systems in Guernsey, but they are not representative of these systems.

[18] Australia prohibited the redemption of no-par redeemable shares whilst partly paid as it was felt that complications involved in the conversion of partly paid redeemable shares would outweigh any benefit to be derived.

We make no recommendation as to abolishing partly paid shares as that is not within the remit of this consultation. However we agree that if partly paid shares continue to be allowed, they should be converted to no-par shares together with all other shares.

7.6 Treatment of the proceeds of issue (see questions 4.6 and 4.32 in Section 6)

This depends on whether the removal of par is to be made in conjunction with any wider reform to the capital maintenance rules.

If it is not, the proceeds of issues should still be treated as capital that may not be returned to shareholders except under the strict conditions currently imposed by the Companies Ordinance. Any amount received towards the issue price of no-par value shares should be carried to a capital account, called "stated capital account" or "contributed capital account", or some other.

It is probably efficient to effect the migration to no-par in conjunction with any other change that may be in contemplation to the capital maintenance regime[19], but separate treatment is not impossible. The UK is currently introducing the solvency test (albeit in a restricted way) even though the move to no-par is on hold. New Zealand, on the other hand, made the change to no-par in conjunction with a more fundamental change to its capital maintenance regime, moving the focus of the regime from preservation of subscribed capital to retaining sufficient capital to meet obligations by using the "solvency test" as the criteria for distribution.[20] In doing so, it did not require the proceeds of issue to be carried to a stated capital account.

More respondents (including, significantly, the Hong Kong Society of Accountants) preferred the solvency test to maintaining the current form of the capital maintenance regime in the event of par value shares being abolished.[21] Clearly a more exhaustive consideration of the issues, and therefore a separate consultation is required if the Government should decide to consider a wider and more fundamental change to the capital maintenance regime than this consultation considers.

7.7 Treatment of amounts in share premium (see questions 4.6 – 4.10 in Section 6)

There was no one clear preference as to this. Respondents were almost equally divided on the options of (1) retaining the share premium as an interim measure, (2) retaining it effectively, and (3) abolishing it altogether. We are of the view that it will defeat the purpose of moving to a no-par system if the share premium account is only abolished in form but not in substance. Our preference is for the whole of the amount in share premium to transfer (by law)

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19 The latter is not within the scope of this consultation.

20 New Zealand's company law regime prior to this was based on the UK's concept of capital maintenance and drawn from the common law and the UK Companies Act 1948.

21 See the analysis of the responses to Question 4.32.

over to the paid-up capital account (by whatever name called) on the effective date of the change to no-par.

7.8 Treatment of amounts chargeable to share premium (see questions 4.8 – 4.10 in Section 6)

More respondents would prefer the currently permitted applications of the share premium account to be retained and extended to the whole of share capital. We would agree with that. Any change to the scope of permitted applications must be for considerations other than migration to no-par.

7.9 Safeguards against dilution of shareholders' interest (see questions 4.38 – 4.40 in Section 6)

Currently these take the form of the floor which par value sets to the issue price, and the cap that the authorised capital sets to the number of shares that can be issued. Neither (as has been shown) provides real protection against dilution of shareholders' interest. Rather it is the directors' fiduciary duty in making issues only on terms that the company receives adequate consideration for the issue that does. Where shares have no par value, directors may appear to have a wider discretion in setting the issue price, but they would still have an overriding fiduciary duty to set that in good faith. Thus, if par value and authorized capital are to be abolished, as we recommend that they be, shareholders are not left without safeguards against dilution of their interests.

The consultation however indicates a preference for legislated measures against dilution, to replace those of par and authorized capital. The measures considered in the consultation were:

(a) requiring a special resolution to approve the issue price where it is less than the immediately preceding issue price of shares of the company; and

(b) requiring companies to state the maximum number of no-par value shares that it can issue.

Whether these replacement measures should be put into place depends ultimately on the direction that the reform of the Companies Ordinance takes. If the ultimate aim is to deregulate, then legislating for these replacement measures would not facilitate that.

7.10 Implementation of recommendations

Legislative change will be required, the nature and extent of this being largely a function of the model of no-par to be adopted and the extent to which it is to be applied. Amendment to the Companies Ordinance is key, if no-par is to be authorised or required for companies with share capital incorporated under the Ordinance.[22] If no-par is to be extended to companies incorporated pursuant to, and governed as to their share capital by other statutes, then these other

[22] or its predecessors.

statutes will have to be amended as well. The Airport Authority and Kowloon-Canton Railway Corporation are two such corporations.[23]

References to nominal value and related concepts in other legislation and rules will also have to be addressed, as will such references in other instruments, contracts and arrangements. As to the latter, jurisdictions that have adopted a form of no-par have either amended these by legislation (by a deeming provision) or left it to the contracting parties to amend. Our preference is for the former (as it will save considerable conversion work for companies), particularly if par value is to be wholly abolished, but there is no reason why a statutory deeming provision (drafted to apply only when shares are converted to no-par) cannot work as well where no-par shares are authorised rather than required. Flexibility, if required, can be retained by allowing parties to exclude (by express provision) the deeming provision.

The amendments can be effected by legislation dedicated to the no-par introduction[24], or separately for each of the relevant legislation and rules. Bringing the amendments together, or at least the more substantive ones, may make them more accessible and easier to follow.

Most respondents would prefer a transitional period before the new no-par regime is made effective. The Stock Exchange of Hong Kong, for example, has said that a delay of a reasonable period (mostly identified as 12 months by respondents) is required to allow time for companies to review their memorandum and articles of association, contracts and other relevant documents. It may be that this time for review is less critical where there is legislative provision to facilitate the change, but it may still be useful to allow parties to consider whether to exclude the application of the deeming provision by express provision (if such is the intention). Since the legislative deeming provision may not always be effective where the document is not governed by Hong Kong Law, the time will also allow parties to these to review their documents.[25]

7.11 Amendments to the Companies Ordinance

These are principally as follows

1. Amendments to abolish par value and authorised capital (assuming the latter):

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[23] These are incorporated pursuant to, and governed by, the Kowloon-Canton Railway Corporation Ordinance and the Airport Authority Ordinance respectively.

[24] As was done in Guernsey. Companies were authorised to issue no-par shares by the Companies (Shares of No Par Value) Ordinance 2002, and The Companies (Shares of No Par Value) (Modification of Legislation) Regulations 2002.

[25] The deeming provision, whilst effective in a domestic setting may not be applied by a foreign court, particularly if the proper law of the contract in question is not Hong Kong law. It may be possible to legislate for the effect of the deeming provision another way so as to increase its likely application by foreign courts. This involves a choice of law consideration of the issue which we can separately advise on should the need arise.

(a) Removal of the requirement in s 5(4)(a) that the memorandum (of a company having a share capital) states the amount of its authorised share capital and par value (in the provision referred to as the fixed amount into which the share capital is divided);

(b) A new provision providing that shares of a company shall have no par value, and the application of this to all shares, whether issued before or after the coming into force of the change.[26]

2. Transitional provisions to deal with:

(a) Amounts standing to the credit of a company's share premium account and capital redemption reserve immediately before the commencement of the no-par regime;

(b) The use of amounts standing to the credit of a company's share premium immediately before the commencement of the no-par regime;

(c) The calculation of amounts paid and unpaid on a share issued before migration to no-par. These are usually done by treating:

(i) the amount paid on the share as the sum of all amounts paid to the company for the share (but not including any premium); and
(ii) the amount unpaid on the share as the difference between the price of issue of the share (but not including any premium) and the amount paid on the share.

(d) The liability for calls in respect of amounts unpaid on a share issued before the conversion to no-par (in respect of the par value or premium). The provision should state that this liability (whether in respect of par value or premium) will continue after that date and will not be affected by the share ceasing to have a par value.

(e) The right (if any) for companies existing prior to the conversion to no-par to be allowed to retain a form of authorised capital. This can be done, for example, by provision allowing election by these companies (within a specified period) to limit the number of shares that they could issue after the conversion to no-par to the number of shares that they could issue consistently with its authorised capital immediately before.

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[26] The Australian provision (s 254 Australian Corporations Act 2001) on this (adopted by Singapore in the proposed new s 62A of the draft Companies (Amendment No 2) Bill 2003, but not legislated) is declaratory in nature - "Shares of a company have no nominal value". Compare the New Zealand provision "No share shall have a nominal or par value" (s 38(1) Companies Act 1993).

3. Consequential changes:

(a) Removal of references to nominal amount or value of a company's share capital (or class thereof) and share premium. These are mostly in provisions requiring information from the companies, eg ss 45 and 49G;

(b) Removal or amendment of provisions that refer to the amount of any share premium that may form part of the consideration on the issue of a share;

(c) Provisions to define permitted applications of the share capital;

(d) Adjustments to provisions that express the proportionate size of shareholdings by reference to (or as a percentage of) nominal value, eg ss 8 and 47G. These may be expressed instead by reference to the number of shares in the issued share capital (or of that class, as the case may be).

(e) If desired, enactment of replacement measures against dilution, eg requiring companies to state the maximum number of no-par value shares that they can issue and or regulating the setting of the issue price;

(f) Amendment of the requirement for a minimum subscription for share allotments (s 42) by removing the requirement for the calculation of the minimum subscription to include the nominal amount of the share (s 42(3)). A company will still be able to specify the minimum amount payable on application for a share by setting out the requirement in the prospectus;

(g) Redefine the rules on capital distribution according to the selected formulation, eg the "stated capital account" or the "solvency test";

(h) Removal of the rule on issue of shares at a discount: s 50;

(i) Removal of the concept of stock;

(j) Changes to the rules on redeemable preference shares to accommodate the abolition of par value, and, if required, clarification that the prohibition of par value does not prevent the issue of redeemable shares;

(k) Treatment of consolidations and subdivisions;

(l) Treatment of the merger and group reconstruction reliefs (ss 48C-E).

4. Provision that preserves the effect of contracts and other private law documents, executed before commencement of the no-par regime, which refer to the par (or aggregate par) value, share premium or right to a return of capital on a share.[27]

The above sets out the framework, but not the details, of changes that will be required to be made to the Companies Ordinance to introduce a no-par system. Particulars of changes can only follow from identification of the precise direction that will be taken on each of the issues relevant to conversion to a no-par regime. The particular provisions in the Ordinance that have to be considered then are set out in the schedule annexed hereto as Annexure G (Part B).[28]

7.12 Amendments to other legislation and rules

Appendix G provides (in Part A) a list of (Hong Kong) legislation and rules that are likely to require amendment should Hong Kong move to a no-par regime. Part B of the appendix sets out the particular provisions in these legislation and rules that have references to par value and related concepts.

The principal legislation that will have to be amended is the Companies Ordinance, and para 7.11 describes what these will be. Not all references to par and related concepts in the legislation and rules are to be removed - some have to be retained because they are necessary to accommodate the structure of foreign companies (for example rule 1.01 of the GEM Listing Rules), and or securities other than shares. Likewise those in the incorporating statutes of companies such as the Airport Authority and Kowloon-Canton Railway Corporation[29] should be retained, unless no-par is to be extended to them.

The other legislation/rules critical to the migration to no-par would be the Securities and Futures Ordinance and the Listing Rules. As these apply to more than Hong Kong equities, the changes will largely be to accommodate companies with no-par value, rather than to apply the provisions exclusively to them. We do not see that there are any particular difficulties to adjusting these. An alternative basis is required to the computation of the annual listing fees that are currently calculated by reference to the nominal value of the listed shares.[30] It is possible to retain the current basis for shares that remain with par values, but it will probably be administratively inefficient to have par and no-par shares being treated differently in respect of annual fees, and this should be avoided unless there is reason to distinguish between them this way.

Most of the references to par can be replaced with provisions that replicate or preserve the original intent of the legislation, if they cannot be simply excised

[27] There are however limitations to such a deeming provision – see fn 24.

[28] Specifically at tab 10.

[29] Being the Kowloon-Canton Railway Corporation Ordinance and the Airport Authority Ordinance respectively.

[30] For both main board and GEM listings.

out[31]. For example provisions that express the proportionate size of shareholdings by reference to (or as a percentage of) nominal value may be expressed instead by reference to the number of shares in the issued share capital (or of that class, as the case may be). This may not work in every case. The provision on apportionment of value by reference to the nominal amount of the share in the Estate Duty Ordinance (s 44) is likely to need special treatment.

Obviously all adjustments should be done with care to avoid a possible unintended result.

7.13 Recommendations on accounting

The accounting treatment of share capital is simplified under a no par value regime. Removing the concept of share premium removes the need for separate entries between the share premium and share capital accounts. The accounting entries for most transactions involving share capital will not, however, differ greatly from those currently required.

Under a no par value regime, share issuances will be accounted for by crediting directly to share capital the receivable proceeds, or where shares are issued other than for cash, an amount equal to the fair value of the consideration received or the fair value of the shares issued. As the concept of share premium does not exist in a no par value regime, there is no requirement to record a separate amount within the share premium reserve. Transaction costs arising on the issue of shares will continue to be recognised as a reduction of the proceeds of the issue and accordingly, will reduce the amount of share capital recorded, provided there are no changes to the Companies Ordinance restricting a company's ability to do so. The reinvestment and capitalisation method of accounting for the issue of shares in lieu of dividends can be applied in the same circumstances and manner under a no par value regime except that no premium will be recorded on issuance of new shares in lieu of cash dividends. The consideration for shares issued in lieu of dividends is measured as the amount of dividend receivable by the shareholders if any available cash alternative had been chosen (the reinvestment method). In the absence of a cash alternative, the treatment is similar to a bonus share issue where it is common to have no accounting entry made as there is no longer a share premium reserve or capital redemption reserve.

No accounting entry within shareholders' equity is generally required for an issue of bonus shares or a share split under a no par value regime, as the total equity does not change but is simply divisible by a greater number of shares. The accounting for an issue of partly paid shares under a no par value regime will be simplified by the absence of a need to allocate the proceeds between

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[31] Those that can are mainly in provisions that require particulars as to these to be provided in some document, for eg Appendices 2 and 5 of the GEM Listing Rules. In some cases, entire provisions (and not just particular references) may be removed, such as Order 102 Rule 7 of the Rules of the High Court (Summons for Directions for an application to sanction the issuance of shares at a discount) since the rule underpinning it (prohibition on issuance of shares at a discount) will itself be removed.

share capital and share premium. Clear guidelines will be required from accounting standard setters however on the allocation of the costs of share repurchases to the various components of shareholders' equity, namely share capital, retained earnings and other reserves. Accounting for group reconstructions following migration will depend on merger relief amendments to the Companies Ordinance that prescribe the value at which shares issued as part of a group reconstruction are recorded. The Hong Kong Society of Accountants will need to consider the impact of any such amendments on SSAP 27, which provides that merger relief must be taken advantage of in order to apply merger accounting.

Transitional provisions to transfer share premium to share capital and to allow a company flexibility to use the balance of the share premium account immediately prior to migration need to be considered.

7.14 Recommendations on taxation

The incidence of profits tax, salaries tax, estate duty and stamp duty will not be significantly different for either issuers or shareholders on migration to a par value regime in Hong Kong. However, as capital duty is levied on the nominal share capital/amount or value of the share premium, the basis on which capital duty is computed will need to be reconsidered. One possible option is the imposition of capital duty by reference to the proceeds of the share issue.

## 8. RECOMMENDATIONS

Our conclusion is that the principle of the no-par system is desirable and we recommend that it be introduced in Hong Kong on a mandatory basis for all companies incorporated in Hong Kong with a share capital. However, we see no pressing need to effect a change at the present time, save that it would be efficient and preferable to have it in consideration in any review of the capital maintenance rules, and for the changes to be made together.

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