



New HKEX Listing Rules on Listed Issuers' Share Schemes to Take effect 1 January 2023

On 29 July 2022, The Stock Exchange of Hong Kong Limited (the **HKEx**) published consultation conclusions on *Proposed Amendments to the Listing Rules relating to Share Schemes of Listed issuers and Housekeeping Rule Amendment* (the **Consultation Conclusions**).

The HKEx had previously issued the *Consultation Paper on Proposed Amendments to Listing Rules* relating to Share Schemes of Listed Issuers¹ in October 2021 on proposals to extend Chapter 17 of the Listing Rules to govern share award schemes, as Chapter 17 currently provides a framework that only governs share option schemes. There were also proposed changes to certain specific requirements in Chapter 17 and to improve disclosure of grants of share options and share awards. The major changes mainly relate to (i) the role of the remuneration committee and INEDs; (ii) the minimum vesting period for share awards and options; and (iii) application of requirements concerning share schemes to subsidiaries of a listed issuer.

A summary of the proposals to be adopted as outlined in the Consultation Conclusions is set out below. The new requirements will take effect on 1 January 2023. The HKEx Conclusions Paper can be found on the HKEx website here.

Chapter 17 HKEx Listing Rules Terms

The following table sets out the meaning of defined terms used in the newsletter. Reference to "Chapters" is a reference to chapters under the Listing Rules.

Term	Definition
1% Individual Limit	The limit on Share Grants to an individual participant over any 12-month period, which, without shareholders' approval, must not exceed 1% of the issued shares of the listed company (or, for a subsidiary scheme, its subsidiary)
Advanced Mandate	An advanced specific mandate approved by shareholders of a listed company for granting new shares under a share award scheme
Board	Board of directors of a company listed on the HKEx
Connected Person	A director, chief executive, or substantial shareholder of the listed company or an associate of any of them

Employee Participants	Directors and employees of the listed company or any of its subsidiaries (including persons who are granted shares or options under the scheme as an inducement to enter into employment contracts with these companies)
INEDs	Independent non-executive directors of the listed company
Insignificant Subsidiary	A subsidiary whose total assets, profits and revenue compared to that of the listed company's group are less than: (a) 10% under the percentage ratios for each of the latest three financial years (or if less, the period since the incorporation or establishment of the subsidiary); or (b) 5% under the percentage ratios for the latest financial year
Listing Rules or the Rules	The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited ² (Main Board, unless otherwise stated)
Principal Subsidiary	A subsidiary whose revenue, profits or total assets accounted for 75% (or more) of that of the listed company under the percentage ratios in any of the latest three financial years
Remuneration Committee	Remuneration committee to the Board
Related Entity Participants	Directors and employees of the holding companies, fellow subsidiaries, or associated companies of the listed company
Scheme Mandate Limit	The limit on Share Grants under all Share Schemes of a listed company (or, for a subsidiary scheme, its subsidiary) approved by its shareholders, which must not exceed 10% of the issued shares of the company (or the subsidiary) at the date of the shareholders' approval of the limit
Service Providers	Persons who provide services to the listed company's group on a continuing and recurring basis in its ordinary and usual course of business which are in the interests of the long-term growth of the company's group
Service Provider Sublimit	A sublimit under the Scheme Mandate Limit for Share Grants to Service Providers
Share Grants	In respect of a listed company's Share Schemes, Share Grants refer to grants of share awards and/or options over new shares of the company. In respect of a subsidiary's Share Scheme, Share Grants refer to grants of share awards and/or options over new or existing shares of the subsidiary.
Share Schemes	Both share option schemes and share award schemes

A summary of main Listing Rule changes adopted as described in the Consultation Conclusions

The major modifications to Listing Rule requirements arising from the Consultation Conclusions are as follows:

(i) Role of Remuneration Committee and INEDs

It was proposed by the HKEx that the Remuneration Committee be required to approve matters relating to the establishment and operation of Share Schemes that are considered unusual or require attention, namely (a) approving matters relating to Share Grants to Service Providers and Related Party Participants (including criteria for their admittance and the Service Provider Sublimit); (b) approving Share Grants that deviate from Chapter 17 requirements; and (c) approving Share Grants to Connected Persons.

The HKEx will adopt relevant proposals (as further described below) except in respect of item (c) above, as respondents were concerned that approval of Share Grants to Connected Persons by the Remuneration Committee may weaken the oversight function, given the Remuneration Committee may include executive directors.

(ii) Vesting period

The HKEx proposed that a minimum vesting period of 12 months should be required for all Share Grants, unless a shorter vesting period has been approved by the Remuneration Committee in respect of Share Grants made to Employee Participants specifically identified by the listed company. Respondents considered that the length of vesting period should depend on actual commercial needs of the listed company and performance measures or criteria considerations of schemes may not necessarily be time based.

After reviewing respondents' comments, the HKEx agreed that listed companies should tailor the performance measures and retention policies based on their needs. It is proposed that listed companies should provide in

its scheme documents the circumstances where Share Grants may have a shorter vesting period for Employee Participants.

(iii) Share Schemes of subsidiaries

Chapter 17 currently applies to subsidiary share option schemes “with appropriate modifications”. It was proposed by the HKEx that Chapter 17 also include share award schemes of subsidiaries, with exemptions provided for schemes of Insignificant Subsidiaries.

After reviewing the comments from respondents (some of which pointed to operational issues or considered the proposals unduly burdensome or impractical), the HKEx decided to modify the proposal to require the application of Chapter 14 requirements to address potential dilution of subsidiary’s interest resulting from Share Grants under subsidiary Share Schemes (and apply Chapter 14A requirements on Share Grants to Connected Persons). Further, chapter 14 will be amended to measure disposals (granting existing shares) or deemed disposals (granting new shares or options over new shares) based on the size of the scheme mandate sought. Chapter 17 requirements will only apply to Share Schemes of a Principal Subsidiary.

Summary of proposals to be adopted

The following is a summary of proposals that will be adopted:

A. Scope

It was proposed that Chapter 17 be extended to govern all Share Schemes involving grants of share awards and grants of share options over new shares of the listed company, further to existing requirements.

The HKEx decided to adopt this proposal and apply Chapter 17 to all Share Schemes funded by an issue of new shares by listed companies. Listed companies may award new shares utilising a general or specific mandate under Rule 13.36 if the share grants fall outside the scope of Chapter 17 (e.g. the grantees do not fall within the definition of eligible participants under Chapter 17). Rule 17.01 (GEM Rule 23.01) will be amended to reflect this change.

B. Eligible participants

The HKEx proposed that eligible participants of Share Schemes should include Employee Participants, Related Entity Participants and Service Providers (including independent contractors) and that Share Grants to Related Entity Participants and Service Providers should be subject to approval of the Remuneration Committee, with reasons for the grants clearly explained in grant announcements of the listed company.

This proposal will be adopted, with a small modification where the grant of Share Grants to Related Entity Participants and Service Providers would not be the responsibility of the Remuneration Committee but that of the Board (given that the Remuneration Committee is not involved in day to day operations of the listed company and may not have full grasp as to contribution of these non-employee participants to long term growth of the listed company).

It should be noted that the definition of Service Providers expressly excludes auditors or valuers who provide assurance or who are required to perform services with impartiality and objectivity (i.e. they may not be an eligible participant of Share Schemes).

Further, the HKEx may, upon establishment of a Share Scheme, require the INEDs to provide their views in the circular on whether the inclusion of non-employee participants to be in the long term interests of the listed company and its shareholders (i.e. in line with business needs or the industry norm etc.).

C. Scheme mandate

The HKEx proposed to apply a Scheme Mandate Limit not exceeding 10% of a listed company’s issued shares to all Share Schemes of the company. The mandate may then be refreshed by shareholders once every three years. Additional refreshments within a three year period would also be allowed, subject to the obtaining of independent shareholders’ approval (where the controller shareholder³) should abstain from voting on the relevant resolution.

The HKEx will adopt these proposal in order to protect minority shareholders by giving them the right to veto repeated refreshments of scheme mandate (especially considering that the fact that most Share Grants are made at nil consideration). However, independent shareholders’ approval is not required for a proportionate increase of the Scheme Mandate Limit following a pre-emptive issue, provided that the unused part of the scheme mandate (as a percentage to the relevant class of shares in issue) upon refreshment is the same as that immediately before the pre-emptive issue. Waivers from the Scheme Mandate Limit may be granted by the HKEx, taking into account factors such as specific circumstances of the listed company and the industry norm.

Further, the HKEx proposed to remove the current requirements that the number of outstanding options should not exceed 30% of the issued shares from time to time. The HKEx adopted this proposal in light of the adoption of the Scheme Mandate Limit as the current 30% limit on outstanding options does not serve to effectively limit shareholding dilution resulting from Share Grants.

The HKEx also proposed, as safeguard against excessive dilution arising from Share Grants to Service Providers, to require a listed company to set a Service Provider Sublimit within the Scheme Mandate Limit and disclose the basis for determining such sublimit in its circular to shareholders. The HKEx will adopt this proposal.

D. Minimum vesting period for Share Grants

The HKEx proposed that a minimum vesting period of 12 months should be required for Share Grants, unless a shorter vesting period is approved by the Remuneration Committee in respect of Share Grants made to Employee Participants specifically identified by the listed company, and that details of the grants should be disclosed in the grant announcement. Such a proposal is intended to align the purpose of Share Schemes to incentivise grantees to the listed company on a longer term basis.

Having considered comments from respondents (including that it would be burdensome for the Remuneration Committee to explain all Share Grants with a shorter vesting period), the proposal will be adopted with the adjustment to allow the Board, at its discretion, to make Share Grants to Employee Participants with a shorter vesting period, provided that:

- (i) the scheme document sets out the specific circumstances where options or awards may be granted with a shorter vesting period. Any such arrangements must be clearly disclosed in the circular for the adoption of the scheme, with an explanation by the listed company's Board as to why the arrangements are appropriate and how the grants of options or awards align with the purpose of the scheme (these disclosures will be subject to the HKEx's review as part of its pre-vetting process of the listed company's circular); and
- (ii) the grant announcement states that the relevant circumstances that are specifically permitted by the scheme when a Share Grant is made with a shorter vesting period. Where the Share Grants are made to the listed company's directors and senior management, the Remuneration Committee's views on why a shorter vesting period would be appropriate.

E. Performance targets and clawback mechanism

The HKEx proposed that scheme documents and grant announcements of a listed company should disclose a narrative description of performance targets attached to Share Grants (including target levels and performance-related measures, method of assessment etc.) and clawback mechanisms, or if none exists, a negative statement. Further, where Share Grants which are made without performance targets and/or clawback mechanisms then the Remuneration Committee must provide an explanation as to why they are not necessary. These proposals were intended to enable shareholders to assess how the Share Grants serve to promote the interest of the listed company through more disclosure.

Having considered respondents concerns, the HKEx adopted these proposals with modifications that (i) the description of performance targets in the scheme document and grant announcement may be general and qualitative; and (ii) the grant announcement must disclose the Remuneration Committee's views as to why performance targets and/or clawback mechanism are not required and how the grants align with the purpose of the scheme if Share Grants are made to any directors and senior management without performance targets or clawback mechanism.

F. Exercise price or Share Grant price

For grants of new shares under share option schemes, the HKEx proposed to retain the current restriction on the exercise price of share options under Chapter 17.⁴ For grants of new shares under share award schemes, it is proposed to not impose a restriction on the share grant price.

This proposal will be adopted while the minimum pricing requirements on share options and share awards may be revisited in a future policy review.

G. Limit on Share Grants

With regards to limits on large Share Grants to individual participants to restrict excessive shareholding dilution, the HKEx proposed that approval is needed in excess of the 1% Individual Limit. This proposal will be adopted.

With regards to limits on Share Grants to Connected Persons, the HKEx proposed that approval by the Remuneration Committee instead of INEDs should be required. However, given the concerns of some respondents that this may potentially weaken the safeguards on grants of new shares to Connected Persons through existing independent review (particularly if the review is led and dominated by executive director(s) on the Remuneration Committee), this proposal will not be adopted.

The HKEx further proposed that a de minimis exemption for grants of share awards to Connected Persons should be provided for:

- (i) grants of share awards to a director (other than an INED) or chief executive of the listed company in excess of 0.1% of the issued shares of the listed company over any 12-month period;
- (ii) Share Grants (including grants of share awards and options) to an INED or substantial shareholder of the listed company in excess of 0.1% of issued shares of the listed company over any 12-month period;
or
- (iii) Share Grants (including grants of share awards and options) to a controlling shareholder of the listed company in excess of 0.1% of issued shares of the listed company over any 12-month period,

and for the HK\$5 million de minimis threshold to be removed for grants of share options to an INED or substantial shareholder of the listed company.

With a view to both protect shareholders from excessive dilution and providing flexibility for listed companies to structure the remuneration package of directors and chief executives, the HKEx will adopt the proposed de minimis exemption for Share Grants to the said Connected Persons. The HKEx will also adopt the proposal to remove the HK\$5 million threshold for grants of share options.

H. Announcements of Share Grants

The HKEx proposed to require disclosure of details of Share Grants by the listed company to the following participants to be made on an individual basis: (i) a Connected Person; (ii) a participant with Share Grants in excess of the 1% Individual Limit; (iii) a Related Entity Participant or Service Provider with Share Grants in excess of 0.1% of the listed company's issued shares over any 12-month period, whereby Share Grants by the listed company to other participants may be disclosed in aggregate by category. Further, it is proposed that the HKEx may require the listed company to submit a list of grantees and the movements of shares and options granted to each grantee from time to time.

The HKEx will adopt this proposal to provide an additional safeguard for large Share Grants to non-employee participants but due to concerns with the possible disclosure of commercially sensitive information (e.g. given target levels are often tied to financial and operational performance which may be confidential), the proposal will be modified by: (i) removing the requirement for listed companies to disclose the duration of service contracts of their Service Providers; and (ii) require qualitative disclosure of performance targets attached to Share Grants, rather than details of the performance target levels.

Further, the HKEx proposed to require disclosure of the number of shares available for future grant under the scheme mandate and the Service Provider Sublimit (if applicable). This proposal will be adopted by the HKEx.

I. Disclosure in interim reports and annual reports

The HKEx proposed that the listed company's interim report and annual report should disclose:

- (i) details of Share Grants by the listed company to participants on an individual basis (following the classification applied in grant announcement described in Proposal H) and other participants on an aggregate basis by category, and their movements during the reporting period;
- (ii) for options and awards granted during the reporting period, their fair value at the time of grant and the accounting policy adopted;
- (iii) the number of options and awards granted under all Share Schemes during the reporting period divided by the weighted average number of issued shares for the period; and the number of shares that are available for grant under the scheme mandate (and the Service Provider Sublimit, if applicable) at the beginning and the end of the reporting period; and
- (iv) a summary of each Share Scheme (for annual reports only)

This proposal will be adopted.

J. Disclosure of Remuneration Committee's work

The HKEx proposed that listed companies should disclose all matters relating to Share Schemes reviewed by the Remuneration Committee during the year in the Corporate Governance Report. Further, the Remuneration Committee should explain why it was appropriate to approve matters and how the Share Grants served the purpose of the Scheme.

The HKEx decided to adopt this proposal with modifications to require disclosure of a summary of material matters only, and to provide that such disclosure may be made in the Remuneration Report or the Corporate Governance Report.

K. Approval for changes to terms of share award or option granted

The HKEx proposed that rather than seeking shareholders' approval for changes to terms of awards or options granted, such changes should be approved by the approving authority (which may include the Board, the Remuneration Committee, the INEDs and/or shareholders) making the initial grant.

Notwithstanding the comments of some respondents who considered the proposal to be too onerous, the HKEx considered that investor protection should not be compromised, and with a view that such proposal is intended to reduce compliance burden, the HKEx will adopt the proposal.

L. Transfer of share awards of options

The HKEx proposed that it may provide a waiver to allow a transfer of share awards or options to a vehicle (including a trust or a private company) for the benefit of the grantee and his/her family members (e.g. for estate planning or tax planning purposes), provided that such a transfer would continue to meet the purpose of the scheme and other requirements of Chapter 17.

The majority of respondents agreed with the proposal and the proposal will be adopted.

M. Voting rights of unvested scheme shares

The HKEx proposed that trustees holding unvested shares of a Share Scheme should abstain from voting on matters that require shareholders' approval under the Listing Rules, and that a listed company should disclose the number of unvested shares in monthly returns. Such proposals seek to address concerns about undue influence over the exercise of voting rights of unvested shares by management of the issuer.

The HKEx will adopt the proposal with modifications to capture situations where unvested shares are held by trustees through special vehicles, and to provide exemption for circumstances where trustees are required by law to vote in accordance with the beneficial owner's direction.

The HKEx however will not adopt the proposal concerning the proposed disclosure of the number of unvested shares in monthly returns due to respondents' concerns that it may be unduly burdensome and unnecessary, given voting rights of unvested shares are already restricted.

N. Disclosure in grant announcements and financial reports

The HKEx proposed that the terms of Share Schemes and share grants funded by existing shares (which do not require shareholders' approval as they do not involve issuance of shares) be disclosed, consistent with Proposal H and I's requirements applicable to Share Schemes funded by new shares.

The HKEx will adopt the proposal and agreed with respondents that the disclosure should be balanced and informative. Therefore, modifications will be made to:

- (i) remove the requirement for announcement of Share Grants involving existing shares; and
- (ii) require disclosure in annual reports of grants of existing shares to (i) directors of a listed company on an individual basis; and (ii) the five highest paid individuals in aggregate. Details of share grants to other participants can be disclosed on an aggregated basis.

O. Subsidiaries' share award schemes

The HKEx proposed to extend Chapter 17 to govern share award schemes of subsidiaries that are funded by new or existing shares of the subsidiaries.

The HKEx proposed to exempt Insignificant Subsidiaries from the shareholders' approval requirement under Chapter 17 and require approval by the Remuneration Committee of the listed company instead, but these Insignificant Subsidiaries should still be subject to disclosure requirements under Chapter 17.

After reviewing comments from respondents (in particular, that the requirements are unduly onerous or impractical to apply, and relevant dilutive effectives of the relevant share awards should instead be governed by deemed disposal requirements of Chapter 14, or Chapter 14A, if Share Grants are made to Connected Persons), the HKEx will modify the proposal and adopt the proposal for Principal Subsidiaries only (given the significant size of such subsidiary to the listed company), regardless if they are listed or not. This means that the proposal will not extend to Insignificant Subsidiaries.

P. Trust arrangements

The HKEx proposed to clarify that Chapter 17 would apply to Share Schemes involving grants of new shares or options through trust or similar arrangements for the benefit of participants specifically identified by the listed company before the grants. It was decided that this proposal will be adopted.

Q. Disclosure of fair value of Options in circular relating to adoption of new share option scheme

The HKEx proposed to remove the recommended disclosure on the fair value of options in shareholders' circular for the approval of the scheme, given that the proposed disclosure of fair value of share options and awards in financial reports (Proposal I) would appear to be more meaningful for shareholders to assess the dilution impact of grants on their interests in the listed company. This will be adopted.

R. Other proposed Rule amendments relating to Share Schemes

The HKEx proposed to amend the below Rules currently applicable to share option schemes to also apply to share award schemes:

- (i) Rule 3.13(2) – A director may still be considered independent if he/she receives shares or interests in securities from the listed company or its subsidiaries under share option schemes established in accordance with Chapter 17.
- (ii) Rule 10.08(1) – The restriction on further issue of shares by a listed company within six months from its new listing on the HKEx does not apply to issuance of shares, the listing of which has been granted by the HKEx, pursuant to a share option scheme under Chapter 17.
- (iii) Rule 13.52(1)(e)(ii) – A listed company should submit draft circulars for any matters relating to share option schemes required under Chapter 17 to the HKEx for review.
- (iv) Paragraph 7 of Appendix 10 – The dealing restriction on securities transactions under the Model Code⁵ does not apply to exercise of options that were granted before a period during which dealing is prohibited under the code at the exercise price pre-determined at the time of grant.

In order to align the requirements applicable to Shares Schemes under other parts of the Rules, the HKEx will adopt the proposal. The issue of pre-vetting listed companies' documents may be considered in future reviews.

Transitional Arrangements

The amended Rules will come into effect on 1 January 2023 and has been approved by the board of directors of the HKEx and the Securities and Futures Commission of Hong Kong. Listed companies should comply with the amended Listing Rules for their Share Schemes before 1 January 2023. Transitional arrangements will be provided for existing Share Schemes that are valid on 1 January 2023. In summary:

- (a) for all existing Share Schemes, listed companies will be required to comply with the new disclosure requirements from the effective date of 1 January 2023, including announcements of grants of shares or options under these schemes and disclosures in interim or annual reports published on or after the effective date.
- (b) for share option schemes and share award schemes with Advanced Mandates which are still valid from the effective date, listed companies may continue to grant share awards or options only to eligible participants as defined in the amended Chapter 17. Listed companies which have adopted share award schemes using general mandate may make Share Grants up to the date of the second annual general meeting after 1 January 2023.

A more detailed look at the transitional arrangement is set out below:

	Listed Company			Principal Subsidiary		Other subsidiaries
	Share option scheme	Share award scheme		Share option scheme	Share award scheme	Share option scheme or Share award scheme
		With Advanced Mandate	Utilising general mandate			
Disclosure in: • Announcement • Interim Report • Annual Report	From 1 January 2023					<u>Share option scheme that has complied with existing Chapter 17:</u> The subsidiary may continue to grant share options under its scheme mandate
Share Grants to eligible participants (amended definition)	New definition of eligible participants applies for financial years commencing on or after 1 January 2023					
Scheme Mandate	Listed companies may continue to make Share Grants using existing scheme mandate	Listed companies may grant shares under general mandate until the second AGM after 1 January 2023	Same as listed company	Listed companies must comply with Chapter 14 and/or Chapter 14A before making Share Grants	<u>Other existing or new share schemes:</u> Grants of share awards or options must comply with Chapter 14 (based on the size of the scheme mandate for future grants) and/or Chapter 14A	
Amendment of terms of scheme to comply with amended Chapter 17	On or before the refreshment of the scheme mandate limit/expiry of scheme mandate above or adoption of new share scheme					

[1] <https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/October-2021-Share-Schemes/Consultation-Paper/cp202110.pdf>

[2] https://en-rules.hkex.com.hk/sites/default/files/net_file_store/consol_mb.pdf

[3] If there is no controlling shareholder, then the executive directors, non-executive directors, and chief executive should abstain

[4] The exercise price of share options which must not be less than the market price of the shares at the time of grant

[5] https://en-rules.hkex.com.hk/sites/default/files/net_file_store/HKEX4476_3785_VER10.pdf

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