July 2022 Legal and Regulatory Update

Top stories

HKEX consultation conclusions on revision of share schemes rules

(i) HKEX published consultation conclusions on proposed amendments to Listing Rules relating to share schemes. The proposals are largely adopted, effective from 1 January 2023 ("effective date"). (**Press release**, **full report**, **FAQ**)

Firstly, **Chapter 17** of the rules will be extended to **share award schemes involving issuance of new shares.** They are also extended to share schemes *(i.e. share option schemes and share award schemes)* of **"Principal Subsidiaries"** *(more details below)*.

(Background: currently, *Chapter 17 governs* ***share option schemes only****. For* ***share award schemes****, issuers currently need to seek shareholders' approval for each grant of new shares at a general meeting, or issue new shares under a general mandate).*

Secondly, there are **changes to specific Chapter 17 requirements**. E.g. define "**eligible participants**" *(currently no restrictions)*, revise scheme mandate **refreshments**, and improve **disclosure**.

The revisions aim to (i) provide issuers the **flexibility** to grant share awards and options, (ii) protect shareholders from **excessive dilution**.

There are some modifications to the original proposals, principally (i) not expanding the **roles of remuneration committee** (*restricted to senior management and directors only)* (ii) allows some flexibility in **shorter vesting period** (iii) covers share schemes of "**Principal Subsidiaries"** only.

Broad transitional arrangements: (i) new **disclosure** requirement from the **effective date** for all existing share schemes, (ii) issuers may make **share grants only to eligible participants** *(under the amended rules)* for **financial years commencing on or after** the effective date. They can continue to make such grants under **existing share option schemes** *(or share award schemes with a specific mandate approved by shareholders)* until refreshment or expiry of scheme mandate. *(For details particularly re: share awards scheme, refer to Attachment to FAQ, P.13)*

Key revisions are summarised below. Some aspects of the rules are technical *(e.g. details on transitional arrangements; disclosure).* Please refer to the FAQs and detailed Listing Rule changes (Appendix III to full report).

What you should know:

Summary of key changes

- **Extend** Chapter 17 to cover **ALL share award schemes funded by issuance of <u>new</u> shares**
- **Define "eligible participants"**
  - Include **directors and employees** of the **issuer** or any **subsidiary**

    (i) **"employee participants"**; (ii) "**related entity participants"** *(directors and employees of holding companies, fellow subsidiaries or associated companies)*; (iii) *(modified)* **"service providers"**
- **Scheme mandate limit**
  - **Limit for all share schemes** with issuance of **new shares:** not exceeding **10%** of issued shares
  - **Refreshment**: may be refreshed by **shareholders once every 3 years**; **additional** refreshments must be approved by **independent shareholders**
  - Set *(and disclose)* a "**service provider" sublimit**
  - **Remove** limit re: **outstanding options** *(up to 30% issued shares)*
- *(Modified)* **Terms of grant**
  - **Minimum vesting period**: **12 months**, **unless** disclosed in scheme document with explanation by the board and *(where involving director/senior executives)* remuneration committee
  - **Performance targets + clawback mechanism:** *(modified)* **disclosure** in scheme document and grant announcements
- **Limits on grant size: individuals or "connected persons"**
  - **Individual participants: shareholder approval** if shares issued/issuable per **relevant share schemes** granted in any 12-month period is **above 1%** of issued shares
  - **"Connected persons"** *(director, chief executive or substantial shareholder of the issuer or an associate of any of them)*

    (i) **general**: approval by **independent directors**

    (ii) grant of share awards to **director** *(not independent director)* or **chief executive**: **independent shareholder approval** if above **0.1%** over any **12-month period**

    (iii) grant of share options/share awards to **independent director** or **substantial shareholder**: **independent shareholder approval** if above **0.1%** over any **12-month period**

- *(Modified)* **Disclosure: grant announcements, interim/annual reports, work done by remuneration committee**
- *(Modified)* **Extended to subsidiaries**
  - Covers **share options, share award schemes funded by <u>new shares or existing shares</u>** held by or for the issuer
  - **Scope: "Principal Subsidiaries"**: 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 3 financial years**
  - **Other** subsidiaries: **Chapter 14 modified** to address **dilution** of subsidiary interest resulting from share grants under subsidiary share schemes *(and **Chapter 14A** re: **connected persons**)*
- Share Schemes funded by **<u>existing</u> shares** *(i.e. no issuance of new shares)*
  - *(Modified)* **disclosure** rules

What you should do:

- Note the **transitional arrangements**
- **Update your board** and relevant **teams** on the broad proposals − after **management's assessment** of the impact and proposed actions, including in light of the significance of share schemes on your group's **remuneration strategy**
- **Factors** to be considered *(e.g. whether your group has share options and/or share award schemes; impact of proposed overall limit; impact of proposed individual limits (particularly if independent shareholder approval needed); check if any subsidiary has share options and/or share award schemes and assess impact of the changes)*

Also in this issue

Regulators

(ii) HKEX imposes a Director Unsuitability Statement against 6 former executive directors *(including former chairman)* and independent non-executive directors of China Creative Global Holdings Limited. (**Announcement**, **Statement of Disciplinary Action**)

The **"Director Unsuitability Statement"** is a public statement that, in HKEX's opinion, each of the directors is **unsuitable** to **occupy a position as director** or within **senior management** of the **company or any of its subsidiaries**. It was introduced under the revised HKEX disciplinary regime *(effective Jul 2021).*

In this case, HKEX made enquiries with the directors in relation to the circumstances surrounding the company's delay in the publication of its financial statements, the winding up of its major subsidiary and the disposal of its PRC subsidiaries.

One of the directors acknowledged receipt of HKEX's reminder letter but still failed to respond to the enquiries. The other directors did not respond to the enquiries at all.

This case reflects **HKEX's view** that directors who **fail to comply with their obligation to cooperate with its enquiries and investigations** are **not suitable to be directors or members of senior management** of an issuer.

(iii) HKEX censures Enterprise Development Holdings Limited, and imposed a Prejudice to Investors' Interests Statement against a former executive director ("ED") of the company. (**Announcement, Statement of Disciplinary Action**)

The "**Prejudice to Investors' Interests Statement**" is a public statement that, in HKEX's opinion, had ED remained on the board of the company, the **retention of office by her** would have been **prejudicial to the interests of investors**.

In Jan 2021, the company made an **announcement on the appointment of ED** *(monthly remuneration: $300,000)*. Significant parts of ED's **biographical details were unsubstantiated and misleading**.

It was found that **ED had provided** the company with **inaccurate, incorrect and/or misleading information** about her working experience. The **company** failed to conduct **due diligence** on it. Neither her **appointment** nor **remuneration** had been considered by the company's **nomination committee and remuneration committee** respectively.

HKEX's announcement states useful lessons learnt *(summarised below)*.

What you should know/do:

Appointment of a director

- Listed issuers must properly consider an appointment in accordance with both the **Corporate Governance Code** and the **terms of reference** of its nomination and remuneration committee
- **Due diligence** required to confirm that a **proposed director** possesses the requisite **character, experience, integrity and competence**
- **Remuneration committee**: in determining **remuneration**, should consider what is **fair and reasonable**
- **Nomination** and **remuneration committees: pivotal roles** in the **appointment of new directors**

ESG resources

(iv) Hong Kong Chartered Governance Institute published a joint report with KPMG China and CLP Holdings "Climate Change Reporting: Imminent, Challenging & Mandatory – The Opening Moves" to help companies anticipate issues in adopting the **forthcoming ISSB Board's standards** as regards **sustainability/climate disclosure**.

What you should know/do:

It highlights 5 focus areas under the forthcoming ISSB standards:

- Adopting the '**Enterprise Value' approach** to **materiality**
- **Quantifying** the current and anticipated **financial effects** of climate issues
- Conducting **climate-related scenario analysis**
- Formulating the **climate transition plan** and setting the **targets**
- Determining and reporting on the **metrics**

Published by Practising Governance Limited

August 2022