

Guidebook
On
Issue of Preference Shares



Securities and Exchange Commission of Pakistan

NIC Building, Jinnah Avenue, Islamabad, Pakistan
Phone No. : 051-9207091-4, Fax: 051-9204915
Website: www.secp.gov.pk
E-mail: headquarters@secp.gov.pk

Table of Contents

	Chapter	Page No.
1.	Introduction	2
2.	Basic Concepts	3-4
3.	Specific Requirements of Law: 1. The Companies Ordinance, 1984 2. Companies Share Capital (Variation in Rights and Privileges) Rules, 2000 3. Companies (Issue of Capital) Rules, 1996 4. Companies (General Provisions and Forms) Rules, 1985 5. Sixth Schedule of the Companies Ordinance, 1984	5 - 8
4.	General Requirements of the Ordinance	9
5.	1. Notice 2. Statement of Material Facts 3. Minimum disclosure of information to shareholders	10 - 12
6.	Application to the Commission	13

Chapter No. 1

INTRODUCTION

This booklet is a guide to the laws and rules governing issue of preference shares by a company limited by shares. This guide is designed to understand the procedure of obtaining approval from the shareholders and filing an application with the Securities and Exchange Commission of Pakistan (the “Commission”) under the provisions of the Companies Ordinance, 1984 (the “Ordinance”), Companies Share Capital (Variation in Rights and Privileges) Rules, 2000 (the “Share Capital Rules”), Companies (Issue of Capital) Rules, 1996 (the “Capital Issue Rules”) and Companies (General Provisions and Forms) Rules, 1985 (the “Companies Rules”).

The guidebook summarizes the provisions of the Ordinance and the Rules relating to preference shares and steps to be taken by companies for issuance of these shares.

The provision of Section 90 of the Ordinance was substituted through Finance Act, 1999 in the year 1999, through which limited companies were allowed to have different kinds of share capital and classes therein as provided in their memorandum and article of associations. Further, under Section 90 of the Ordinance, the Share Capital Rules were prescribed in the year 2000. Rule 3 (1) of the Share Capital Rules provide that a company limited by shares may have more than one kind of share capital and may have different classes of shares under each kind.

Earlier to this provision of the Ordinance, companies could have only one class of share capital i.e. Ordinary shares having same kind of rights and privileges, attached thereto. However, now under the provisions of Section 90 of the Ordinance and under Rule 4 of the Share Capital Rules, different rights and privileges in relation to the different classes of shares have been conferred in a manner as prescribed in the aforesaid rule.

The guidebook highlights the important provisions of the following laws:

- The Companies Ordinance, 1984;
- The Companies Share Capital (Variation in Rights and Privileges) Rules, 2000;
- The Companies (Issue of Capital) Rules, 1996; and
- The Companies (General Provisions and Forms) Rules, 1985.

Chapter No. 2

Basic concepts:

Preference shares:

Generally the preference shares means shares which fulfills the following conditions:

1. During the continuance of the company it must have assured preferential dividend. The preferential dividend may consist of a specified amount payable to preference shareholders before any thing is paid to ordinary shareholders, or the amount payable as preferential dividend may be calculated at a fixed rate / percentage.
2. On the winding up of the company it usually carry a preferential right to be paid, that is, the amount paid up on preference shares must be paid back before any thing is paid to the ordinary shareholders.
3. Generally such shares do not carry voting rights.

Cumulative preference shares:

If the Company is not able to pay preference dividend in one year, the arrears of dividend are to be carried forward and paid out of the profits of the subsequent years, such preference shares are known as cumulative Preference shares.

Non cumulative preference shares:

If unpaid dividend is not carried forward but lapses then such shares are known as non-cumulative preference shares.

Participatory preference shares:

Preference shares which are entitled to participate in surplus profits, i.e. profit proposed to be distributed among the shareholders after dividend to preference and ordinary shareholders, are termed as participatory preference shares.

Similarly in the winding up of a company, if, after paying back both the preference and ordinary shareholders, there is surplus, and the preference shareholders are entitled to share in the distribution of available surplus, then such preference shares are also known as participatory preference shares.

Convertible preference shares:

Preference shares which are convertible into any other shares of the Company after a specified period of time or on occurrence of a defined event are termed as convertible preference shares.

Redeemable preference shares:

Preference shares which are issued for a definite time period after the expiry of which the preference shares will be redeemed in cash are termed as redeemable preference shares.

Irredeemable preference shares:

If preference shares are not redeemable / convertible after a specific period of time are called irredeemable preference shares.

Stepped preference shares:

Preference shares with dividend which increases annually by a specified amount and with a predetermined capital return.

Zero dividend preference shares:

Preference shares which receive no dividend through out their lives and instead a fixed known amount is paid at maturity.

Chapter No. 3

Relevant provisions of the Ordinance, in brief, stipulating various conditions regarding further issue of capital by a Company are narrated hereunder however detailed provisions may be read from the Ordinance and the Rules:-

2.1. The Companies Ordinance, 1984

Specific Requirements

- ✓ **Section 28** of the Ordinance regarding alteration of articles requires that a company may alter its Articles of Association by passing a special resolution and any alteration or addition so made shall be as valid as if originally contained in the articles, and be subject in like manner to alteration by special resolution. The Company needs to pass a special resolution to alter its Articles of Association, to give effect to the increased authorized and paid up capital of the Company and different kinds and classes therein.
- ✓ **Section 86** of the Ordinance regarding further issue of capital requires that where the directors decide to increase the capital of the company by issue of further shares, such shares shall be offered to the members in proportion to the existing shares held by each member, irrespective of class, and such offer shall be made by notice specifying the number of shares to which the member is entitled and limiting a time, within which the offer, if not accepted, will be deemed to be declined:

Provided that the Federal Government may, on an application made by any public company on the basis of special resolution passed by it, allow such company to raise its further capital without issue of right shares.

- ✓ **Section 90** of the Ordinance regarding “Classes and kinds of share capital” states that a company limited by shares may have different kinds of share capital and classes therein as provided by its memorandum and articles:

Provided that different rights and privileges in relation to the different classes of shares may only be conferred in such manner as may be prescribed

- ✓ **Section 85** of the Ordinance regarding the **redemption of preference shares** states that:
(1) Subject to the provisions of this section, a company limited by shares may redeem the preference shares issued by it:

Provided that—

- (a) no such shares shall be redeemed except out of profits of the company which would otherwise be available for dividend or from out of a sinking fund created for this purpose or out of the proceeds of a fresh issue of shares made for the purposes of the redemption or out of sale proceeds of any property of the company;
- (b) no such shares shall be redeemed unless they are fully paid;

(c) where any such shares are redeemed otherwise than out of the proceeds of the fresh issue, there shall be out of profits which would otherwise have been available for dividend be transferred to a reserve fund, to be called “the capital redemption reserve fund”, a sum equal to the amount applied in redeeming the shares, and the provisions of this Ordinance relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the capital redemption reserve fund were paid-up share capital of the company;

(d) where any such shares are redeemed out of the proceeds of a fresh issue, the premium, if any, payable on redemption must have been provided for out of the profits of the company before the shares are redeemed or out of the share premium account.

(2) If a company fails to comply with the provisions of sub-section (1), the company and every officer of the company who knowingly and willfully is in default shall be liable to a fine not exceeding five thousand rupees.

(3) The redemption of preference shares under this section by a company shall not be taken as reducing the amount of its authorized share capital.

(4) Subject to the provisions of this section, the redemption of preference shares there under may be effected on such terms and in such manner as may be provided by the articles of the company.

- ✓ Provisions of **Sub-section (b) of Section 160** of the Ordinance, as to meetings and votes, requires that:

where any special business, that is to say business other than consideration of the accounts, balance-sheets and the reports of the directors and auditors, the declaration of a dividend, the appointment and fixation of remuneration of auditors, and the election or appointment of directors, is to be transacted at a general meeting, there shall be annexed to the notice of the meeting a statement setting out all material facts concerning such business, including, in particular, the nature and extent of the interest, if any, therein of every director, whether directly or indirectly, and, where any item of business consists of the according of an approval to any document by the meeting, the time when and the place where the document may be inspected shall be specified in the statement;

2.2 The Companies Share Capital (Variation in Rights and Privileges) Rules, 2000

Relevant Rules of the Share Capital Rules are as under:

3. Kinds and classes of share capital

1. A company limited by shares may have more than one kind of share capital and may have different classes of shares under each kind;

2. Where a company intends to have different kinds of share capital and classes of shares therein, it shall specifically so provide in its memorandum and articles.

4. Nature of rights and privileges

Each kind of share capital of a company and class or classes of its shares, if any, as specified in the memorandum and articles may have different rights and privileges, which shall be provided in the articles. The variation in the rights and privileges of the shareholders in a kind of share capital or class or classes therein may be of the nature, including the following, namely:

1. different voting rights; voting rights disproportionate to the paid up value of shares held; voting rights for specific purposes only; or no voting rights at all;
2. different rights for entitlement of dividend, right shares or bonus shares or entitlement to receive the notices and to attend the general meetings; and
3. rights and privileges for indefinite period, for a limited specified period or for such periods as may from time to time be determined by the members through special resolution.

5. Conditions.

1. No company shall issue further share capital of any kind or class carrying different rights and privileges except with prior approval of the Commission to be obtained on the basis of a special resolution.
2. Subject to the provisions of section 86 of the Ordinance, offer of further share capital of any kind or class carrying different rights and privileges shall be made to each existing shareholder proportionately without any discrimination.
3. If any of the existing shareholders declines to accept the offer made under sub-rule (2) of Rule 5, the shares so declined shall be disposed of by the directors in such manner as may be provided in the articles or in accordance with the special resolution passed by shareholders.
4. In case share capital of a company has different classes having different rights and privileges and the same is to be offered to the general public, the fact shall be distinctly mentioned in the offering document and the difference in the rights and privileges of any class of share capital shall be conspicuously mentioned in the offering document or prospectus, etc.

2.3 Companies (Issue of Capital) Rules, 1996

Relevant extracts of **Rule 5** of the Capital Issue Rules regarding issue of right shares by listed company requires that a listed company may issue right shares subject to following conditions, namely:-

- i. the company shall not make a right issue within one year of the first issue of capital to the public or further issue of capital through right issue;
- ii. the company while announcing right issue, shall clearly state the purpose of the right issue, benefits to the company, use of funds and financial projections for three years. The financial plan and projections shall be signed by all the directors who were present in the meeting in which the right issue was approved.
- iii. the decision of the company to issue right shares shall be communicated to the Authority and the respective stock exchange on the day of the decision;
- iv. book closure shall be made within forty-five days of the announcement of the right issue and the payment and renunciation date once announced for the letter of right shall not be extended except with the permission of the respective stock exchange under special circumstances; and
- v. if the announcement of bonus and right issue is made simultaneously, resolution of the board of directors shall specify whether the bonus shares covered by the announcement qualify for right entitlement

2.3. Companies (General Provisions and Forms) Rules, 1985

- ✓ **Rule 30** of the Companies Rules explain the mode of submission of application to the Commission for its approval allowing the Company to issue preference shares. It has been stated that the application shall, in addition to complying with the any other requirement of the Ordinance or the rules, be –
 - (i) duly signed and verified by an affidavit by the applicant indicating complete name and address and, in the case of a company, signed and verified by an affidavit by a responsible officer of the company;
 - (ii) neatly and legibly written, typed or printed, setting out precisely the facts, grounds and claims or relief applied for in serially numbered paragraphs and specifying the relevant provisions of the Ordinance under which action or relief is applied for;
 - (iii) accompanied by documents referred to in the application or relied upon and, in the case of an appeal against any order or decision, by a certified copy of such order or decision;
 - (iv) accompanied by one spare copy ,duly signed ,dated and verified and accompanied by copies of the documents as aforesaid; and
 - (v) accompanied by original bank challan or draft for the fee paid for the application.

2.3. Sixth schedule of the Ordinance:-

Para VII of the Sixth Schedule of the Ordinance provides that filing fee, by or on behalf of a company, for application with the Commission or the Registrar shall be Rs.500.

Chapter No. 4

General Requirements of the Ordinance:

Only relevant extracts are reproduced hereunder:

- ✓ Provisions of **Section 91** of the Ordinance stipulate that only fully paid shares should be issued and no company shall issue partly paid shares.
- ✓ **Section 92** of the Ordinance states that a Company limited by shares, if so authorized by its articles, may alter the conditions of its memorandum so as to increase its share capital by such amount as it thinks expedient. Sub-section (2) of the aforesaid provision of the Ordinance explains that the new shares issued by the company shall rank *pari passu* with the existing shares of the class to which the new shares belong in all matters, including the right to such bonus or right issue and dividend as may be declared by the company subsequent to the date of issue of such new shares. Provisions of Sub-section (3A) provides that notwithstanding anything contained in this Ordinance or any other law for the time being in force or the memorandum and articles, where the authorized capital of a company is fully subscribed, or the un-subscribed capital is insufficient, the same shall be deemed to have been increased to the extent necessary for issue of shares to a scheduled bank or financial institution in pursuance of any obligation of the company to issue shares to such scheduled bank or financial institution
- ✓ Provisions of **Sub-section (1) of Section 94** of the Ordinance states that where a company having a share capital has resolved to increase its share capital beyond the authorized capital or such capital is increased under sub-section (3-A) of section 92 of the Ordinance it shall file with the registrar, within fifteen days after the passing of the resolution, a notice of the increase of capital and the registrar shall record the increase.

Provided that where default is made by a company in filing a notice of increase in the authorized capital under sub-section (3-A) of section 92, the scheduled bank or the financial institution to whom shares have been issued may file notice of such increase with the registrar and such notice shall be deemed to have been filed by the company itself and the scheduled bank or financial institution shall be entitled to recover from the company the amount of any fee properly paid by it to the registrar in respect of such increase.

- ✓ **Sub-section (2)** of the aforesaid provisions of the Ordinance provides that the notice to be given under sub-section (1) shall include particulars of the shares to be affected and the conditions, if any, subject to which the new shares are to be issued.
- ✓ Provisions of **Section 95** of the Ordinance require that (1) No company shall have power to buy its own shares or the shares of its holding company.

(2) No company limited by shares, other than a private company, not being a subsidiary of a public company, shall give, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with purchase made or to be made by any person of any shares in the company or, where the company is a subsidiary, in its holding company:

Provided that nothing in this sub-section shall prevent the company from advancing or securing an advance to any of its salaried employees, including a chief executive who, before his appointment as such, was not a director of the company, but excluding all directors of the company, for purchase of shares of the company or of its subsidiary or holding company, if making or securing of such advance is a part of the contract of service of such employee.

Chapter No. 5

4.1 Notice of General Meeting

The notice of general meeting shall be sent to the members at least twenty-one days before the date of the meeting and, in the case of a listed company, such notice, in addition to its being dispatched in the normal course, shall also be published at least in one issue each of a daily newspaper in English language and a daily newspaper in Urdu language having circulation in the Province in which the stock exchange on which the company is listed is situated [Section 158 & 159 of the Ordinance].

Notice of general meeting must be faxed to the Commission along with statement under Section 160 of the Ordinance on the same date on which it is sent to the shareholders and copies of the newspaper in which the notices of general meeting are published may be sent to the Commission within 07-days of their publication. [Circular No. 5 dated March 14, 2002]

The notice of the general meeting in which business for issuance of preference shares is placed before the shareholders for approval, must specifically indicate:

1. the proposed resolution is a special resolution;
2. the fact that this issue of shares is subject to approval of the Commission;
3. provision of the Ordinance under which the resolution is proposed;
4. provision of the Share Capital Rules;
5. amendments to be made in the Memorandum and Articles of Association with regards to:
 - i). give effect to the increased authorized capital, if necessary;
 - ii). specify the various kinds and classes of shares i.e. ordinary and preference shares;
 - iii). specify the rights and privileges attached to each kind and class of shares;
6. total number of preference shares to be issued;
7. price per such share;
8. total amount of capital to be issued;
9. rate of preference dividend;
10. preference shares to be issued as rights or otherwise than rights;
11. In case the preference shares are to be issued otherwise than right then to whom these shares are to be issued.

4.2 Statement of Material Facts

Clause (b) of Sub-section (1) of Section 160 of the Ordinance requires that where any special business is to be transacted at a general meeting, there shall be annexed to the notice of the meeting a statement setting out all material facts concerning such business.

As the provisions of Rule 5(1) of the share Capital no company shall issue further share capital of any kind or class carrying different rights and privileges except with prior approval of the Commission to be obtained on the basis of a special resolution.

In view of the above a Company is required to circulate statement of material facts along with the notice of general meeting in which the agenda for issuance of preference shares has been placed before the shareholders of the Company for approval.

4.3 Information to be disclosed to the shareholders

The provisions of Section 160 of the Ordinance clearly states that the statement annexed with the notice of the general meeting with regards to special business provide all material facts concerning such business. Therefore the aforesaid statement at minimum may include the following information with regards to issue of preference shares:-

- ✓ **Justification** for issuance of preference shares and for not issuing ordinary shares;
- ✓ **Price** at which the proposed shares will be issued. Justification, with details of the latest available market price, if any of the previous issue of preference shares is already listed on the Stock Exchange;
- ✓ **Purpose** of the issue, **utilization** of the proceeds and **benefits** to the Company and its shareholders with necessary details;
- ✓ **Rate** of preference dividend;
- ✓ Specific **Rights and privileges** attached to the proposed preference shares such as voting rights, participation in future issue of rights shares and bonus shares etc.;
- ✓ Whether the preference shares will be listed on Stock Exchange(s);
- ✓ **Nature** of preference shares i.e. redeemable or otherwise, cumulative or otherwise, participatory, convertible etc.

If Redeemable:

- ✓ Maximum number of preference shares which will be redeemed;
- ✓ Maximum period after which preference shares will be redeemed;

- ✓ Mechanism / scheme for redemption clearly describing the modus operandi for both call and put options whichever is applicable;
- ✓ Specific time period during which redemption of preference shares will be made;
- ✓ What remedy is available to either party i.e. Company or the preference shareholder, if the shares could not be redeemed within the specified period;
- ✓ Whether the preference shareholders will be entitled to participate in the surplus available for shareholders in the event of winding up of the Company;

If Irredeemable:

- ✓ What precise exit is available to Irredeemable preference shareholders;
- ✓ Whether the preference shareholders will be entitled to participate in the surplus available for shareholders in the event of winding up of the Company.

If Cumulative:

- ✓ The circumstances in which the Company will be authorized to cumulate the preference dividend;
- ✓ Revised rate of preference dividend in case of accumulation;
- ✓ Scope / limit of maximum accumulations;
- ✓ Whether at the time of redemption / conversion the accumulated preference dividend will also be redeemed or converted;
- ✓ If the Company fails to redeem or convert the preference shares on specified date, whether preference dividend will be accrued till the final redemption / conversion.

If convertible:

- ✓ Maximum number, along with percentage, of preference shares which will be converted into other kinds and classes of shares of the Company;
- ✓ Present status of the kinds and classes of the shares (total issued capital, listing status, market price etc.) in which conversion of preference shares is proposed;
- ✓ Period after which the preference shares will be eligible for conversion;
- ✓ Event on the occurrence of which conversion option can be exercised by any of the two parties i.e. the Company or the preference shareholders;

If preference shares are proposed to be issued otherwise than rights then the Commission's Guide book for "Further issue of shares otherwise than rights" may be consulted.

Chapter No. 6

Application to the Commission:

The Company after passing of the special resolution has to file duly filled form 26 with the concerned Registrar and obtain a certified copy of the same. The application to be filed with the Commission, for its approval, under Rule 5 of the Share Capital Rules read with Section 90 of the Ordinance (and under proviso to Sub-section (1) of Section 86 of the Ordinance, if issued otherwise than rights) may be submitted in a following manner accompanying with the following documents:-

- ✓ The application must narrate **detailed information** of BMR / expansion plan or any other purpose for which the proceeds of the issue will be utilized;
- ✓ The application must be **signed** by the officer/ director of the Company who have been authorized by the shareholder to accomplish the transaction;
- ✓ **Financial projections** for next three years reflecting the implementation of the plan and its benefits;
- ✓ Amended **certified copy** of the Memorandum and Articles of Association of the Company;
- ✓ **Certified copy of form 26** along with special resolution;
- ✓ **Minutes of the board of director's meeting**, along with attendance sheet, in which decision for issuance of further shares otherwise than rights was made;
- ✓ **Attendance sheet of shareholders**, who attended the general meeting either in person or through proxies;
- ✓ **Affidavit** as required under Rule 30 of the Rules;
- ✓ Copy of **voucher** evidencing deposit of application fee.



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
N.I.C BUILDING, JINNAH AVENUE, ISLAMABAD – PAKISTAN
Ph: 051- 9207091-4 Fax: 051-9204915
Web: www.secp.gov.pk
E-mail: headquarters@secp.gov.pk