

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.

The Group strongly supports a relaxation of the Rules relating to transactions with persons connected at the subsidiary level as, in its experience, the vast majority of such transactions are carried out on an arm's length basis and serve the interests of the listed company and its shareholders as a whole. The arguments in favour of excluding persons connected at the subsidiary level are well articulated in paragraph 18 of the Consultation Paper. The Group therefore agrees that in casting the net so wide, the potential exists for the costs, in terms of the issuer's administrative and compliance costs, to outweigh the actual benefits from the perspective of the minority shareholders.

Nevertheless, the Group acknowledges that the situation in Hong Kong is unique in that a large number of its listed companies are off-shore holding companies and all or most of the business activities of those issuer groups are carried out at the subsidiary level. The impact of a complete exemption for all persons at the subsidiary level is therefore potentially greater than in other listing jurisdictions. While actual abuse of the system is rare, the potential for abuse cannot be ignored as the market continues to mature. The Group is generally against using the Exchange's right to deem a person to be connected as a means to catch abusive transactions as an alternative to a blanket ban on all potentially abusive transactions (as suggested at paragraph 19 of the Consultation Paper). Over-reliance on such deeming provisions makes for uncertainty as to the scope of the Rules' application.

For the above reasons, rather than an exemption for all persons connected at the subsidiary level, the Group supports the alternative approach of providing a specific exemption for persons connected with "insignificant subsidiaries". The Group would, however, like to see this area kept under review so that, as the market matures, further relaxation of these Rules can be reconsidered.

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.

Please see the response to question 2 above.

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.

One of the principal areas in which it would be used is in the context of joint ventures below the relevant threshold. Joint ventures involving overseas entities often prove problematic for listed issuers as there is generally no comparable requirement in the jurisdiction of the joint venture partner, especially as continuing connected transactions caught in Hong Kong are often not caught overseas if they are of a revenue nature. Joint venture partners generally operate completely independently and they are often reluctant to disclose annual caps which they regard as commercially sensitive. Ideally such continuing connected transactions of a revenue nature will be able to be exempted in the future (please see the responses to questions 12 and 19 below). In the meantime, however, an exemption for transactions with persons connected at the level of an “insignificant” subsidiary will at least confer an exemption on transactions involving joint venture partners which are below the adopted threshold. Of the two options proposed, the Group prefers Option 2, the UK approach adopting a 10% threshold, which should exempt a greater number of transactions.

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.

As stated in the Consultation Paper, calculation of the threshold on the basis of three years' figures would lessen the impact of unusual results and be less open to manipulation. The Group also considers that the exemption should still apply in circumstances where, as a result of unfavourable economic conditions, such as those existing in 2008, a subsidiary is pushed above the qualifying threshold for the exemption (for example if the issuer's profits/revenues fall more than those of the subsidiary). The Group therefore suggests that the Exchange consider providing for a waiver from strict compliance with the qualifying 10% threshold where failure to meet that threshold results from the issuer being temporarily and adversely affected by the general economic climate. The waiver could be in similar terms to the waiver available to listing applicants from strict compliance with the profit test requirement under Rule 8.05(1)(a) for companies temporarily and adversely affected by the global financial crisis as set out in the Exchange's news release of 5 June, 2009.

In addition, or alternatively, the Group would like to see provision for a "buffer" of a few per cent. above the 10% threshold, so that a minor variance above the 10% threshold in any year will not automatically disqualify a subsidiary from "insignificant subsidiary" status. The objective would be to prevent subsidiaries and relevant transactions see-sawing in and out of the exemption which would be administratively complicated. Clearly, however, it would be necessary to ensure that this latter provision does not allow the qualifying threshold to creep up in individual cases.

- (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.

However, please note the Group's comment above that a waiver from strict compliance with the 10% threshold of revenues or profit should be available to ensure that unfavourable economic conditions affecting the issuer do not deprive companies of the availability of the exemption.

- (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.

The Group agrees with the proposals that agreements relating to exempt continuing connected transactions should be for a limited duration as set out in Rule 14A.35. It is noted however that companies often wish to see a longer permitted duration in order, for example, to secure supplies of raw materials on a long-term basis.

The Group also agrees with the proposal that the availability of the exemption should be reassessed annually, provided that if a subsidiary no longer qualifies as “insignificant”, the issuer is only required to disclose the facts in its annual report and to comply with the reporting requirements under Rules 14A.45 and 14A.46, and is not additionally required to seek independent shareholder approval. This appears to be the effect of the proposed draft Rule 14A.33(4)(b).

As outlined in the response to question 5(a), the Group further considers that there should be scope for: (i) a waiver from strict compliance with the 10% threshold where this is due to temporary adverse economic conditions; and (ii) a buffer zone above the 10% threshold so that a variation above the qualifying threshold which is not material will not result in the loss of the exemption part way through a 3-year agreement.

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.

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? Please provide reasons for your views.

Yes

No

Issuers should find it easier to comply with the Listing Rules if the definitions of the different types of “subsidiary” are consistent. Otherwise a subsidiary which accounts for more than 5%, but less than 10%, of the issuer’s total assets, profits and revenues will be a “major subsidiary” for the purposes of Chapter 13, but an “insignificant subsidiary” for the purposes of Chapter 14A.

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 Group considers that Hong Kong should follow best practice in other major markets and thus should raise the threshold for independent shareholders’ approval to 5%.

- (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.

The percentage threshold should be increased to reduce the administrative burden on issuers in relation to immaterial transactions, particularly if the Rules will not be amended to exempt revenue transactions conducted at arm's length in the ordinary and usual course of business with connected persons.

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.

The Group agrees with the view expressed at paragraph 42 of the Consultation Paper that materiality should be determined as a percentage of any particular issuer's financial figures.

However, as there has been no relaxation of the de minimis exemptions since 1991, the Group would urge the Exchange to consider raising the monetary floors aimed at exempting very small transactions. These currently stand at only HK\$1 million for the exemption from the reporting, announcement and shareholders' approval requirements and HK\$10 million for the exemption from shareholders' approval only.

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.

Logically, it should be the case that revenue transactions conducted on an arm's length basis with connected persons are exempt. Nevertheless, given the large number of majority controlled issuers and state-controlled PRC issuers listed on the Exchange, the Group generally agrees with the Exchange that it may be premature to grant a blanket exemption to all such revenue transactions. The Group nevertheless welcomes the proposed preliminary steps aimed at exempting certain revenue transactions and hopes that the Exchange will keep this area under review as the market matures and Hong Kong's requirements can be brought more into line with those in other major listing jurisdictions.

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.

Transactions with associates of a passive investor present little scope for the investor to abuse its position and, in cases where the substantial shareholder has many other similar investments, the compliance costs for the issuer of meeting the connected transaction requirements could well outweigh the actual risk from the point of view of minority shareholders.

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.

From the point of view of the issuer's minority shareholders, 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.

The Group considers that the exemption should extend to associates of the same class of investors as is contemplated in Note 2(a) to Listing Rule 8.08(1), in relation to the Exchange's discretion not to suspend where an issuer's breach of the public float requirement is due to an acquisition of the issuer's shares by "institutional investors with a wide spread of investments other than in the listed securities concerned". The Group would like to see the same wording used to exempt relevant transactions with associates of all institutional investors, which it would expect, in normal circumstances, to include unauthorised hedge funds and private equity funds.

(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)*:
Governments and institutional investors (as contemplated in Note 2(a) to Listing Rule 8.08(1)).

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.

The Group has no firm views on this matter.

(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.

The Group agrees with the reasoning set out in paragraphs 65 and 66 of 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.

A further possibility which could be considered in addition to the proposed new exemptions would be to follow the approach adopted on the Singapore Main Board. Accordingly, while the connected transaction rules would apply to transactions in the ordinary and usual course of business, provision could be made to allow listed issuers to seek a general mandate from shareholders for recurring transactions of a revenue or trading nature or those necessary for its day to day operations. Conditions similar to those applicable to non-exempt continuing connected transactions under Rules 14A.35 and 14A.36 could be imposed on continuing connected transactions approved under the general mandate. The general mandate would also be subject to annual renewal.

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.

This extension of the definition is consistent with the definition of associate in Rule 1.01. The Group prefers for clarity to be provided in the Listing Rules as to who constitutes a connected person rather than for the Exchange to rely on its power to deem a person to be connected.

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.

As transactions between such parties have been dealt with in the past by the grant of waivers, the Group considers that in order to provide for greater certainty, the Rules should contain a specific exemption covering this situation.

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.

The Group agrees with the reasons given in paragraphs 81 and 82 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.

The Group agrees with the reasoning set out at paragraph 86 of the Consultation Paper.

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.

The Group agrees that the definition of connected person under the Main Board and GEM Rules should be aligned now that the lock-ups after listing under both sets of Rules apply to controlling shareholders rather than management shareholders.

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.

The Group appreciates the logic that if a sale of shares in an issuer’s subsidiary can rely on the exemptions provided by Rules 14A.31(2) and 14A.32 and the sale proceeds used to subscribe new shares in the subsidiary, then an issue of new shares by the subsidiary (i.e. a deemed disposal by the listed issuer) should likewise be eligible to benefit from the de minimis exemption. However, while one Group member agrees with the proposal to remove the restriction, the others consider that there must be an argument for preserving the integrity of the capital structure of the issuer’s group and retaining the disclosure and/or shareholders’ approval requirements for deemed disposals of an issuer’s interest in its subsidiary.

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.

N/A

(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.

In relation to continuing connected transactions, the Group would also like consideration to be given to providing for a buffer in percentage terms above the annual cap. The objective would be to prevent breaches of the annual cap by relatively small amounts triggering the reporting, announcement and independent shareholders' approval requirements under Rule 14A.35(3) and (4). The rationale for this is to prevent an issuer being put in breach of the Listing Rules in cases where the annual cap has often been inadvertently exceeded.

- End -