

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.

The draft new Chapter 14A is a clear, concise and user-friendly document setting out the concepts and requirements of connected transaction rules. We are supportive to use the new Chapter 14A to replace the current version.

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.

We have not identified any inconsistencies and would have no reason to question the desired accuracy based on what we have been exposed to so far.

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.

Given the new Chapter 14A is yet to be fully tested in its applications, it is important that the listed issuers be given the benefit of relying on the current Charter 14A rules, notes or wording to support or illustrate their views in advocating a particular case in front of the HKEx during a transitional period.

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.

While we support the proposal which would remove shareholder approval requirement, the requirements for independent board approval and disclosure to the shareholders are unnecessary and overly burdensome for the transactions with persons connected only at the subsidiary level.

We believe that our following views are generally aligned with the views and conclusions in paragraphs 82, 85, 87, 88 and 89.

- Persons connected only at subsidiary level are unlikely to have undue influence over the issuer.
- Potential for abuse by persons connected only at subsidiary level is limited given the control by the listed issuer as the parent company of the subsidiary and that the interest of the listed issuer as the controlling shareholder of the subsidiary is aligned with all the shareholders of the listed issuer, vis-à-vis the subsidiary level connected person.
- HK has more stringent regime for subsidiary level connected persons which imposes disproportional compliance burden on the listed issuer with no clear benefit to the public shareholders of at the listed issuer level.

We submit further that

- The focus of the listing rules (whether they impose requirements on the listed issuer or its subsidiaries) should be the protection of public shareholders at the issuer’s level. The listing rules on transactions with persons only connected at subsidiary level may create a misperception that the listing rules are attempting to protect minority or public shareholders at the subsidiary level.
- Any attempt to protect minority or public shareholder at the subsidiary level should be outside the remit of the listing rules governing the parent/holding company (here, the HK listed Issuer) of the subsidiary. The subsidiary level shareholder protection should be more properly dealt with by the company law principles, contractual arrangements or listing rules (for listed subsidiaries) which the subsidiary may be directly subject to.
- In the case of an indirect subsidiary of the listed issuer, very likely it would be inconsistent with the company law principles or listing rules of most jurisdictions to seek direct approval of ultimate parent’s board on the transactions at the level of such indirect subsidiary or below.

We note that other common law jurisdictions (such as UK) have insignificant subsidiary exemptions similar to what are under the current HK rules. We would like to bring to HKEx’s attention that the latest UK approach to related party transactions has been creating an exception for all the transactions that are “in the ordinary of course of business” which is a further relaxation from its previous approach of distinguishing revenue transactions from non-revenue transactions. This powerful exception has effectively pre-empted all other exemptions and exceptions and taken vast majority of transactions with the issuer’s related parties (both at the issuer’s level and its subsidiary levels) outside of scope of related party transaction rules. As a result, for the most of part, the issuer does not even need to resort to “insignificant subsidiary exemptions” for subsidiary level transactions.

Assuming HKEx is not prepared to follow a similar path, there is a merit to consider more seriously about removing the connected transaction requirements for persons only “connected” at subsidiary level in order to rebalance its focus on areas of higher risk to the public shareholder protection at the listed issuer level.

- (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.

While we support the proposal which would exempt all transactions between the issuer group and connected persons at the subsidiary level, we are of view that the exemption should cover (and not exclude) any transaction between a subsidiary (or any subsidiary below it) and the person connected with that subsidiary.

As an alternative, we propose to exclude persons connected only at the subsidiary level from the definition of “connected person”

Our reasons are generally the same as those in the response to Q5(a) above.

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.

We do not have a very strong view on the particular proposals but question why the HKEx does not believe its existing deeming power and definition of “associates” to be sufficiently wide to catch the proposed expanded categories. Also, as a matter of drafting flow, the rules on the same subject should either adopt the principle based test consistently or bright line test throughout and it would be confusing to list these two types of criteria in separate parallel categories.

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.

While we support the proposal to exclude all persons connected only because of its relationship with the issuer's insignificant subsidiaries, for the reasons stated in our responses to Q5(a) and (b), we are of the view that the exclusion should be extended to all persons connected because of its relationship with any subsidiary.

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.

While we support the codification of the existing practice, we believe that the UK approach of completely excluding trustees of pension schemes and employee share schemes from the connected transaction regime is more sensible given the nature and ways of operation of these schemes.

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.

Whether it is in a financial assistance transaction or other type of transaction, the incentive for undue influence by the connected person to the listed issuer would be much stronger if the commonly held entity is either a “connected subsidiary” of the issuer or an associate of the connected person, either case having been covered by the existing rules. The scenarios in paragraph 123 are neither connected subsidiary nor associate cases. They are being separately subject to connected transaction rules only in financing assistance transactions. However, we fail to see the risk of abuse by the connected person in the financing arrangement being so much higher than the risk in other type of transactions that justifies a separate category of connected transactions with the commonly held entity, an otherwise non connected person.

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.

The test should not be the amount or length of the information but whether the information disclosed meaningfully gives public shareholder assurance that transactions are on normal commercial terms. In that connection, the disclosure of the listed issuer's tender procedures or general pricing policies/guidelines for product sales, procurement and sourcing and the confirmation of compliance with such policies/guidelines in a particular CCT would be much more meaningful to the public shareholders than disclosing detailed pricing information itself for such CCT.

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.

As stated in our response to Q14, the main concern should be whether the transactions are conducted on normal commercial terms. The requirement of setting cap on CCTs does not address the normal commercial term issue but create unnecessary restrictions on listed issuers conducting transactions on arm's length basis. We strongly believe that the cap requirement should be removed.

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.

If a framework agreement is permitted to be longer than 3 years (see footnote 29 of paragraph 134), the shareholder mandate as its alternative should also be allowed to exceed 3 years under the similar circumstances.

(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.

As stated in our response to Q16(a), we do not agree with 3 year limit (Condition(2)). We do not believe the shareholder approval is necessary or adding any value at the time of renewal if the INEDs can confirm no material changes to the facts and circumstances.

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.

Our support to this proposal should be without prejudice to our strong opposition against the cap requirement for a CCT as stated in our response to Q15.

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.

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.

(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.

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.

For a large cap issuer such as Standard Chartered, we would typically rely on ratio test to qualify for di minimis exemption. So we do not hold a strong view as to the appropriate monetary limit for smaller issuers. However, we do believe that HK\$1 million threshold set in 2004 would be too low in light of inflation, issuer's compliance burden versus benefit to the public shareholder, among other factors.

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.

Please see our response to Q23.

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.

Passive Investor Exemption

We have been advocating expanding the application of Passive Investor Exemption to the Passive Investor itself in addition to its associates since the introduction of the exemption in 2010. The current technical distinction between the Passive Investor itself and Passive Investor associates would confer no incremental benefit to the protection of public shareholders. Practice since the introduction of the Passive Investor Exemption shows that this is very specific type of exemption with clear and strict conditions attached (in the definition of a Passive Investor) and would pose no risk of abuse if Passive Investor itself is covered by the exemption.

Non-preemptive Placing to a Passive Investor

Similarly, we have been urging HKEx to consider relaxing the restrictions on the participation of Passive Investor and its associates in the non-preemptive market placing. We submit the request once again as part of this around of connected transaction rule consultations and would be happy to discuss in greater detail with the HKEx on our views and rationales behind.

Revenue transactions with connected persons

HKEx decided in the 2009 connected transaction rule consultation conclusion that revenue transactions will continue to be subject to connected transaction rules. The residual concern of the debate of the issue was that the expropriation of minorities may be still be possible through provision of goods and services in the issuer’s ordinary course of business.

We submit that

- this more stringent approach adopted by the HKEx is not in line with international norms and imposes significant compliance burdens on the issuers
- revenue transactions with connected persons pose low risk of abuse generally
- risk of abuse would be particularly low when the issuer is a large international company with diversified business lines and products or diversified shareholder base or in a regulated industry, such as banking.

As noted in our response to Q5, London Stock Exchange has moved further to make exception for all transactions that are made in the ordinary course of business (without even distinguishing whether it is an revenue transaction or not) so to avoid the necessity to interpret what was of “revenue nature” which can be difficult at times. The “ordinary course of business” test would provide a much clearer and easy to follow guiding principle to the listed issuers.

As HKEx regulatory model traces the same historical roots as the UK model, it is worth reassessing this issue so that Hong Kong as a credible emerging international financial center can maintain its competitive edge for balancing the objectives of investor protection and user-friendliness of its listing environment.

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