

# Hong Kong Capital Markets Update

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## HKEX's consultation conclusions on Share Schemes of listed issuers

On 29 July 2022, the Stock Exchange of Hong Kong Limited (the "Exchange") published the [conclusions](#) of its consultation ("Conclusions") 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. The key amendments are summarised as below:

### Key Amendments

#### Share Schemes funded by issuance of new shares of listed issuers

- Extend Chapter 17<sup>1</sup> of Listing Rules to **govern both share award schemes and share option schemes (together, "Share Schemes")**.
- Define **eligible participants** of Share Schemes to be (i) **Employee Participants**, (ii) **Related Entity Participants** and (iii) **Service Providers**.
- Require issuers to set a **Scheme Mandate Limit** and a **Service Provider Sublimit**. A **scheme mandate refreshment within a three-year period** will require **independent shareholders' approval**.
- Require **shareholders' approval** for **Share Grants** to (i) an **individual participant in excess of the 1% Individual Limit**; or (ii) a **Connected Person** in excess of the de minimis threshold.
- Require a **minimum vesting period of 12 months**, except for **Employee Participants** who may be subject to a shorter vesting period **under specific circumstances** set out in the scheme document.
- Require **disclosure of details on an individual basis** for (i) **Connected Persons**; (ii) **participants in excess of the 1% Individual Limit**; and (iii) **Related Entity Participants** or **Service Providers in excess of 0.1% Limit**.

#### Share Schemes funded by existing shares of listed issuers

- Require **disclosure in annual reports** (i) a **summary of each Share Scheme**; and (ii) **information relating to grants of existing shares during the year**.

#### Share Schemes of subsidiaries of listed issuers

- **Apply Chapter 17** of Listing Rules to Share Schemes of a **Principal Subsidiary only**. Share Schemes of **other subsidiaries** will be **subject to requirements under Chapters 14<sup>2</sup> and/or 14A<sup>3</sup>** of Listing Rules.

### Effective date

- **The revised Listing Rules will be effective on 1 January 2023.**

<sup>1</sup> MB Listing Rules Chapter 17/ GEM Listing Rules Chapter 23

<sup>2</sup> MB Listing Rules Chapter 14/ GEM Listing Rules Chapter 19

<sup>3</sup> MB Listing Rules Chapter 14A/ GEM Listing Rules Chapter 20

## Background

To enhance the Share Schemes regulation to manage dilution of listed shares and provide informative disclosure to maintain high levels of shareholder protection, the Exchange published a [consultation paper](#) (the “Consultation Paper”) on 29 October 2021 which set out proposed amendments to the Listing Rules in relation to Share Schemes of listed issuers and their subsidiaries to provide a consistent framework to govern both grants of share options and share awards (“Share Grants”). The consultation period ended on 31 December 2021.

Having carefully considered the responses received, the Exchange concluded that the proposals outlined in the Consultation Paper should be adopted with modifications to reflect respondents’ comments where appropriate. Those modifications mainly relate to the role of the remuneration committee, vesting period for share awards and options, and share schemes of subsidiaries.

The key amendments to the Listing Rules are as follows, which will become effective on 1 January 2023:

### **(A) Share Schemes funded by issuance of new shares of listed issuers**

#### Scope – extend to govern share award schemes

The current Chapter 17 of Listing Rules only apply to share option schemes of issuers and their subsidiaries, but not to share award schemes.

Under the revised Listing Rules, Chapter 17 will be extended to govern all Share Schemes involving grants of share awards and grants of options to acquire new shares of issuers.

#### Eligible participants

The current Listing Rules has no restriction on the categories of eligible participants.

Under the revised Listing Rules, “eligible participants” of a Share Scheme are defined as follows:

**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**<sup>4</sup> – persons who provide services to the issuer 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 issuer group.

However, the original proposal of requiring the remuneration committee to approve the Share Grants to Related Entity Participants and Service Providers will not be adopted. These matters will continue to be approved by the board of directors. As an additional safeguard, the Listing Rules will be modified so that the Exchange may, upon establishment of the scheme, require the independent non-executive directors (“INEDs”) to provide their views in the circular on whether the inclusion of Related Entity Participants and Service Providers aligns with the purpose of the scheme and the long-term interests of the issuer and its shareholder.

#### Scheme mandate

The current Listing Rules 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.

Under the revised Listing Rules, a scheme mandate limit of not exceeding 10% of an issuer’s issued shares to all Share Schemes of the issuer (“Scheme Mandate Limit”) will be applied and the 30% limit on outstanding options will be removed. The Exchange may 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 of grants under the mandate.

Also, any additional refreshments of the scheme mandate within a three-year period must be approved by independent shareholders of the issuer. The Exchange considers this safeguard can protect the minority shareholders from dilution by giving them the right to veto repeated refreshments of scheme mandate within a three-year period.

In addition, the issuer is required, as an additional safeguard against excessive dilution arising from Share Grants to Service Providers, to set a sublimit within the Scheme Mandate Limit on Share Grants to Service Providers (“Service Provider Sublimit”). This sublimit (including any refreshment) must be separately voted on by shareholders, but the remuneration committee’s approval is not required as compared to the original proposal.

<sup>4</sup> Service providers exclude (i) placing agents or financial advisers providing advisory services for fundraising, mergers or acquisition; and (ii) professional service providers such as auditors or valuers who provide assurance, or are required to perform their services with impartiality and objectivity.

### **Share Grants to individual participants**

The current Listing Rules require shareholders' approval for the grants of options to an individual if the number of shares covered by the grants exceed 1% of the shares in issue over any 12-month period ("1% Individual Limit").

Under the revised Listing Rules, the same approval requirement will be extended to all Share Schemes.

### **Share Grants to Connected Persons**

The current Listing Rules require approval from INEDs (excluding any INED who is the grantee) for all grants of options to a Connected Person<sup>5</sup>. 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 grant.

Under the revised Listing Rules, the above requirement will be extended to all Share Schemes (i.e. Share Grants will be approved by INEDs), but the proposal of having the approval from remuneration committee is not adopted.

Also, a new de minimis exemption will be introduced (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 (including grants of share awards and share options) to an INED<sup>6</sup> or the substantial shareholder of the issuer, in which independent shareholders' approval will only be required if such grant is in excess of 0.1% of the issued shares of the issuer over any 12-month period.

In addition, the current HK\$5 million de minimis threshold for grants of options to INEDs or substantial shareholders will be removed.

### **Minimum vesting period**

The current Listing Rules do not have specific requirements on vesting periods.

Under the revised Listing Rules, a minimum vesting period of 12 months is required for all Share Schemes, except for Employee Participants who may be subject to a shorter vesting period under specific circumstances set out in the scheme document. No shorter vesting period is allowed for non-employee participants.

For the board of directors to make Share Grants to Employee Participants with a shorter vesting period:

- (i) the scheme document must set 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 from the issuer's board of directors (and the remuneration committee where the arrangements may apply to Share Grants to the issuer's directors and senior management) as to why the arrangements are appropriate and how the Share Grants align with the purpose of the scheme. These disclosures will be subject to the Exchange's review as part of the pre-vetting process of the circular; and
- (ii) the grant announcement must state the relevant circumstances that are specifically permitted by the scheme when a Share Grant is made with a shorter vesting period (and the remuneration committee's views on why it is appropriate when the Share Grants are made to the issuer's directors and senior management).

### **Performance targets and clawback mechanism**

The current Listing Rules require a narrative description of the performance targets attached to Share Grants to be provided in the scheme document, 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 circumstances.

Under the revised Listing Rules, the issuer is required to include in the scheme document a description of the performance targets and the clawback mechanism, or a negative statement for no performance target and/or clawback mechanism respectively. The description of the performance targets may be qualitative and may include a general description of target levels and performance related measures and the method for assessing how they are satisfied.

Also, the issuer is required to disclose in the grant announcement the performance targets (which may be qualitative) and the clawback mechanism attached to Share Grants, if any. When Share Grants are made to directors and senior management without performance targets and/or a clawback mechanism, the issuer must disclose the remuneration committee's views on why they are not required and how the grants align with the purpose of the scheme in the grant announcement (see Table A below for details).

<sup>5</sup> A director, chief executive or substantial shareholder of the issuer or an associate of any of them as defined under MB Listing Rules Chapter 14A/ GEM Listing Rules Chapter 20.

<sup>6</sup> In January 2022, the Exchange introduced a new recommended best practice that an issuer generally should not grant equity-based remuneration (e.g. share options or awards) with performance-related elements to INEDs.

### Exercise price/ share grant price

The current Listing Rules require the exercise price of share options must be not less than market price of the underlying shares at the time of grant.

Under the revised Listing Rules, the current requirement on the exercise price of share options will be retained. For the grant price of shares under share award schemes, no restriction will be imposed.

### Disclosure requirements

The current Listing Rules require an issuer to disclose details of option grants and only the grants to a Connected Person must be disclosed on an individual basis.

Under the revised Listing Rules, the disclosure of Share Grants must be made on an individual basis for (i) a Connected Person; (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 ("0.1% Limit"), while the Share Grants to other participants can be disclosed in aggregate by category.

For the proposed disclosure requirements of Share Grants in the announcements on grant and in the annual and interim reports, see Table A below for details. In addition, the issuer is required to disclose a summary of material matters<sup>7</sup> relating to Share Schemes that were reviewed and/or approved by the remuneration committee during the financial year in its remuneration report or corporate governance report.

<b>Table A: Disclosure of Share Grants funded by issuance of new shares</b>		<b>Announcement</b>	<b>Annual and interim report</b>
(1) General	<ul style="list-style-type: none"> <li>• Disclosure of the following information <u>by category of participants</u>:               <ul style="list-style-type: none"> <li>➢ Details of Share Grants (e.g. description of grantees, date of grant, number of awards/ options granted, vesting period, qualitative disclosure of the performance target, clawback mechanism)</li> <li>➢ Movement of Share Grants during the reporting period</li> <li>➢ Fair value of share awards and options at the time of grant and the accounting policy adopted</li> <li>➢ Number of awards and options available for grant under the scheme mandate and the service provider submit (if applicable) at the beginning and the end of the reporting period</li> <li>➢ Number of share awards and options granted divided by the weighted average number of issued shares for the reporting period</li> </ul> </li> </ul>	√	√
(2) Grants to Connected Persons or any participant in excess of the 1% Individual Limit	<ul style="list-style-type: none"> <li>• Disclosure of information in item (1) above <u>on an individual basis</u></li> </ul>	√	√
(3) Grants to Related Entity Participants or Service Providers	<ul style="list-style-type: none"> <li>• Disclosure of information in item (1) above <u>on an individual basis</u> if Share Grants to a Related Entity Participant or a Service Provider exceed 0.1% of issued shares in any 12-month period</li> <li>• The reasons for the grant and the nature of services provided</li> <li>• The board's views on why the grants are made and how they align with the purpose of the scheme</li> </ul>	√ √	√
(4) Grants to Employee Participants with a vesting period less than 12 months	<ul style="list-style-type: none"> <li>• Disclosure of information in item (1) above <u>by category of participants (other than grants to participants in item (2) and (3) which should be disclosed on an individual basis)</u></li> <li>• The relevant circumstances that are specifically permitted by the scheme</li> <li>• For Share Grants to issuer's directors and senior management, the remuneration committee's views on why a shorter vesting period is appropriate</li> </ul>	√ √	√
(5) Grants to participants without performance targets and/or clawback mechanism	<ul style="list-style-type: none"> <li>• Disclosure of information in item (1) above <u>by category of participants (other than grants to participants in item (2) and (3) which should be disclosed on an individual basis)</u></li> <li>• For Share Grants to issuer's directors and senior management, the remuneration committee's views on why performance targets and/or clawback mechanism is/are not required and how the grants align with the purpose of the scheme</li> </ul>	√ √	√

### **(B) Share Schemes funded by existing shares of listed issuers**

Under the revised Listing Rules, despite shareholders' approval is not required for share award schemes funded by existing shares as they do not involve issue of new shares, the issuer is required to disclose in annual reports of (i) a summary of each Share Scheme and (ii) information relating to grants of existing shares to (a) each director of the issuer on an individual basis; (b) the five highest paid individuals on an aggregated basis; and (c) other participants (including non-employee participants) on an aggregated basis, resulting in additional disclosure on the major terms of share grants and the movements of grants during the reporting period.

<sup>7</sup> For matters relating to Share Grants to the issuer's directors and senior management with a shorter vesting period, or without performance targets or a clawback mechanism, the issuer should disclose the remuneration committee's view on why it was appropriate to approve those matters, the factors that it took into account and how the grants align with the purpose of the scheme.

### (C) Share Schemes of subsidiaries of listed issuers

Under the revised Listing Rules, Chapter 17 of Listing Rules will only apply to Share Schemes of a subsidiary whose revenue, profits or total assets accounted for 75% (or more) of that of the issuer in any of the latest three financial years ("Principal Subsidiary"), instead of applying to all subsidiaries' share award schemes in the original proposal.

Share Schemes of subsidiaries other than the Principal Subsidiary will be subject to Chapter 14 of Listing Rules to address dilution of subsidiary's interest resulting from Share Grants under subsidiary share schemes and Chapter 14A of Listing Rules for Share Grants under subsidiary share schemes to connected persons.

#### Transitional arrangements

For the transitional arrangements, see Table B below for details.

Table B: Transitional arrangements	Listed issuer			Principal Subsidiary		Other subsidiaries
	Share option scheme	Share award scheme		Share option scheme	Share award scheme	Share option scheme/ Share award scheme
		With Advanced Mandate	Utilising general mandate			
Disclosure in: - Announcement - Interim Report - Annual Report	From effective date (1 January 2023)					
Share Grants to eligible participants (amended definition)	New definition of eligible participants applies for financial years commencing on or after 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
Scheme mandate	Issuers may continue to make Share Grants using existing scheme mandate	Issuers may grant shares under general mandate until the <u>second</u> AGM after 1 January 2023	Same as listed issuer	Issuers must comply with Chapter 14 (based on the size of the scheme mandate for future grants) 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					

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