

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.

Whilst a number of jurisdictions would typically define connected persons as including those connected at the subsidiary level, as noted in the paper the Hong Kong rules are more stringent, in general, with regard to the connected transaction provisions than those in, for example, the UK, Singapore and Australia. In particular, the UK provisions exempt transactions of a revenue nature, and tend to have higher de minimis levels. As such, the definition in Hong Kong of connected persons should exclude those connected by virtue of their relationship with an issuers' subsidiaries.

We note that concerns have been expressed by some parties that such connected persons may take advantage of their positions to the detriment of the minority shareholders. If there are concerns over controlling shareholders at the listed issuer level abusing their position, and if revenue transactions are not to be excluded (other than on the fairly narrow basis proposed in the paper), one alternative would be to exclude connected persons at the subsidiary level where there is no substantial shareholder at the listed issuer level.

Clearly HSBC has an interest in this, but this would also be of benefit and attraction to other international companies, with no substantial shareholders at the listed issuer level, seeking to list in Hong Kong.

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.

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.

Our preference is to exclude connected persons at the subsidiary level. However, if this is not acceptable then we support (with two provisos) introducing an “insignificant subsidiary exemption”, which will bring the HK Rules more into line with other jurisdictions.

We have concerns over imposing a requirement for the insignificant subsidiary to have been in the Group for one year or more. Specifically for financial institutions, structured finance transactions often involve the setting up of a joint venture specifically for the purpose of the financing transaction. This will often be a subsidiary of the listed issuer, with the counterparty being a substantial shareholder. These companies are typically formed at the time of entering into the structured finance transaction and will not have been in the Group for more than one year, but which will on any reasonable criteria fall within the definition of an insignificant subsidiary. We will be happy to elaborate further on this if that will help.

Whilst there is a one year requirement for the insignificant subsidiary to have been in the Group in the UK, the UK rules exclude transactions of a revenue nature, which will typically be the case in finance transactions.

Similarly, when setting up joint ventures for matters such as insurance or securities related businesses with JV partners, the JV will be formed at the time of entering into the agreement. Those JV partners will often be substantial shareholders in the JV subsidiary.

In addition, HSBC is strongly opposed to requiring issuers to maintain a record of insignificant subsidiaries. The workload required to not only prepare, but update at least half-yearly, such a list will be significant. HSBC, for example, has more than 2,000 subsidiaries. When an issuer proposes to enter a transaction with a person connected with its subsidiary, the issuer will need to perform various checks including whether the subsidiary is “insignificant”. That should be sufficient, and involves significantly less workload than maintaining (and updating) potentially large lists of insignificant subsidiaries.

Although a response has not been invited on this matter, we note that clause 27 of the consultation paper states that if the issuer enters into a continuing connected transaction falling within the proposed exemption, the Exchange proposes that “the duration of the agreement must follow the requirements in Rule 14A.35”.

If, however, the transactions falls within an exemption outlined in 14A.31, then surely there is no requirement to have a written agreement. Requiring written agreements for exempt transactions negates, to some extent, the benefits of that exemption.

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.

HSBC has already come across a number of instances where the insignificant subsidiary exemption was available under the UK Listing Rules, but not under the HK Rules.

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.

We favour option 2, but without the need for three year’s financial figures (see response 3 above).

- (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): **Profits and Assets**

Please provide reasons for your views.

This will be in line with the UK rules.

- (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.

(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.

An agreement should not be required for an exempt transaction.

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.

Proposed rule 14A.33(4)(a) should be deleted.

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.

This will help with consistency of definitions.

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.

This will be in line with international standards.

- (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.

This logically aligns materiality of a transaction to the size of an issuer.

In the example given in the paper, a figure of HK\$500 million is used as a potentially non-disclosable transaction. Whilst the sum may look large, for HSBC a transaction of US\$64 million would represent less than 0.003% of total assets and 0.03% of the market cap.

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.

As indicated in the paper, revenue transactions are excluded in the UK and Australia, and we encourage the Exchange to reconsider not introducing a general exemption for revenue transactions with connected persons. Concerns are expressed in the paper relating to companies with controlling shareholders. In similar manner to the response in Q1, we suggest that consideration also be given, if a general exemption is not allowed, to allowing such an exemption where there are no substantial shareholders at the listed issuer level.

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.

If a transaction is of a revenue nature, in the ordinary and usual course of business and on normal commercial terms, we do not see why it cannot be exempt from the connected transaction provisions.

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.

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.

- (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)*:

No

Please provide reasons for your views.

(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.

(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.

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.

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.

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.

As indicated in the paper, revenue transactions are excluded in the UK and Australia, and we encourage the Exchange to reconsider not introducing a general exemption for revenue transactions with connected persons. Concerns are expressed in the paper relating to the high proportion of majority controlled listed companies and state-controlled PRC issuers. In similar manner to the response in Q1, we suggest that consideration also be given, if a general exemption is not allowed, to allowing such an exemption where there are no substantial holders at the listed issuer level.

If a transaction is of a revenue nature, in the ordinary and usual course of business and on normal commercial terms, we do not see why it cannot be exempt from the connected transaction provisions.

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.

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.

(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.

The present definition including relatives is already extensive, and the proposed change will make the HK Rules even more burdensome.

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.

N/A

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.

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.

It is sensible and helpful to allow the de minimis provisions to apply to issues of securities by subsidiaries.

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.

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 have various additional suggestions to make:

(1) In the UK Listing Rules, the definition of associate, in the section relating to trustees, excludes any trust which is either an occupational pension scheme or an employees share scheme which does not, in either case, have the effect of conferring benefits on persons all of whom or most of whom are related parties. We suggest that a similar exemption be introduced in Hong Kong. In the UK it is common for occupational pension schemes and employee share plan benefits to be delivered through a trust. Such trusts are to facilitate the delivery of benefits to employees as a whole, not just connected persons and it is on that basis that there is an exemption in the UK Listing Rules. Whilst Employee Share Schemes may not be prevalent in Hong Kong at the moment, with recent global developments regarding employee remuneration it is possible that these may become more common.

(2) In annexe 1R to the UK Listing Rules there are two related party exemptions which we feel could usefully be introduced in Hong Kong. These are:

- (a) exempting transactions which were agreed at a time before the person became a related party and have not been amended since the party became a related party, but which takes place after the person is a related party; and*
- (b) transactions that consist of either granting an indemnity to a director if they are in accordance with matters for which directors may be indemnified under the Companies Ordinance, or taking out an insurance contract if it meets those same requirements (i.e. D&O cover, or indemnification for directors).*

(3) We also suggest that the Exchange take this opportunity to amend the definition of subsidiary so that it is restricted to concepts of “control and dominant influence” as used in the Companies Ordinance (s2, s2B and Sch23). Accounting consolidation may not be reflective of actual direct control exercisable by a shareholder in a subsidiary of a listed issuer. Accounting Standards can give rise to consolidation in circumstances where an entity would not otherwise fall within the definition of a subsidiary under the Companies Ordinance. For example, where an Authorised Institution which is a Listed Issuer establishes a special purpose funding vehicle, there may be circumstances where it is required to consolidate the vehicle, even though it is 100% owned by (for example) a charitable trust and the Listed Issuer has no directors on the board of the vehicle. In these circumstances, accounting rules may require consolidation based on who sets up the vehicle and who bears the majority of the risks and rewards (in the absence of definitive and more direct forms of control). Under the existing Listing Rules, consolidation would result in the professional trustee of the charitable trust (in the example given) becoming a connected party to the Listed Issuer.

We therefore submit that the test for application of the rules should be framed by reference to Companies Ordinance definitions of subsidiary which clearly identify the means of influence/control which cause an entity to be considered a subsidiary. This will be similar to the approach adopted in the UK Listing Rules.

(4) Rule 14A.31(2), referring to de minimis transactions, refers to calculations being performed on each of the percentage ratios “other than the profits ratio”. We understand that this means that the profits ratio test need not be carried out, but it is not completely clear from the present wording that this is the case. It would be helpful to take the opportunity to clarify that the profits ratio test need not be carried out when performing the de minimis level tests.

- End -