

Hong Kong Capital Markets Update

ISSUE 2021-07 | November 2021

HKEX's consultation for Share Schemes of listed issuers

On 29 October 2021, the Stock Exchange of Hong Kong Limited (the "Exchange") published a [consultation paper](#) ("Consultation") seeking market views on proposed amendments to the Listing Rules in relation to share schemes (including both share option schemes and share award schemes) of listed issuers and their subsidiaries ("Share Schemes"). The deadline for submissions is 31 December 2021.

Key Proposals:

1. Extend the Listing Rules to govern grants of share awards.
2. Define eligible participants of Share Schemes to be (i) Employee Participants, (ii) Related Entity Participants and (iii) Service Providers.
3. Require issuers to set a Scheme Mandate Limit and a Service Provider Sublimit.
4. Require independent shareholders' approval for scheme mandate refreshment within a three-year period.
5. Require a minimum vesting period of 12 months for all Share Schemes.
6. Require performance targets and a clawback mechanism.
7. Revise the approval requirements for Share Grants to (i) individual participants and (ii) Connected Persons.
8. Increase in types of grantees subject to share grants disclosures on individual basis.

Background

To ensure the Listing Rules remain fit for their purpose and represent acceptable standards that help promote investor confidence, the Exchange conducts reviews from time to time to consider market developments and international best practices.

Given the increasing adoption of share award schemes by listed issuers, the Exchange set out proposed amendments to the Listing Rules in relation to Share Schemes¹ of listed issuers and their subsidiaries to provide a consistent framework to govern both grants of share options and share awards (“Share Grants”).

Appendix I to the Consultation has set out all the proposed changes and the applicable Listing Rules. The key proposals can be categorised into the following areas:

- (i) share award schemes;
- (ii) eligible participants;
- (iii) scheme mandate;
- (iv) terms of grants;
- (v) Share Grants to (i) individual participants and (ii) Connected Persons; and
- (vi) disclosure requirements.

Share award schemes

The Listing Rules currently only apply to share option schemes of issuers and their subsidiaries, but not to share award schemes. Since share award schemes are increasingly popular for listed issuers to incentivise and retain talents, the Exchange considers the Listing Rules should also govern share award schemes.

Therefore, the Exchange is proposing to extend the Listing Rules to govern all Share Schemes. The requirements currently applicable to share option schemes would also apply to share award schemes, subject to modifications proposed in this Consultation.

Eligible participants

The Listing Rules currently require issuers to disclose in scheme documents the categories of eligible participants of a share option scheme and the basis of determining their eligibility. However, there is currently no restriction on the categories of eligible participants.

The Exchange considers that Share Schemes are generally established to reward and incentivise participants to contribute to the long-term growth of the issuer and to align their interests with those of the issuer and its shareholders, and hence proposed to define “eligible participants” of a Share Scheme to include:

Employee Participants – directors and employees of the issuer or any of its subsidiaries;

Related Entity Participants – directors and employees of related entities (i.e. the holding companies, fellow subsidiaries or associated companies of the issuer); and

Service Providers – other persons who provide services to the issuer group on a continuing and recurring basis in its ordinary and usual course of business which are material to the long-term growth of the issuer group.

Under the proposal, the Exchange would place more emphasis on the role of the remuneration committee of the issuer in overseeing the operation of Share Schemes to ensure that Share Grants can meet the purpose of the schemes. Therefore, the Exchange proposed that Share Grants to Related Entity Participants and Service Providers must be approved by the remuneration committee with the reasons for the grants clearly explained and disclosed (see Table A below for details of disclosure requirements of Share Grants).

Also, the Exchange would require the remuneration committee to determine whether a Service Provider can provide services to the issuer group on a continuing and recurring basis in its ordinary and usual course of business which are material to the long-term growth of the issuer group and, hence, is eligible for a Share Scheme. Financial advisors or placing agents providing fundraising or M&A services, or consultants providing professional services to issuers should be excluded from eligible participants according to the Exchange.

¹ MB Listing Rules Chapter 17/ GEM Listing Rules Chapter 23

Scheme mandate

The Listing Rules currently limit grants of share options from all share option schemes of an issuer to 10% of its total issued shares. Issuers may seek approval from shareholders to refresh the scheme mandate at any time, provided that the options outstanding do not exceed 30% of the issued shares.

The Exchange proposed to apply a scheme mandate limit not exceeding 10% of an issuer's issued shares to all Share Schemes of the issuer ("Scheme Mandate Limit") and prepare to grant waivers from the Scheme Mandate Limit after taking into account factors such as the necessity of the proposed mandate, the industry norms and the criteria for granting shares under the mandate.

Under the current proposal, the scheme mandate may be refreshed by shareholders once every three years and additional refreshments within a three-year period must be approved by independent shareholders of the issuer. The Exchange considers it is necessary to allow minority shareholders the right to veto repeated refreshments within a three-year period to safeguard their interests from additional shareholders' dilution.

As an additional safeguard against excessive dilution arising from Share Grants to Service Providers, the Exchange further proposed the issuer set a sublimit within the Scheme Mandate Limit on Share Grants to Service Providers ("Service Provider Sublimit"). The Exchange also believes that it would be appropriate for an issuer's remuneration committee to determine the Service Provider Sublimit based on the issuer's business needs and remuneration policy and this should be clearly disclosed (see Table A below for details of disclosure requirements of Share Grants). The sublimit (including any refreshment) must be separately voted on by shareholders.

Since the 30% limit on options outstanding has little or no practical effect given the 10% Scheme Mandate Limit imposes a stricter restriction, the Exchange suggested to remove this 30% limit from the Listing Rules.

Terms of grants

The Listing Rules currently do not have specific requirements on vesting periods. Since the Exchange considers no or short vesting periods may not serve the purpose of Share Schemes, which is to incentivise grantees to contribute to the long-term growth of the issuer, a minimum vesting period of 12 months is proposed for all Share Schemes, unless a shorter vesting period is approved by the remuneration committee in respect of Share Grants made to Employee Participants specifically identified by the issuer.

Performance targets attached to Share Grants are currently required to be set out in scheme documents under the Listing Rules, or a negative statement where there is no performance target. However, there is no specific disclosure requirement relating to a clawback mechanism where an issuer may recover or withhold any shares or options granted to a participant in the event of serious misconduct, a material misstatement in the issuer's financial statements or other special circumstances.

In order to enable shareholders to assess how the Share Grants serve to promote the interests of the issuers and reflect international market practices on the disclosure of executive compensation and remuneration policies, the Exchange proposed the scheme document must describe, on top of the performance targets attached to the Share Grants, the clawback mechanism, or where there is no clawback, a negative statement. In case there are concerns about disclosing any specific details which are confidential and commercially sensitive, the Exchange may grant waivers on a case-by-case basis.

When Share Grants are made without performance targets and/or a clawback mechanism, the Exchange requires issuers to disclose the remuneration committee's views on why performance targets and/or a clawback mechanism is/are not necessary and how the grants serve the purpose of the scheme (see Table A below for details of disclosure requirements of Share Grants).

Finally, the Exchange proposed retaining the current requirement of the exercise price of share options, which must be not less than market price of the underlying shares at the time of grant. However, since it is the market practice for share awards to be granted at nil consideration, no restriction will be imposed on the grant price of shares under share award schemes.

Share Grants to individual participants

Currently, grants of options to an individual under the Listing Rules are subject to shareholders' approval if the number of shares covered by the grants exceed 1% of the shares in issue over any 12-month period ("1% Individual Limit"). The Exchange proposed extending the same requirement to all Share Schemes.

Share Grants to Connected Persons

All grants of options to a Connected Person currently require approval by INEDs (excluding any INED who is the grantee). Also, any grant of share awards to a Connected Person constitutes a connected transaction under Listing Rules and must be approved by independent shareholders regardless of the size of the grant.

Under the proposal, all Share Grants to Connected Persons will be approved by the remuneration committee instead of INEDs², which aligns with the Corporate Governance Code requiring remuneration committees to be accountable to shareholders for the issuers' policy on remuneration of directors and senior management.

Also, the Exchange would like to introduce a new de minimis exemption (i) for grant of share awards to director (other than an INED) or the chief executive of the issuer and (ii) for all Share Grants to an INED or the substantial shareholder of the issuer, in which independent shareholders' approval will be required if it will cause the aggregate number of shares covered by such grant to exceed 0.1% of the issued shares over any 12-month period.

The Exchange has reiterated that, as a recommended best practice, INEDs should not be given equity-based remuneration with performance-related elements as it may lead to bias in INEDs' decision and compromise their objectivity and independence. Therefore, INEDs should be subject to a higher level of scrutiny similar to substantial shareholders, in which they are normally in a position to control or exert significant influence over the issuer's board.

As part of the proposal, the Exchange suggested to remove the current HK\$5 million de minimis threshold for grants of options to INEDs or substantial shareholders as such monetary thresholds cannot meaningfully reflect the extent of dilution on an issuer.

Disclosure requirements

Under the current Listing Rules, an issuer must disclose details of option grants and only disclosures of grants to a Connected Person must be made on an individual basis.

The Exchange proposed that disclosures of Share Grants must be made on an individual basis for (i) Connected Persons; (ii) a participant with Share Grants in excess of the 1% Individual Limit; and (iii) a Related Entity Participant or Service Provider with Share Grants in excess of 0.1% of the issuer's issued shares over any 12-month period, while the Share Grants to other participants can be disclosed in aggregate by category. In case there are circumstances where issuers have concerns about commercial sensitivity or data privacy in individual cases, the Exchange may grant waivers on a case-by-case basis.

For the proposed disclosure requirements of Share Grants, see Table A below for details.

Transitional arrangements

If the proposals in this Consultation are adopted, the new requirements would apply to new Share Schemes adopted on or after the effective date of the Listing Rules amendments ("Effective Date"). The Exchange is proposing the following transitional arrangements for existing Share Schemes that are valid as at the Effective Date:

For all existing Share Schemes:

Issuer would be required to comply with the new disclosure requirements from the Effective Date.

For existing share option schemes:

Issuer may continue to grant options only to eligible participants under the amended Listing Rules after the Effective Date, but it must follow the new requirements and amend the terms when the existing schemes are refreshed.

For existing share award schemes with advanced specific mandates approved by shareholders:

Issuer may continue to grant awards only to eligible participants under the amended Listing Rules after the Effective Date, but no further refreshment of the scheme mandate is allowed.

For existing share award schemes involving grants of new shares under general mandate:

Issuer may continue to grant awards to eligible participants under the amended Listing Rules up to the date of the first annual general meeting after the Effective Date. Thereafter, the issuer should amend the terms of the schemes to comply with the amended Listing Rules.

² The Corporate Governance Committee of WVR issuer should also make a recommendation on any Share Grants to a WVR beneficiary.

Table A: Disclosure of Share Grants		Announcement	Annual and interim report	Corporate governance report
(1) General	<ul style="list-style-type: none"> Disclosure of the following information <u>by category of participants</u>: <ul style="list-style-type: none"> Details of Share Grants (e.g. description of grantees, date of grant, number of options/ awards granted, vesting period, narrative description of the performance target, clawback mechanism) Movement of Share Grants during the reporting period Fair value of share awards and options at the time of grant and the accounting policy adopted Number of share awards and options granted divided by the weighted average number of issued shares for the reporting period 	√	√	
(2) Grants to any participant in excess of the 1% Individual Limit	<ul style="list-style-type: none"> Disclosure of information in item (1) above <u>on an individual basis</u> 	√	√	
(3) Grants to Connected Persons	<ul style="list-style-type: none"> Disclosure of information in item (1) above <u>on an individual basis</u> The reason for the grant The remuneration committee's views on why it is appropriate to approve the grant, the factors that it took into account and how the grant serves the scheme purpose 	√ √ √	√	√
(4) Grants to Service Providers	<ul style="list-style-type: none"> Disclosure of information in item (1) above <u>on an individual basis</u> if Share Grants to a Service Provider exceed 0.1% of issued shares over any 12-month period The reasons for the grant, the nature of services provided and the duration of the relevant service contract The remuneration committee's views on why it is appropriate to approve the grant, the factors that it took into account and how the grant serves the scheme purpose The remuneration committee's confirmation that the service provider provided services on a continuing and recurring basis in its ordinary and usual course of businesses during the period which are material to the long-term growth of the issuer group 	√ √ √	√ √	√
(5) Grants to Related Entity Participants	<ul style="list-style-type: none"> Disclosure of information in item (1) above <u>on an individual basis</u> if Share Grants to a Related Entity Participant exceed 0.1% of issued shares over any 12-month period The reason for the grant The remuneration committee's views on why it is appropriate to approve the grant, the factors that it took into account and how the grant serves the scheme 	√ √ √	√	√
(6) Grants to Employee Participants with a vesting period less than 12 months	<ul style="list-style-type: none"> Disclosure of information in item (1) above <u>by category of participants</u> The reason for adopting a shorter vesting period The remuneration committee's views on why a shorter vesting period is appropriate and how the grant serves the scheme 	√ √ √	√	√
(7) Grants to participants without performance targets and/or clawback mechanism	<ul style="list-style-type: none"> Disclosure of information in item (1) above <u>by category of participants</u> The remuneration committee's views on why performance targets and/or clawback mechanism is/are not necessary and how the grant serves the scheme 	√ √	√	√

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