## OVERVIEW COMMENTS

We welcome the Exchange's proposals with regard to the regulation of share schemes. The proposals address the gap on the regulation of non-option share awards, and the lack of consistency with the regulation of share options.

In particular, we welcome proposal to regulate non-options share award schemes and allowing share awards to be granted at nil consideration. However, we note that the requirement that the exercise price for share options should be market price has not changed. This begs a clear distinction between share awards and share options. As underlying shares for share awards can be new shares issued under the general mandate, it is not clear how to the two should be distinguished. We encourage the Exchange to consider providing more guidance on this.

In terms of the transitional arrangements, we would like the Exchange to clarify whether existing share award schemes (i.e. those adopted prior to the change of the Listing Rules) can be considered compliant with Chapter 17 if their terms (i.e. terms of the scheme as set out in scheme rules) comply with new Chapter 17 although no shareholders' approval for adoption was obtained. This clarification is necessary; otherwise all existing share award schemes will need to be terminated and new share award schemes adopted instead of taking advantage of the transitional arrangement of only amending the terms of existing share award schemes to comply with new Chapter 17 requirements. The concept of "compliance with Chapter 17" is important as granting share awards to connected persons (within specified limits) is exempt from Chapter 14A.

### Drafting Comment

We have a specific drafting comment on the proposed Rule 17.03(14) – The last sentence in the note is confusing. It currently says "The cancelled options or shares cannot be added back to replenish the scheme mandate." However, the rule itself states that "a provision for the cancellation of options granted but not exercised or awards granted but shares in respect of which are not yet issued." Hence, the note should not refer to cancelled shares or share awards where underlying shares have been issued. These shares should be able to go back to the pool. Otherwise, the company will need to repurchase them and cancel them which will have implications on public float, capitalization etc.

## RESPONSES TO CONSULTATION QUESTIONS

### 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?

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| √ | Yes |
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Please give reasons for your views.

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| Yes, we agree that Chapter 17 should also govern share award schemes involving the grant of new shares of listed issuers. Share awards other than share options have been increasingly used as a tool to incentive employees, but there has not been a specific set of rules to regulate them. The market has relied on the application of general listing rules such as those relating to the issuance of shares and connected transactions. The application of these rules has been inconsistent and a revised Chapter 17 to cover share award schemes involving the grant of new shares of listed issuers would benefit from clarity of regulation. |

**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)?

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| √ | Yes |
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Please give reasons for your views.

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**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?

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| | Yes |
| √ | No |

Please give reasons for your views.

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| While we agree that eligible participants should include Service Providers, we do not agree with the definition set out in Rule 17.03A(1)(c) which is too narrow to limit to those service providers whose services are "material to the long term growth of the issuer group."<br><br>There are justifiable reasons (e.g., the developmental stage of a company which may limit its ability to pay cash for services, or the type of services provided typically involves upside sharing) why a service provider should be awarded shares rather than paid cash, even though the services in question provided at a subsidiary or a new or developmental business may not meet the materiality standard in terms of "the long term growth of the issuer group," especially in the context of sizeable companies. The more appropriate test would be whether the grants to service providers are "in the interests of the long term growth of the issuer group", with a meaningful explanation at the time of the grant. The danger of a rigid test is that issuers will become used to providing standardized justifications for the grants. |

**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?

- [x] Yes
- [ ] No

Please give reasons for your views.

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| The extension of eligible participants to Related Entity Participants is important for ecosystem businesses. We suggest the rules clarify the definition of "associated companies" to include any company in which the listed issuer has an equity interest of 5% or more, as this reflects the type of investments (which may start with a smaller shareholding) made by technology companies. |

**Question 5**

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

- [x] Yes
- [ ] No

Please give reasons for your views.

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| We would like to make an important point on the scheme mandate limit for subsidiary schemes, which is also relevant to the several references in the proposed Chapter 17 to the "relevant class of shares" - see the proposed Rules 17.03B(1), 17.03C(2), 17.03D(1), 17.04(2) and 17.07 (the "Relevant Provisions"). The scheme mandate limit as well as the individual limit, and grants to directors, related party participants and service providers apply to "the relevant class of shares of the listed issuer (or the subsidiary)." In the context of subsidiaries, it is common for subsidiary-level schemes to grant non-voting or non-participating shares to scheme participants, such that participants of a particular subsidiary-level scheme may well account for ALL of the shares of that class. This arrangement is beneficial to listed issuers as it allows them to maintain absolute control over their subsidiaries. We urge the Exchange to consider amending the references to the "relevant class of shares" in the Relevant Provisions to be determined based on the total economic interests for subsidiary-level schemes to reflect these circumstances. |

**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?

- [ ] Yes
- [x] No

Please give reasons for your views.

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| We do not agree that refreshing scheme mandate limit needs "independent shareholders'" approval. The interests of controlling shareholders and other shareholders are the same in this regard and granting share awards to directors and substantial shareholders are already subject to other safeguards. |

**Question 7**

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

- [x] Yes
- [ ] No

Please give reasons for your views.

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**Question 8**

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

- [x] Yes
- [ ] No

Please give reasons for your views.

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**Question 9**

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

- [ ] Yes
- [x] No

Please give reasons for your views.

We strongly disagree with this proposed requirement. For administrative and compliance reasons, issuers may grant awards in batches during a year, which includes awards that should have been granted earlier but had to wait for a subsequent batch. This means that vesting periods may be shorter to reflect the time from which an award would have been granted but for the administrative arrangements of particular issuers.

Rather than mandating that the remuneration committee only be allowed to make grants with a shorter vesting period to participants specifically identified by the issuer, we suggest that:

a. the remuneration committee may make a general disclosure of the shorter vesting period without specifically identifying a participant, in such circumstances where the period beginning from the time from which the award should have been granted

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| until the vesting date (the "Effective Vesting Period") would have been 12 months or more; or<br>b. the remuneration committee be given the power to determine shorter vesting periods where appropriate, with an explanation that may be given in respect of a category of participants or a grant event. |

**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?

- [ ] Yes
- [x] No

Please give reasons for your views.

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| Please see our response to Question 9. |

**Question 11a**

Do you agree with the proposed disclosure requirements relating to performance targets?

- [x] Yes
- [ ] No

Please give reasons for your views.

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**Question 11b**

Do you agree with the proposed disclosure requirements relating to clawback mechanism?

- [x] Yes
- [ ] No

Please give reasons for your views.

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**Question 12**

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

- [x] Yes
- [ ] No

Please give reasons for your views.

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| If there is no restriction on the grant price of shares under share award schemes, we do not see why a restriction should be imposed on the exercise price of share options given that both share awards and share options involve dilution through the issuance of new shares. This is likely to result in issuers gravitating away from share options, similar to the current situation where share options have become less common compared to share awards because share awards are not governed by the current Chapter 17 of the Listing Rules. |

**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?

☐ Yes
√ No

Please give reasons for your views.

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| We believe that the 1% individual limit should not be applied to subsidiary schemes, or a higher limit be imposed (e.g., 5%) to reflect the need to incentivize employees at certain types of businesses or business units, especially those at an incubation or developmental stage. The 1% limit for subsidiaries at an incubation or developmental stage would typically not be a sufficiently meaningful incentive.<br><br>Please also refer to our response to Question 5 on the amendment of the references to the “relevant class of shares” in the Relevant Provisions to be determined based on the total economic interests for subsidiary-level schemes. |

**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?

√ Yes
☐ No

Please give reasons for your views.

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**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 of the Consultation Paper?

- [x] Yes
- [ ] No

Please give reasons for your views.

### 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 of the Consultation Paper?

- [x] Yes
- [ ] No

Please give reasons for your views.

### 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 of the Consultation Paper?

- [x] Yes
- [ ] No

Please give reasons for your views.

### 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?

- [x] Yes
- [ ] No

Please give reasons for your views.

### 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?

- [x] Yes
- [ ] No

Please give reasons for your views.

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| Please also refer to our response to Question 5 on the amendment of the references to the "relevant class of shares" in the Relevant Provisions to be determined based on the total economic interests for subsidiary-level schemes. |

**Question 20**

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

- [x] Yes
- [ ] No

Please give reasons for your views.

**Question 21**

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

- [x] Yes
- [ ] No

Please give reasons for your views.

**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?

- [x] Yes
- [ ] No

Please give reasons for your views.

**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?

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| | Yes |
| √ | No |

Please give reasons for your views.

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| We do not think the proposal of allowing transfer of share awards and options work if there are performance targets requirement and on what basis can the Exchange grant or not grant a waiver. We believe the Exchange should just set out in the rule the types or circumstances of transfers will be allowed (e.g. transfer to a trust where beneficiaries are and remain to be family members) instead of a waiver on a case by case basis. |

**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 of the Consultation Paper?

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| | Yes |
| √ | No |

Please give reasons for your views.

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| We believe that share awards should be permitted to be transferred in the circumstances described in the Note to Rule 17.03(17) without the need for a waiver. Estate and tax planning are very common and it would be unduly burdensome to have to seek a waiver each time a participant proposes to transfer the share awards as described. |

**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?

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| √ | Yes |
| | No |

Please give reasons for your views.

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| We agree that in relation to unvested shares albeit issued to trustee, the trustee cannot exercise voting rights over such shares. However, in the situation where the trustee still holds onto underlying shares for vested share awards (e.g. pending payment of withholding |

tax etc.), we believe the rules should allow trustee to vote in accordance with relevant employee's instruction.

**Question 26**

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

- [x] Yes
- [ ] No

Please give reasons for your views.

**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?

- [x] Yes
- [ ] No

Please give reasons for your views.

We agree that in relation to unvested shares albeit issued to trustee, the trustee cannot exercise voting rights over such shares. However, in the situation where the trustee still holds onto underlying shares for vested share awards (e.g. pending payment of withholding tax etc.), we believe the rules should allow trustee to vote in accordance with relevant employee's instruction.

**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?

- [x] Yes
- [ ] No

Please give reasons for your views.

Share award schemes of subsidiaries, whether in respect of new shares or existing shares, are effectively a disposal of interests or deemed disposal of interests in those subsidiaries. Even if the award constitutes a connected transaction, the *de minimus* exemption is available. The concept of insignificant subsidiary is used for the purpose of Chapter 14A only, i.e. where there is a conflict of interests situation because of a connected person. The adoption of a share award scheme with a 10% limit may not pose any conflicts of interests

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| and we believe that the normal size tests checklists should be used to determine if the 10% limit results in a major transaction requiring shareholders' approval. As for the remaining provisions about 1% and 0.1% individual limits, that are too restrictive for a company not yet listed. |

**Question 29**

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

√ Yes
No

Please give reasons for your views.

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| However, we believe that the proposed exemption should be extended to the disclosure requirements under Chapter 17. Share awards of insignificant subsidiaries have little dilutive impact on the listed issuer's interest in these subsidiaries and the requirement to make extensive disclosures does not add any meaningful disclosure for investors, and will unnecessarily clutter the financial reports of the listed issuer (especially for sizeable companies with a great number of subsidiary Share Schemes). We believe that generic disclosure regarding the existence of share award schemes over insignificant subsidiaries and their aggregate dilutive impact would suffice. |

**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?

√ Yes
No

Please give reasons for your views.

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**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?

√ Yes
No

Please give reasons for your views.

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**Question 32**

Do you agree with our proposals to amend the Rules described in paragraph 100 of the Consultation Paper?

- [x] Yes
- [ ] No

Please give reasons for your views.

Response from Simpson Thacher & Bartlett.
December 31, 2021