

Box 5 REDENOMINATION OF STERLING BONDS AND COMPANY SHARE CAPITAL

A consultation paper by the City Euro Group on the UK legislation that would be needed for EMU entry

If the UK were to join EMU, UK legislation would be needed to facilitate the redenomination of bonds and company share capital. This paper, which was published in November 2003 as a basis for consultation with market practitioners and legal experts, identifies points (mainly from the City Guide) which might need to be covered in UK legislation.

Redenomination of bonds

All UK Government sterling-denominated registered debt securities (including Treasury bills) would be redenominated to euro on the date of UK entry, using the conversion rate. Redenomination would take place by converting the recorded value in the register of each individual holding, by each stock account, and rounding to the nearest euro cent under Article 5 of Council Regulation (EC) 1103/97.¹

The minimum holding and tradable amount would, following redenomination, be changed from £0.01 to €0.01.

Gilts in bearer form would be deemed to be redenominated on entry, but without requiring an actual exchange of paper instruments or physical 'stamping over' of existing instruments.

Non-UK Government sterling-denominated debt securities, whether registered or bearer, could be redenominated at any point during a transition period, by decision of the issuer, subject to the terms of the offering circular². In the case of companies, this could be done by a simple resolution of the board. Where redenomination followed the same method as for gilts, the issuer would not be required to obtain the consent of bondholders (unless the terms and conditions specifically required this).

Issuers, either directly or through their agents, should make reasonable efforts to inform bondholders about the redenomination of their bonds³. Issuers would determine when and in what manner information would be sent to registered holders, while holders of bearer bonds could only receive such information when they contacted their issuer or agent.

Where securities had not been redenominated, but cash flow payments were made in euro, the calculation of interest payments or principal repayments should be made by converting into euro the amount due on the basis of the recorded value in the register, or the face value in the case of bearer bonds, of each individual holding.

¹ As amended by Council Regulation (EC) 2595/2000.

² This assumes that an equivalent to Council Regulation (EC) 974/98 (as amended by Council Regulation (EC) 2596/2000) would apply in the UK, if the UK were to join EMU, and that the Regulation would include an equivalent to Article 8(4), as it did in the case of the euro area.

³ The IPAA recommends that issuers that do not redenominate their bonds on entry should redenominate them on an interest payment date.

The legislation might also specify that, where calculation of interest or principal repayments was made by reference to an index or a market reference rate, any modification to the index or market reference rate as a result of redenomination would not affect the validity of the contract. Issuers should make reasonable efforts to communicate this information to bondholders, as necessary. Any such provision would not seek to specify which successor rate should be used. That would be a matter for the relevant market associations. But it would make clear that a change in reference rate would not affect the validity of the contract.

Holders of redenominated securities would not have to meet any of the costs of redenomination.

There are several other points that would need to be considered:

- whether there were any other relevant provisions in the Government Stock Regulations and related legislation, some of which date back to 1832;
- whether the legislation would need to refer specifically to sterling debentures, convertibles, options and warrants;
- how legislation would cover contracts subject to Scottish and Northern Irish law, as well as contracts subject to English law; and
- how sterling Eurobonds subject to foreign law would be treated.

Redenomination of company share capital⁴

If the proposed Company Law Reform Bill is enacted in its present form, a simplified procedure, to enable directors of a UK company to resolve that their company's sterling share capital should be redenominated to euro during a transition period, would already be available to both public and private companies. But if the UK were to join EMU, specific legislation might be needed: to empower the board of directors to resolve to redenominate from sterling to euro at any time during the transition period; and to clarify what would happen at the end of the transition period in the case of companies which had not voluntarily redenominated before then.

Companies would be required to adopt a top-down method of conversion, by converting the total nominal amount of the authorised share capital (both issued and unissued) in each class, rounding to the nearest euro cent and then dividing by the number of authorised shares in

⁴ A method for avoiding the need to redenominate company share capital would be for the legislation to allow true 'no par value' (NPV) shares. Instead of individual shares having a fixed nominal value, each NPV share would represent a proportion of a company's total share capital. The number of shares in issue could remain the same; there would be no par value to redenominate; no resulting decimal figures to round or renominialise; and changes to registers and certificates would be minimal. It would also avoid the need to cash out any awkward fractional interest which might arise when shares are redenominated and renominialised. There is considerable support in the UK for the 'true' type of NPV share. It would not have any monetary relationship to a company's share capital and would simply represent a fractional share in the company's total net worth. However, in the case of public companies, this type of NPV share, which is commonly used in the US, would not appear to be compatible with the Second EC Company Law Directive in its present form.

order to arrive at the nominal euro amount of each individual share, as illustrated in the following example.

Method of redenominating company share capital: an example

- (1) Convert authorised share capital from sterling to euro at the conversion rate and round to the nearest euro cent.
- (2) Find the nominal value of each share by dividing the result at (1) by the number of authorised shares.
- (3) Either leave the resulting nominal amount of each share stated to several decimal places (without rounding or truncating), or round it upwards or downwards with a corresponding adjustment to the company's reserves.
- (4) The company balance sheet will show the issued (redenominated) share capital and the change to the reserves.

Example:

Assume a company with authorised share capital of £100,000 (100,000 shares of £1 each), and issued share capital of £75,000 (75,000 shares of £1 each).

Assume a hypothetical conversion rate, for illustration only, €1=£0.456789⁵

Authorised share capital of £100,000 converted to euro @ 0.456789 = €218,919.46 ((1) above).

Nominal value of each £1 share = €2.1891946 ((2) above).

If reserves are available, renominalise the par value of each share upwards to €2.20 and capitalise €810.41 to pay the difference (€0.0108054) on the issued shares ((3) above).

If no reserves are available, round down the nominal value of each share to the nearest euro cent, so reducing it by €0.0091946; then multiply this amount (€0.0091946) by the number of shares in issue (75,000) to give €689.60, which amount is transferred to a special undistributable reserve((3) above).

If the shares are renominalised upwards to €2.20 each by capitalising reserves, the authorised share capital would be €220,000, the issued share capital would be €165,000 and reserves would be reduced by €810.41((4) above). Alternatively, if the nominal amount of each share is rounded downwards to the nearest euro cent, the authorised share capital would be €218,000, the issued share capital would be €163,500 and reserves would be increased by €689.60 ((4) above).

⁵ This hypothetical conversion rate is used here to enable the presentation of a worked example. It is the same hypothetical rate that was used for this purpose in NCP3.

Mandatory rounding under Article 5 of Council Regulation (EC) 1103/97⁶ applies only where 'monetary amounts' are to be 'paid or accounted for' after a conversion to the euro. There are differing views as to how widely or otherwise this should be interpreted. It has been suggested by the Law Society's Company Law Committee and the City of London Law Society's Company Law Sub-Committee in their memorandum dated April 2003, Redenomination of Legacy Currency Share Capital following the Introduction of the Euro (the Joint Memorandum), that the rounding rule should apply both to the payment of dividends and sums due on redemption and also to a set of accounts being prepared or a statement as to the amount of share capital being made in compliance with a legal obligation. If the UK were to join EMU, further guidance might need to be given on this question, particularly when the 'read as euro' principle came into operation at the end of a UK transition period.

The legislation should state whether the nominal amount of each share so converted would be left stated to several decimal places or rounded to the nearest euro cent. As rounding could give rise to significant differences in the case of shares with small nominal amounts, it might be best if rounding of nominal amounts was made possible but not compulsory. If this approach were followed, companies could still choose, after conversion had occurred, to redenominate their shares by a shareholders' resolution.

For all legal purposes, the number of decimal places to which the redenominated nominal amount of each share would be stated should be determined by the board of directors in accordance with Articles 4 and 5 of the Council Regulation (EC) 1103/97⁷. Although it would seem attractive to permit companies, purely for reporting or presentational purposes, to state the nominal amount of shares to two decimal places, it would be necessary to consider whether this could lead to confusion and inconsistencies. If the total nominal amount of the authorised share capital had been calculated by the top-down method but the nominal amount of each share was stated to a rounded amount (without having been redenominated), there would be an apparent mathematical inconsistency between the two figures. In other words, the rounded nominal amount of each share when multiplied by the number of authorised shares, would rarely (if ever) match the stated total nominal amount of the authorised share capital.

Companies should be permitted by the legislation to adjust the resulting nominal amount of each share to a more convenient round figure in euro, by passing an ordinary resolution (without the need for any court approval) as contemplated in the proposals announced by the DTI in September 1998. This resolution could be conveniently passed at an AGM in order to avoid the costs of convening a separate shareholders' meeting.

Any change in the total nominal share capital arising from redenomination or redenomination would need to be combined with a corresponding adjustment to the company's reserves, as contemplated in the example above.

It would seem sensible that, if a company were to redenominate its sterling share capital to euro during a transition period, it could also resolve that any references in a company document to share capital be read as euro at the official conversion rate with effect from the date of redenomination. However, care would need to be taken in drafting the legislation to ensure that it had no unintended (adverse) impact on the rights of third parties. After the end

⁶ As amended by Council Regulation (EC) 2595/2000.

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of a UK transition period, the ‘read as euro’ principle would automatically apply in any event, assuming that Article 14 of Council Regulation (EC) 974/98⁸ would be replicated for UK entry.

A company should not be obliged to issue new share certificates on redenomination or renominatisation, provided that the number of shares in issue remained unaltered. This should be specified in the legislation, for the avoidance of doubt.

Issuers, either directly or through their agents, should make reasonable efforts to inform shareholders about the redenomination and renominatisation of their shares.

Where costs were incurred in redenominating and (if applicable) renominatising shares, the legislation should make clear that this would be an expense of the issuing company (not reclaimable from shareholders) and tax deductible as such.

⁸ As amended by Council Regulation (EC) 2596/2000