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31 December 2021

Dear Sirs

Response to Consultation Paper on Proposed Amendments to the Listing Rules relating to Share Schemes of Listed Issuers

We welcome the opportunity to comment on the Consultation Paper on Proposed Amendments to the Listing Rules relating to Share Schemes of Listed Issuers (**Consultation Paper**). Unless otherwise defined, terms used in this letter shall have the meaning ascribed to them in the Consultation Paper.

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Our specific comments / observations

Q2. 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.

We agree with the proposal and suggest further clarifications be provided as to whether the scope of "eligible participants" also covers (i) part-time employees, and (ii) former employees who have historically made contributions to the success and development of listed issuer group.

Q9. Do you agree with the proposal to require a minimum of 12-month vesting period? Please provide reasons for your views.

We disagree with the proposal for the following reasons: (i) the Consultation Paper does not intend to impose any requirement on minimum duration of employment or service in order for any grantee to qualify as Employee Participant, Related Entity Participant or Service Provider; (ii) duration of employment/service may not be directly linked to the contribution or the significance of an employee/service provider to listed issuers. Flexibility should therefore be given to listed issuers to adopt other vesting criteria such as performance targets in lieu of time-based vesting criteria; (iii) there is currently no ground to justify the reasonableness of the minimum vesting period of 12 months. We note the Consultation Paper makes no reference to the circumstances in the U.S. (where listed issuers on the New York Stock Exchange and Nasdaq are allowed more flexibility on vesting).

Generally speaking, we suggest listed issuers be allowed sufficient discretion in formulating their own talent recruitment and retention strategies and the related safeguard mechanism to respond to changing market conditions and competition from industry rivals.

Q11. Do you agree with the proposed disclosure requirements relating to (a) performance targets; and (b) clawback mechanism? Please provide reasons for your views.

Performance targets and clawback mechanism are often tied to the financial and operational performance of the listed issuers, which are confidential and commercially sensitive. Therefore, we believe mandatory disclosure requirement is likely to discourage listed issuers from adopting numeric performance targets and lead them to opt for more general and qualitative ones in order to minimise disclosure. To consider and grant waiver case by case would lead to a flood of applications requesting such waivers and lacks certainty and transparency. For the reasons set out in the foregoing, we disagree with the proposed mandatory disclosure requirements.

Notably, clawback mechanism may not be practicable due to tax implications and foreign exchange control in different jurisdictions. As mentioned above, we suggest listed companies be allowed sufficient discretion and flexibility in formulating its own recruitment and retention strategies in response to changing market conditions and industry competition.

Q13. 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? Please provide reasons for your views.

Considering the different practice in relation to share awards and share options, in particular, the grantees of share options are required to pay exercise price while those of share awards are not, we suggest setting up separate limits for grants of share options and share awards, respectively, e.g. 1% limit for grants of share awards and 1% limit for grants of share options.

We also note that the Consultation Paper makes no specific reference to the limit of Share Grants applicable to directors, chief executives and connected persons at the subsidiary level of listed issuers, and we suggest clarifications be made on such limit (i.e. whether the 1% Individual Limit is applicable).

Q15. 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.

We agree with the proposal in principle to relax the current shareholders' approval requirement for grants of share awards to a director or a chief executive except that it is not clear from paragraph 65 whether the proposal will apply to share awards funded by new or existing shares.

- In the case of share awards schemes funded by *new* shares of listed issuers, no specific reason was provided for setting a substantially lower limit in respect of grants to directors or chief executive (i.e., 0.1% over any 12 months) than to other individual grantees (i.e., the 1% Individual Limit). Our observation is that directors and chief executive, given their roles in driving the strategy and operation of a listed issuer, are likely to receive higher compensation and incentive rewards than normal individual grantees. Accordingly, we suggest that the Exchange consider a higher threshold for grants to directors and chief executive, e.g., to apply the 1% threshold to all grantees including directors and chief executive.
- If the proposal is also intended to apply to share awards schemes funded by *existing* shares of listed issuers, we believe the threshold of 0.1% over any 12 months threshold is too restrictive. Notably, a grant of less than 0.1% existing issued shares to directors or chief executive is much likely to fall within the

scope of *de minimis* transactions under Rule 14A.76 and be fully exempted from the requirements applicable to connected transactions. Accordingly, in the case of a share award funded by *existing* shares, the 0.1% threshold would not represent a meaningful relaxation from the current Listing Rules requirements.

Q19. Do you agree with the proposal that eligible participants shall include Related Entity Participants, subject to additional disclosure and approval by the remuneration committee? Please provide reasons for your views.

Listed issuers may need to grant shares options to the directors and employees of affiliated companies to reward their contribution to and involvement in the listed issuer's business development. We agree with the Consultation Paper's proposal for the scope of eligible participants to cover "Related Entity Participants", provided that remuneration committee's approval is obtained, and justification is disclosed, for such grants to minimise confer of undue benefits on this category of grantees who are not employees of the listed issuer and its subsidiaries.

Furthermore, we suggest applying a more relaxed disclosure requirement threshold to "Related Entity Participants" than to Service Providers as (i) "Related Entity Participants" have a clearly defined scope, i.e., directors and employees of the holding companies, fellow subsidiaries, or associated companies of a listed issuer; and (ii) the contribution by "Related Entity Participants" tends to be more visible than Service Providers who should be paid by service fees for their services rendered. The Consultation Paper currently proposes to apply the same disclosure threshold to Related Entity Participants and Service Providers, i.e., 0.1% of the issuer's issued shares over any 12-month period. We suggest the Exchange considers applying a more relaxed disclosure threshold, such as 1% of the issuer's issued shares over any 12-month period, to grants to the Related Entity Participants. Subject to the foregoing, we agree with the proposal.

Q22. 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.

While we agree with the Exchange's regulatory principle to enhance transparency of the work performed by remuneration committee given its important role in overseeing the operation of the Share Schemes, we suggest written guidance be provided to clarify on the scope of the disclosure requirements under the proposed rule 17.07A. The current proposal for "a summary of *each matter* relating to share schemes that were reviewed and/or approved by remuneration committee during the financial year" is too broad in scope.

Q28. 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 Exchange's views as stated in paragraph 20 of the Consultation Paper that, "*share award schemes funded by existing shares of issuers do not require shareholders' approval as they do not involve issuance of new shares and therefore would not result in a dilution of shareholders' interests in the issuers.*" In line with the aforesaid regulatory rationale, we do not consider it necessary to subject share awards schemes of subsidiaries of a listed issuer, whether funded by new or existing shares of the subsidiary ("**Subsidiary-level Share Schemes**"), to the same requirements governing the Share Schemes funded by new shares of listed issuers" under Chapter 17 of the Listing Rules.

Chapter 17 is intended to protect shareholders' interests in the trading of shares of a listed issuer from dilution while grants of subsidiaries' shares pursuant to a Subsidiary-level Share Scheme would not have such dilutive effect. In addition, it is generally considered that the board and the management of a listed issuer (the "**Core Management**") are delegated powers to manage the business of the company and the acquisition/disposal of equity interests in subsidiaries fall within the discretion of the Core Management. The reduction in a listed issuer's equity interests in a subsidiary resulted from grants pursuant to a Subsidiary-level Share Scheme, whether funded by new or existing shares of the subsidiary, is akin to a disposal of subsidiary's equity interests by the listed issuer. We believe Subsidiary-level Share Schemes can be regulated by Chapter 14 of the Listing Rules which provides for the long-standing size tests and related shareholder protection mechanism for notifiable transactions based on materiality thresholds. While we note the Exchange proposed to introduce a materiality threshold to Chapter 17 leveraging the concept of Insignificant Subsidiaries in Chapter 14A, we believe Subsidiary-level Share Schemes differ from the share option schemes of the listed issuers in the sense that they would not dilute shareholders' interests in the shares of the listed issuer and can be regulated in the same way as a proposed disposal under Chapter 14.

Q30. 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 suggest clarifications be provided as to whether Chapter 17 shall also be applied to share award schemes in the form of limited partnership, which are more often adopted by listed issuers incorporated in the People's Republic of China.

Others. Transitional Arrangement under paragraph 103 of the Consultation Paper

The Consultation Paper provides that, "*for share award schemes involving grants of new shares under general mandate, the issuer may continue to grant share awards to eligible participants under the amended Chapter 17 up to the date of the first annual*

general meeting after the effective date. Thereafter, the issuer should amend the terms of the schemes to comply with the amended Chapter 17". We suggest the Exchange clarify whether shareholders' approval is needed for amending existing share award schemes involving the grant of new shares. We also suggest providing a longer grace period for listed issuers to amend their respective existing share incentive schemes towards full compliance with the amended Chapter 17.

Should the Exchange wish to discuss any of our comments please do not hesitate to contact our

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Yours faithfully

Clifford Chance