



31 December 2021

Our Ref.: C/CG, M132625

The Stock Exchange of Hong Kong Limited
8/F, Two Exchange Square,
8 Connaught Place, Central,
Hong Kong

Dear Sirs,

Consultation Paper: Proposed Amendments to Listing Rules relating to Share Schemes of Listed Issuers

We sought views from members of the Organizing Committee for the Hong Kong Institute of CPAs' Best Corporate Governance and ESG Awards, among others, on the above consultation paper. Our responses to the specific proposals are contained in the Appendix.

The publication of this consultation is timely. In view of the Covid-19 pandemic, many employers may now be facing the dilemma of wanting to reward their deserving and loyal employees, while they may not have the necessary cash reserves to pay out substantial cash bonuses. An increasing number of employers may have implemented, or may be considering implementing, employee share incentive schemes to reward their deserving employees, or to attract new and valuable talent to join their organizations.

In general, we support the broad direction of the proposals in the consultation paper to align the regulatory requirements of both share option schemes and share award schemes. At the same time, in view of the expanded role of remuneration committees envisaged under the proposals, we consider that the spotlight is, to some extent, turned towards the composition, operation and functioning of these committees. In our view, this also needs to be looked at, and issues such as whether there should be a requirement (or, at least, a recommended best practice) for lead independent non-executive director on boards, and whether executive directors should continue to be eligible for appointment to remuneration committees, should be discussed.

While it may not be practical or necessary to obtain approval for share schemes from independent shareholders in all circumstances, we consider that it would still be preferable to obtain their approval for refreshment of scheme mandates. In addition, given the increased responsibility placed on the remuneration committee to safeguard interests of minority shareholders, it will be important to ensure that there is good disclosure of the committees' work and the reasons for its decisions in relation to share schemes, among other matters.

Should you have any questions on this submission, please feel free to contact me at the Institute on 2287 7084 or at <peter@hkicpa.org.hk>.

Yours faithfully,

Peter Tisman
Director, Advocacy & Practice Development

PMT/WW/NC/pk
Encl.

Response to HKEX Consultation Paper: Proposed Amendments to Listing Rules relating to Share Schemes of Listed Issuers

<u>Questions</u>	<u>Comments</u>
<p>1. Do you agree with the proposal to amend Chapter 17 to also govern share award schemes involving the grant of new shares of listed issuers? Please provide reasons for your views.</p>	<p>We agree with the proposal which extends the scope of Chapter 17 to also govern share award schemes involving the grant of new shares of listed issuers. As both the share schemes, i.e. share option and share award schemes serve to reward and incentivize employees and service providers to contribute to the listed issuers on a longer term basis, and align their interests with those of the issuers and their shareholders, these two types of schemes should, as far as possible, be subject to the same regulations, to ensure a level playing field.</p> <p>From paragraph 13 of the consultation paper (“CP”), it is noted that about 79% of listed issuers have adopted share option schemes and 14% have share award schemes. In addition, in paragraph 14, it is mentioned that there is an increasing adoption of share award schemes. To understand the full picture, it would be useful to have some statistics to illustrate the trend over the years.</p>
<p>2. Do you agree with the proposed definition of eligible participants to include directors and employees of the issuer and its subsidiaries (including persons who are granted shares or options under the scheme as an inducement to enter into employment contracts with these companies)? Please provide reasons for your views.</p>	<p>We agree with this proposal as employees, including directors, of the listed issuer and its subsidiaries are key parties responsible for daily operations of their employers. By offering them a stake in the ownership of business, employers can foster loyalty to, and closer engagement with, the business, and help align these stakeholders’ and the controlling shareholder’s interests in driving the performance and stakeholder value of the company.</p> <p>We support the inclusion of directors and employees of the issuer’s subsidiaries as the issuer’s main businesses are often operated through different subsidiaries that contribute significantly to the revenue and profit of the issuer.</p>
<p>3. Do you agree with the proposal that eligible participants shall include Service Providers, subject to additional disclosure and approval by the remuneration committee?</p>	<p>While we note the examples given in paragraph 33 of the CP, some further analysis of what, in practice, is happening in the market and the kind of service providers that are currently benefiting from share schemes would be helpful.</p> <p>We also observe that compared with various other international and regional markets, Hong Kong has one of the most generous and flexible regimes for share awards schemes from the point of view of</p>

<u>Questions</u>	<u>Comments</u>
<p>Please provide reasons for your views.</p>	<p>issuers (as is clear from in paragraph 39). This makes it all the more important to have sufficient safeguards in place to protect the interests of ordinary investors.</p> <p>Some of our members who are active in the corporate governance (“CG”) and corporate finance fields agree that service providers should be included within the defined scope of “eligible participants”, as this allows flexibility for cash-strapped listed issuers to grow and better finance their business. Giving equity as compensation can help build loyalty among contractors/ consultants, as they will have a vested interest in the issuer’s success. Other members, however, disagree with the proposal which does not seem to be widely adopted in other major jurisdictions. Share grant schemes are common incentive arrangements between employees and their employers, whose relationship would normally be governed by employment contracts, i.e., prima facie, a more long-lasting mutual arrangement than that typically between an issuer and its service providers.</p> <p>However, in the final analysis and on the basis that, currently, there are no specific restrictions, we would not suggest introducing limits on the scope of “eligible participants” to exclude service providers altogether. But, again, this emphasizes the importance of having sufficient safeguards against abuses.</p> <p>The risk of share schemes being manipulated, and the interests of the minority shareholders being adversely affected, overall may not seem to be great. Equity should be considered among an issuer’s most precious resources. While service providers’ share grants can end up being worth many times more after a few years, the ownership of the existing shareholders may be further diluted each time service providers are compensated with equity. Thus, in principle, there does not seem to be any incentive for existing shareholders to agree unquestioningly to the granting of shares to eligible service providers. On the other hand, unless there is an independent shareholders’ vote, which would not be required where the grant is not to connected persons, minority shareholders may not be in strong position to challenge new grants. Some service providers may be concerned about the future value of their vested shares, and so be encouraged to perform a due-diligence check on the issuer, e.g., reviewing their business and financial sustainability, which may, in turn, serve as further check on issuers.</p> <p>We note that additional safeguards will be in place so that share grants to the service providers must be approved by the remuneration committee (“RC”) and the issuer must disclose the reasons for the grants and how they would serve the purpose of the share scheme. This places more responsibility on the shoulders of the RC and so the focus will shift, to some extent, on the composition, operation and</p>

<u>Questions</u>	<u>Comments</u>
	<p>functioning of RCs. Although, under the listing rules, a majority of the members of an RC has to be independent non-executive directors (“INEDs”), INEDs in Hong Kong are often appointed by and beholden to the controlling shareholders, families, and the nomination committees that they are intended to monitor. In addition, in principle, RCs in Hong Kong may continue to include some executive directors, who may be able to exert influence on the RC. Ideally, therefore, share awards should be approved by independent shareholders, but we appreciate that this may not always be practical given costs and administrative burden of organizing extraordinary meetings.</p> <p>Therefore, the quality of the monitoring and relevant disclosures made by RCs under the proposals will be an important part of safeguarding the interests of the minority shareholders. In this regard, we have advocated in previous submissions to the Exchange that consideration should be given to introducing a requirement for a lead INED, who could, among other things, report on the work done by INEDs during the year. This could include the work done by INEDs on the RC. Such a proposal could be implemented, initially, on a comply-or-explain basis (or even as a recommended best practice) in the Corporate Governance Code. Secondly, the question of whether executive directors should continue to be eligible to join the RC should also be open for discussion.</p> <p>The provision of some quantitative criteria in the definition of “service provider” would also help increase certainty (e.g., the Canadian listing rule-requirement that service providers must have rendered services for at least 12 months and the ASIC requirement in Australia that service providers must work a pro-rata equivalent of 40% or more of a comparable full-time position; see paragraph 39(b) and footnote 35 of the CP).</p> <p>While granting share awards/ options to service providers may help align their interests with those of the issuers, in some cases, having separate joint venture/ profit sharing agreements, etc. could produce a similar outcome, without diluting the interests of minority shareholders.</p>
<p>4. Do you agree with the proposal that eligible participants shall include Related Entity Participants, subject to additional disclosure and approval by the remuneration</p>	<p>Related entity participants are defined in the CP as employees of the holding company, fellow subsidiaries or associated companies of the issuer. For the employees of the holding companies and fellow subsidiaries, we agree that they should be included for the reasons indicated in the response to Question 2 above. However, since the contribution of associated companies may not be as significant as subsidiaries, granting share awards/ options to the directors and employees of associates’ may be</p>

<u>Questions</u>	<u>Comments</u>
committee? Please provide reasons for your views.	<p>more questionable. With the proposed expanded role of RCs, we have some similar concerns to those outlined in the response to Question 3.</p> <p>Consideration could be given, therefore, to specifying some quantitative criteria for issuers to adopt before granting shares to the directors and employees of associates; for example, the associates should contribute a certain minimum percentage of revenue to the group.</p>
5. Do you agree with the proposal to allow the scheme mandate to be refreshed once every three years by obtaining shareholders' approval? Please provide reasons for your views	<p>More explanation should be provided as to why "three years" is regarded as the appropriate interval. In Hong Kong, it seems to be quite common for the controlling/ family shareholders to retain a majority of the shares of their companies, and therefore it may not be difficult for them to get their agendas approved. To better protect the interests of minority shareholders, in general, it would be preferable to require independent shareholders' approval upon refreshment of a scheme mandate.</p>
6. Do you agree with the proposal to allow the scheme mandate to be refreshed within three years from the date of the last shareholders' approval by obtaining independent shareholders' approval? Please provide reasons for your views	<p>In principle, and subject to our response to Question 5, we agree with this proposal which will allow better protection of the interests of minority shareholders. However, as currently proposed, an issuer would be able to refresh the mandate every three years and continually by-pass the need for independent shareholders' approval.</p>
7. Do you agree with the proposal to remove the 30% limit on outstanding options? Please provide reasons for your views	<p>We do not support this proposal. While in paragraph 47 it is stated that "this 30% limit has little or no practical effect given the 10% scheme mandate limit imposes a stricter restriction, it is uncommon for issuers to have outstanding share options of 30% at any time" (sic), we also note the point made in paragraph 41, i.e.: "Since the 10% scheme limit can be refreshed multiple times, an issuer can effectively issue options over and above 10% of its total issued shares."</p> <p>In practice, it may be uncommon for issuers to have outstanding share options of 30%. Furthermore, we understand that, under the proposals, the 10% Scheme Mandate Limit can be refreshed only once every three years except with independent shareholders' approval, and that the duration of share options normally last for two or three years, after which, the option will lapse; so, prima facie, it would seem</p>

<u>Questions</u>	<u>Comments</u>
	unlikely that the 30% threshold will be reached in future. At the same time, the 30% ceiling would give a signal and act as another safeguard against excessive dilution of existing shareholders' holdings where, for example, they may be enticed into voting for a refreshment of the Scheme Mandate Limit within three years, after receiving inadequate or even, potentially, misleading information.
8. Do you agree with the proposal to require a sublimit on Share Grants to Service Providers? Please provide reasons for your views.	We agree that a sublimit should be set on share grants to service providers, which are not the employees of the issuers concerned, to minimize the potential negative impact on minority shareholders. See also our response to Question 3.
9. Do you agree with the proposal to require a minimum of 12-month vesting period? Please provide reasons for your views.	<p>A minimum of 12-month vesting period may be considered too short to incentivize the grantees to contribute to the long-term growth of the issuer.</p> <p>A common schedule is a four-year vesting term, with a one-year cliff. This means that the options will vest over a four-year term from the date of grant at the rate of 25% per year. In the first year, no options will vest until the first anniversary of the date of grant, when 25% of the options will immediately vest. After that, vesting occurs monthly. In all, it takes four years before the shares are fully vested.</p> <p>From the information in paragraph 53 of the CP, the average vesting period among the Mainland, Singapore, and the U.K. is around 2.5 years.</p>
10. Do you agree with the proposal that Share Grants to Employee Participants specifically identified by the issuer may vest within a shorter period or immediately if they are approved by the remuneration committee with the reasons and details disclosed? Please provide reasons for your views.	<p>We have some reservations over this proposal, in view of our comments on the expanded role of the RC in response to Question 3. Any disclosures of the reasons and details should not be generic but specific. They should include an explanation and justification for the change, the circumstances that have triggered the shorter vesting period, etc.</p> <p>Generally, the RC must avoid boilerplate disclosures and should be prepared to provide a detailed explanation of how the relevant share award/ option schemes will benefit the issuer and not prejudice the interests of shareholders.</p> <p>Paragraph 52 of the CP indicates that “the vesting period may be shortened by exception only” and under “justifiable circumstances”. What kinds of circumstances is this facility intended to accommodate?</p>

<u>Questions</u>	<u>Comments</u>
	<p>This may need to be further explained. For example, is the proposal intended to be able to accommodate performance-based vesting, where, say, the vesting of a sales director’s share grant might begin upon quarterly recurring revenue reaching a specific amount, which could mean some vesting within 12 months?</p> <p>We would agree that, in principle, share grants should be given to incentivize the grantees to contribute to an issuer’s long-term performance and not to focus on short-term gains; and that they should be structured accordingly.</p>
<p>11. Do you agree with the proposed disclosure requirements relating to (a) performance targets; and (b) clawback mechanism? Please provide reasons for your views.</p>	<p>We agree with the proposal. In addition to making the relevant disclosures under the grant announcements, the same should also be disclosed in issuer’s annual report to enhance transparency to stakeholders.</p> <p>Clawback mechanisms can be further classified as a “hard clawback”, under which the participants get nothing, and a “soft clawback”, under which their entitlements may be negatively adjusted. The nature of the clawback mechanism should also be disclosed. Another area of clarification relates to the expected period for which awards should be subject to clawback following vesting. It seems that the market practice on this point is still evolving, with periods ranging from one to five years. Though this may be determined by individual employers, some further guidance for issuers could be helpful.</p>
<p>12. Do you agree that it is not necessary to impose a restriction on the grant price of shares under share award schemes? Please provide reasons for your views.</p>	<p>It is reasonable to allow issuers some flexibility over the grant price so that they can incorporate timely and appropriate incentive policies.</p>
<p>13. Do you agree with the proposal to apply the 1% Individual Limit to Share Grants (including grants of shares awards and share options) to an individual</p>	<p>The imposition of the same regulatory requirements, i.e., 1% individual limit on share grants (including grants of shares awards and share options) to an individual participant will help ensure a level playing field for market players.</p> <p>A 1% individual limit should be reasonable to attract or retain talent, according to our observations of the practice in large international companies.</p>

<u>Questions</u>	<u>Comments</u>
<p>participant? Please provide reasons for your views.</p>	
<p>14. Do you agree with the proposal to require approval from the remuneration committee instead of INEDs for all Share Grants to Connected Persons? Please provide reasons for your views.</p>	<p>We have reservations about this proposal, including in view of our comments on the expanded role of the RC in our response to Question 3. More explanation may need to be provided as to why it is proposed that the requirement for obtaining approval be transferred from INEDs to the RC, whose composition normally consists of a majority of, but not all, INEDs.</p> <p>It is noted that the share awards granted below 0.1% of issued shares over any 12-month period can be approved by the RC. While the percentage looks minimal, in terms of the absolute amount it may not be the case, depending on the market capitalization of the relevant issuers. For example, 0.1 percent of a company such as Tencent could be worth up to HK\$4.25 billion (based on the company's market capitalization on 22 December 2021, which could be equivalent to a sizeable proportion of all its employees' wages, salaries and bonuses). Since the absolute amount may be significant, we would recommend that independent shareholders' approval should need to be sought not only if the 0.1% threshold is exceeded, but also if the absolute value of the grant exceeds a certain pre-determined threshold.</p>
<p>15. Do you agree with the proposal to relax the current shareholder approval requirement for grants of share awards to a director (who is not an INED) or a chief executive set out in paragraph 65 above? Please provide reasons for your views.</p>	<p>The same reservations indicated in our response to Question 14 apply here.</p>
<p>16. Do you agree with the proposal to also relax the current shareholder approval requirement for grants of share awards to an INED or substantial shareholder of the</p>	<p>The same reservations indicated in our response to Question 14 apply here. We also note and agree with the statement in paragraph 70 of the CP that, as good CG practice, "INEDs should not be given equity-based remuneration (e.g. options or awards with performance-related elements. This is because performance-based remuneration may lead to bias in INEDs' decision and compromise their objectivity and independence."</p>

<u>Questions</u>	<u>Comments</u>
<p>issuer set out in paragraph 68 above? Please provide reasons for your views.</p>	
<p>17. Do you agree with the proposal to relax the current shareholder approval requirement for grants of share awards to a controlling shareholder of the issuer set out in paragraph 69 above? Please provide reasons for your views.</p>	<p>The same reservations indicated in our response to Question 14 apply here.</p>
<p>18. Do you agree with the proposal to remove the HK\$5 million de minimis threshold for grants of options to an INED or substantial shareholder of the issuer? Please provide reasons for your views.</p>	<p>We agree with the removal of HK\$5 million de minimis threshold from the perspective of protecting minority shareholders' interests. We also agree with the statement in paragraph 70 of the CP that, as good CG practice, "INEDs should not be given equity-based remuneration (e.g. options or awards with performance-related elements. This is because performance-based remuneration may lead to bias in INEDs' decision and compromise their objectivity and independence."</p>
<p>19. Do you agree with the proposals to require disclosure of Share Grants to Related Entity Participants or Service Providers on an individual basis if the grants to an individual Related Entity Participant or Service Provider exceed 0.1% of the issuer's issued shares over any 12-month period?</p>	<p>We agree with the proposal, as this will enhance transparency, enabling stakeholders to make more informed decisions. But see also our response to Question 14.</p> <p>In addition to the disclosure proposed for a service provider with share grants in excess of 0.1% of the issuer's issued shares over any 12-month period, the Exchange should consider imposing other disclosures, e.g. how share grants may impact the market price of products or services offered by the service provider to the issuer, and an explanation of how conflicts of interest are avoided.</p>

<u>Questions</u>	<u>Comments</u>
Please provide reasons for your views.	
20. Do you agree with the proposed disclosure requirement for the grant announcement? Please provide reasons for your views.	<p>We agree. In addition to disclosing details of grants by way of an announcement, the same or a summary, together with any updates, should also be disclosed in annual reports, which are a key communication channel between issuers and their stakeholders.</p> <p>In respect of circumstances referred under paragraph 78, where issuers may be able to apply for a waiver on disclosing the details of specific grants, while we appreciate that this will be considered on a merit basis, where given, waivers should be supported with a sound rationale and, where possible, disclosure of this to the public to further enhance transparency.</p>
21. Do you agree with the proposed disclosure requirements for Share Grants in an issuer's interim reports and annual reports? Please provide reasons for your views.	<p>We agree with this proposal. However, merely disclosing the movement of share grants in summary may not be sufficient. As suggested in our response to Question 20, details of share grant announcements (e.g. where relevant, key performance indicators, and information on clawback mechanisms), should also be disclosed, at least in summary, in annual reports, so that these different channels of disclosure can complement each other.</p>
22. Do you agree with the proposal to require disclosure of matters reviewed by the remuneration committee during the reporting period in the Corporate Governance Report? Please provide reasons for your views.	<p>We agree with the proposal. While we raise concerns over the expanded role of the RC in our response to Question 3, if the role of the RC will be expanded, issuers should be advised not to make boilerplate disclosures. For example, merely indicating the objective of incentivizing the issuers' employees with share grants may not be sufficient. This should be supported with other relevant information (e.g. industry analysis, financial position of the issuer, the underlying key performance indicator and why these are considered reasonably challenging yet attainable, etc.). As indicated in our response to Question 10, generally, the RC must avoid insubstantial or opaque disclosures and should be prepared to provide, e.g., a detailed explanation of how share award/ option schemes approved by it will benefit the issuer and not prejudice the interests of shareholders.</p> <p>More guidance many need to be provided to issuers as to the expectations of them in this regard.</p>
23. Do you agree with the proposal to require changes to the terms	<p>In view of ever-changing business environment, it makes sense to be able amend the terms of share awards or share options on a timely basis to help retain the current staff and attract new talent.</p>

<u>Questions</u>	<u>Comments</u>
<p>of share award or option granted be approved by the remuneration committee and/or shareholders of the issuer if the initial grant of the award or option requires such approval? Please provide reasons for your views.</p>	<p>The role of the RC will become even more important if it is to oversee the latest incentive policies for relevant participants, particularly where the initial grants of the options or awards to an individual participant are within the 1% individual limit, or to related entity participants or service providers that are within 0.1% of the issuer's issued shares over any 12-month period. Hence our concerns about the composition, operation and functioning of RCs.</p>
<p>24. Do you agree with the proposal to provide a waiver for a transfer of share awards or options granted under Share Schemes as described in paragraph 86? Please provide reasons for your views.</p>	<p>We have no strong view on this. While, in principle, it seems reasonable based on the example provided in paragraph 56, more information on any limitation, rules and requirements around granting waivers should be provided.</p>
<p>25. Do you agree with the proposal to restrict the voting rights of unvested shares held by the trustee of a Share Scheme and require disclosure of the number of such unvested shares in monthly returns? Please provide reasons for your views.</p>	<p>The proposal seems reasonable. For the reason given in paragraph 88, and also that the unvested shares are indicative of the fact that the relevant participants have not yet met all the applicable conditions for the shares to become vested, it makes sense that these shares should not be entitled to voting rights.</p> <p>We support the disclosure of the number of unvested shares in monthly returns so that the potential diluting effects can be monitored.</p>
<p>26. Do you agree with the proposed disclosure requirements for Share Schemes funded by existing shares of listed issuers? Please provide reasons for your views.</p>	<p>We agree with the proposed disclosure requirements for share schemes funded by existing shares of listed issuers, as they serve a similar purpose to those funded by new shares and should be subject to appropriate disclosure requirements.</p>

<u>Questions</u>	<u>Comments</u>
27. Do you agree with the proposal to restrict the voting rights of unvested shares held by the trustee of a Share Scheme and require disclosure of the number of such unvested shares in monthly returns? Please provide reasons for your views.	We agree with this proposal for the same reasons as given in our response to Question 25.
28. Do you agree with our proposal to amend Chapter 17 to also govern share award schemes funded by new or existing shares of subsidiaries of listed issuers? Please provide reasons for your views.	We agree with the proposal for the reason given in paragraph 94 of the CP.
29. Do you agree with the proposed exemption for Share Schemes of Insignificant Subsidiaries? Please provide reasons for your views.	We have no strong view on this proposal.
30. Do you agree with our proposal to amend Chapter 17 to also govern Share Schemes involving grants of shares or options through trust or similar arrangements for the benefit of specified participants? Please provide reasons for your views.	We agree with the proposal, as the grants of shares or option through trust or similar arrangement is de facto the same as if employees received the options. The ultimate beneficiary of the share options/ share awards is also the same with or without trust or similar arrangement. The proposal helps increase the transparency of how the share options are handled for the benefit of shareholders.

<u>Questions</u>	<u>Comments</u>
<p>31. Do you agree with our proposal to remove the recommended disclosure requirement for the fair value of options as if they have been granted prior to the approval of the scheme? Please provide reasons for your views.</p>	<p>We welcome the requirement for more information to be disclosed in issuers' annual reports and interim reports.</p> <p>However, information on the fair value of options and awards already granted is not the same as "the value of all options that can be granted under the scheme as if they had been granted at the latest practicable date prior to the approval of the scheme." Unless no further grant can be made under the scheme after the initial grant has been made, it would seem that this is additional information, which may be of some value. Therefore, more explanation of why this is no longer regarded as useful should be provided.</p>
<p>32. Do you agree with our proposals to amend the Rules described in paragraph 100? Please provide reasons for your views.</p>	<p>Regarding Rule 3.13(2), please see our response to Question 18.</p> <p>Regarding Rule 13.52(1)(e)(ii), some of our members who are active in CG question the necessity of submitting draft circulars relating to share option schemes under Chapter 17 to the Exchange for review, given that these are relatively less important than e.g. takeover transactions or initial public offering prospectuses. Unless the experience of the Exchange has shown this to be necessary, in their view, it may just add to the administrative burden on issuers.</p>