

By E-mail [REDACTED]

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Dear Sirs or Madams

Response to the Consultation Paper on the Proposed Amendments to Listing Rules relating to Share Schemes of Listed Issuers ("Consultation Paper") issued by The Stock Exchange of Hong Kong Limited (the "Exchange")

1. INTRODUCTION

- 1.1. We are writing on behalf of our client, whose shares are listed on the Main Board of the Exchange (the "**Company**"), in response to the Consultation Paper. Unless otherwise indicated, the terms used in this letter shall have the same meaning as defined in the Consultation Paper.
- 1.2. While the Company appreciates the Exchange's initiatives in reviewing the current requirements under Chapter 17 of the Listing Rules ("**Chapter 17**"), it would like to highlight its views and observations in response to the Consultation Paper particularly with respect to the application of the proposed requirements on Share Schemes funded by existing shares of listed issuers or their subsidiaries (i.e., Questions 26, 27 and 28 in the Consultation Paper).

2. VIEWS AND OBSERVATIONS

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- 2.1. Share incentives (including options and other forms of securities) are commonly used to attract and retain talents by listed issuers and their subsidiaries nowadays. Such incentives should be tailored for each listed issuer's business model, human resources policy and industry ecosystem. While requirements should be aligned and refined to ensure shareholders' protection and maintain high corporate governance standards, the Company believes any overly restrictive disclosure or approval requirement may hamper the effects of the share incentives and even result in undesirable competition among industry peers.
- 2.2. Based on the following reasons and observations, the Company is of the view that the proposed requirements under Proposals H, I and M should not be applied to Share Schemes funded by existing shares of listed issuers and/or their subsidiaries.
- (A) There is no dilution effect of a Share Scheme funded by existing shares:*
- 2.3. Chapter 17 currently applies to all schemes involving the grant by a listed issuer or any of its subsidiaries of options over new shares or other new securities of the listed issuer or any of its subsidiaries, to, or for the benefit of, specified participants of such scheme.¹ The regulatory rationale of Chapter 17 was stated in the consultation paper issued by the Exchange back in May 2000 to, among others, address the concerns relating to the on-going dilution effect on the interest of existing shareholders of listed issuers or any of their subsidiaries resulted from adoption of such Share Schemes funded by new shares.
- 2.4. In contrast, Share Schemes funded by existing shares do not create any dilution effect on the listed issuers or their subsidiaries that may prejudice the existing shareholders' interest. The source of funding for such Share Schemes is typically the salaries, bonuses or other form of cash compensation that the eligible participants would otherwise receive based on one or more historical or target performance indicator(s), and the funding is used to purchase the listed issuers' existing shares from secondary market as share awards to the eligible participants. This gives flexibility to the listed issuers in respect of the form of remuneration to their scheme participants. In this way, the share award is merely a form of benefit in kind (as opposed to remuneration in cash, such as salaries and performance-based cash bonuses). Absent any dilution effect, imposing restrictive disclosure requirements for individual Share Grants do not appear to enhance shareholders' protection. Instead, it will be burdensome and costly for the listed issuers to comply with the disclosure requirement in grant announcements and financial reports.
- 2.5. Having in place the long-standing requirements under Chapter 17, such regulatory rationale should be upheld in the proposed amendments under the Consultation Paper.

¹ See Rule 17.01(1) of the Listing Rules.

It is also recognised by the Exchange that it is not necessary to subject Share Schemes funded by existing shares to the same requirements as those funded by new shares.²

(B) *Sufficient disclosure as currently required under the Listing Rules and other applicable laws and regulations:*

2.6. While it is reasonable to impose stringent scrutiny over Share Grants to Connected Persons (in particular, directors and chief executives) to avoid any abuse in remunerating these officers, the Company believes there exist sufficient disclosure requirements regarding the remuneration package (including any Share Grants) of directors and chief executives under the current regime, particularly:

2.6.1. It is required under the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) (the "SFO") that directors and chief executives shall make disclosure of interest ("DI") filing within three business days after he/she directly or indirectly acquires an interest in any share of listed corporation of which they are a director or a chief executive and associated corporations of the listed corporation (as these terms are defined under the SFO). In other words, if any director or chief executive of a listed issuer receives only one share, or an option to acquire only one share, of such listed issuer as his/her remuneration, such director or chief executive is required to make timely DI filing which is publicly available at the Exchange's website. Furthermore, the interests held by directors and chief executives in the listed issuers and their associated corporations as required to be recorded under the SFO as at the end of the relevant financial year/period are required to be disclosed in the listed issuers' annual reports and interim reports, which are published on the Exchange's and the listed issuers' websites. Shareholders and potential investors should have been well informed of any such Share Grants made to listed issuers' directors and chief executives.

2.6.2. In addition, there are other requirements under the Listing Rules and the Companies Ordinance (Cap. 622 of the Laws of Hong Kong) that listed issuers are required to disclose the details of their directors and past directors' emoluments (by name) and the five highest paid individuals (who are not directors) during the financial year in their annual financial statements. Typically, detailed information including but not limited to the directors' and chief executive's fees for the financial year, share options or other share-based compensation and any benefit in kind, performance-based bonus and inducement compensation are set out in tabular form in a listed issuer's annual report.

2.7. All these current disclosure requirements have enabled adequate and timely disclosure of the remuneration package of directors, chief executives and the other highest paid senior management personnel of listed issuers to their shareholders and the investing public.

² See paragraph 20 of the Consultation Paper.

2.8. To impose additional disclosure requirement on Share Schemes funded by existing shares in line with those required for Share Schemes funded by new shares (e.g., issue of announcements with grant details including vesting period and performance targets by name) would highlight confidential information to employees as well as industry competitors without achieving any regulatory end for shareholder protection. Notably, business information such as remuneration and motivation strategy and internal performance measurement system is critical to companies which often face head-to-head competition with industry rivals in talent recruitment and retention.

(C) *More stringent requirements over Share Schemes in Hong Kong than in other major stock markets:*

2.9. It is noted that the disclosure requirements (including the disclosure timing and level of details) and shareholders' approval requirements proposed by the Exchange under the Consultation Paper are more restrictive and burdensome than those in the other major stock markets such as in the PRC and in the U.S.

2.10. In the PRC, A-share listed issuers are allowed to adopt share purchase plans where the listed issuer purchases its listed shares on the secondary market using funds from the employees' salaries and cash bonuses ("**A-share Share Purchase Plan**"). The disclosure requirements for such A-share Share Purchase Plan are much more lenient, requiring mainly the listed issuers to disclose the names of the directors, supervisors and senior management and the number and proportion of their share entitlement on a group basis. There is no specific disclosure requirement with respect to individual share grants or the details of such A-share Share Purchase Plan.

2.11. In the U.S., there is no strict requirement to announce each grant of share incentives to the eligible scheme participants. In addition, there is a 1% materiality threshold in respect of specific disclosure of share ownership by principal shareholders (irrespective of whether they are third parties or the issuer's directors, senior management and employees) in annual reports. To the extent the individual beneficially owns less than 1% of the class of shares, the issuer is allowed to indicate so by an asterisk and explanatory footnote (or by similar means) instead of setting out that person's individual share ownership in the annual reports.

2.12. As there are numerous "A+H" listed issuers and an increasing interest in homecoming listings from the U.S., extending the proposed amendments to Share Schemes funded by existing shares without regard to the standards of other major stock markets will make the Hong Kong stock market much less attractive to listed issuers and potential listing applicants.

3. CONCLUSION

3.1. Given the absence of dilution effect of Share Schemes funded by existing shares and the sufficient disclosure requirements already in place, the Company believes extending the proposed amendments to Chapter 17 to Share Schemes funded by existing shares

will be unduly burdensome and costly to the listed issuers yet the regulatory aims to enhance shareholders' protection cannot be achieved.

- 3.2. Based on the above, in response to Questions 26, 27 and 28 in the Consultation Paper, the Company disagrees with the proposed requirements for Share Schemes funded by existing shares, and would respectfully propose that all the proposed amendments in the Consultation Paper should only be limited to Share Schemes funded by new shares of listed issuers or their subsidiaries.
- 3.3. Should the Exchange wish to discuss any of our comments please do not hesitate to contact our [REDACTED] on [REDACTED] or [REDACTED] and [REDACTED] on [REDACTED] or [REDACTED].

Yours faithfully

[REDACTED]

Clifford Chance