

Issued on: 31 December 2021

The Exchange's Consultation Paper
Proposed Amendments to Listing Rules
relating to Share Schemes of Listed Issuers (October 2021)

In relation to the captioned Consultation Paper, The Hong Kong Institute of Directors has the following views and comments.

General comments

Boards should have the flexibility to deploy share options and share awards to reward and incentivize employees and service providers. Share awards are being utilized more and more. Given that Chapter 17 of the Rules govern only share option schemes but not share awards, it would make sense to bring share award schemes under the purview of Chapter 17, and thereby providing a consistent framework to govern all Share Schemes.

Share schemes funded by new shares will have dilutive effects, however. The proposals are in large part to neutralize (reduce at least) the dilutive impact.

Role of remuneration committee

The proposals place an important gate-keeping function on the remuneration committee in overseeing the operation of Share Schemes. Consultation Paper para 81. We concur. We trust that remuneration committee members (and the full board of directors) will perform their gate keeping function having regard to all shareholders' interests.

We do note that Share Schemes is only one part of the issuer's remuneration policy. It is important that the remuneration policy adopted by the issuer to be one that embodies a credible compensation philosophy. The policy and its implementation will need to be communicated to stakeholders by way of disclosure.

Director compensation is one part of remuneration policy. The formulation and explication of that compensation philosophy is as important if not more. We would highlight the one principle that no director or any of their associates should be involved in deciding that director's own remuneration. See the (to be revised) Corporate Governance Code, especially CP E.1.3 and 1.5 as re-arranged.

Disclosure matters

The proposals also include requirements for the disclosure of Share Grants information sufficient for stakeholders to make informed assessment. Consultation Paper para 76. We concur.

Guidance could be useful to issuers

The section on Remuneration in the (to be revised) Corporate Governance Code is a good place to start. Further guidance could be useful to issuers. For disclosure matters, we note that the Exchange intend to extend Rule 13.53(1)(e)(ii) to require issuers to submit draft circulars for any matter relating to share schemes for review. Consultation Paper para 100 and Question 32.

On INED compensation

According to the Consultation Conclusions recently published in December 2021, the revised Corporate Governance Code will include a new RBP that an issuer generally should not grant equity-based remuneration (e.g., share options or grants) with performance-related elements to INEDs as this may lead to bias in their decision-making and compromise their objectivity and independence.

As we stated in our submission to that consultation exercise, we have reservation about the RBP.

If a straight-jacket directors' fee remuneration is meant to ensure "neutrality" and to keep directors from being mired with personal gains in their decision making, there is then the equally likely opposite effect, that because the flat retainer is all that is there, the director need not be rigorous and need not earn the money the hard way. Directors' fees for INEDs among Hong Kong issuers are not high; some say meagre. They do not really reflect the increasing burden and liabilities that are thrust on the INEDs.

Equity-based remuneration can align incentives of directors with shareholders, all shareholders. Equity-based remuneration, if it rewards actual share value appreciation and risks assumed, can make for a needed incentive for the INEDs to perform and prove their worth in value creation. When EDs on the same board can be rewarded with equity-based remuneration, we do not see why INEDs should be deprived of their opportunity to participate in the economic success of the company.

The nature and the detail of the equity-based remuneration is key. The better best practice is to have the right design of the remuneration package, one that factors the issuer's needs and the qualities of the recipient INEDs into the analysis. Appropriate vesting schedules to go along with well-reasoned expected payout can align compensation for good service while protecting the issuer. We need not go too far in cautioning against all forms of equity-based remuneration for INEDs.

Responses to consultation questions

Subject to our general comments above, we state our responses to specific questions as set out in the Consultation Paper as follows:

Share Schemes funded by issuance of new shares

Extend scope of Chapter 17

Question 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?

HKIoD Response:

- AGREE
 - To provide a consistent framework to govern shares schemes.

Eligible participants

Question 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)?

HKIoD Response:

- AGREE

Question 3 Do you agree with the proposal that eligible participants shall include Service Providers, subject to additional disclosure and approval by the remuneration committee?

HKIoD Response:

- AGREE
 - The grants would have to be approved by the remuneration committee and the reasons must be disclosed. In addition, there are additional safeguards proposed, viz:
 - Service Provider Sublimit (see Question 8)
 - requirement to disclose if the grants to an individual Service Provider exceed 0.1% of issued shares over any 12-month period (see Question 19).
 - The proposal seems to take Service Providers who would be eligible participants to mean only individuals, not firms. Conceivably, those persons providing important service to the issuer could be operating through a business entity. Conceivably, the important service could be provided by a team through a service firm setting. Given the approval and disclosure requirements and the other safeguards being proposed, corporate form should not itself be a bar to becoming eligible participants. We note the Exchange's intent to not include service providers that are in the financial or transaction advisory realm nor those in the run of the mill professional services. Consultation Paper para 33.

Question 4 Do you agree with the proposal that eligible participants shall include Related Entity Participants, subject to additional disclosure and approval by the remuneration committee?

HKIoD Response:

- AGREE
 - The grants would have to be approved by the remuneration committee and the reasons must be disclosed.

Scheme mandate

Question 5 Do you agree with the proposal to allow the scheme mandate to be refreshed once every three years by obtaining shareholders' approval?

HKIoD Response:

- AGREE
 - To have the scheme mandate refreshed once every three years seems reasonable. Shareholders are in a position to assess and make their approval.
 - We note that there is the possibility of additional refreshments within the three years with independent shareholders' approval. See Question 6.
 - We note that there is the possibility to seek waivers in connection with large Share Grants as part of remuneration strategies. Consultation Paper para 46.

Question 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?

HKIoD Response:

- AGREE
 - Independent shareholders are in a position to assess and approve additional refreshments.

Question 7 Do you agree with the proposal to remove the 30% limit on outstanding options?

HKIoD Response:

- AGREE
 - It seems uncommon to have an overhang of 30%. Consultation Paper para 47. The 10% limit is the more restrictive limit.
 - The 30% limit could be seen as one safeguard the lifting of which could hurt minority shareholders' interests. We trust that remuneration committee members (and the full board of directors) will perform their gate keeping function having regard to all shareholders' interests. Per the proposals, information will have to be disclosed for shareholders to make their decisions to buy, sell or hold.

Question 8 Do you agree with the proposal to require a sublimit on Share Grants to Service Providers?

HKIoD Response:

- AGREE

- The proposal would require a disclosure of the basis for the sublimit and for the sublimit to be separately voted on by shareholders. Consultation Paper para 48.

Minimum vesting period of Share Grants

Question 9 Do you agree with the proposal to require a minimum of 12-month vesting period?

HKIoD Response:

- AGREE
 - A minimum vesting period of 12 months is reasonable.

Question 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?

HKIoD Response:

- AGREE
 - The justification for a shorter vesting period must be disclosed and the Employee Participants to which such grants are made must be specifically identified.

Performance targets and clawback mechanism

Question 11 Do you agree with the proposed disclosure requirements relating to (a) performance targets; and (b) clawback mechanism?

HKIoD Response:

- as to (a) AGREE; as to (b) AGREE
 - The disclosure should enable shareholders and investors to better assess the effect and impact of the scheme. Consultation Paper para 56.
 - Case by case waiver possible, if an issuer has concerns about disclosing any specific details which are confidential and commercially sensitive. Consultation Paper para 57. This should add some flexibility, though if given too liberally the waiver could become routine practice.

Exercise price or share grant price

Question 12 Do you agree that it is not necessary to impose a restriction on the grant price of shares under share award schemes?

HKIoD Response:

- AGREE
 - Not necessary to impose restriction on grant price for share awards, which are usually granted at nil consideration. Consultation Paper para 59.
 - Other markets tend not to impose restrictions on grant price. Consultation Paper para 59. The PRC is one notable exception, requiring a minimum grant

price of 50% of market price. Issuers listing on our Exchange could well be subject to tougher home jurisdiction rules than the Listing Rules would otherwise permit. And the larger PRC legal system is certainly one different from that of Hong Kong. On this matter, we think it is suitable and reasonable to go with no restrictions.

Share Grants to individual grantees

Question 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 participant?

HKIoD Response:

- AGREE

Share Grants to Connected Persons

Question 14 Do you agree with the proposal to require approval from the remuneration committee instead of INEDs for all Share Grants to Connected Persons?

HKIoD Response:

- AGREE WITH RESERVATION
 - The Exchange’s reasoning for this proposal is to bring things in line with the Corporate Governance Code, which requires remuneration committees to be accountable to shareholders for the issuer’s policy on remuneration of directors and senior management. Consultation Paper para 63. We note that the new Corporate Governance Code and related Listing Rule changes will come into effect from 1 January 2022.
 - There may be a reason to keep it at “approval by INEDs” nonetheless, to emphasize the check and balance role of INEDs in remuneration matters.
 - For instance, what happens if the Connected Person grantee is also sitting on that remuneration committee? In a committee of three with majority INED, if the Connected Person grantee is the ED, the two INEDs will be making the approval which is fine; but if the Connected Person grantee is an INED, the ED and the other INED will be making the approval. No one is approving his/her own compensation, sure. But doing it the old way, it would all be INEDs making the approval.
 - We note that some other jurisdictions already require (at least recommend) that remuneration committees consist of all INEDs. The Listing Rules would only require one chaired by an independent nonexecutive director and comprising a majority of independent non-executive directors. Rule 3.25. According to website information, the remuneration committee of the HKEX Group consists of at least 4 INEDs (and the HKEX Board has a significantly large majority of INEDs).

Question 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?

HKIoD Response:

- AGREE
 - To have a de minimis threshold for shareholder approval is reasonable.
 - Under the proposal, grants of shares awards that total 0.1% or less in any 12-month period will not require independent shareholders' approval.

Share Grants to INEDs or substantial shareholders

Question 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 issuer set out in paragraph 68 above?

HKIoD Response:

- AGREE
 - To have a de minimis threshold for shareholder approval is reasonable.
 - Under the proposal, grants of shares awards that total 0.1% or less in any 12-month period will not require independent shareholders' approval.

Share Grants to controlling shareholders

Question 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?

HKIoD Response:

- AGREE
 - To have a de minimis threshold for shareholder approval is reasonable.
 - Under the proposal, grants of shares awards that total 0.1% or less in any 12-month period will not require independent shareholders' approval.

Question 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?

HKIoD Response:

- AGREE

Announcement of Share Grants

Question 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?

HKIoD Response:

- AGREE

Question 20 Do you agree with the proposed disclosure requirement for the grant announcement?

HKIoD Response:

- AGREE

Disclosure in interim reports and annual reports

Question 21 Do you agree with the proposed disclosure requirements for Share Grants in an issuer's interim reports and annual reports?

HKIoD Response:

- AGREE

Disclosure of remuneration committee's work

Question 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?

HKIoD Response:

- AGREE

Approval for changes to terms of share award or option granted

Question 23 Do you agree with the proposal to require changes to the terms 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?

HKIoD Response:

- AGREE

Transfer of share awards or options

Question 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?

HKIoD Response:

- AGREE
 - The waiver is reasonable, to facilitate wealth management and estate planning for the individuals concerned. The premise should be that there is no substantive change to the dilutive effects of the options/awards already made. We do note that waivers if given too liberally could become routine practice to defeat the purpose of the rule regime.

Voting rights of unvested scheme shares

Question 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?

HKIoD Response:

- AGREE
 - The proposal seems reasonable. The rationale is to address the concerns about undue influence over the exercise of voting rights of unvested shares by management of the issuer. Consultation Paper para 88. See also our response to Question 27.

Share Schemes funded by existing shares

Disclosure in grant announcements and financial reports

Question 26 Do you agree with the proposed disclosure requirements for Share Schemes funded by existing shares of listed issuers?

HKIoD Response:

- AGREE
 - The proposal is to require disclosure of the terms of the schemes and details of the share grants, much similar to that required of Share Schemes funded by issuance of new shares.

Voting rights of unvested scheme shares

Question 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?

HKIoD Response:

- AGREE
 - See Question 25.

Extend scope of Chapter 17 to also govern share award schemes of subsidiaries

Question 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?

HKIoD Response:

- AGREE

Share schemes of insignificant subsidiaries

Question 29 Do you agree with the proposed exemption for Share Schemes of Insignificant Subsidiaries?

HKIoD Response:

- AGREE

Other rules relating to Share Schemes

Trust arrangements

Question 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?

HKIoD Response:

- AGREE

Disclosure of fair value of options

Question 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?

HKIoD Response:

- AGREE
 - There is the proposal to require disclosure of the fair value of options and awards granted by issuers in their annual reports and interim reports, in line with HKFRS2.

Other proposed rule amendments relating to Share Schemes

Question 32 Do you agree with our proposals to amend the Rules described in paragraph 100?

HKIoD Response:

- The purpose is to amend the Rules to also apply to share award schemes.
 - as to (a), on Rule 3.13(2), AGREE
 - This concerns director independence.
 - as to (b), on Rule 10.08(1), AGREE
 - This concerns the restriction on further issuance of shares by a listed issuer within six months of new listing.
 - as to (c), AGREE
 - Issuers are to submit draft circulars on matters relating to share option and share award schemes to the Exchange for review. As noted elsewhere, further guidance on how to make the disclosure contemplated by the current proposals could be useful to issuers.
 - as to (d), AGREE
 - This concerns dealing restrictions on securities transactions under the Model Code.

ENDS