

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 do not agree with the proposed exclusion for the following reasons:

1. the potential influence of a substantial shareholder or a director of a major operating subsidiary can be significant;
2. check and balance by the issuer's board of directors may not be sufficient especially if the subsidiary has its own board of directors or where the transaction is not substantial;
3. although the Exchange can deem a person as connected person in individual cases, it will be difficult for the Exchange to monitor in practice. The Exchange will not know about the transaction in the first place unless there is a regime under which the issuer is required to notify the Exchange; and
4. under Chapter 14 of the Listing Rules, independent shareholders' approval is only required for a transaction classified as "major transaction" or above. If all transactions with persons connected at subsidiary level are to be excluded from the connected transaction Rules, such transactions will only be subject to independent shareholders' approval if it triggers the 25% major transaction threshold.

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.

We agree with the proposal to introduce an “insignificant subsidiary exemption” subject to the following comments:

1. exemptions in our view should not be considered simply by looking at how significant the subsidiary is. The size of the transaction is also an important factor and we set out below our suggestion for consideration by the Exchange:

(a) all transactions with persons connected at “significant subsidiary” level will be governed by connected transaction Rules; and

(b) transactions between an issuer and persons connected at “insignificant subsidiary” level will also be governed by connected transaction Rules if the size of the transaction reaches a certain threshold (eg. 5% for announcement requirement and 10% for independent shareholders’ approval requirement);

2. a transaction exempted under the “insignificant subsidiary exemption” should be exempted once and for all (please see response to Question 5(d) below).

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.

Yes, we believe the "insignificant subsidiary exemption" under either Option 1 or Option 2 will be used by our clients.

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.

Option 1 is in line with the existing regime in assessing whether a subsidiary is "significant". Further, the "three years average" concept in Option 2 is not in line with the existing Rules (eg. the rules relating to size tests calculation).

(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.

Agree, these ratios are well understood by the market.

(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.

We agree with the proposal subject to the comments below:

1. in addition to consideration ratio, we believe the additional safeguard should cover asset ratio, revenue ratio and profits ratio as well. All these ratios are relevant in assessing the “significance” of a transaction and the consideration ratio on its own may not afford sufficient protection to public investors;

2. the proposed additional safeguard will not be required if our suggestion on Question 3 above is adopted.

(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.

We agree with the following proposals under paragraph 27 of the Consultation Paper:

1. if an issuer enters into any continuing connected transaction falling within the “insignificant subsidiary exemption”, the duration of the agreement must not exceed three years except in special circumstances; and
2. if the connected person no longer qualifies for the exemption, the issuer must comply with all applicable connected transaction requirements (including independent shareholders’ approval) when it renews or changes the terms of the existing agreement or enters into a new agreement for the continuing connected transaction.

However, we do not support the proposal that the issuer must reassess the situation annually based on the latest published audited financial information and, if the exemption no longer applies, the issuer must disclose the facts in its annual report and comply with the reporting requirements. We set out below reasons for our view:

1. the proposal would introduce a new concept to the Rules. Under the current Rules and practice, a transaction which is exempted will be exempted once and for all and there is no need for an issuer to reassess the transaction on an annual basis and to comply with reporting requirements;
2. the proposal will be contrary to the purpose of easing the burden on issuers. The issuers will need to keep track of each exempted transaction and reassess every year whether the “insignificant subsidiary exemption” still applies for the purpose of that transaction; and
3. the requirements set out above (ie. the duration of the agreement must not exceed three years and the issuer must comply with all connected transaction requirements when it renews or changes the terms of the existing agreement or enter into a new agreement) should be sufficient to avoid possible abuse of the “insignificant subsidiary exemption”.

We noted it is proposed in paragraph 28 of the Consultation Paper that for continuing connected transactions, an issuer will need to maintain a record of its insignificant subsidiaries. An issuer could have a large number of subsidiaries and some of these subsidiaries/persons connected with such subsidiaries may never get involved in any transaction with the issuer group. The requirement to identify and maintain a list of all insignificant subsidiaries and to update the list every year would be onerous for an issuer. We would suggest that an issuer is only required to assess whether a subsidiary concerned is an “insignificant subsidiary” when a transaction is in contemplation.

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.

Please see comments on Question 5 above.

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.

We agree with Option 1 for the reasons set out above.

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 less onerous and in line with other markets.

- (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.

This will be less onerous and in line with other markets.

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.

We agree that a percentage threshold is sufficient. Whether a transaction is “material” or not should be determined from the perspective of the issuer concerned and imposing a monetary threshold will be unfair to big companies.

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.

Revenue transactions could be subject to abuse by connected persons like other connected transactions.

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.

On the basis that a "passive investor" has no influence in the management of the issuer or any of its subsidiaries, the proposed exemption would not prejudice the interests of public shareholders.

Given the strict definition of "passive investor", would the Exchange consider extending the exemption to continuing connected transactions which are not of a revenue nature but are entered into on normal commercial terms in the ordinary course of business of the issuer?

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.

Whether the passive investor has management involvement in the associate is not really relevant as the question here is whether the investor can influence management decision at the issuer/subsidiary level.

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.

Such a requirement would make the exemption unnecessarily restrictive. Asset management arms of financial institutions or insurance companies may not be an authorised unit trust or mutual fund.

(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.

The exemption should be made available to private equity funds and asset management arms of financial institutions or insurance companies so long as they are “passive investors”.

(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.

In addition, a “passive investor” should not have influence on the management of the issuer or any of its subsidiaries by way of negative control (eg. reserved matters which require prior approval of the investor).

(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 include:

1. the substantial shareholder and the relevant associate are connected persons only because the substantial shareholder is a substantial shareholder of the issuer or any of its subsidiaries; and
2. the substantial shareholder is independent of the directors, chief executive, controlling shareholder(s) and any other substantial shareholder(s) of the issuer or any of its subsidiaries.

It seems to us that the two conditions are trying to deal with the same concern (ie. the passive investor and its associate are not “connected” for any other reason). Please delete condition (2) or clarify the meaning of “independent” if it is the intention of the Exchange for condition (2) to apply beyond the scope of “connected person”.

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.

Comments:

1. Rule 14A.33(4)(b)(ii): “wide spread of investments” too subjective?
2. Rules 14A.33(4)(b)(iii), 14A.33(4)(b)(iv) and 14A.33(4)(b)(v): replace “listed issuer” by “listed issuer or any of its subsidiaries”?

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.

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 Rules which catch associates of an associate are too onerous. Referring to the structure charts in paragraphs 68(e) and 68(f) of the Consultation Paper:

1. we agree to exclude Company A and Company B as "associates" of Mr. X. Mr. X only holds a less than 50% shareholding in Investee Company and it is unlikely that Mr. X would be able to exert significant influence over the holding company of Investee Company (ie. Company A) and any other subsidiary of the holding company (ie. Company B). Further, as Mr. X does not have any interest in Company A or Company B, the risk of Mr. X taking advantage of his position for the benefit of Company A/Company B is remote;
2. we agree to exclude Company C, Company D, Company E and Company F as "associates" of Company Y. Given Company Y has a less than 50% shareholding in Investee Company and Investee Company in turn has a less than 50% shareholding in Company C, Company Y only has a less than 25% effective interest in Company C and it is unlikely that Company Y would be able to exert significant influence over Company C or any of its subsidiaries, holding companies and fellow subsidiaries (ie. Company D, Company E and Company F). Further, Company Y does not have any interest in Company E or Company F and the risk of Company Y taking advantage of its position for the benefit of Company E/Company F is remote.

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.

We agree that the proposed amendment would help to remove the potential loophole under Rule 14A.11(4).

In addition to a company in which a connected person's relative has a majority control, we believe the amendment should catch all other forms of entities such as joint venture, partnership and trust.

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.

Please see comments on Question 22 above.

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.

It is not the spirit of the Rules to catch these transactions. For intra-group transactions between a connected subsidiary and its own subsidiaries or between subsidiaries of the connected subsidiary, there should not be any concern about abuse of power by any connected person.

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.

Yes, no harm to public shareholders and is in line with the spirit and intent of the connected transaction Rules.

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.

We agree with the reasons set out in the Consultation Paper. Promoters do not by their status as “promoter” have control or influence over the management of an issuer.

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.

The key point is that a “PRC Governmental Body” is not a commercial enterprise and the same principle should apply whether the issuer is a PRC issuer or not.

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.

We agree that an issue of shares by a subsidiary is in substance a deemed disposal by the issuer and that such deemed disposal should be treated in the same way as a straight disposal.

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.

The “pro-rata” requirement should provide sufficient safeguard and we agree that the exemption should apply where the commonly held entity is a connected person.

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.

Comment: In relation to the acquisition exemption, one of the conditions set out in Note 3(iv) is that where the director, chief executive or controlling shareholder of the company being acquired remains a controlling shareholder following the acquisition by the issuer, there must not be any increase in his interest in the company as a result of the issuer's acquisition. Would the Stock Exchange consider adding a similar requirement for the disposal exemption (ie. the exemption will not apply where the director, chief executive or controlling shareholder is also selling his/its interest in the company)?

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.

Please see comments on Question 38 above.

(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.

Quite often formal board approval will not be obtained for an exempted continuing connected transaction and it will be difficult for directors to assess these transactions once a year.

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.

- End -