

Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please make your comments by replying to questions below against proposed changes discussed in the Consultation Paper at the hyperlink: http://www.hkex.com.hk/consul/paper/cp200910ct_e.pdf.

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

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

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

Yes

No

Please provide reasons for your views.

We consider that as the issuer has majority control over its subsidiary, any undue influence on a subsidiary by the person connected at the subsidiary level would be subject to the check and balance of the issuer's board of directors who should act in the interest of the issuer and its shareholders as a whole. It is unlikely that the person can unduly influence the issuer's action only by virtue of his relationship with the subsidiary.

2. If your answer to question 1 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

We note from the draft rule amendments in Appendix I to the Consultation Paper that the HKEx's proposal is to relax the definition of connected person for the purpose of Chapter 14A only, although the wording of the HKEx's press release which says "revisiting whether the definition of connected person should include a person connected at the subsidiary level", as well as Question 1 may give an impression that the proposal involves amending the general definition of connected person as set out in rule 1.01.

There is no proposed amendment to the general definition of connected person as set out in rule 1.01 which applies to other parts of the Listing Rules, such as Chapter 3 (for rules relating to independent non-executive directors), Chapter 3A (sponsors and compliance advisers), Chapter 8 (for rules relating to public float), Chapter 13 (for rules relating to public float, issue of securities to connected persons and independent financial advisers), Chapter 17 (share option schemes), Chapter 19A (for rules relating to issue of securities to connected persons). Furthermore, it should be noted that there are cross-references in certain parts of these chapters to Chapter 14A, and vice versa. We therefore consider that the HKEx should clarify whether the term "connected person" that appears in other chapters refer to the definition in rule 1.01 or Chapter 14A, especially when a cross-reference is made to Chapter 14A or vice versa.

The HKEx may wish to clarify its intention and highlight the implications to the market, and to see if any further rule amendments may be necessary.

3. On the basis that the definition of connected person will continue to include person connected at the subsidiary level, do you agree with the proposal to introduce an "insignificant subsidiary exemption" for connected transactions?

Yes

No

Please provide reasons for your views.

We consider the proposal under Question 1 a more preferable option.

4. Based on your experience, do you think that the "insignificant subsidiary exemption" would be used by you (or for market practitioners, your clients)?

Yes

No

Please describe the circumstances and refer to Option 1 or 2.

Not applicable

5. If your answer to question 3 is “Yes”, do you agree with

(a) the proposed materiality threshold under (i) Option 1 or (ii) Option 2?

Yes (*please choose one of the following options*)

Option 1

Option 2

No

Please provide reasons for your views.

Not applicable

(b) the proposed bases for assessing the significance of a subsidiary, i.e. the asset ratio, revenue ratio and the profits ratio?

Yes

No. The significance of a subsidiary should be determined by (*please specify*): _____

Please provide reasons for your views.

Not applicable

(c) the proposed additional safeguard to require the consideration ratio be less than 10% if an “insignificant” subsidiary concerned is itself a party to the transaction or its securities/assets are the subject of the transaction?

Yes

No

Please provide reasons for your views.

Not applicable

- (d) the proposed mechanism for applying the exemption to continuing connected transactions described in paragraph 27 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

Not applicable

6. If your answers to question 5 are “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

Not applicable

7. If you agree with Option 2, do you think that the definition of “major subsidiary” under Rule 13.25 should be amended to align with that in the “insignificant subsidiary exemption” if adopted?

Yes

No

Please provide reasons for your views.

Not applicable

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

8. (a) For the exemption from independent shareholders' approval requirement, do you support the proposal to revise the percentage threshold to 5%? If your answer is "No", please specify the percentage threshold that you consider appropriate.

Yes

No. The percentage threshold should be *(please specify)*: _____

Please provide reasons for your views.

- (b) For the exemption from all reporting, announcement and independent shareholders' requirements, do you support the proposal to revise the percentage threshold to 1%? If your answer is "No", please specify the percentage threshold that you consider appropriate.

Yes

No. The percentage threshold should be *(please specify)*: _____

Please provide reasons for your views.

9. If your answer to question 8 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

10. Do you agree that a percentage threshold is sufficient to assess whether a connected transaction is eligible for the de minimis exemptions?

Yes

No

Please provide reasons for your views.

11. Do you believe that an absolute monetary cap should also be imposed, irrespective of the percentage threshold test for de minimis exemptions? If your answer is yes, please specify the monetary cap that you consider appropriate for fully exempt connected transactions (the monetary cap for connected transactions exempt from independent shareholders' approval would be adjusted proportionately).

Yes. The monetary cap for fully exempt connected transactions should be:

- HK\$100 million
- HK\$200 million
- HK\$500 million
- HK\$1,000 million
- Other monetary cap (*please specify*): HK\$ _____

No

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

12. Do you agree that the connected transaction Rules should govern revenue transactions with connected persons?

Yes

No

Please provide reasons for your views.

We agree so on the basis that the definition of connected persons is relaxed to exclude persons connected only at the subsidiary level (our answer to Question 1 refers). We agree that in the context of the Hong Kong market, in the absence of separation of owners and management, there is less check and balance to safeguard against connected persons taking advantage of their positions.

However, we suggest the HKEx consider removing the requirement for an annual cap for continuing connected transactions because imposing a limit on revenue transactions on normal commercial terms may limit the commercial benefits to listed issuers and at the same time create significant administrative burden on issuers (to keep transaction values within caps). As long as the transactions are conducted on normal commercial terms, we see no reason why a cap should be imposed on those revenue transactions with connected persons.

Proposed exemption for revenue transactions with associates of a passive investor

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

Yes

No

Please provide reasons for your views.

The potential for abuse by this type of shareholders is relatively small and the proposed exemption would reduce the compliance burden of issuers.

14. Do you think that the proposed exemption should also require the substantial shareholder be a passive investor in the relevant associate, for example, it is not involved in the management of the relevant associate?

Yes

No

Please provide reasons for your views.

Paragraph 59 already sets out the criteria that the substantial shareholder should meet in order to be qualified as a passive investor. The view has already been taken that the potential of abuse by this type of shareholders is relatively small. As such, there is no need to impose further conditions on the associates of such shareholders.

15. If your answer to question 13 is “Yes”,

- (a) do you agree that the passive investor must be a sovereign fund or an authorised unit trust or mutual fund?

Yes

No

Please provide reasons for your views.

We do not consider that there should be any differentiation between passive investors, and hence neither sovereign fund nor an authorised unit trust or mutual fund should be distinguished out with a different treatment.

- (b) do you think that the exemption should be made available to other passive investors? If so, which?

Yes. The exemption should be made available to *(please specify)*:
All passive investors fulfilling the criteria set out in the third bullet point of paragraph 59 other than the first and fifth sub bullet points as noted below.

No

Please provide reasons for your views.

We do not consider that there should be any differentiation between different types of passive investors, as long as they meet the other criteria as set out in the third bullet point of paragraph 59 of the Consultation Paper, apart from “it is a sovereign fund, or a unit trust or mutual fund” (please refer to our answer to Question 15(a)) and “it does not have any representation on the board of directors of the issuer or any of its subsidiaries (our comments to Question 15(c) refers).

- (c) do you agree that the passive investor must not have representative on the board of directors of the issuer and its subsidiaries?

Yes

No

Please provide reasons for your views.

Given the size of the investment, it would be unlikely that an investor would not seek board representation to protect its interest. However, board representation would not necessarily allow the investor to exert undue influence over the issuer's management. This can be regarded as another form of check and balance in the board of directors of the listed issuers. The HKEx may consider imposing a condition that the investor must not nominate any executive director or senior management member.

(d) do you agree with other proposed conditions set out in paragraph 59 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

The proposed conditions should provide sufficient restrictions which are not unduly onerous.

16. If your answer to question 13 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

We agree to the proposal subject to our comments raised in Question 15(a), (b) and (c).

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

17. Do you agree with the proposed changes to expand the exemption for acquisition of consumer goods or services described in paragraph 66 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

We agree to the rationale set out in the Consultation Paper.

18. If your answer to question 17 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

19. Can you think of any other suggestions to improve the regulation of revenue transactions with connected persons?

Yes

No

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

We refer to answer to Question 12, and suggest that the HKEx consider removing the requirement for an annual cap for continuing connected transactions.

Furthermore, the HKEx may also need to provide more guidance, for enhancing transparency, as to the circumstances under which it may consider aggregating continuing connected transactions with a single connected person under rule 14A.27. We understand that in the past, transactions of different natures, for instance purchase of materials from the parent company, utilisation of certain services provided by the parent, were not aggregated. However, we note from some practitioners that in recent years, there have been instances where the HKEx required aggregation of all continuing connected transactions with the same party that were dealt with in a single announcement under vetting.

D. Definition of associate

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

20. Do you support the proposal to carve out from the definition of associate the following entities?

- (i) The holding company of the investee company or a fellow subsidiary of this holding company described in paragraph 68(e) of the Consultation Paper.

Yes

No

- (ii) A company controlled by the investee company (not being a subsidiary of the investee company) described in paragraph 68(f) of the Consultation Paper and this company's subsidiary, holding company and fellow subsidiary.

Yes

No

Please provide reasons for your views.

The current definition is too wide and may catch entities which fall outside the purpose of the rules. The proposal is in line with international practices.

21. If your answer to question 20 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

We note that the HKEx has also deleted references to "trustee controlled company" and "trustee interests". Whilst we agree to such deletions, we are not sure whether the HKEx has already adequately explained such proposed deletion in the Consultation Paper.

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

22. Do you 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 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

This has been a potential loophole and the proposal clarifies the HKEx's position. However, we do not understand why "more than 50% of the voting power" is used as opposed to "more than 30% of the voting power" as used in the definition of "associate" in Rule 1.01 of the Listing Rules. This may cause confusion to the public.

23. If your answer to question 22 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

Whilst we agree to the proposed extension of the definition of associate to a company in which a connected person's relative has significant influence, we have a concern about using "50% of the voting power" in the draft amendments to Rule 14A.11(4)(c)(ii) which is inconsistent to Rule 1.01 of the Listing Rules.

E. Definition of connected person

(1) Non wholly-owned subsidiary

24. Do you 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?

Yes

No

Please provide reasons for your views.

We consider such intra-group transactions not a concern as far as protection of minority shareholders is concerned.

25. If your answer to question 24 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

26. Do you 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) of the Consultation Paper?

Yes

No

Please provide reasons for your views.

27. If your answer to question 26 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

(2) Promoter of a PRC issuer

28. Do you support the proposal to delete "promoter" of a PRC issuer from the definition of connected person?

Yes

No

Please provide reasons for your views.

29. If your answer to question 28 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

(3) PRC Governmental Body

30. Do you support the proposal to apply those provisions for PRC Governmental Body in Chapter 19A to connected persons of non-PRC issuers?

Yes

No

Please provide reasons for your views.

31. If your answer to question 30 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

(4) Management shareholder of a GEM issuer

32. Do you support the proposal to delete “management shareholder” from the definition of connected person in the GEM Rules?

Yes

No

Please provide reasons for your views.

33. If your answer to question 32 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

F. Other changes to the connected transaction Rules

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

34. Do you agree with the proposal to remove the restriction on applying the de minimis exemptions to an issue of securities by the issuer’s subsidiary?

Yes

No

Please provide reasons for your views.

35. If your answer to question 34 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

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

36. Do you 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?

Yes

No

Please provide reasons for your views.

37. If your answer to question 36 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

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

38. Do you 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 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

39. If your answer to question 38 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

(4) Annual review of continuing connected transactions

40. Do you agree with the proposed 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?

Yes

No

Please provide reasons for your views.

We agree that the HKEx should clarify the intended purposes of the rules. We agree that the auditors' annual review requirements should only apply to those transactions that are subject to reporting and disclosure requirements in Chapter 14A. Transactions not subject to reporting and disclosure requirements will not be disclosed in annual reports and will not be subject to caps.

41. If your answer to question 40 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

42. Are there any other comments you would like to make?

Yes

No

If your answer is "Yes", please elaborate your views.

We would like to set out our further comments in addition to our answers to Questions 12 and 19 above.

Note 1 to rule 14A.11(4)

Note 1 to rule 14A.11(4) states that "a company which is an 'associate' of a person referred to in rules 14A.11(1), (2) or (3) only because that person has an indirect interest in the company through its shareholding in the listed issuer is not a connected person."

We however consider a clarification is required for the application of Note 1 to rule 14A.11(4) in the following illustration:

Mr X holds 51% of Listed Company A which in turn holds 95% of its non wholly owned Subsidiary B. Mr X is a connected person of Listed Company A at the listed company level, but not at the level of its subsidiaries.

Under Scenario 1, where Mr X does not have any other interest in Subsidiary B other than the indirect interest held through Listed Company A, Subsidiary B will not be regarded as an associate of Mr X.

However, under Scenario 2 where Mr X holds 0.1% direct interest in Subsidiary B, Subsidiary B will be considered as an associate of Mr X under Note 1 to rule 14A.11(4) and therefore will be a connected person of Listed Company A.

If it is the case in Scenario 2, it contradicts the definition of connected person under rule 14A.11(5) which includes “any non wholly owned subsidiary of the listed issuer where any connected person(s) of the listed issuer (other than at the level of its subsidiaries) as defined under rules 14A.11(1) to (4) is / are (individually or together) entitled to exercise, or control the exercise of, 10% or more of the voting power at any general meeting or such non wholly-owned subsidiary”. It appears that under Scenario 2, Subsidiary B will not be regarded as a connected person of Listed Company A under rule 14A.11(5) but will be caught as a connected person of Listed Company A under Note 1 to rule 14A.11(4). We therefore consider that a clarification is required for this scenario.

Whilst there may be a reason for the existence of Note 1 to rule 14A.11(4), we consider that the HKEx may need to clarify that Note 1 to rule 14A.11(4) is not intended to catch Scenario 2 above in the illustration involving a non wholly owned subsidiary which is already governed by rule 14A.11(5) with a 10% threshold.

Rule 14A.38

According to Rule 14A.38, the auditor of a listed issuer is required to provide a letter to the board of directors of the listed issuer confirming 4 particular issues concerning continuing connected transactions. A copy of this letter needs to be provided to the HKEx at least 10 working days prior to the bulk printing of the listed issuer’s annual report. And Rule 14A.39 requires the listed issuer’s board of directors to state in the annual report whether its auditors have confirmed these 4 particular matters. However, in the exposure draft of a practice note recently released by the Hong Kong Institute of Certified Public Accountants (HKICPA) regarding auditors’ work on continuing connected transactions, the wordings of both the auditors’ letter (Appendix 2 of the draft practice note) and the illustrative example of such disclosure in the annual reports (under paragraph 86 of the exposure draft) are all set out in the form of negative assurance.

Given that there are inconsistencies between the exposure draft and the Listing Rules, and the timing for the letter to be provided to the HKEx is not feasible in some occasions, the HKEx may wish to consider revisiting these requirements to ensure consistency and feasibility.

- End -