

Part B Consultation Questions

A. Transactions with persons connected with an issuer only by virtue of their relationship with the issuer's subsidiaries

1. We think that the definition of connected persons should exclude persons connected by virtue of their relationship with an issuer's subsidiaries.

Under normal circumstances, as the issuer has absolute control over its subsidiary, persons connected by virtue of their relationship with an issuer's subsidiaries are less influential to the subsidiary's decisions.

3. On the basis that the definition of connected person will continue to include person connected at the subsidiary level, we do not agree the proposal to introduce an 'insignificant subsidiary exemption' for connected transactions.

Our view to exclude persons connected by virtue of their relationship with an issuer's subsidiaries has been clearly stated in Q1. We do not support the introduction of an 'insignificant subsidiary exemption' because it will be too complicated to determine whether a subsidiary is insignificant or not. As a result, if the definition of connected person continues to include person connected at the subsidiary level, we support that all subsidiaries are subject to the current connected transactions Rules.

4. In our case, insignificant subsidiary exemption will not be applicable as we so far have no connected transactions transacted between the group and the connected persons at the subsidiary level.
5. Not applicable.
6. Not applicable.
7. Not applicable.

B. De minimis thresholds that trigger disclosure or shareholders' approval requirement for connected transactions

8. (a) We support the proposal to revise the percentage threshold to 5%. Even though the change of percentage threshold from 2.5% to 5% is minor and only reduces the number of connected transactions that require shareholders' approval by about 8%, however, the proposal, which is in line with international standards, is important to enhance our competitiveness as an international finance center.

(b) We support the proposal to revise the percentage threshold to 1%. The minor change of percentage threshold from 0.1% to 1% may not have material impact on the minority shareholders' interests. However, the proposal will greatly reduce the number of connected transactions requiring disclosure by 31%. As a result, many insignificant connected transactions can be exempted for disclosure requirement under this proposal.

10. We agree that a percentage threshold is sufficient to assess whether a connected transaction is eligible for the de minimis exemptions. The same percentage materiality test for all issuers is fair and objective and this practice is in line with current international standards and practices.

11. We do not believe that an absolute monetary cap should be imposed.

The proposed monetary cap is not in line with current international standards practiced by other major stock exchanges in the world. Given that the market capitalization of each issuer varies significantly, an absolute monetary cap will mean differently to different issuers. As such, an absolute monetary cap cannot serve as an objective benchmark for all issuers.

C. Transactions that are revenue in nature and in the ordinary and usual course of business

12. We agree that the connected transaction Rules should govern revenue transactions with connected persons.

High proportion of majority controlled listed companies and state-controlled PRC issuers easily give rise to connected transactions. To better improve corporate governance and protect minority shareholders, it is appropriate to govern material revenue transactions (except for de minimis transactions) with connection persons.

Proposed exemption for revenue transactions with associates of a passive investor

13. We agree with the proposed exemption for revenue transactions with associates of a substantial shareholder who is passive investor in the issuer group.

If the substantial shareholder who is a passive investor does not exercise influence in the issuer's operations, any transaction with the relevant associate of the passive investor should not constitute as a connected transaction. In such case, the proposed exemption can reduce the volume of connected transactions.

14. We think the proposed exemption should not require the substantial shareholder be a passive investor in the relevant associate.

As long as the substantial shareholder is qualified as a passive investor (who has not exercised any influence) to the issuer, the transaction would not constitute as a connected transaction whether or not the substantial shareholder is a passive investor in the relevant associate. Moreover, the new requirement requires the issuer to keep track of substantial shareholders' various investments, and this contradicts to the purpose of proposed exemption to reduce issuer's compliance burden.

15. (a) & (b) We think the passive investor should not limit to a sovereign fund or an authorized unit trust or mutual fund. Any substantial shareholder who is qualified as a passive investor and has no influence and involvement in the issuers' day to day operations should apply the proposed exemption, e.g. an investment holding company or private equity fund.

(c) We agree that the passive investor must not have representative on the board of directors of the issuer and its subsidiaries. It is difficult to justify that the passive investor having a board seat has no influence and involvement in the issuers' day to day operations.

(d) We agree with other proposed conditions because other conditions have ensured its independence to the issuer other than a mere passive investment. However, we would like to raise a concern that how to measure or quantify a passive investor who has '*a wide spread of investments other than securities of the issuer*' in the second bullet point of paragraph 59.

Proposed modification of the exemption for provision of consumer goods or consumer services

17. We agree with the proposed changes to expand the exemption for acquisition of consumer goods or services described in paragraph.

As long as there is neither favourable nor unfavourable term for a revenue transaction between the connected parties (i.e. prices published or publicly quoted and applied to other independent consumers imply no party has exercised influence on the terms of transaction), the connected transaction should be exempted for reporting and disclosure.

19. With the proposed amendments in de minimis exemptions and other extended exemptions, we think current reporting and disclosure on revenue transactions with connected persons are reasonably adequate to address the balance between shareholder protection and compliance burden to issuers.

D. Definition of associate

(1) Definition of associate in Rule 1.01 (for non-PRC issuer) and Rule 19A.04 (for PRC issuer)

20. We support the proposal to carve out from the definition of associate (i) the holding company of the investee company or a fellow subsidiary of this holding company described in paragraph 68(e) and (ii) a company controlled by the investee company described in paragraph 68(f) and this company's subsidiary, holding company and fellow subsidiary.

We agree that these connected persons (referred to Company A, B, C, D, E and F in paragraph 68 (e) and (f), respectively) can unlikely exert significant influence over (i) the investee company's holding company and its fellow subsidiaries or (ii) the investee company's associated companies and take advantage in the transactions between the issuer and these entities. The reduced scope of 'associate' is in line with other countries' practices for similar connected transaction Rules.

(2) Extended definition of associate in Rule 14A.11(4)

22. We agree with the proposed extension of the definition of associate to a company in which a connected person's relative has a majority control as described in paragraph 74.

If the relative of connected person has a majority control in such a company, it is possible the connected person may exercise influence and take advantage in the transactions between the issuer and the company under the control of the relative. As such, these transactions should be caught as connected transactions and subject to reporting, review and disclosures if they are material.

E. Definition of connected person

(1) Non wholly-owned subsidiary

(i) Rules 14A.11(5) and (6)

24. We agree with the proposed exemption for (i) transactions between a connected subsidiary and any of its own subsidiaries and (ii) transactions between any subsidiaries of the connected subsidiary.

This type of intra group transactions would unlikely give rise to any concern about the possible abuse by the connected person to the detriment of the issuer's minority shareholders.

(ii) Rules 14A.11(1) and (4)

26. We agree that a non wholly-owned subsidiary should not be regarded as a connected person in the circumstances described in paragraphs 81(a) and (b).

The connected transaction between Subsidiary A and other members of the Listed Co group, in paragraph 81(a), is also an intra group transaction. This type of intra group transactions would unlikely give rise to concern to the minority shareholders. Secondly, in paragraph 81(b), the connected person (i.e. Mr. F) is unlikely to exert influence over the issuer to take advantage in a transaction between Subsidiary E and any other members of the issuer group.

27. We suggest 14A.11 (4) (a) Notes 2 can be repealed if the definition of connected person has excluded persons connected by virtue of their relationship with an issuer's subsidiary as mentioned in Q1.

(2) Promoter of a PRC issuer

28. We support the proposal to delete 'promoter' of a PRC issuer from the definition of connected person.

Given that the promoters mainly undertake the establishment of a PRC issuer and have no particular influence over the issuer after listing, they should not be treated as connected persons of the issuer.

(3) PRC Governmental Body

30. We support the proposal to apply those provisions for PRC Governmental Body in Chapter 19A to connected persons of non-PRC issuer for the purpose of connected transactions Rules.

There are many red-chip issuers in Hong Kong whose controlling shareholders are state-owned enterprises or have connected or related with PRC Governmental Body. Consistent application of those provisions for PRC Governmental Body in Chapter 19A to both PRC issuers and non-PRC issuers ensures same treatment for all issuers.

(4) Management shareholder of a GEM issuer

32. We support the proposal to delete 'management shareholder' from the definition of connected person in the GEM Rules.

We support to unify the GEM and Main Board Rules and practices as much as possible. Usually, management shareholder is also the controlling/substantial shareholder, chief executive or director of the issuer. In such case, management shareholder is duplicated and should be deleted from the definition of 'connected person' under GEM Rules to bring that in line with Main Board Rules.

F. Other changes to the connected transaction Rules

(1) Exemption for small transaction involving issue of new securities by subsidiary

34. We agree with the proposal to remove the restriction on applying the de minimis exemptions to an issue of securities by the issuer's subsidiary.

An issue of securities by the issuer's subsidiary to connected persons should be treated as other straight disposal which will be subject to exemption for small transaction on the basis of relevant percentage ratios.

(2) Exemption for financial assistance provided on a pro-rata basis

36. We agree with the proposal to clarify that the exemption under Rule 14A.65(3)(b)(i) will apply where the commonly held entity is also a connected person.

We do not see any material impact on the issuer between the diagrams provided in paragraph 99 and 101. Hence, the risk of potential abuse is remote under such specific circumstances.

(3) Transactions with third parties involving joint investments with connected persons

38. We agree with the proposal to extend the exemption under Note 3 to Rule 14A.13(1)(b)(i) to disposal transactions mentioned in paragraph 108.

As the risk that the target company's substantial shareholder can exert significant influence over the issuer and take an advantage in the disposal to the detriment of the issuer's shareholders is remote, the exemption should be extended to disposal transactions.

(4) Annual review of continuing connected transactions

40. We agree with the proposal Rule amendments to clarify that the annual review requirements apply to continuing connected transactions that are subject to reporting and disclosure requirements in Chapter 14A.

If the volume of continuing connected transactions is large, it will be too burdensome for the issuer to require the independent non-executive directors and auditors reviewing all continuing connected transactions. The clarification of the scope of annual review requirements (limited to continuing connected transaction that are subject to reporting and disclosure requirements) will ease the issuer's compliance burden.