HKEx LISTING DECISION
Cite as HKEx-LD40-2 (October 2004) (Withdrawn in January 2023)

[This Listing Decision is withdrawn following the amendments of Chapter 17 of the Rules to govern both share option schemes and share award schemes of issuers. The amended Rules became effective on 1 January 2023]

Summary	
Category	Listing Decisions Series 40-2 (LD40-2)
Name of Party	Company A - a Main Board listing applicant
Subject	Whether the mandate given by the existing shareholders of Company A prior to listing to authorise the grant of shares under a share-based remuneration plan (the "Plan") would have a binding effect on future shareholders of Company A
Listing Rules	Rules 8.20; 13.36(1)(a)
Decision	Company A would be allowed to adopt the Plan but the mandate authorising the issue of shares under the Plan was required to be specific in terms of (1) the number of shares to be issued; and (2) the time frame for the validity of the mandate, which should not be longer than one financial year to enable shareholders to review it annually. There also was required to be prominent disclosure of the terms of the Plan and the potential maximum dilution effect in the prospectus, circulars to shareholders and subsequent annual reports

Summary of Facts

Company A intended to adopt, among several other share-based incentive schemes, a share-based remuneration plan in favour of the employees of the group (including the directors of Company A) (the "Plan") prior to listing. As the Plan did not involve any grant of options to purchase shares of Company A, the Plan was not subject to the requirements of Chapter 17 of the Listing Rules.

The life of the Plan was intended to be 10 years. Under the Plan, the remuneration committee, consisting of a majority of independent non-executive directors, would be delegated the power to administer the Plan, and this committee would give instructions to a trustee to award eligible employees or directors for their services with Company A's shares.

The Plan involved an initial issue of a specific number of shares amounting to approximately 2% of the issued share capital of Company A immediately upon listing to the trustee by capitalising its retained earnings. The maximum number of shares that could be subscribed or purchased by

the trustee under the Plan could not exceed 2% of the total number of shares of Company A as at the beginning of each financial period. If the initial pool of shares under the Plan should be depleted or should there be insufficient shares for the purpose of making the awards, the remuneration committee would make cash payments (accounted as a deferred expenditure to be amortised to the profit and loss accounts of Company A) to the trustee. The trustee would then use the cash to (i) subscribe new shares at par and make the award of such shares to persons who were not connected persons, or (ii) purchase shares in the open market and make awards of such shares. Accordingly, the shares to be awarded to the eligible directors/employees under the Plan would be at no cost to such directors/ employees.

Company A proposed that any shares awarded to eligible grantees under the Plan would be issued pursuant to a one-time "specific mandate" given by the existing shareholders prior to listing to authorise directors of Company A to issue, in each financial year for up to 10 years, new shares subject to a maximum of 2% of its issued share capital.

Question Presented

Whether the mandate given by the existing shareholders of Company A prior to listing to authorise the grant of shares under the Plan would have a binding effect on future shareholders of Company A?

Applicable Listing Rules

Rule 8.20 provides that "[*L*]isting must be sought for all further issues of securities of a class already listed prior to the issue of the securities."

Rule 13.36(1)(a) provides that, except in the circumstances mentioned in Rule 13.36(2), the directors of a listed issuer shall obtain the consent of shareholders in general meeting prior to allotting, issuing or granting shares of the issuer.

Rule 13.36(2) provides for two circumstances under which no consent from shareholders is required for an allotment, issue or grant of shares. The first circumstance is where the allotment, issue or grant of shares is made pursuant to an offer made to the shareholders of the issuer (excluding those residing outside Hong Kong) on a pro-rata basis (see Rule 13.36(2)(a)); and the second circumstance is where the existing shareholders have previously approved by ordinary resolution in general meeting a general mandate to the directors of the issuer to allot or issue shares not exceeding 20% of the existing issued share capital of the issuer (see Rule 13.36(2)(b)).

Analysis

In order to obtain listing approval for further issues of shares, an issuer is required under the Listing Rules to obtain a mandate from its shareholders for the issue, unless the shares are issued on a pro-rata basis to existing shareholders (excluding those residing outside Hong Kong). In order to

qualify as a specific mandate from shareholders, as opposed to a general mandate, for an issue of shares pursuant to Rule 13.36(1), the Exchange normally expects a mandate from existing shareholders of an issuer to be specific in terms of (i) number of shares; (ii) issue price; and (iii) time frame.

In this case, the Exchange determined that the mandate proposed by Company A for the approval of the Plan did not contain the typical features that should be found in a specific mandate. In particular, it lacked the time frame for the issue of new shares. The Exchange considered that the life of the mandate was particularly material to investors and shareholders for assessing the dilution effect and profitability impact (with reference to the fair value/market value/net asset value of the shares of Company A) caused by an issue of shares under the Plan. The longer the life of the specific mandate, the more difficult it would be for an investor/shareholder to assess the resulting dilution effect and the profitability impact.

In the present case, the Exchange noted with concern the dilution effect on Company A's net asset value and the impact on Company A's results given that the award shares under the Plan would be issued at par, the price of which would very likely be substantially lower than the fair value of the shares at the time they would be issued to the eligible grantees.

The Exchange also considered that the number of the new shares that might be issued under the Plan (that is, even disregarding the combined impact of the other share remuneration plans on Company A, namely up to 2% dilution each year for up to 10 years) to be material to the shareholders.

The Exchange considered that, if Company A intended to adopt the Plan, the mandate for issues of shares under the Plan must be specific in terms of numbers and subject to a time limitation. The imposition of a time limitation on the mandate would, in substance, be a formalisation of a right of challenge by shareholders of Company A's decision to issue shares under the Plan periodically.

Furthermore, the Exchange was of the view that the prospectus, circulars to shareholders relating to the grant of specific mandate and future annual reports of Company A must contain sufficient information to enable investors and shareholders to appraise the possible dilution effect on their shareholding interests as well as the likely impact on the employee costs.

Decision

Based on the analysis set out above and the facts and circumstances of the case, the Exchange decided that Company A would be allowed to adopt the Plan but the mandate authorising the issue of shares under the Plan was required to be specific in terms of (1) the maximum number of shares that might be issued; and (2) the time frame for the validity of the mandate, which should not be longer than one financial year to enable shareholders to review it annually.

The prospectus of Company A was required to disclose the accounting treatment, the dilution effect and the impact of employee costs on Company A (assuming the shares were issued at fair

value) in respect of the issue of shares under the Plan. Such disclosure was required to be made in the financial information section of the prospectus and be highlighted as a risk factor.

The circulars to shareholders relating to the grant of a specific mandate were required to provide such information as would be necessary to allow shareholders to assess the effect of the share issue, including analysis of or reference to the estimated fair value of the shares to be issued, the dilution effect on the shareholders and the likely impact of employee costs on Company A if such shares were issued at the estimated fair value. Shareholders who were also beneficiaries under the Plan would be required to abstain from voting on the proposal.

Future annual reports of Company A were required to disclose the fair value of the shares issued under the Plan, with separate disclosure of the impact of employee costs on Company A if the shares were issued at fair value.