

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.

As a large number of listed issuers in Hong Kong are offshore holding companies (incorporated in Bermuda or Cayman Islands) and majority of their business activities/operations are carried out at the subsidiary level, the potential influence exerted by a substantial shareholder or director of an operating subsidiary on a listed group could be significant and that transactions with persons connected at the subsidiary level can potentially be detrimental to the minority shareholders of the listed issuer. We would, therefore, have reservations about giving a blanket exclusion of all persons connected by virtue of their relationship with an issuer's subsidiaries from the definition of "connected person".

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.

N/A

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.

While we would support a relaxation of the existing Listing Rule requirements for transactions with persons connected at the subsidiary level, as the relevant rules in Hong Kong are more stringent than those in other major listing jurisdictions such as the United Kingdom, Singapore and Australia, we have reservations about the introduction of a new “insignificant subsidiary exemption” for connected transactions. We consider that the proposed basis for assessing the significance would increase the administrative complexity of the Listing Rules and it could be burdensome for listed issuers to identify and maintain a record of all insignificant subsidiaries.

To avoid increase the complexity of the complicated connected transaction rules further, consideration could be given instead to exempting transactions with persons connected at the subsidiary level by reference to the value of the transactions, which would be consistent with the existing exemption regime for connected transactions.

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.

N/A

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.

N/A

(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.

N/A

(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.

N/A

(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.

N/A

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

N/A

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.

N/A

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.

The 5% threshold is in line with other markets (the United Kingdom, Singapore and Australia) as indicated in paragraph 34 of the consultation paper.

- (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.

In principle, we support raising the current threshold (0.1% of the percentage ratios) to lessen the administrative burden for issuers in relation to immaterial transactions. However, the other markets referred to in the consultation paper do not all adopt the same approach and we are not clear as to the rationale for adopting the proposed 1% threshold (ten times the existing threshold) as opposed to a different threshold.

We would suggest, therefore, that further analysis and explanation may be needed to justify a particular threshold as providing an effective benchmark for material connected transactions.

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.

N/A

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.

In view of the proposed increase in the de minimis percentage threshold, the monetary value of an exempted connected transaction for a large company, as indicated by the example in paragraph 41 of the consultation paper, could be very substantial. Therefore, in order to provide a more effective safeguard to protect the interests of minority shareholders, it would be appropriate to also impose a monetary cap, in addition to the percentage cap, in assessing the de minimis exemptions.

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\$ *it is suggested the Stock Exchange put forward an appropriate level of a monetary cap with reference to the outcome of this consultation.*

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 that it is inappropriate to grant a general exemption for revenue transactions with connected persons for the reasons given in paragraph 53 of the consultation paper.

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.

We believe that the scope for a passive investor to abuse its position would be low if the "passive investor" meets the proposed conditions and criteria set out in paragraph 59 of the consultation paper (subject to our further comments on the proposed criteria, see our response to question 15 below).

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.

We consider that it should be sufficient for the substantial shareholder to be a passive investor in the issuer group.

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.

Without a fuller knowledge of the operation, management, investment objectives and policies of the majority of such funds, it is difficult to give a “yes” or “no” answer on this question. We would doubt, for example, that there should be any initial assumption that sovereign funds are necessarily passive investors.

(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.

We are not in a position to suggest any other broad types of entity to which the exemption be made available. It may be preferable to specify criteria/conditions that would need to be met for an entity to qualify for an exemption and then to consider whether any other broad types of entity generally meet the same.

(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.

This would minimise the scope for a passive investor to exert undue influence over an issuer’s board of directors.

(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.

It appears that the additional conditions (i.e., there is an open market and transparency in pricing the goods or services involved) would minimise the scope for potential abuse of the exemption.

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.

We agree with the reasoning set out in paragraphs 69-70 of the consultation paper.

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 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.

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.

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.

Given that it is not the intention to catch this type of intra group transactions in the connected transaction rules and it has been the Stock Exchange's practice to grant waivers to listed companies from compliance, we agree that it would provide greater clarity and certainty to provide a specific exemption in the Listing Rules for such transactions.

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.

We agree with the reasoning set out in paragraph 81 of the consultation paper.

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 note, from paragraphs 85 and 86 of the consultation paper, that, in practice, promoters of PRC issuers have not been in a position to exert particular influence over the issuers simply because of their promoter status, and that waivers from compliance with connected transaction requirements have been granted by the Stock Exchange to PRC issuers for transactions with their promoters. If the Stock Exchange is satisfied that promoters of PRC issuers are, in principle, (and not merely as a matter of common practice) not in a position to exert particular influence over the issuers because of their role, we would agree to delete such promoters from the definition of connected person.

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.

We have no strong view on this proposal.

Nevertheless, in view of the reasoning for introducing such provisions in the first place, as set out in paragraph 89 of the consultation paper, we would suggest the Stock Exchange consider all the implications of extending the application of these provisions to connected persons of non-PRC issuers, which would appear to go beyond the obvious example of “red-chip” companies referred to in the consultation paper. For example, would this exclude PRC government entities from the requirements of the connected persons rules were a non-PRC, non-red chip listed issuer, in future, to have a related PRC sovereign fund as a significant investor? Would this relaxation be a listing policy of the Stock Exchange that would potentially apply in future to the governmental bodies of Hong Kong listed issuers from other jurisdictions?

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.

A "management shareholder" of a GEM company is any person who can direct or influence the management of the issuer, and so that person could be important to the business development and/or expansion of a GEM company, enabling it to qualify for transfer to the main board. This being the case, we consider that it would be preferable to retain management shareholders in the definition of connected person in the GEM rules, rather than to rely on the Stock Exchange to exercise its power to deem such persons to be connected.

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.

N/A

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 issue of securities by an issuer's subsidiary is, in substance, a deemed disposal of the issuer's interest in that subsidiary, and that its treatment should be same as a straight disposal of a subsidiary by the issuer.

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.

We would accept that the risk of potential abuse of the exemption would be remote if the financial assistance were to be provided on a pro-rata basis.

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.

As regards a disposal transaction, the connected person (by virtue of being a substantial shareholder and controller of the subsidiary to be disposed of (“disposal target”)) has already been within the group and the disposal target for a certain period of time, and as such, its position would be different from the acquisition transaction described in paragraph 105 of the consultation paper. Also, its potential influence over the listed group, or the disposal target, enabling it to gain advantage in the disposition, would be higher than in the situation described in paragraph 105. Under the circumstances, we would have reservations about extending the exemption under Note 3 to Rule 14A.13(1)(b)(i), which seems to be tailored to acquisition transactions, to disposal transactions.

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.

N/A

(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.

It should be made clear that the annual review requirements apply only to continuing connected transactions that are subject to reporting and/or disclosure requirements in Chapter 14A.

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.

Note 1 to rule 14A.11(4) of the Listing Rules (“Note 1”) 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.” Thus, if in addition the company is an “associate” of a person referred to in sub paragraphs (1), (2) or (3) of rule 14A.11 for any other reasons, then that company will itself be a connected person.

The Listing Division's interpretation of Note 1 is that if a connected person has any other interest in the company in question (no matter how small) in addition to his indirect interest through the listed issuer, then that company will be treated as an associate of the relevant connected person.

We do not believe that this interpretation accords with the literal wording of Note 1, as illustrated by the example below.

For instance, an individual holding a small direct holding of say less than 1% in a company which does not make that company an associate of the individual for the purposes of rule 1.01. If that individual then acquires an indirect interest in the company through acquiring shares in the listed issuer and such indirect interest makes that company technically an 'associate' of the individual, then it is a fact

that it is only because of such indirect interest through the listed issuer that the company is an 'associate' of the individual. Under the literal meaning of Note 1, that company should not be a connected person because that small direct interest does not have any bearing upon whether or not the company is an associate of the individual for the purposes of rule 1.01.

We consider that the interpretation adopted by the Listing Division is also inconsistent with the rationale behind rule 14A.11(5) of the Listing Rules. Under rule 14A.11(5), a non-wholly owned subsidiary of a listed issuer will only be considered a connected person 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 of such non-wholly owned subsidiary”. Notes 1 and 2 to rule 14A.11 (5) further elaborate that:

- “1. It follows that a non wholly-owned subsidiary is not a connected person where: (a) no 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 of such non wholly-owned subsidiary; and (b) the non wholly-owned subsidiary is not an associate of a person referred to in rules 14A.11(1), (2) or (3).*
- 2. An interest of a connected person of the listed issuer (other than at the level of its subsidiaries) in the subsidiary which is held through the listed issuer is to be excluded from the 10% referred to in this rule.”*

Under rule 14A.11(5), a degree of significance is built in when deciding whether a non-wholly owned subsidiary of a listed issuer is a connected person of the listed issuer when some connected person(s) of the listed issuer (other than at the level of its subsidiaries) has(have) some direct interest in the non-wholly owned subsidiary not held through the listed issuer.

Accordingly, we believe that, following the literal meaning of Note 1, in assessing whether a company is a connected person of an issuer, one has to assess whether any other interest held by that connected person in the company, other than the indirect interest held through the listed issuer, is an interest which would result in such company being an associate (for the purposes of Rule 1.01) of that connected person.

The Stock Exchange may consider whether the market should be consulted as to any proposed change to Note 1 or alternatively, whether any guidance should be provided as to the proper interpretation of Note 1.

- End -