

## EMPLOYEES' SHARE OPTION SCHEMES

The rules issued by the Stock Exchange on share option schemes ("SOS") are set in Clause 947 and Practice Note No. 9h of the Listing Manual. Clause 947 states that all schemes implemented by listed issuers or their subsidiaries that involve the issue of shares or other securities (including options) to employees must comply with the guidelines set out in Practice Note No. 9h.

On 6 April 1999, the Stock Exchange made several substantial amendments to the rules contained therein which took immediate effect. For the present purposes, only the rules which have been amended will be considered. The amendments to the rules are set out by the Stock Exchange as follows:-

(i) **Size Limit**

The limit on the size of SOS has been raised from 5% to 15% for Main Board listed issuers and removed for SESDAQ listed issuers.

(ii) **Participation By Controlling Shareholders And Non-Executive Directors**

Current rules provide that only employees and executive directors of the listed group, excluding those who are substantial shareholders of the listed issuer, may participate in an SOS. The rules have been amended to allow (1) non-executive directors of the listed group; and (2) employees and directors of the listed group who are controlling shareholders and their associates, to participate in the listed issuer's SOS.

Participation by such persons is, however, subject to certain conditions:-

- (1) Shareholders' approval for the participation by each such person and for each grant of options to them; and
- (2) For Main Board listed issuers, the aggregate number of shares available to controlling shareholders and their associates should not exceed 25% of the shares available under the SOS, and the number of shares available to each controlling shareholder or his associate should not exceed 10% of the shares available under the SOS.

"Controlling shareholder" has been redefined using a substance test as "a shareholder exercising control over a company", where "control" means "the capacity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of a company". Unless rebutted, a person who controls directly or indirectly a shareholding of 15% or more of a company's issued share capital shall be presumed to be a controlling shareholder of that company.

Pursuant to the above amendment, consequential changes have also been made to Clause 101 on the definition of "controlling interest", and paragraphs 1(2), 1(8) and 1(9) of Appendix 5 on Articles of Association.

Listed issuers proposing to allow controlling shareholders and their associates to participate in their share option schemes would be expected to provide clear justifications for allowing such participation and for the specific grants to be made to such persons.

(iii) **Participation By Parent Group Employees**

Current rules do not allow directors and employees of a listed issuer's parent group who do not hold positions in the listed group ("parent group employees") to participate in the listed issuer's SOS. The amended rules allow parent group employees who have contributed to the success and development of the listed

group to participate in the listed issuer's SOS. Participation by such persons is, however, subject to the following conditions:-

(1) For Main Board listed issuers, the aggregate number of shares available to parent group employees must not exceed 20% of the shares available under the SOS; and

(2) Approval of independent shareholders must be obtained for the aggregate number of options to be granted to parent group employees under the scheme, as well as any significant grant to a parent group employee that will increase the aggregate number of options granted to that employee to 5% or more of the total options available to parent group employees ("significant recipient").

When seeking shareholders' approvals, listed issuers are expected to provide clear justifications for allowing participation by and grant of options to the parent group employees so that shareholders can make informed decisions on the company's proposals.

**(iv) Participation By Directors And Employees Of Associated Companies**

Practice Note No. 9h currently provides that employees of an associated company may participate in a listed issuer's SOS provided that:-

(1) The listed issuer has control over the management of the associated company;

(2) The associated company contributes at least 40% of the listed issuer's average group pre-tax profits for the last 3 years; and

(3) The associated company does not have a scheme of its own.

Under the amended rules, a listed issuer may allow employees of an associated company to participate in its SOS, provided only that the listed issuer has control over the management of the associated company. The reasons for allowing such employees to participate in the SOS should be disclosed in the circular to shareholders when seeking shareholders' approval for the scheme.

**(v) Participation In More Than One Scheme**

The existing rules providing that an employee shall not participate in more than one scheme implemented by the listed group, and that he should always participate in the scheme of the company in which he is principally employed, have been deleted. Under the amended rules, the decision on whether employees should be allowed to participate in more than one scheme is left to listed issuers.

**(vi) Options Exercise Price**

The existing rules provide that the exercise price of options shall be pegged at the average market price prevailing during the price fixing period immediately before the options are granted. The amended rules allow the exercise price to be set at a discount to the market price, subject to a two-year vesting period and provided that shareholders had specifically approved the maximum discount quantum. In the case of a Main Board listed issuer, a maximum limit of 20% is imposed on the discount. Clear justifications should be disclosed in the circular for shareholders to make an informed decision on whether to approve the maximum discount quantum.

(vii) **Annual Report Disclosure**

To promote transparency in the grant of options, listed issuers are required to disclose in their annual reports:-

- (1) Details of options granted to and exercise by:-
  - (A) Directors of the listed issuer;
  - (B) Controlling shareholders and their associates; and
  - (C) Employees who receive 5% or more of the total options available under the scheme.
- (2) Details of options granted to parent group employees.
- (3) Names of the members of the Committee administering the scheme.

Such additional disclosure requirements will apply from the financial year ending on or after 30 June 1999.

(viii) **Option Grant And Exercise Period**

The current rule providing that options may only be granted within a period of 42 days commencing from the fifth market day following the announcement of financial results, has been deleted.

The existing rule requiring a two-year moratorium to be imposed on the exercise of options by employees who have served less than one year of service in the listed group at the time of grant, has been relaxed. Under the amended rules, such options may be exercised any time after one year of the date of offer.

(ix) **Scheme Administration**

Current rules provide that the SOS must be administered by a Committee consisting of directors of the listed issuer who are not participating in the scheme. The amended rules allow directors who participate in the scheme and not more than one nominee of the listed issuer's parent company to join as members of the Committee, provided that a member who is a participant shall not be involved in the deliberations of the Committee in respect of the individual options to be granted to him.

(x) **Schemes Of Unlisted Subsidiaries**

Practice Note No. 9h also sets out the requirements which an unlisted subsidiary of a listed issuer has to comply with if it wishes to implement an SOS of its own. Under the amended rules, unlisted subsidiaries are subject to the same rules that apply to a listed issuer.

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