

# Review of the Companies (Further Issue of Shares) Regulations, 2020

April 2020



## 1. Background to the 2020 Regulations

The Companies (Further Issue of Shares) Regulations, 2020 (the “**2020 Regulations**”) were issued by the Securities and Exchange Commission of Pakistan (the “SECP”) on 16 March 2020. The 2020 Regulations repealed the Companies (Further Issue of Shares) Regulations, 2018 (the “**Repealed Regulations**”)¹. These Repealed Regulations had consolidated and updated the following laws:

- Companies (Issue of Capital) Rules, 1996;
- Companies' Share Capital (Variation in Rights and Privileges) Rules, 2000;
- Public Companies (Employees Stock Option Scheme) Rules, 2001;
- Guidelines for the Structuring and Offering of the Employees Stock Option Schemes, 2016; and
- Circular 30 of 2016 dated September 16, 2016.

Through the issue of the 2020 Regulations, the mechanism for issue of further shares has been further simplified through a significant reduction of the regulatory red tape. It is part of the series of reforms being undertaken by SECP and is expected to facilitate capital formation and mobilization by interested investors.

This document considers the key aspects of the 2020 Regulations and highlights material differences between the Repealed Regulations and the 2020 Regulations.

<sup>1</sup> Section 12(1) of the 2020 Regulations.

<sup>2</sup> Preamble to the 2020 Regulations

## 2. Application of 2020 Regulations

The 2020 Regulations have been issued pursuant to Section 58 (classes and kinds of share capital), Section 82 (power to issue shares at a discount) and Section 83 (further issue of share capital) of the Companies Act, 2017<sup>2</sup>. The 2020 Regulations have come in force upon issuance except in the case of issues announced on or before the date of 2020 Regulations

The issue of further shares pursuant to the 2020 Regulations will at all time remain subject to the conditions stipulated in the applicable provisions of the Companies Act, 2017, and additionally the Securities Act, 2015, for listed companies.

The ambit of the 2020 Regulations is similar to that of the Repealed Regulations. It applies to issue of further shares through the following methods:

- i. rights issue;
- ii. other than rights issue;
- iii. bonus issues;
- iv. shares with differential rights including preferential shares;
- v. employees' stock option scheme.<sup>3</sup>

The 2020 Regulations do not apply to initial public offerings or the private placement of securities to which

<sup>3</sup> Sub-regulation 1(3) of the 2020 Regulations.

the Public Offering Regulations, 2017, and the Private Placement of Securities Rules, 2017, apply, respectively.

### **3. Rights Issue**

#### **Application to listed / unlisted companies**

Sub-regulation 3(1) of the 2020 Regulations (conditions for right issue) has been stipulated to apply specifically to listed companies. Accordingly, the conditions for rights issue which have been stipulated in sub-regulation 3(1) of the 2020 Regulations will not apply to issue of further shares by unlisted companies.

#### **More than one rights issue in a year**

One of the most important change that has been brought through the 2020 Regulations is that the restriction on issue of more than one rights issue by a listed company within a twelve (12) month period under the Repealed Regulations<sup>4</sup> has been omitted in the 2020 Regulations.

#### **No requirement to provide financial projections**

The requirement to provide financial projections or plans signed by all the directors approving rights issue, justifying the benefits of the such right issue to the SECP<sup>5</sup> has been omitted from the 2020 Regulations.

#### **Issue of shares on discount, premium and face value**

The requirements with respect to issue of shares at a discount or at a premium to face value have also been simplified and the conditions applicable to the same are now limited to an undertaking by the directors and substantial shareholders that:

- i. they will subscribe the right shares to be offered to them as per their right entitlement or arrange subscription for the same through other persons; and
- ii. the balance of the right issue is underwritten through at least two underwriters, not being associated companies or associated undertakings of the issuing company.<sup>6</sup>

The abovementioned undertaking from the directors and shareholders is also required for issue of shares at face value. Consequently, the provision with respect to failure

of a listed company to complete the right issue in the manner and within the specified time has been omitted in the 2020 Regulations.

#### **Fractional shares**

In relation to fractional shares, while the position under the Repealed Regulations was that fractional shares shall be consolidated and disposed of by the company and the proceeds from such disposition shall be distributed in due course by the company in the manner provided under applicable law and articles of association of the company,<sup>7</sup> the 2020 Regulations now require that the proceeds from such consolidation of fractional shares and disposition thereof shall be paid to such of the entitled shareholders as may have accepted such offer.<sup>8</sup>

#### **Decision of the board of directors**

The matters required to be considered in the decision of the board of directors for issue of shares have been slightly modified in that the board of directors is no longer required to make a statement that the requirements of Companies Act, 2017, and the regulations have been considered by the board of directors and shall be duly complied with by company, although, of course the relevant requirements will need to be complied with notwithstanding the foregoing.

Further, the decision of the board of directors' is now also required to make a clear statement with respect to the utilization of the proceeds of issue.<sup>9</sup> As with the Repealed Regulations, the reporting requirements under the 2020 Regulations also require that starting from within thirty (30) days of issue of shares, a progress report on the utilisation of proceeds of the rights issue on a quarterly basis shall be provided to the SECP in the specified manner.<sup>10</sup>

Subject to above, the matters required to be considered in the decision of the board of directors for rights issue are substantially similar to those that were required to be considered under the Repealed Regulations and require that the decision of the board of directors state the quantum, size, price and purpose of issue, utilization of the proceeds of issue, benefits of issue to company and shareholders, risks associated with the issue and justification for issue of shares at premium or discount to face value (if applicable).<sup>11</sup>

<sup>4</sup> Sub-regulation 3(1)(i) of the Repealed Regulations.

<sup>5</sup> Sub-regulation 3(1)(viii) of the Repealed Regulations.

<sup>6</sup> Sub-regulation 3(1)(iv) and 3(2) of the 2020 Regulations.

<sup>7</sup> Sub-regulation 3(1)(iv) of the Repealed Regulations.

<sup>8</sup> Sub-regulation 3(1)(ii) of the 2020 Regulations.

<sup>9</sup> Sub-regulation 3(1)(iii) of the 2020 Regulations.

<sup>10</sup> Sub-regulation 10(2) of the 2020 Regulations.

<sup>11</sup> Sub-regulation 3(1)(iii) of the 2020 Regulations.

The stipulation that the approval of the board of directors to increase the share capital shall be considered as right announcement.<sup>12</sup> However, it is unclear at this stage from a bare reading of the 2020 Regulations whether this omission is / will be of any material value.

#### **Other provisions**

As with the Repealed Regulations, once the rights issue has been announced by the board of directors of a listed company, the same shall not be varied, postponed, withdrawn or cancelled.<sup>13</sup>

Schedule 1 to the 2020 Regulations which list the information to be provided to members of a company on issue of rights share continues to require substantially the same information as was required to be provided under Schedule 1 of the Repealed Regulations.

#### **4. Other than Rights Issue**

Issue of shares other than rights issue can be undertaken by a public company.<sup>14</sup>

#### **Omission of procedural requirements**

Under the 2020 Regulations, the provisions with respect to issue of shares other than right issue have been significantly curtailed as although the requirement to obtain shareholders' and SECP approval for issue of shares other than right remain<sup>15</sup>, the provisions listing the procedural requirements with respect to notices and minutes of general meeting and application to SECP have been removed.

#### **Decision of the board of directors**

As with the Repealed Regulations, the issue of shares other than right is required to be proposed by the board of directors.<sup>16</sup>

The Repealed Regulations required the board of directors to make statements in their proposal with respect to the issue being subject to approval of shareholders and SECP, the quantum of issue, issue price and justification of same, whether shares will be issued against cash or other than cash, persons to whom the shares will be issued, benefits of the issue to company and its members, and purpose and justification of the issue other than rights issue.

In addition to the foregoing, the 2020 Regulations now require the board of directors to also make the following statements in their decision:

- i. breakup value per share as per the latest available audited and reviewed accounts;
- ii. consent of the person(s) to whom the shares are to be issued have been obtained;
- iii. the proposed new shares shall rank *pari passu* in all respects with the existing ordinary shares of the company. In case the proposed new shares are different from the issued ordinary shares in any respect, then the board of directors' decision must state the differences in detail;
- iv. average market price of the share, in case of a listed company, during the last three (3) months preceding the board of directors' decision as well as the latest available market price; and
- v. where shares are proposed to be issued for consideration other than in cash, the value of non-cash assets or services or intangible assets shall be determined by a valuer.<sup>17</sup>

As per sub-regulation 5(2) of the 2020 Regulations, the decision of the board of directors, in case of a listed company, shall be communicated to the SECP and the Pakistan Stocks Exchange on the same day as the board of directors' decision was taken.

#### **5. Issue of Bonus Shares**

The provisions with respect to issue of bonus shares have not been materially modified under the 2020 Regulations. A company may issue bonus shares, in accordance with its articles of association of the company, provided that:

- i. the issue of bonus shares has been approved by the board of directors; and
- ii. in the case of a listed company, the board resolution has been communicated to the SECP and the Pakistan Stocks Exchange on the same day as the board of directors' approval was provided.<sup>18</sup>

<sup>12</sup> Sub-regulation 3(1)(iii) of the Repealed Regulations.

<sup>13</sup> Sub-regulation 3(5) of the 2020 Regulations.

<sup>14</sup> Section 83 of the Companies Act, 2017.

<sup>15</sup> Section 83(1)(b) of the Companies Act, 2017.

<sup>16</sup> Sub-regulation 5(1)(i) of the 2020 Regulations.

<sup>17</sup> Sub-regulation 5(1)(ii) of the 2020 Regulations.

<sup>18</sup> Sub-regulation 4(1) of the 2020 Regulations.

The decision of the board of directors to issue bonus shares shall not be varied, postponed, withdrawn or cancelled once it has been announced.<sup>19</sup>

## **6. Issue of different classes and kinds of shares**

### **Omission of procedural requirements**

In similar vein as the provisions for issue of shares other than right, the provisions with respect to issue of different classes and kinds of shares have been significantly curtailed. While the requirement to obtain shareholder and SECP approval for issue of shares different classes and kinds of shares remain<sup>20</sup>, the provisions listing the procedural requirements with respect to notices and minutes of general meeting and application to SECP have been removed.

### **Key Conditions**

The key conditions to the issue of different classes and kinds of shares are now limited to recommendation of the board, authorization of the shareholders through a special resolution and approval of the SECP.

### **Removed requirement of maintaining specific post issue capital ratio, track record of profitability and no default in filing and payments**

The following restrictions have been omitted in the 2020 Regulations:

- i. the shares with differential rights of a listed company shall not exceed twenty-five per cent of the total post-issue paid up share capital including shares with differential kinds/ rights issued at any point of time;
- ii. the company to have a consistent track record of distributable profits for the last three (3) years;
- iii. the company has not defaulted in filing financial statements and annual returns for three (3) financial years immediately preceding the financial year in which it decided to issue such shares;
- iv. the company has not defaulted in the payment of a declared dividend to its members or on payment of the dividend on previously issued preference shares; and

- v. the company has not defaulted on conversion or redemption, as the case may be, of its preference shares or debentures that have become due or on payment of interest on such debentures.

Further, the provisions that the issue of different classes and kinds of shares shall be authorised by the articles of association of the company and that the issue shall be subject to Section 83 of the Companies Act, 2017, have been omitted from the 2020 Regulations. Nonetheless, such requirements will continue to apply by virtue of Section 58 and Section 83 of the Companies Act, 2017, respectively.

### **Failure to comply with terms and conditions of different class of shares**

The provisions outlining the consequences of failure to completely or partially, fulfil or comply with any of the relevant terms and conditions of preference shares have been simplified in the 2020 Regulations: it has been stipulated that the company shall not amend, alter, vary or reassess the terms and conditions of such issue without approval of *“the preference shares holders”* and the SECP failing which the SECP may:

- i. direct such company to redeem the entire issue with immediate effect and make full compensation along with interest accrued therein, if any; or
- ii. direct such company to convert the entire issue into ordinary shares with immediate effect; or
- iii. give direction as deemed appropriate by the SECP through an order after providing the company an opportunity of hearing.<sup>21</sup>

Despite the language of the abovementioned requirement which references approval of preference shareholders and the SECP, it is likely that restriction on modification of the terms and conditions of issue will be considered to extend to classes of shares other than preferential shares as well if only because the terms and conditions for issue of any different class of shares is subject to approval of the SECP in the first place (the **“initial approval”**) and any modification to the terms and conditions of issue which has been so approved should therefore be deemed subject to the approval of the SECP (the **“second**

<sup>19</sup> Sub-regulation 4(2) of the 2020 Regulations.

<sup>20</sup> Sub-regulation 6(iii) and 6(iv) of the 2020 Regulations.

<sup>21</sup> Sub-regulation 6(v) and 6(vi) of the 2020 Regulations.

approval”), with a failure to obtain such second approval prior to modification of the terms and conditions being considered a contravention of the SECP’s initial approval. In practice, therefore, an approval for modification of a different class of shares, including those other than preferential shares, will be sought to err on the side of caution.

The Companies Act, 2017, in the context of amendments to articles of association, also provides that an alteration that affects the substantive rights or liabilities of members or of a class of members, shall be carried out only if a majority of at least three-fourths of the members or of the class of members affected by such alteration, as the case may be, vote for such alteration.<sup>22</sup>

### **Decision of the board of directors**

Under the 2020 Regulations, the matters required to be stated in the board of directors’ decision to issue of shares of a different class or kind are similar in substance to the corresponding provisions of the Repealed Regulations, except that the provision in the Repealed Regulations which required the board of directors to consider such further condition in the decision as may be deemed appropriate by the SECP has now been replaced with any other feature as may be deemed important by the board of directors.<sup>23</sup>

The decision of the board should state, *inter alia*, the quantum, size, price and purpose of issue, utilization of the proceeds of issue, benefits of issue to company and shareholders, risks associated with the issue, justification for issue of shares at premium or discount to face value (if applicable), description of different kinds of shares and the rights and privileges attached to such class / kind of shares, whether shares are being issued as right or other than right, whether the holders of such shares will be entitled to participate in profits for surplus funds, and whether payment of dividends will be on cumulative or non-cumulative basis etc.<sup>24</sup>

### **Other requirements**

As with the provisions of the Repealed Regulations, the 2020 Regulations also require that in case of rights issue, the letter of offer shall distinctly mention the fact that different classes or kinds of shares are being issued and the difference between the rights and privileges of any

class of share capital shall be conspicuously mentioned in directors’ report to members.<sup>25</sup>

### **7. Employees’ Stock Option Scheme**

A public company can issue shares to employees pursuant to an employee stock option scheme (the “**Scheme**”).<sup>26</sup>

The regulatory requirements with respect to the Scheme have been completed overhauled and the process for issue of shares pursuant to a Scheme has been made easier and straightforward in the 2020 Regulations.

#### **Omission of procedural requirements**

The provisions listing the procedural requirements with respect to notices and minutes of general meeting and application to SECP have been removed.

#### **Removed conditions on eligibility of employees, three years of operation, no default in filing and payments, and compliance with IFRS**

Under the 2020 Regulations the following conditions / requirements have been omitted:

- i. only regular / permanent employees of the company are to be eligible for issue of shares under a Scheme;
- ii. the company to have been in operation for three (3) years;
- iii. company to not have defaulted in filing financial statements and annual returns for three (3) financial years immediately preceding the financial year in which it decided to offer the Scheme;
- iv. company to not have defaulted in the payment of a declared dividend to its members or preference shareholders or in conversion or redemption of its preference shares or debentures that have become due or on payment of interest on such debentures;
- v. company to not have defaulted in payment of any dues of employee to any authority or has not failed to honor its commitments under any previously issued Scheme;
- vi. company to ensure compliance with applicable International Financial Reporting Standards; and

<sup>22</sup> Section 38 of the Companies Act, 2017.

<sup>23</sup> Sub-regulation 6(ii)(j) of the 2020 Regulations.

<sup>24</sup> Sub-regulation 6(ii) of the 2020 Regulations.

<sup>25</sup> Sub-regulation 9(2) of the 2020 Regulations.

<sup>26</sup> Section 83(1)(a)(iv) of the Companies Act, 2017 and sub-regulation 7(1)(i) of the 2020 Regulations.

vii. company granting option to its employees pursuant to the Scheme to have the freedom to determine the exercise price and other provisions with respect to settling of exercise price.

#### **Conditions of issue**

While the approval of the SECP for issuance of shares to employees is no longer required under the 2020 Regulations, except where the shares are being issued at a discount to the face value pursuant to Section 82 of the Companies Act, 2017, it should be noted that the Companies Act, 2017, does require that the Scheme should be approved by the SECP in accordance with the procedure and on such conditions as may be specified and accordingly further clarification may be needed from the SECP in relation to the same.<sup>27</sup>

The other conditions for the issue of shares under a Scheme previously stipulated in the Repealed Regulations have generally been incorporated in the 2020 Regulations. These include the following conditions:

- i. The board of directors shall approve the offer of the Scheme and provide the specified information in its decision.
- ii. the articles of association of the company should authorise the offer of the Scheme;
- iii. an employee shall not have the right to receive any dividend or to vote or be entitled to rights of members in respect of option granted to him, till shares are issued to such employee on exercise of option; and
- iv. an option granted to an employee shall not be pledged, hypothecated, mortgaged or otherwise alienated in any other manner.

#### **Terms of reference of compensation committee**

The terms of reference for the compensation committee, which is required to be formed by the board of directors, for the administration and superintendence of the Scheme,<sup>28</sup> have not been stipulated under the 2020 Regulations.

<sup>27</sup> Section 83(1)(a)(iv) of the Companies Act, 2017.

<sup>28</sup> Sub-regulation 7(ii) of the 2020 Regulations.

#### **Outstanding options at time of IPO**

A new insertion has been made in the 2020 Regulations which provides that, if any options granted to employees in pursuance of a Scheme are outstanding at the time of an initial public offering, the offering document shall disclose the number of such outstanding options and other specified information, in case all the outstanding options are exercised.<sup>29</sup>

#### **8. General Conditions, Reporting and Disclosure Requirements and Miscellaneous Provisions**

The material differences in the Repealed Regulations and the 2020 Regulations that apply to various types of issue of shares have been considered in the above paragraphs including the general conditions and reporting requirements applicable to such types of issue of shares.

In addition to those, the following may be noted:

- i. Under the Repealed Regulations, the SECP had retained the right to provide a company relaxation from the requirements / conditions imposed under the Repealed Regulations. A corresponding right to provide relaxation from the applicable requirements / conditions has not been retained in the 2020 Regulations.
- ii. The Repealed Regulations had provided for a provision on disclosure of information including the information required to be disclosed in the directors' report. This provision has been omitted from the 2020 Regulations.
- iii. Under the reporting requirements, the Repealed Regulations required the company to submit a report to the SECP within thirty (30) days from the date of issue of shares indicating the shares issued to directors, associated companies, other shareholders, underwriters and persons to whom unsubscribed shares are issued under Section 83(1) of the Companies Act, 2017. This requirement has been mirrored in the 2020 Regulations except that the shares issued to underwriters are no longer required to be reported.<sup>30</sup>

<sup>29</sup> Regulation 8 of the 2020 Regulations.

<sup>30</sup> Sub-regulation 10(1) of the 2020 Regulations.



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