



# Listed Issuer Regulation Newsletter

## Highlights

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- What are the amended Rules on share schemes and how will they impact you?
- Preparing for your upcoming financial year-end reporting and annual general meetings:
  1. Change of auditors
  2. Compliance with Core Standards for issuers incorporated in Bermuda and Cayman Islands
  3. New corporate governance and ESG requirements
- Secondary-listed issuers getting ready for “homecoming”

Welcome to the December 2022 edition of HKEX's Listed Issuer Regulation Newsletter. Published on a semi-annual basis, this newsletter aims to keep you informed on our latest issuer regulatory updates and support you on your compliance journey.

## What are the amended Rules on share schemes and how will they impact you?

On 29 July 2022, we published the consultation conclusions on the [Proposed Amendments to Listing Rules relating to Share Schemes of Listed Issuers](#). Effective 1 January 2023, Chapter 17<sup>1</sup> will be amended to govern share option schemes and share award schemes of listed issuers and their principal subsidiaries. In this newsletter, we cover what the key amendments are and how issuers can prepare themselves.

These amendments set out: i) minimum requirements on the eligible scheme participants and the terms of the grants<sup>2</sup>; ii) requirements for approvals by shareholders, the independent directors (**INEDs**) (for grants to connected persons) and/or the remuneration committee (**REMCO**); and iii) required disclosures in announcements and financial reports.

After the effective date, **listed issuers with existing share schemes may continue to make grants** subject to the transitional arrangements summarised below. They should make a disclosure in grant announcements and financial reports following the amended Chapter 17 requirements.

Issuers may also refer to our [FAQs No. 083-2022 to 101-2022](#) for further guidance.

### What are the key changes to Chapter 17?

#### Eligible participants

- Eligible participants may only include directors and employees of the issuer group (**Employee Participants**), directors and employees of its holding companies or associated companies and service providers.
- Service providers are persons who provide services to the issuer group on a continuing and recurring basis in its ordinary and usual course of business which are in the interest of the long-term growth of the issuer group. Issuers must set out the criteria for this category of persons in the scheme document.

#### Terms of grants

- A minimum vesting period of 12 months. Grants to Employee Participants may have a shorter vesting period if such circumstances are clearly set out in the scheme document.
- The scheme document should disclose i) the performance targets attached to the grants and ii) the clawback mechanism, or a negative statement.
- For share awards, there is no restriction on the share grant price.

<sup>1</sup> GEM Rules Chapter 23

<sup>2</sup> Grants refer to both grants of shares and share options.



### Approval requirements

- Shareholders must approve the scheme mandate limit (of not exceeding 10% of the issuer's issued shares for all of its share schemes) and a service provider sublimit. Under the amended Rules, this mandate limit may be refreshed by shareholders once every three years or by independent shareholders within the three-year period.
- Shareholders must also approve grants to (i) a participant exceeding the 1% individual limit; or (ii) a connected person exceeding the de minimis threshold as follows:
  - Directors – grants of share awards exceeding 0.1% of issued shares over a 12 month period (0.1% limit).
  - INEDs and substantial shareholders – grants of share awards and share options exceeding the 0.1% limit.

Grants below the 0.1% limit, and grants of share options to directors may be approved by INEDs.

- REMCO must provide its view on grants to directors or senior managers if they are made without a performance target and/or clawback mechanism, or if the vesting period is less than 12 months.

### Requirements for other share schemes

- For **share schemes funded by existing shares**, certain disclosures are required in issuers' annual reports. Additionally, the trustee should abstain from voting on matters that require shareholders' approval under the Listing Rules<sup>3</sup>.
- Only share schemes of principal subsidiaries<sup>4</sup> are subject to the amended Chapter 17. Shares or options grants in other subsidiaries' share schemes may be a notifiable transaction under Chapter 14.

### Can an issuer continue to grant shares or options under its existing scheme?

An issuer may grant options or shares under an existing **share option scheme** if there is an unused scheme mandate limit, **or share award scheme** where an advance mandate had been sought from shareholders and is unutilised. For an existing **share award scheme** involving grants of new shares using a general mandate, an issuer may continue to grant new shares up to its second annual general meeting after 1 January 2023. In all cases, an

issuer must seek a new scheme mandate limit from shareholders when it amends the terms of its existing share schemes to comply with the amended Chapter 17.

In all cases, grants may only be made to eligible participants starting from the financial year commencing on or after 1 January 2023.



<sup>3</sup> Unless otherwise required by law to vote in accordance with the beneficial owner's direction.

<sup>4</sup> Principal subsidiaries refer to those whose revenue, profit or total assets accounted for 75% (or more) of that of the issuer under the percentage ratios in any of the latest three financial years.

## Preparing for your upcoming financial year-end reporting and annual general meetings

### Change of auditors

This year, we have noted an increase in the number of issuers announcing a change of auditors. Some issuers announced resignation of auditors close to or after their financial year ends, causing delays in audits and in some cases, trading suspensions.

We note that issuers often announced that the reasons for the auditors' resignations were an inability to agree on the audit fee and/or timetable with the issuers which, in some cases, arose as the pandemic prolonged the audit process and increased costs. In some cases, incoming auditors completed their audits within a very aggressive timetable.

Under the Corporate Governance Code, the audit committee is primarily responsible for making recommendations to the board on the appointment, reappointment and removal of auditors, and to approve the remuneration and terms of engagement of the external auditors and any questions of their resignation. The audit committee is also responsible for monitoring the effectiveness of the audit process, and should also discuss with the auditors the nature and scope of the audit and reporting obligations before the audit commences.

Accordingly, we expect the audit committee to:

- Maintain a dialogue with the auditors throughout the audit process and keep apprised of any contentious audit issues;
- Understand clearly the underlying reasons for the auditors' resignation. The audit committee should hold a private meeting with the outgoing auditors and discuss, among others, any contentious audit issues raised during the course of the audit. It should also ensure that the auditors' resignation letter clearly reflects the reasons for their resignation, and procure the issuer to announce anything that needs to be brought to shareholders' attention regarding any issues or matters affecting the audit process or fee, or the issuer's relationship with the auditors, in the auditors' resignation announcement;
- Critically review the capabilities and resources of the incoming auditors. The incoming auditors should possess appropriate industry knowledge and technical competence, and have adequate resources to perform a quality audit within the agreed time frame. The audit committee should also ensure that audit fees are commensurate with the extent of audit work required; and
- Discuss with the incoming auditors to assess whether they clearly understand the reasons leading to the outgoing auditors' resignation and how their proposed audit procedures can address those issues such that they can obtain sufficient appropriate audit evidence to draw a reasonable conclusion on which the audit opinion is based.

Audit committees may refer to the Guidelines for [Effective Audit Committees – Selection, Appointment and Re-appointment of Auditors](#) (the **Guidelines**) issued by the Accounting and Financial Reporting Council (the **AFRC**) in December 2021, and also their [open letter](#) to PIE auditors on late change in auditors appointment.

### Survey

**The AFRC launched an online survey to all PIE auditors and issuers' audit committees on 17 November 2022. The survey seeks to understand how the Guidelines have been implemented by listed issuers in Hong Kong. Issuers' audit committees are encouraged to complete this survey by 16 December 2022.**

### Compliance with Core Standards for issuers incorporated in Bermuda and Cayman Islands

In January 2022, we amended our Rules to adopt a uniform set of shareholder protection standards (the **Core Standards**)<sup>5</sup> for all issuers regardless of their place of incorporation. Issuers are required to demonstrate that their constitutional documents, in combination with the applicable domestic laws, rules and regulations, conform to these Core Standards.

Listed issuers are required to conform to the Core Standards **by the second annual general meeting following 1 January 2022**. For issuers with a December financial year end, the deadline will fall in or around June 2023.

There are over 2,000 issuers incorporated outside Hong Kong and the PRC, the vast majority of which are incorporated in Cayman Islands or Bermuda. So far, approximately 40% of these overseas issuers have amended their constitutional documents.

In our [December 2021 newsletter](#), we highlighted gaps (see below) between the Core Standards and the legal frameworks for issuers incorporated in Bermuda and Cayman Islands. Issuers should review their constitutional documents to consider whether amendments need to be made to meet the Core Standards.

Core Standards not specifically set out in the company laws	Bermuda	Cayman Islands
<b>Core Standard 5:</b> an issuer is required to provide its members with the right to speak at a general meeting.	✓	✓
<b>Core Standard 7:</b> minority shareholder of an issuer should be entitled to convene an extraordinary general meeting and propose resolution. The threshold for the minority stake should not be higher than 10% of the voting rights in the share capital of the issuer.		✓
<b>Core Standard 10:</b> an issuer is required to approve the appointment, removal and remuneration of auditors by a majority of its members, or other body that is independent of the board of directors.		✓
<b>Core Standard 14:</b> an issuer is required to approve its voluntary winding up by a super-majority vote of the issuer's members in a general meeting.	✓	✓

Based on issuers' enquiries and our review of their shareholders' circulars, we recommend the below areas for issuers to take note of when considering their compliance with the Core Standards:

**Right to speak** – Some issuers incorporated in Cayman Islands and Bermuda considered it unnecessary to expressly provide for such rights in their constitutional documents, given that the companies' laws do not impose any restriction on shareholders' right to speak and they consider it logical to infer that members are permitted to speak before exercising their voting rights. We consider that, in the absence of an express provision by law, issuers should incorporate the right to speak in their constitutional documents.

**Removal of auditors** – The laws of Cayman Islands do not stipulate the voting threshold for removing auditors, and some issuers suggested maintaining a higher threshold (i.e. by a special resolution) in their articles. This view does not comply with the Core Standards, which require the removal of auditors by an ordinary resolution.

<sup>5</sup> See Appendix 3 to the Main Board Rules / GEM Rules.



In a few isolated cases, shareholders voted down the proposed amendments to the constitutional documents. In some cases, the voting results were attributed to the shareholders' lack of understanding of the rationale and effects of the amendments, or the issuers bundling resolutions with other amendments unrelated to Core Standards conformation.

We recommend issuers make a clear disclosure in the shareholders' circular on the reasons for, and the effects of the proposed amendments, and where appropriate, engage shareholders prior to the general meeting to explain the proposed amendments and address any concerns and queries they may have. To comply with the Listing Rules, issuers should avoid bundling resolutions and present each proposed amendment separately<sup>6</sup>.

Issuers can also refer to our frequently asked questions ([FAQs No. 078-2022 to 082-2022](#)) for further guidance.



### New corporate governance and ESG requirements

The Corporate Governance Code and its related Listing Rules were last revised in December 2021 to enhance issuers' corporate governance standards and diversity practices. Among those revisions, the following requirements for the **appointment of directors** and **publication of reports** will soon become effective. We would like to remind issuers to take the following steps as soon as possible (if they have not already done so) to bring themselves into compliance with the new requirements:

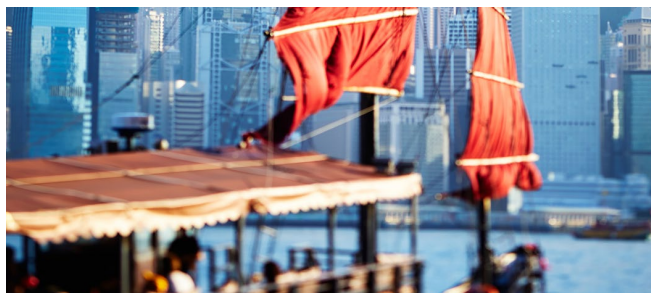
- Issuers with all INEDs having served for more than nine years should appoint a new INED no later than their AGM to be held in 2023;
- The new mandatory disclosure on diversity (including targets and timelines for board gender diversity and gender ratio for workforce) and shareholder communication policy (including two-way communication channels and review of their effectiveness) will apply to CG reports for the financial years commencing on or after 1 January 2022;
- Single-gender board issuers must appoint a director of a different gender by 31 December 2024. Single-gender boards are strongly encouraged to commence their recruitment process as soon as possible to identify their suitable candidate(s), and this can be part of their succession planning (e.g. when an existing director is due for retirement under a rotation requirement); and
- Issuers must publish their ESG reports for the financial years commencing on or after 1 January 2022 at the same time as their annual reports.

<sup>6</sup> See also [Code Provision F.2.1 of Appendix 14 to the Main Board Rules](#) and [Code Provision E.2.1 of Appendix 15 to the GEM Rules](#) requiring proposal of separate resolutions for substantially separate issues at general meeting.

## Secondary-listed issuers getting ready for “homecoming”

This year, four secondary-listed issuers have successfully converted to a primary-listing on the Exchange, and a number of secondary-listed issuers have expressed their intention to convert to a primary listing. To facilitate planning by these prospective homecoming issuers, we recommend the following areas for them to pay attention to and make arrangements for.

Issuers can plan their primary conversion along the following areas: i) identify Rules that will become applicable after conversion and establish proper internal controls to ensure Rule compliance; ii) identify areas where dispensation of Rules requirements are warranted; and iii) seek shareholders’ mandate for certain corporate actions, where appropriate. Issuers can refer to our Guidance Letter ([HKEX-GL112-22](#)) setting out the conversion procedures and Rule compliance arrangements.



### Dispensation of Rule requirements

Secondary-listed issuers may have adopted arrangements common in their primary-listed jurisdictions in accordance with the regulations of those jurisdictions. Where removal of these arrangements may be unduly burdensome to the issuers and they do not pose undue risks to shareholders, we may consider dispensation from our Rules, subject to relevant shareholder protection provided under the rules of the dual primary listing venue<sup>7</sup>. For example:

- A dually listed issuer in the U.S. continued to prepare its financial statements under the U.S. GAAP and included a description of the relevant key differences between U.S. GAAP and IFRS and a reconciliation statement in its interim and annual reports.
- A dually listed issuer adopted non-discretionary share repurchase plans and directors’ trading plans in the U.S. for securities dealings during the black-out periods. These plans are common to issuers listed in the U.S. and were allowed to continue after the primary conversion, in light of overseas regulations (i.e. Rule 10b5-1 of the U.S. Exchange Act) which provided equivalent safeguards to prevent the use of inside information when dealing in the issuer’s securities.
- Some PRC-based technology issuers adopted variable interest entity structures. These structures continued and certain connected transaction requirements were waived in light of their low risks of abuse.

### Identifying applicable Rules and establishing controls

The Rules adopt a light-touch approach to regulating secondary-listed issuers and provide extensive Rule exemptions and waivers. After conversion to a primary listing, these exemptions and waivers will no longer apply.

Issuers should note that corporate actions commonly undertaken in the capital market may be subject to a variety of disclosure and other requirements under the Listing Rules. For example, compared to the U.S., the Exchange adopts different requirements in areas such as mergers and acquisitions, related party transactions, equity fundraisings and employee incentive programs. Among others, shareholders’ approvals may be required for material corporate actions.

Issuers should establish internal control systems to ensure the identification of such actions and their timely compliance with the Listing Rules. They should put in place the necessary governance structure (such as establishing board committees with appropriate composition and terms of reference) as well as procedures to enable proper discharge of their reporting obligations.

<sup>7</sup> See the [Guide on Waiver Applications](#) for our approach in handling waiver application.



## Seeking shareholders' advance mandate on corporate actions

Given the differences in the regulatory frameworks between the primary-listed jurisdictions and Hong Kong, issuers should plan for their future corporate actions and where necessary, seek an advance shareholders' mandate in a general meeting. For example, the Rules require all issuance of securities to be made on a pre-emptive basis, or alternately, shareholders must approve the share issuance. To maintain flexibility, issuers may consider seeking a general mandate for share issuance in the upcoming year.

Other common areas requiring shareholders' advance mandate include share repurchase, granting of shares or options under share schemes, and continuing transactions with connected persons.

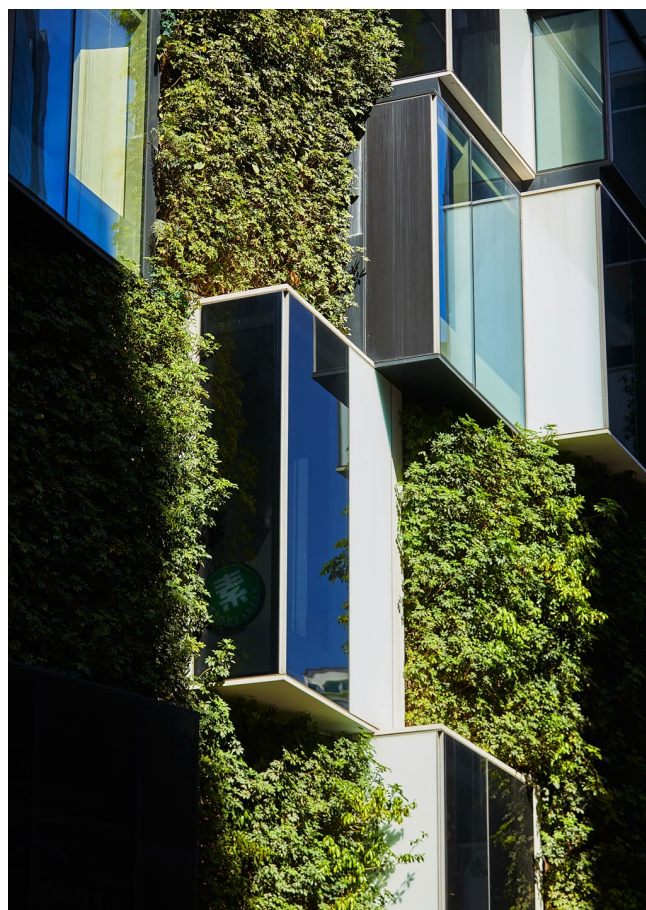
## Publications

### Release of new e-Forms

New version of e-Forms will be released and available for download on the E-submission System and the HKEX website from 10 December 2022. We will accept both the existing and new versions of the e-Forms until 7 January 2023, after which the existing e-Forms may no longer be submitted. **Issuers should take note and download the latest e-Forms for submission in future.**

### Other recent publications

- Revised guidance letter [GL95-18](#) (24 June 2022) to reflect our established polices on (i) granting time extension for a suspended issuer whose failure to remedy all issues within the remedial period was directly due to Covid-19 disruptions; (ii) granting listing approval for equity fundraisings by a suspended issuer if the issuer can demonstrate fulfilment of all resumption guidance and eligibility for trading resumption after the fundraisings; and (iii) the administrative approach of the Listing Committee in deciding on a delisting.
- Listing decision [LD136-2022](#) (24 June 2022) – whether the issuer's proposed acquisition which constituted a disclosable transaction was a reverse takeover.
- Listing Decision [LD137-2022](#) (24 June 2022) – whether the issuer could proceed with its proposed issuance of shares that was highly dilutive.
- [FAQ No. 102-2022 to 117-2022](#) (16 September 2022) to address certain questions relating to Special Purpose Acquisition Companies (SPAC) including matters regarding SPAC Promoters, independence of INEDs, and obligations of a trust/custodian.
- We have published consultation paper on [Specialist Technology Companies](#) (19 October 2022) on our proposal to create a listing regime for Specialist Technology Companies in Hong Kong. The consultation period will close on 18 December 2022.



We welcome your feedback.

Please send your thoughts and comments to [listingnewsletter@hkex.com.hk](mailto:listingnewsletter@hkex.com.hk)