

Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEx website at: <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp201304.pdf>

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

Chapter III: Plain Language Amendments to Connected Transaction Rules

1. Do you support the proposal to re-write Chapter 14A?

☒ Yes

☐ No

If your answer is “No”,¹ please give reasons for your views.

In principle, HKAB supports the use of plain English, which is a positive step for regulatory reform in Hong Kong. We consider that the use of diagrams generally assists in understanding the connected transaction relationships and will help compliance with the Rules. We therefore support the proposal, subject to the amendments suggested in our response to Question 3 below.

2. Do you consider that the draft new Chapter 14A in Appendix I of the Consultation Paper accurately reflects the current Chapter 14A?

☒ Yes

☐ No

If your answer is “No”, please give reasons for your views.

Leaving aside the developments and clarifications included in the proposed Chapter 14A, we consider that the substance is substantially similar.

3. Do you have any other comments on the draft Rule amendments in Appendix I of the Consultation Paper?

¹ **HKAB note:** HKAB has elected to provide reasons for each of its responses to this consultation (even where reasons are only asked for a “No” response, for example), to assist HKEx to understand and evaluate its responses. We will be pleased to provide further details if needed.

☒ Yes

☐ No

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

Margin notes have been inserted to cross reference the relevant Rules and FAQs. HKAB requests that the margin notes also cover the relevant Listing Decisions, Interpretative Letters and Guidance Materials. This would assist market participants in understanding how the relevant Rules have been applied in practice.

Such cross-references are particularly crucial to issuers when they are negotiating a complex transaction which is potentially a “connected transaction” under a tight timeline. Aggressive transaction timelines often mean an issuer needs to quickly consider implications internally. It is therefore important that all the guidance materials in relation to the relevant Rules are consolidated in one place for the sake of efficient application.

The plain language draft should also clearly define key relevant terms where they are used in a context that is not their ordinary or usual meaning. We suggest that terms such as “group” and “indirect interest” be defined since they are so important to the interpretation of the Rules and are used in ways other than their plain language meaning. For example, in Rule 14A.11, it is unclear whether the “group” refers to an ordinary group of companies (ie, a third party group), or whether it refers specifically to a group of companies of which the connected person is a member (ie, a connected person group).

NB: HKAB has assumed that HKEx’s interpretation and application of the proposed Rule amendments will be consistent with the current Chapter 14A, to the extent applicable (that is, the proposed plain language rewrite will not, of itself, affect that interpretation or application).

Chapter IV: Scope of Connected Persons and Connected Transactions

Part 1 – Scope of connected persons

A. Definition of connected person

A(1) Connected persons at the issuer level

4. Do you agree that there is no need to extend the definition of connected person to the key management personnel of an issuer's controlling shareholder/holding company?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

HKAB supports the proposal, because there are sufficient checks and balances in place to prevent a director of the holding company of the issuer from exerting influence over the issuer to the detriment of minority shareholders. Such a director is already:

- under fiduciary duties to act in best interest of the holding company of the issuer;
- monitored by their fellow directors; and
- subject to the oversight of the shareholders in a general meeting.

Although there is a risk such director may exercise influence over the board of directors of the issuer's controlling shareholder, which then exerts influence over the issuer, HKAB suggests that any regulation to safeguard against this risk would create a significant compliance burden on the issuer in trying to determine whether that director has acted for an improper purpose. An issuer faces practical difficulties in compelling the directors of its controlling shareholder, who are not bound by the Rules, to provide the issuer with the necessary information.

A(2) Connected persons at the subsidiary level

5. Do you support:

- (a) the proposal described in paragraph 90(a) of the Consultation Paper to require transactions with persons connected only at the subsidiary level be subject to the approval of the issuer's board members (including independent non-executive directors) who do not have a material interest in the transaction, instead of the approval of shareholders, and disclosed to the shareholders?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

HKAB supports the proposal to the extent that the issuers will be exempt from obtaining shareholders' approval for transactions between the issuer group and any persons connected at the subsidiary level. HKAB submits that any express requirement to:

- obtain approval by the issuer's board members who do not have a material interest in the transactions ("**Board Approval Requirement**"); and
- disclose the relevant transactions to the shareholders ("**Disclosure Requirement**")

would not seem to offer additional protection to the minority shareholders of the issuers or that any such protection is disproportionate to the compliance burden that would be imposed on issuers.

More specifically, we believe that persons who are connected to an issuer at the subsidiary only are less likely to expropriate value from the issuer to the detriment of minority shareholders because any such transaction is subject to the oversight of the board of directors of the issuer, which is the controlling shareholder of the subsidiary and has an alignment of interests with its minority shareholders. Given that the potential of abuse is very limited, we suggest that the Disclosure Requirement and the Board Approval Requirement will not provide additional safeguards to the shareholders of issuers. In addition, the Listing Rules shall not be looking to protect minority shareholders at the subsidiary level.

As mentioned in the Consultation Paper, the existing Listing Rules governing connected persons at the subsidiary level are more stringent than the equivalent rules in other jurisdictions that were under review. Based on the above, we believe that the Board Approval Requirement and the Disclosure Requirement would impose a disproportionate compliance burden on the issuers.

- (b) the proposal described in paragraph 90(b) of the Consultation Paper to exempt all transactions between the issuer group and connected persons at the subsidiary level, other than transactions between a subsidiary (or any subsidiary below it) and the person connected with that subsidiary?

☒ Yes

☐ No

If your answer is “No”, please give reasons for your views.

HKAB also supports this proposal to the extent that the exemption also covers the transactions between a person connected with a subsidiary and such subsidiary. Alternatively, HKAB submits that the proposal can be modified such that persons connected at the subsidiary level only are exempt from the definition of “connected person”. According to the Consultation Paper, such modified proposal is consistent with the regime adopted in Shanghai, Singapore and Australia.

As mentioned in our response to Question 5(a) above, the existing Listing Rules governing connected persons at the subsidiary level are more stringent than the equivalent rules in other jurisdictions that were reviewed. A narrower scope of connected persons reduces an issuer’s compliance burden, especially where it has a large number of subsidiaries, or other connected persons (such as its directors) at the subsidiary level.

Similar to the reasons given in response to Question 5(a) above, we believe that persons who are connected to an issuer at the subsidiary only are less likely to expropriate value from the subsidiary because any such transaction is subject to the oversight of the board of directors of the issuer, which is the controlling shareholder of the subsidiary.

B. The deeming provision

6. Do you agree with the proposal to introduce principle-based tests described in paragraph 95 of the Consultation Paper for deeming a person as connected?

☒ Yes

and

☒ No

If your answer is “No”, please give reasons for your views.

HKAB **supports** the proposal to deem a shadow director a connected person to the extent that a shadow director under the Rules has the same meaning as that defined

under the Companies Ordinance (“CO”). This ensures consistency of treatment as between the CO and the Rules.

However, HKAB **disagrees** with the proposal to extend the deeming provision to cover *de facto* controlling shareholders of the issuer, and to persons who are accustomed to act according to a connected person’s directions or instructions. These terms do not have any equivalent terms under the CO and HKAB is unclear as to when they would apply.

The existing Rules deem an entity a connected person if it has entered into an arrangement with a connected person. HKAB suggests that this is sufficient and has the effect of covering *de facto* controlling shareholders and persons who are accustomed to act according to a connected person’s directions or instructions, provided that an arrangement with the connected person is in place. A clear line has already been drawn by the existing Rules. Moreover, HKEx has a wide power to deem any person as a connected person under the existing Rules.

C. Exceptions to the definition of connected person

C(1) Insignificant subsidiary exemption (if persons connected at the subsidiary level are not excluded from the definition of connected person)

7. Do you agree with the proposal described in paragraph 100 of the Consultation Paper to exempt all persons connected only because of its relationship with the issuer’s insignificant subsidiaries?

☒ Yes

☐ No

If your answer is “No”, please give reasons for your reviews.

We support the proposal for reason of materiality.

Currently, transactions between the issuer and a person connected to the issuer’s insignificant subsidiaries are exempt if the consideration for the transaction is less than 10% of the total market capitalisation of the issuer. The proposal will mean that all persons connected with the insignificant subsidiary will be excluded from the definition of connected person. Issuers would no longer have to maintain a record of persons connected with insignificant subsidiaries and monitor the size of the transaction with these persons. We consider that this is appropriate since any expropriation of value from the issuer by such person is *de minimis* to the issuer.

However, we are also of the view that the exclusion should be extended to all persons connected because of its relationship with any subsidiary (not just the insignificant subsidiary), for the reasons stated in our responses to Questions 5(a) and (b) above.

C(2) Exemption for trustee interests

8. Do you agree with the proposal described in paragraph 105 of the Consultation Paper to exclude from the definition of associate any trustee of an employee share scheme or occupational pension scheme if the connected persons' interests in the scheme are less than 10%?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

We understand that this proposal is a codification of HKEx's existing practice. As a result, HKAB believes this is a positive step to improve clarity. We therefore support the proposal. However, we suggest that HKEx clarify whether the 10% threshold includes the aggregate interests of all connected persons if several connected persons are beneficiaries of the scheme.

C(3) Exemption for connected person holding an interest in an associate through the issuer

9. Do you agree with the proposal described in paragraph 110 of the Consultation Paper to clarify that the exemption in Note 1 to Rule 14A.11(4) (paragraph 9 of the Guide) would apply if the connected person and his associate's interests in the entity (other than those held through the issuer) are less than 10%?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

HKAB supports the proposal.

The proposal is consistent with the existing requirement, which treats a subsidiary (defined as "connected subsidiary" under Chapter 14A of the Rules) to be connected with the issuer if a connected person has 10% or more direct interest in the subsidiary.

The proposal makes clear that a subsidiary of the issuer is not an associate of a connected person who holds an indirect interest in the subsidiary through their shareholding in the issuer only, unless a connected person holds more than a 10% direct interest in the subsidiary.

Part 2 – Scope of connected transactions

D. Financing arrangements with a commonly held entity

10. Do you agree that we should retain the connected transaction requirements for financing arrangements with commonly held entities?

☐ Yes

☒ No

If your answer is “No”, please give reasons for your views.

HKAB asks HKEx to consider amending the existing connected transaction requirements such that financial assistance by the issuer to a commonly held entity is exempt and not conditional on the financial assistance being given on a pro rata basis.

As expressed in the Consultation Paper, HKEx considers that all the shareholders of a commonly held entity should be responsible for financial assistance given to that entity *pro rata* their respective holdings. HKAB suggests that, in practice, the bank lending to a commonly held entity decides the best entity to provide credit support. A bank is likely to require the issuer to guarantee the repayment of loan obtained by its commonly held entity and that the issuer be solely, or jointly and severally, liable, for the financial assistance. As such, our suggestion has the effect of enhancing the ability of a commonly held entity to obtain loans from banks for legitimate transactions.

We believe the board of the issuer is best placed to determine whether it alone, or all the shareholders, should provide credit support pro-rata their respective holdings.

E. Buying or selling interests in a target company

11. Do you agree with the proposal described in paragraph 131(a) of the Consultation Paper to restrict Paragraph (i) of Rule 14A.13(1)(b) (paragraphs 27 to 29 of the Guide) to transactions involving controllers at the issuer level?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

HKAB supports the proposal, because:

- there is an alignment of interests between the issuer and its controlling shareholders. They both benefit to the extent of their respective holdings in the target; and
- the proposal will exclude these types of transactions and thereby reduces the compliance burden for issuers.

12. Do you agree with the proposal described in paragraph 131(b) of the Consultation Paper to exclude disposals of interests in target companies from Paragraph (i) of Rule 14A.13(1)(b) (paragraphs 27 to 29 of the Guide)?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

HKAB supports this proposal for the reasons outlined in our response to Question 11 above.

13. Do you agree with the proposal described in paragraph 131(c) of the Consultation Paper to remove Paragraphs (ii) to (iv) of Rule 14A.13(1)(b) (paragraphs 31 and 32 of the Guide)?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

HKAB supports this proposal for the reasons outlined in our response to Question 11 above.

Chapter V: Connected Transaction Requirements

F. Compliance framework for continuing connected transactions (“CCTs”)

14. Do you consider that information provided to shareholders regarding CCTs conducted under framework agreements contains sufficient specificity, in particular as to the methods or procedures to determine pricing for investors to make informed decisions?

☒ Yes

☐ No

Not applicable.

If your answer is “No”, please also state the information that you consider should be disclosed in announcements and circulars.

Please give reasons for your views.

HKAB suggests that it is not necessary to expand the CCT disclosure requirements. The existing disclosure requirements governing CCTs which involve entry of framework agreements are specific enough to ensure that the shareholders have sufficient information to assess whether the transactions are on normal commercial terms.

As acknowledged in the Consultation Paper, the actual terms of this type of CCT are usually negotiated subsequent to the date of the framework agreement. As such, it is not unusual for framework agreements to contain generic pricing parameters which are less specific than what the shareholders would expect from a normal commercial agreement.

The disclosure requirement should be practical, but not overly specific, for a framework agreement. Otherwise, we suggest this could curtail the parties’ intention to enter into a framework agreement (for instance, the intention to include generic pricing methods such that parties are less exposed to risks in relation to currency fluctuations and change in market demand).

The requirements for, among other things:

- the independent board committee and independent financial adviser to opine on these transactions in the shareholders circular;
- independent shareholders’ approval to be obtained;
- annual cap to be approved by shareholders when the cap is first set and when the cap is exceeded (but see our comments in response to Question 15);
- annual confirmation by independent non-executive directors that the transactions are on normal commercial terms and were entered into in the interest of the shareholders as a whole; and
- annual review by auditors to confirm that the transactions were approved by the

board, conducted in accordance with the relevant agreement and has not exceeded the annual cap,

provide sufficient safeguards to ensure that these transactions will be entered into on normal commercial terms and not prejudicial to the interests of the issuer and its shareholders as a whole (including the minority shareholders).

These safeguards apply in addition to each director's duty to enter into transactions in the best interests of the issuer.

15. Do you consider that the current Rules governing CCTs and market practice in relation to CCTs that are conducted under framework agreements are appropriate? Do they provide sufficient safeguards to ensure that the transactions will be on normal commercial terms and will not be prejudicial to the interests of the issuers and its minority shareholders?

☒ Yes

☐ No

Please give reasons for your views.

Please see our response to Question 14. HKAB further submits that the requirement to obtain shareholders' approval on the annual cap may restrict issuers from conducting transactions on arm's length basis but does not necessarily ensure that transactions are entered into on normal commercial terms. For that reason, one HKAB member strongly believes that the annual cap requirement should be abolished. We suggest this would not undermine the protections otherwise available under the Rules, as summarised in our response to Question 14, to protect the interests of all shareholders.

F(1) Written agreements

16. Do you agree with the proposal to codify the waiver practice to allow an issuer to obtain a shareholders' mandate (or a mandate from the board if the transactions is exempt from the shareholder approval requirement) in lieu of a framework agreement with the connected person?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

HKAB agrees with the proposal to codify this current practice.

In certain industries, it is not common and may be impractical to enter into written framework agreements. For example, a listed issuer may enter into a transaction with a subsidiary of a connected person, but if that subsidiary operates independently of the connected person, it may require a significant investment of time and effort to negotiate an appropriate framework agreement with the connected person. In such circumstances, the time and cost spent to conclude a framework agreement can be highly disruptive to a commercial transaction, and may be disproportionate to the safeguards that entering into a framework agreement provides.

The proposal acknowledges this practical difficulty and allows issuers to obtain a waiver from the written arrangement requirement provided they give sufficient disclosure to its shareholders. We agree that the proposal strikes the right balance between the protection of minority shareholders and industry practice.

17. If your answer to Question 16 is 'Yes':

(a) Do you agree to limit the mandate period to not more than 3 years?

☐ Yes

☒ No

If your answer is "No", please give reasons for your views.

HKAB does not believe that the proposed change to the waiver practice will be useful in practice unless the duration of the mandate is flexible and can extend longer than three years.

Under the existing Rules, the term of the agreement governing the CCT may be more than three years in circumstances where the nature of the transaction warrants a longer period (provided that an independent financial adviser provides justification for this).

We suggest that the mandate period should be in line with this approach and permit the mandate period to exceed three years in the circumstances mentioned above and on the condition that an independent financial adviser provides sufficient justification for a longer term.

(b) Do you agree with the waiver conditions described in paragraph 151 of the Consultation Paper?

☐ Yes

☒ No

If your answer is "No", please give reasons for your views.

As stated in our response to Question 17(a) above, HKAB disagrees with the three-year time limit for the mandate period. As such, we disagree with this condition for the waiver.

In addition, we do not believe that shareholders' approval is necessary or adds any value at the time of renewing the mandate if the Independent Non-executive Directors can confirm that there are no material changes to the facts and circumstances of the transaction.

F(2) Annual cap

18. Do you support the proposal to allow the cap for a CCT of a revenue nature be expressed a percentage of the issuer's annual revenue or other financial items in its published audited accounts?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

Without prejudice to our recommendation in our response to Question 15, HKAB agrees with the proposal in principle. We understand certain issuers may find it difficult to predict the monetary value of their connected transactions. As a result, issuers may include large buffers in the monetary cap to allow for volatility and changes in market conditions. In such cases, the monetary cap does not accurately reflect the size of the CCT and may not allow shareholders to properly assess the transaction.

The percentage annual cap may be more appropriate for certain issuers, in particular, if the size of the CCT grows in proportion with the size of the issuer, the percentage based cap will more accurately reflect the value of the transaction.

Allowing issuers to express the annual cap for CCTs as a percentage of the issuer's annual revenue gives greater flexibility to issuers to choose the most accurate form of disclosure. This benefits shareholders as they will receive more meaningful information about the CCTs.

However, we think that there needs to be further development and clarification of the Rule.

Suggested clarifications

The proposal only applies to transactions of a revenue nature. We suggest that the proposal should extend to also cover expense transactions. Revenue transactions involve receiving money, and expense transactions involve paying money, but both pose the same risks to minority shareholders for abuse and thus, should be treated similarly under the proposal.

In addition, the proposal needs to clarify which "published audited accounts" would be used as a reference for the percentage cap. If the percentage cap is based off already published accounts, it would be no different to stating a monetary cap since the actual figure can be calculated. For example, if the issuer expressed the cap for CCTs in 2013 at 10% of the revenue for 2012, it is likely that the issuer would already know the exact revenue for 2012 and could simply express the cap as a monetary figure, calculated as 10% of 2012 revenue.

Therefore, HKAB suggests that the proposal would be more useful to issuers and would be a real alternative to the current monetary cap if the percentage is based off the audited accounts in the year in which the transaction takes place. This would mean that a

transaction which takes place in 2013 would be measured against the percentage cap based on the 2013 published accounts. This would allow the issuer to calculate the appropriate percentage level to align with its business plan.

F(3) Auditors' confirmation letter

19. Do you support the proposal described in paragraph 161 of the Consultation Paper to modify the Rules relating to auditors' confirmation on CCTs in line with PN 740?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

HKAB supports the proposal to harmonise the Rules with PN 740. We expect that the proposal will have little practical effect on issuers or corporate advisers, and is mainly aimed at minimising the uncertainty surrounding the current practice of auditors.

G. Requirements for connected transactions involving option arrangements

G(1) Transfer or non-exercise of option

20. Do you agree with the proposed alternative classification Rules for any transfer or non-exercise of an option?

☒ Yes

☐ No

If your answer is “No”, please give reasons for your views.

HKAB supports the initiative to simplify the process, although some HKAB members are concerned that it will lead to additional cost and work for the issuer.

Currently transactions involving the transfer or non-exercise of options are valued as if the option were exercised. The alternative would allow issuers to value the option at the higher of:

- the difference between the exercise price and the value of the underlying assets; and
- any amount payable or receivable by the group.

Importantly, the alternate is the economically correct valuation of the option.

The current method of calculating the value of such a transaction may overstate the real value of the option since the exercise price is not to be paid. The alternate method of calculating the value of options might result in a lower valuation and hence, a lower classification of the connected transaction. This lower classification might exempt the transaction from the connected transaction rules and allow the issuer to avoid certain disclosure and shareholder approval requirements, which we think is reasonable.

However, in order to use this alternative, the issuer will have to obtain:

- a valuation of the underlying assets from an independent expert; and
- a confirmation from the independent non-executive directors and an independent financial adviser that the transaction is fair and reasonable.

These procedures will add to the cost of the transaction. HKAB asks HKEx to consider removing the need to obtain some of these confirmations so that it will be more cost effective for the issuer to choose this alternative. We also ask the HKEx to ensure that the cost of applying the valuation mechanisms it adopts are not disproportionate to the current method of valuing the option as having been exercised.

G(2) Termination of option

21. For any termination of an option involving a connected person:

- (a) Do you agree with the proposal described in paragraph 170 of the Consultation Paper to classify the termination as if the option is exercised unless the issuer has no discretion over the termination?

☒ Yes

or (depending on the valuation method)

☒ No

If your answer is "No", please give reasons for your views.

HKAB's support for this proposal depends on how the termination of the option is valued.

- **Current valuation method** - If this proposal were to be implemented under the current method of classifying transfers or the non-exercise of options, we disagree with the proposal. This is because the current method of calculating the value of the terminated option would be to treat it as having been exercised. We suggest that this does not accurately reflect the value of the transaction. In other words, regardless of whether the option is in- or out-of-the-money, the issuer would have to value the termination as if the option had been exercised. This may overstate the value of the option because by terminating the option, the exercise price would not be paid.
- **New valuation method** - However, if the proposed alternative classification described in section G(1) were to be implemented, then HKAB supports the proposal, since the alternative classification would, in our view, more closely represent the actual value of the termination.

- (b) Do you agree that the proposed alternative classification Rules described in paragraph 166 of the Consultation Paper should also apply to the termination?

☒ Yes

☒ No

If your answer is "No", please give reasons for your views.

HKAB supports for the proposal for the reasons explained in our response to Question 20 above.

H. Minor changes to clarify the requirements relating to independent advice on connected transactions

22. Do you agree with the proposed Rule change to clarify that the independent board committee also needs to advise whether the connected transaction is on normal commercial terms and in the issuer's ordinary and usual course of business?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

HKAB supports the proposal which (as noted in the Consultation Paper) merely clarifies existing market practice.

The proposal to codify this practice is unlikely to impose a significant extra burden on issuers, because it is already current market practice to have the independent board committee give its opinion as to whether a connected transaction is on normal commercial terms and in the issuer's ordinary and usual course of business.

Similarly, the proposal will not affect corporate advisers since they are already required by Rule 14A.22 to give their opinion as to whether the connected transaction is on normal commercial terms and in the issuer's ordinary course of business.

Chapter VI: Exemptions for Connected Transactions

I. De minimis exemptions

23. Do you agree that we should retain the monetary limit of HK\$1 million for fully exempt connected transactions?

☐ Yes

☒ No

If your answer is “No”, do you think that the limit should be increased to HK\$2 million, HK\$3 million, HK\$4 million, HK\$5 million, or some other amount (*please specify with reasons*)?

- ☐ HK\$2 million
☐ HK\$3 million
☐ HK\$4 million
☐ HK\$5 million
☐ Other amount (*please specify*):

Please give reasons for your views.

HKAB disagrees with the proposal to retain the monetary limit of HK\$1 million for fully exempt connected transactions and suggests a higher monetary limit.

The monetary *de minimis* limits are aimed providing issuers a simple exemption for transactions that are deemed too low to present a material risk to shareholders.

The current monetary limit of HK\$1 million for fully exempt transactions has been in place for more than 10 years. The markets and transactions have grown significantly in this time and yet the limit has remained the same. This means that the *de minimis* threshold now offers much less coverage for transactions than it originally did.

Meanwhile, costs of compliance have increased and as a result, the compliance burden is out of proportion with the objective of protecting minority shareholders from detrimental connected transactions.

Smaller issuers will benefit from a higher monetary limit for the *de minimis* exemption. Under the current Rules, only companies with a market capitalisation of less than HK\$1 billion can avoid the Chapter 14A requirements for connected transactions of up to HK\$1 million even if the transaction exceeds the threshold of 0.1%.

We recommend a higher monetary threshold, which would allow larger issuers to take advantage of the exemption and afford greater flexibility to the market. However, we do not express a view as to the specific increased monetary limit for this exemption, but will be pleased to discuss it further with the HKEx if required.

24. Do you agree that we should retain the monetary limit of HK\$10 million for connected transactions exempt from the shareholder approval requirements?



Yes



No. The appropriate limit should be (*please specify*): An updated amount over HK\$10 million that is reflective of relevant compliance costs – see our comments below.

Please give reasons for your views.

HKAB disagrees with the proposal to retain the monetary limit of HK\$10 million for the shareholder approval requirements exemption. We ask that HKEx increase the current monetary limit.

Similar to HK\$1 million monetary limit discussed in our response to Question 23, the HK\$10 million limit has not been increased in over 10 years. Yet, the costs involved in preparing the required disclosures and calling for shareholder approval has gone up. The old monetary limit now covers much fewer and less material types of transactions than it covered when it was originally put in place. As such, the increased cost of compliance is no longer proportionate to the governance objective of protecting shareholders. The monetary limit should be increased to reflect an appropriate contemporary *de minimis* transaction.

We do not express a view as to the specific increased monetary limit for this exemption, but will be pleased to discuss it further with HKEx if required.

J. Exemption for provision of consumer goods or services

25. Do you support the proposal described in paragraph 181 of the Consultation Paper to remove the 1% cap on transaction value for the exemption for provision or receipt of consumer goods or services?

☒ Yes

☐ No

If your answer is “No”, please give reasons for your views.

HKAB supports the proposal.

We suggest that there is minimal risk that minority shareholders will be adversely affected by transactions involving the provision of consumer goods and services. This is because there are already stringent conditions for this exemption, including, among others, the requirement that the transaction be made no more favourably to the connected person than available to independent third parties. In addition, the provision of goods or services must be for private consumption and not for resale or use in the buyer's business.

HKAB also believes that the 1% cap on the transaction value requires issuers to set up systems to monitor the cap and the cost of compliance is disproportionate to its benefit. Removing the 1% cap will ease the compliance burden associated with having to monitor the value of transactions involving consumer goods or services.

K. Exemption for provision of director's indemnity

26. Do you agree with the proposal described in paragraph 183 of the Consultation Paper to exempt an issuer granting indemnity to a director against liabilities that may be incurred in the course of the director performing his duties, if it does not contravene any law of the issuer's place of incorporation?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

HKAB supports the proposal, as it codifies HKEx's existing practice.

It is standard market practice in developed markets for properly advised directors of listed issuers to seek indemnities and insurance to protect themselves from claims arising from the proper discharge of their duties. Importantly, we understand that the indemnities and insurance will only protect directors where they have performed their duties properly and in accordance with the law.

27. Do you agree with the proposal described in paragraph 186 of the Consultation Paper to exempt an issuer purchasing and maintaining insurance for a director against liabilities to third parties that may be incurred in the course of performing his duties, if it does not contravene any law of the issuer's place of incorporation?

☒ Yes

☐ No

If your answer is "No", please give reasons for your views.

HKAB supports this proposal for the same reasons explained in our response to Question 26. It is usual practice in developed markets for directors to seek insurance and indemnities to protect them from any claim which they may face in the proper discharge of their duties.

28. Do you have any other comments or suggestions relating to the connected transaction Rules?

☐ Yes

☒ No

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

Passive Investor Exemption

HKAB asks HKEx to consider expanding the “Passive Investor Exemption” in Rules 14A.31(10) and 14A.33(5) so that they also apply to the Passive Investors themselves (not just their associates). We suggest that the current approach draws an unnecessarily technical distinction between the Passive Investors and their associates, with limited benefit to the protection of public shareholders. We also believe that such expansion would pose a limited risk of abuse in practice.

Revenue transactions

We refer to the consultation paper on connected transaction rules that was published in 2010 and note that certain respondents considered revenue transactions with connected persons that are conducted at arm's length in the ordinary and usual course of business (“**Revenue Transactions**”) should be exempt from the connected transaction rules. This is based on the reasons that the existing Rules are not in line with international norms and impose significant administrative burdens on the issuers, especially when these transactions form part of an issuer’s day-to-day activities.

While the current proposed changes under the Consultation Paper address part of the problems indicated above, the HKAB submits that the Revenue Transactions exemption is worth re-considering.

Although HKEx may have reservations about a one-size-fit-all exemption for Revenue Transactions, the HKAB asks HKEx to consider whether there are any categories of listed company which, by their nature, would undertake Revenue Transactions that are less likely to prejudice minority shareholders. For example, HKAB asks HKEx to consider applying the Revenue Transaction exemption to any listed company which is a regulated entity, such as an HKMA-regulated authorised institution, SFC-regulated registered institution, or an insurance company which is already under prudential regulation. Since the operations and business of these regulated entities have already been regulated for the sake of the interest of their respective depositors, policy holders, shareholders and the public, the HKAB submits that the risk of any substantial shareholders, directors or their associated abusing the relevant regulated entity through connected transactions is very remote. To comply with the regulations to which these regulated entities are subject to, there are numerous systems and controls in place to prevent such abuse. In any case, the size and complexity of these regulated entities generally means that transactions are usually initiated by individual business units and the scope for a connected person to influence individual day-to-day transactions is very

limited. The HKAB notes that time-to-market is crucial to the participants of the financial industry, who are required by the operating environment to make timely business decisions. This is particularly relevant when the changing policies of the central banks on Quantitative Easing cause unprecedented volatility in the market. The existing Rules on Revenue Transactions may not be flexible enough to allow financial institutions to get all sort of timely support from connected persons in the ordinary course of business, especially when the support is needed on an urgent basis.

By way of background, one HKAB member also note that certain markets such as the London Stock Exchange has moved further to exempt all transactions that are made in the ordinary course of business (without distinguishing whether it is an revenue transaction or not), mainly because there was a difficulty in interpreting what was meant by “revenue nature” – certain transactions that were thought suitable for exemption were perfectly “ordinary course” activities but were either an expense item or treated as capital expenditure and it was not clear whether it was only the “revenue” element that was exempt, or whether the test was intended to be generic.

Since HKEx is facing competition for listed business from other markets, anything making our listing environment more competitive is worth considering.

Other than the above, we do not have any further comments other than to thank HKEx for the opportunity to respond to this consultation. Please contact us if you have any questions about our responses, which have been developed with the input of our members and legal support of King & Wood Mallesons.

- End -