

## Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEx website at: <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201304.pdf>

Where there is insufficient space provided for your comments, please attach additional pages.

### Chapter III: Plain Language Amendments to Connected Transaction Rules

1. Do you support the proposal to re-write Chapter 14A?

Yes

No

If your answer is “No”, please give reasons for your views.

2. Do you consider that the draft new Chapter 14A in Appendix I of the Consultation Paper accurately reflects the current Chapter 14A?

Yes

No

If your answer is “No”, please give reasons for your views.

3. Do you have any other comments on the draft Rule amendments in Appendix I of the Consultation Paper?

Yes

No

If your answer is “Yes”, please elaborate your views.

There are inconsistencies between the wording in the new Ch.14A and the existing Chapters 14 & 14A, namely:

(1) The new Ch.14A.21(1) refers to "any buying or selling of assets", which is slightly different to the existing wording in Ch.14.04(1)(a) which refers to "the acquisition or disposal of assets". The wording in both Chapters should be similar to avoid any confusion.

(2) The new Ch.14A.61 refers to "an agreement with fixed terms", which is slightly different to the existing wording in Ch.14A.41 which refers to "an agreement" (ie. without reference to the agreement being for a fixed term) and Ch.14A.33 - Note 2 which refers to an agreement "for a fixed period with fixed terms".

## **Chapter IV: Scope of Connected Persons and Connected Transactions**

### **Part 1 – Scope of connected persons**

#### **A. Definition of connected person**

##### **A(1) Connected persons at the issuer level**

4. Do you agree that there is no need to extend the definition of connected person to the key management personnel of an issuer’s controlling shareholder/holding company?

Yes

No

If your answer is “No”, please give reasons for your views.

## A(2) Connected persons at the subsidiary level

5. Do you support:

- (a) the proposal described in paragraph 90(a) of the Consultation Paper to require transactions with persons connected only at the subsidiary level be subject to the approval of the issuer's board members (including independent non-executive directors) who do not have a material interest in the transaction, instead of the approval of shareholders, and disclosed to the shareholders?

Yes

No

If your answer is "No", please give reasons for your views.

- (b) the proposal described in paragraph 90(b) of the Consultation Paper to exempt all transactions between the issuer group and connected persons at the subsidiary level, other than transactions between a subsidiary (or any subsidiary below it) and the person connected with that subsidiary?

Yes

No

If your answer is "No", please give reasons for your views.

## B. The deeming provision

6. Do you agree with the proposal to introduce principle-based tests described in paragraph 95 of the Consultation Paper for deeming a person as connected?

Yes

No

If your answer is “No”, please give reasons for your views.

The proposed deeming provision is too vague.

What is a “shadow director” and what is the aim of this proposed amendment? The existing Listing Rules definition of ‘director’ is already wide enough to cover a shadow director (specifically by including the words “... *by whatever name called*”).

What is a “de facto controlling shareholder”? The term is not defined nor is there any guidance given as to what factors or parameters the Exchange would consider before deciding whether or not to exercise the deeming provision. Take, for example, an investment by a Private Equity (PE) fund which takes the form of convertible bonds. This is a popular investment structure for PE funds (and other third party investors, where deals are completed at arm’s length) because it affords the investor certain protection, for example, negative undertakings in respect of disposal of assets, assurances re. compliance with the listing rules or the debt/equity ratio of the target, board representation etc.. The convertible bond holder also benefits in a winding up as a creditor. It goes too far, and is at odds with the contractual and commercial reality of this type of investment, to allow the Exchange to deem a convertible bond holder to be a connected person - at a time before the bond holder has even converted. How is the investor to know when it will be treated as a connected person? Does the investor need to consult the Exchange every time? If so, how do you decide to exercise the deeming provision? The vague drafting gives the Exchange an extremely wide power whilst remaining completely free of any sort of guidance for investors who may be affected by the rule. This is not fair and goes against the spirit of the consultation (ie. to simplify the connected transaction rules so that their application is clear to all). It would introduce considerable uncertainty into normal arm's length commercial dealings between parties, and without any identifiable criteria and/or guidance as to how and when the Exchange may exercise the deeming provision, it may also lead to unfair application in practice. At a minimum, clear guidance and/or thresholds are needed, and were the Exchange to consider this as an option a fresh consultation on the proposed guidance/thresholds would be needed.

There may be extreme cases – for example, where a convertible bond holder holds the right to convert on a fully diluted basis to, say, 75% or more of the shares in the target company and chooses not to convert. Here, the position is pretty clear, and whilst we can understand the aim behind the proposed deeming provision being in place to catch this sort of situation – even then, the factors that the Exchange would consider in deciding to exercise the deeming provision in this case would need to be clear so that any deeming by the Exchange of a “de facto controlling shareholder” as a connected person was completely transparent.

In summary, it appears to us that the proposed ‘de facto controlling shareholder’ deeming provision may only be applicable in a very small minority of cases (ie. extreme cases of abuse); being cases where the Exchange already has power under LR14A.06 to deem anyone a connected person. Compare that to the considerable amount of uncertainty which this deeming provision would create in relation to the very popular investment choice of convertible bonds, and we are of the view that the proposed deeming provision is completely unnecessary.

**C. Exceptions to the definition of connected person**

**C(1) Insignificant subsidiary exemption (if persons connected at the subsidiary level are not excluded from the definition of connected person)**

7. Do you agree with the proposal described in paragraph 100 of the Consultation Paper to exempt all persons connected only because of its relationship with the issuer's insignificant subsidiaries?

Yes

No

If your answer is "No", please give reasons for your reviews.

**C(2) Exemption for trustee interests**

8. Do you agree with the proposal described in paragraph 105 of the Consultation Paper to exclude from the definition of associate any trustee of an employee share scheme or occupational pension scheme if the connected persons' interests in the scheme are less than 10%?

Yes

No

If your answer is "No", please give reasons for your views.

**C(3) Exemption for connected person holding an interest in an associate through the issuer**

9. Do you agree with the proposal described in paragraph 110 of the Consultation Paper to clarify that the exemption in Note 1 to Rule 14A.11(4) (paragraph 9 of the Guide) would apply if the connected person and his associate’s interests in the entity (other than those held through the issuer) are less than 10%?

Yes

No

If your answer is “No”, please give reasons for your views.

**Part 2 – Scope of connected transactions**

**D. Financing arrangements with a commonly held entity**

10. Do you agree that we should retain the connected transaction requirements for financing arrangements with commonly held entities?

Yes

No

If your answer is “No”, please give reasons for your views.

**E. Buying or selling interests in a target company**

11. Do you agree with the proposal described in paragraph 131(a) of the Consultation Paper to restrict Paragraph (i) of Rule 14A.13(1)(b) (paragraphs 27 to 29 of the Guide) to transactions involving controllers at the issuer level?

Yes

No

If your answer is “No”, please give reasons for your views.

12. Do you agree with the proposal described in paragraph 131(b) of the Consultation Paper to exclude disposals of interests in target companies from Paragraph (i) of Rule 14A.13(1)(b) (paragraphs 27 to 29 of the Guide)?

Yes

No

If your answer is “No”, please give reasons for your views.

13. Do you agree with the proposal described in paragraph 131(c) of the Consultation Paper to remove Paragraphs (ii) to (iv) of Rule 14A.13(1)(b) (paragraphs 31 and 32 of the Guide)?

Yes

No

If your answer is “No”, please give reasons for your views.

## **Chapter V: Connected Transaction Requirements**

### **F. Compliance framework for continuing connected transactions (“CCTs”)**

14. Do you consider that information provided to shareholders regarding CCTs conducted under framework agreements contains sufficient specificity, in particular as to the methods or procedures to determine pricing for investors to make informed decisions?

Yes

No

If your answer is “No”, please also state the information that you consider should be disclosed in announcements and circulars.

Please give reasons for your views.

In practice it is hard to be more specific in relation to framework agreements. The important reference points for any investor are historical pricing information and ultimately the level of the annual cap. Investors will also need to rely on the annual review by independent directors/auditors.

15. Do you consider that the current Rules governing CCTs and market practice in relation to CCTs that are conducted under framework agreements are appropriate? Do they provide sufficient safeguards to ensure that the transactions will be on normal commercial terms and will not be prejudicial to the interests of the issuers and its minority shareholders?

Yes

No

Please give reasons for your views.

(See our answer to Question14 above.)

### **F(1) Written agreements**

16. Do you agree with the proposal to codify the waiver practice to allow an issuer to obtain a shareholders’ mandate (or a mandate from the board if the transactions is exempt from the shareholder approval requirement) in lieu of a framework agreement with the connected person?

Yes

No

If your answer is “No”, please give reasons for your views.



17. If your answer to Question 16 is ‘Yes’:

(a) Do you agree to limit the mandate period to not more than 3 years?

Yes

No

If your answer is “No”, please give reasons for your views.

(b) Do you agree with the waiver conditions described in paragraph 151 of the Consultation Paper?

Yes

No

If your answer is “No”, please give reasons for your views.

## **F(2) Annual cap**

18. Do you support the proposal to allow the cap for a CCT of a revenue nature be expressed a percentage of the issuer’s annual revenue or other financial items in its published audited accounts?

Yes

No

If your answer is “No”, please give reasons for your views.

### **F(3) Auditors' confirmation letter**

19. Do you support the proposal described in paragraph 161 of the Consultation Paper to modify the Rules relating to auditors' confirmation on CCTs in line with PN 740?

Yes

No

If your answer is "No", please give reasons for your views.

### **G. Requirements for connected transactions involving option arrangements**

#### **G(1) Transfer or non-exercise of option**

20. Do you agree with the proposed alternative classification Rules for any transfer or non-exercise of an option?

Yes

No

If your answer is "No", please give reasons for your views.

The proposed alternative classification under LR14A.80(4)(b) is a slight improvement, as it presents a more realistic approach, but this will still be a fairly involved (and expensive) process - involving an independent expert valuation and confirmations from the INEDs and IFA.

Whilst we recognize that the following points do not form part of this consultation exercise, we urge the Exchange to reconsider the current requirement for transfer or non-exercise (or termination) to be classified as if the option is exercised. We feel that this is too restrictive. Whilst there may be extreme situations, we are of the view that in the vast majority of cases there will be valid commercial reasons behind the decision to transfer, or elect not to exercise, an option - in addition to the value of the asset which is the subject of the option. The Directors, in deciding on the transfer or non-exercise, are bound by fiduciary duties and must make that decision in the best interests of the company. What if the decision not to exercise was classified as requiring shareholder approval, and such approval was not forthcoming? Would the Directors be forced to exercise it? If so, what would happen if the Company suffered a loss as a result? Is it appropriate for the Listing Rules to effectively dictate the decisions a Director can take?

Why should the transfer to a third party be treated as a connected transaction?

Re. New LR14.80(4)(b) - why is additional disclosure required "in any event"? Would this apply where the result of the classification is below the disclosure threshold?

## **G(2) Termination of option**

21. For any termination of an option involving a connected person:

- (a) Do you agree with the proposal described in paragraph 170 of the Consultation Paper to classify the termination as if the option is exercised unless the issuer has no discretion over the termination?

Yes

No

If your answer is “No”, please give reasons for your views.

Please see our answer to Question 20 above.

- (b) Do you agree that the proposed alternative classification Rules described in paragraph 166 of the Consultation Paper should also apply to the termination?

Yes

No

If your answer is “No”, please give reasons for your views.

Please see our answer to Question 20 above.

## **H. Minor changes to clarify the requirements relating to independent advice on connected transactions**

22. Do you agree with the proposed Rule change to clarify that the independent board committee also needs to advise whether the connected transaction is on normal commercial terms and in the issuer’s ordinary and usual course of business?

Yes

No

If your answer is “No”, please give reasons for your views.

## Chapter VI: Exemptions for Connected Transactions

### I. De minimis exemptions

23. Do you agree that we should retain the monetary limit of HK\$1 million for fully exempt connected transactions?

Yes

No

If your answer is “No”, do you think that the limit should be increased to HK\$2 million, HK\$3 million, HK\$4 million, HK\$5 million, or some other amount (*please specify with reasons*)?

HK\$2 million

HK\$3 million

HK\$4 million

HK\$5 million

Other amount (*please specify*):

Please give reasons for your views.

It is appropriate to increase the HK\$1 million limit now, if only because of inflation.

24. Do you agree that we should retain the monetary limit of HK\$10 million for connected transactions exempt from the shareholder approval requirements?

Yes

No. The appropriate limit should be (*please specify*):

Please give reasons for your views.

Shareholder approval is the key protection mechanism in place against abusive connected transactions, so any increase in the limit needs to be considered very carefully. Transactions beyond HK\$10 million are still 'significant' for most companies (given the size and composition of the majority of listed companies in Hong Kong). On that basis we would prefer to retain the HK\$10 million limit.

**J. Exemption for provision of consumer goods or services**

25. Do you support the proposal described in paragraph 181 of the Consultation Paper to remove the 1% cap on transaction value for the exemption for provision or receipt of consumer goods or services?

Yes

No

If your answer is “No”, please give reasons for your views.

**K. Exemption for provision of director’s indemnity**

26. Do you agree with the proposal described in paragraph 183 of the Consultation Paper to exempt an issuer granting indemnity to a director against liabilities that may be incurred in the course of the director performing his duties, if it does not contravene any law of the issuer’s place of incorporation?

Yes

No

If your answer is “No”, please give reasons for your views.

27. Do you agree with the proposal described in paragraph 186 of the Consultation Paper to exempt an issuer purchasing and maintaining insurance for a director against liabilities to third parties that may be incurred in the course of performing his duties, if it does not contravene any law of the issuer’s place of incorporation?

Yes

No

If your answer is “No”, please give reasons for your views.

28. Do you have any other comments or suggestions relating to the connected transaction Rules?

Yes

No

If your answer is “Yes”, please elaborate your views.

- End -