

## GETTING READY FOR THE NEW SHARE SCHEME REGIME FOR LISTED ISSUERS IN HONG KONG

The Stock Exchange of Hong Kong Limited (HKSE) has published the consultation conclusions on its proposed amendments to the Listing Rules relating to share schemes of listed issuers. Overhaul amendments to Chapter 17 of the Listing Rules will take effect on 1 January 2023. This briefing discusses some practical tips that may help Main Board issuers to comply with the new regulatory regime.

### DO THE REQUIREMENTS UNDER CHAPTER 17 APPLY TO YOUR SCHEME?

At present, Chapter 17 of the Listing Rules only applies to an issuer's own share option scheme and any share option scheme set up at the subsidiaries level. Chapter 17 does not apply to share award schemes.

Starting from 1 January 2023:

- at the issuer level, the comprehensive requirements under Chapter 17 will govern **all schemes involving grant of new shares and/or grant of options** ie to acquire **new shares** of issuers, including those where trust arrangements are in place. Any share scheme funded by the existing shares of the issuers, be it a share award or a share option scheme, will be primarily subject to the requirements to make disclosures in the issuer's annual reports;
- at the subsidiaries level, Chapter 17 will apply to the share scheme(s) of any principal subsidiary of an issuer. A subsidiary whose revenue, profits or total assets accounted for 75% (or more) of that of the issuer under the percentage ratios in any of the latest three financial years will be considered as a "principal subsidiary".

For other subsidiaries of an issuer which are not principal subsidiaries of an issuer, the requirements under Chapter 17 will not apply. However, the notifiable and/or connected transaction requirements under Chapters 14 and/or 14A of the Listing Rules will apply to the grants of share awards and/or options over new or existing shares of these subsidiaries:

- any disposal (involving grants of existing shares of the subsidiary held by the issuer) and deemed disposals (involving grants of new shares or options over new shares by the subsidiary) would be subject to disclosure (if any percentage ratio based on the size of the scheme mandate is over

### Key Takeaways

- Requirements on shareholders' approval and other substantive terms set forth under Chapter 17 will apply to all schemes of listed issuers involving grant of new shares and/or grant of options to acquire new shares of listed issuers
- Share schemes of principal subsidiaries of listed issuers to acquire new or existing shares of principal subsidiaries will also be captured by Chapter 17. Share schemes of other non-principal subsidiaries will not be required to comply with Chapter 17, but Chapters 14 (disposal/deemed disposal) and 14A (grant to connected person) will be relevant

5%) and shareholders' approval (if any percentage ratio is over 25%) under Chapter 14;

- share grants to a connected person would be subject to disclosure and/or independent shareholders' approval if the grants to such person in a 12-month period exceed the de minimis thresholds under Chapter 14A.

## **MAKE SURE SHAREHOLDERS' AND OTHER TYPES OF APPROVAL WOULD BE OBTAINED TO ADOPT THE SCHEME(S)**

A listed issuer must seek shareholders' approval in general meeting to adopt its own share scheme involving its new shares and all share schemes of its principal subsidiaries, but not for any share scheme(s) set up by subsidiaries other than the principal subsidiaries.

For a new applicant, shareholders' approval will not be required if the share scheme is adopted prior to its listing, but all material terms of the scheme must be disclosed in the prospectus.

There will be instances where different types of approvals (approval by shareholders / independent shareholders / board of directors or other types of approvals) will be required for other aspects of the share scheme(s) - please see next section.

## **MAKE SURE THE TERMS OF SCHEME DOCUMENTS ARE COMPLIANT**

### **Share schemes adopted by new applicant**

Grants of options or awards made under non-compliant share scheme adopted by a new applicant prior to listing may, subject to HKSE's listing approval of the new applicant's shares to be issued in respect of such scheme, be valid after listing, but no further options or awards may be granted under the scheme after listing.

If a new applicant proposes to adopt a post-listing share scheme and intends to issue new shares to the trustee of the share scheme before listing to fund future grants of awards and options to participants after listing, HKSE would not grant listing approval for the issue of new shares under such scheme as there are no specified participants when the new shares are issued to the trustee.

### **Share schemes adopted post-listing**

Apart from the approval requirement applicable to the adoption of a share scheme mentioned in the preceding section, there are a number of instances where approval requirements are imposed pursuant to Chapter 17. Highlights as follows:

#### **Grants to eligible participants only**

All share schemes under Chapter 17 must **limit the participants to "eligible participants" only**, which means:

- employee participants: directors and employees of the issuer / its subsidiaries (including persons who are granted shares or options under the scheme as an inducement to enter into employment contracts with

these companies). Regarding this requirement, please note that: (i) part-time employees may also be included as employee participants; and (ii) former employees may continue to hold any outstanding options or awards granted to him/her as employee participants after termination of employment provided that the scheme provides for such scenario;

- related entity participants: directors and employees of the holding companies, fellow subsidiaries or associated companies of the issuer;
- service providers: persons who provide services to the issuer group on a continuing and recurring basis in their ordinary and usual course of business which are in the interests of the long-term growth of the issuer group.

If an issuer wishes to award new shares to individuals who do not fall within the above definition of "eligible participants", the issuer may grant such award utilising a general or specific mandate.

#### **Scheme mandate limit and service providers sub-limit**

- "Scheme mandate limit": issuers are required to set a "scheme mandate limit" of not exceeding 10% of an issuer's issued shares to share grants<sup>1</sup> under all share schemes of the issuer. The scheme mandate may be refreshed by shareholders' approval once every three years. For the refreshment of a scheme mandate within a three-year period, independent shareholders' approval<sup>2</sup> will be required.
- "Service providers sub-limit": issuers are required to set a sub-limit under the "scheme mandate limit" for share grants to service providers, and disclose the basis for determining the sub-limit in its circular to shareholders.

#### **Minimum vesting period**

- A minimum vesting period of 12 months will be required for the share option / award entitlement, with the exception that grants to employee participants can be made with shorter vesting period under specific circumstances set out in the scheme.

Examples of specific circumstances where HKSE may consider acceptable include: (i) grants with performance-based vesting in lieu of time-based vesting criteria, (ii) grants of make-whole share awards to new joiners to replace the share awards they forfeited when leaving the previous employers, (iii) grants that are made in batches during a year for administrative and compliance reasons such that the grants should have been made earlier but had to wait for a subsequent batch, etc.

- In cases of grants to directors and senior management with shorter vesting period, approval by the remuneration committee will be required.

#### **Limits on large share grants to individual participants**

- "1% individual limit": issuers are required to set up a limit on share grants to an individual participant over any 12-month period which must not

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<sup>1</sup> "Share grants": (a) in respect of an issuer's share schemes, share grants refer to grants of share awards and/or options over new shares of the issuer; and (b) 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.

<sup>2</sup> "Independent shareholders' approval" means the approval of shareholders in general meeting whereby any controlling shareholder, director (excluding INEDs), chief executive of the issuer and their respective associates must abstain from voting.

exceed 1% of the issued shares of the issuer (or, for a subsidiary scheme, its subsidiary). Any excess will require independent shareholders' approval.

#### **Additional limits on large share grants to connected persons at the issuer level**

- For share grants to connected persons at the issuer level (ie a director, chief executive or substantial shareholder of the issuer or an associate of any of them):
  - all such share grants will require the approval of independent non-executive directors (INEDs);
  - a de minimis exemption of 0.1% for grants to connected persons is allowed, ie (i) the limit on grants of share awards (involving new shares but excluding share options) to a director (other than an INED) or chief executive of the issuer; or (ii) the limit on share grants to an INED or substantial shareholder of the issuer must not exceed 0.1% of the issued shares of the issuer over any 12-month period. Any excess will require independent shareholders' approval.

The current restriction on the exercise price of options (which must be higher of: (i) the closing price of the shares as stated in the HKSE's daily quotations sheet on the date of grant, which must be a business day; and (ii) the average closing price of the shares as stated in the HKSE 's daily quotations sheets for the five business days immediately preceding the date of grant) will be retained, but such restriction will not apply to a share award scheme.

## **MAKING PROPER DISCLOSURES**

### **Share schemes involving new shares**

Highlights of some key disclosure requirements applicable to share schemes involving new shares include:

#### **Announcement of share grants**

- disclosure of details of share grants by the issuer 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 issuer's issued shares over any 12-month period;
- share grants by the issuer to other participants may be disclosed in aggregate by category. The HKSE may require the issuer to submit a list of grantees and the movements of shares and options granted to each grantee from time to time;
- disclosure of the number of shares available for future grant under the scheme mandate and the service provider sub-limit (if applicable);

#### **Disclosures in the interim report and annual report**

- details of share grants to participants (eg vesting period and exercise / grant price) and their movements during the reporting period;
- for options and awards granted during the reporting period, their fair value at the time of grant and the accounting policy adopted;

- the number of shares that may be issued in respect of options and awards granted during the reporting period divided by the weighted average number of issued shares for the period;
- the number of shares that are available for grant under the scheme mandate (and the service provider sub-limit, if applicable) at the beginning and the end of the reporting period;
- (for annual report only) a summary of each share scheme;

#### **Disclosures in corporate governance report**

- a summary of the material matters relating to the share schemes that were reviewed and/or approved by the remuneration committee during the financial year in the corporate governance report or the remuneration report (as the case may be).

#### **Share schemes involving existing shares**

Whilst an announcement of share grants will not be required and the terms of the share schemes involving existing shares will not be required to comply with the comprehensive requirements set out above, any issuer with a share scheme funded by its existing shares will be required to make disclosures in its interim<sup>3</sup> and annual reports. Key disclosures in annual reports as mandated under Chapter 17 include:

- details (eg vesting period and exercise / grant price) of the grants of existing shares to (i) each director of the issuer on an individual basis; and (ii) the five highest paid individuals on an aggregated basis (and the movements of grants during the reporting period);
- details of share grants to other (non-employee) participants on an aggregated basis.

### **NEXT STEP – ACTION TO COMPLY WITH CHAPTER 17 FOR EXISTING SHARE SCHEMES OF ISSUERS**

#### **At the issuer level - for existing share schemes of issuer involving issue of new shares**

The following requirements will apply to existing share schemes of issuer involving issue of new shares:

##### **Disclosures pursuant to Chapter 17**

- disclosure requirements set forth in the above section will apply from 1 January 2023;

##### **Limit grants to eligible participants**

- share grants may only be made to eligible participants effective from the financial year commencing on or after 1 January 2023;

##### **Grants made subject to existing scheme mandate limit**

- in relation to share option scheme and share award scheme with advanced mandate (ie an advanced specific mandate approved by

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<sup>3</sup> Notwithstanding Chapter 17 does not require disclosure in interim reports of grants pursuant to share schemes involving existing shares, issuers may still be required to make disclosure of the grants in interim reports pursuant to other applicable laws and rules (eg disclosure of interest by directors).

shareholders), the issuer may continue to make share grants using existing scheme mandates;

- in relation to existing share award schemes involving grants of new shares under general mandate, the issuer may continue to grant share awards up to the earlier of (i) the second annual general meeting after 1 January 2023 or (ii) the adoption of new scheme mandate or amendments of the terms of any existing schemes to comply with the amended Chapter 17;

#### **Timing of amending the terms of existing schemes**

- issuer must amend the terms of the existing schemes to comply with Chapter 17 when the issuer refreshes the scheme mandate limit. However, issuers are not allowed to further refresh the scheme mandates for existing share award schemes with advanced mandates.

### **At the subsidiaries level - for existing share schemes of subsidiaries**

#### **Share option schemes of principal subsidiaries**

- Issuers should apply the abovementioned arrangement at the issuer level to any share option scheme of its principal subsidiaries as if it is an existing share option scheme at the issuer level involving new shares.

#### **Share award schemes of principal subsidiaries**

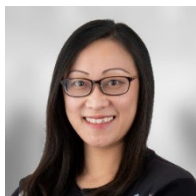
- Effective from 1 January 2023, any grant made under existing share award schemes must be made to eligible participants only.
- Additionally, any such grant made must comply with Chapters 14 and 14A. Issuer shall calculate size test using the size of the scheme mandate available for future grants and consider its implications under Chapter 14 (ie announcement and/or shareholders' approval), and subsequent grants should observe Chapter 14A as discussed in the first section above.

#### **Share option schemes and share award schemes of other non-principal subsidiaries**

- For existing share option schemes of non-principal subsidiaries which have been approved by shareholders pursuant to the existing Chapter 17, the subsidiary may continue to grant share options under the existing scheme mandate.
- For existing share award schemes of non-principal subsidiaries, similar to share award schemes of principal subsidiaries, issuers shall calculate size test using the size of the scheme mandate available for future grants and consider its implications under Chapter 14, and subsequent grants should observe Chapter 14A as discussed in the first section above.

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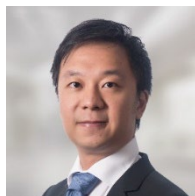
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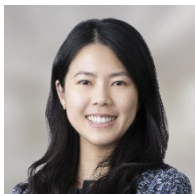
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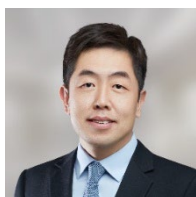
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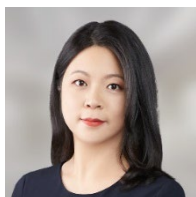
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