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25 June 2013

Corporate Communications Department  
Hong Kong Exchanges and Clearing Limited  
12<sup>th</sup> Floor, One International Finance Centre  
1 Harbour View Street  
Central, Hong Kong

Dear Sirs

**Re: Consultation Paper on Review of Connected Transaction Rules**

The Hong Kong Institute of Directors ("HKIoD") is pleased to forward our response to the captioned paper.

HKIoD is Hong Kong's premier body representing directors to foster the long-term success of companies through advocacy and standards-setting in corporate governance and professional development for directors. We are committed to contributing towards the formulation of public policies that are conducive to the advancement of Hong Kong's international status.

In developing the response, we have consulted our members and organised focused discussions.

Should you require further information regarding our response, please do not hesitate to contact me on tel no. [REDACTED]

With best regards

Yours sincerely  
The Hong Kong Institute of Directors



Issued on: 25 June 2013

### **Consultation Paper on Review of Connected Transaction Rules (April 2013)**

In relation to the Consultation Paper, the Hong Kong Institute of Directors (“HKIoD”) is pleased to present its views and comments.

\* \* \*

#### **General comments**

HKIoD welcome the proposals. Some of the Rule amendment proposals will exclude certain persons or transactions previously subject to the connected transaction rules. We believe they will significantly ease issuers’ compliance burden without compromising the interest of (minority) shareholders.

However, the over-arching principle of the connected transaction rules regime should be to target at those who can exercise significant influence over an issuer for personal gains. The deeming provisions should therefore be augmented to reflect this principle.

Some of the Rule amendment proposals will remove the shareholder approval requirement, and the issuer’s board will appropriately assume the approval authority. In some other situations where shareholder approval requirement is retained, the issuer’s board continues to play an important role in scrutinizing the subject transactions to give confirmation or approval at the issuer’s board level. While directors should conscientiously equip themselves to perform and to act with diligence to discharge their duties, they must also be properly shielded from liability. We therefore think the proposals to encourage issuers to grant indemnity to and purchase insurance coverage for directors are necessary and appropriate.

On a related subject matter, we generally agree with the proposed changes discussed in the **Consultation Paper on Proposed Changes to Align the Definitions of Connected Person and Associate in the Listing Rules**.

We also want to praise the Exchange for making the connected transaction rules easier to understand. The use of plainer language, and in particular the schematic diagrams, goes a long way to help investors as well as practitioners to understand the rules. Going forward, we encourage the Exchange to take a similar approach in Rules or in guidance documents, to consider including schematic diagrams or other forms of illustrations, as appropriate.

\* \* \*

### **Response to consultation questions**

Subject to our general comments above, we state our responses to specific questions as set out in the Consultation Paper as follows.

## **Chapter III: Plain Language Amendments to Connected Transaction Rules**

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

HKIoD Response:

- SUPPORT.

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

HKIoD Response:

- YES, we consider the draft new Chapter 14A an accurate reflection of Chapter 14A.

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

HKIoD Response:

- At this time, we do not have other comments on the plain language amendments in Appendix I of the Consultation Paper.

## **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**

Question 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?

HKIoD Response:

- AGREE.

## A(2) Connected persons at the subsidiary level

Question 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?
- (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?

HKIoD Response:

➤ As to 5(a), SUPPORT.

- HKIoD commented on this issue in the 2010 consultation. There, we recommended that the definition of connected person should exclude persons connected by virtue of their relationship with an issuer's subsidiaries, and we maintain this view. As we stated in the 2010 consultation response, the connected person at the subsidiary level, often the other shareholder of the subsidiary in a joint venture with the issuer, would not have the incentive to provide the information just to facilitate the issuer's compliance with the Listing Rules. To include persons connected at the subsidiary level creates a compliance burden that, even if met, does not yield significant benefit to (minority) shareholders of the issuer.
- However, we can support the current proposal. The connected person at the subsidiary level is unlikely to have undue influence over the actions of the issuer. The interest of the issuer as shareholder of the subsidiary is aligned with the interest of the (minority) shareholders of the issuer itself. The issuer's board should provide sufficient safeguard against abuse and is the appropriate level of approval. There is no need to retain a shareholder approval requirement.

➤ As to 5(b), SUPPORT.

- To exempt transactions between the issuer group and persons connected at the subsidiary level would ease issuers' compliance burden.
- We see no need to exclude from the application of the exemption transactions between a subsidiary (or any subsidiary below it) and the person connected with that subsidiary. However, we can support the proposal. The issuer's board

should provide sufficient safeguard against abuse and is the appropriate level of approval. See also our response to 5(a).

## **B. The deeming provision**

Question 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?

HKIoD Response:

- AGREE.
  - The over-arching principle of the connected transaction rules regime should be to target at those who can exercise significant influence over an issuer for personal gains. Bright-line tests and other specifically enumerated categories of connected persons (or associates) are convenient, but should never overtake and consume this over-arching principle.

## **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)**

Question 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?

HKIoD Response:

- AGREE.
  - See, generally, our response to 5(a) and (b).

### **C(2) Exemption for trustee interests**

Question 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%?

HKIoD Response:

- We can SUPPORT the proposal.
  - We believe there is merit to follow the UK approach to completely exclude trustees of pension schemes and employee share schemes.

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

Question 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%?

HKIoD Response:

➤ AGREE.

**Part 2 – Scope of connected transactions**

**D. Financing arrangements with a commonly held entity**

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

HKIoD Response:

➤ AGREE.

**E. Buying or selling interests in a target company**

**E(a) Exclude controllers at the subsidiary level**

Question 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?

HKIoD Response:

➤ AGREE.

○ See, generally, our response to 5(a) and (b).

**E(b) Exclude disposals of interests in target companies**

Question 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)?

HKIoD Response:

- AGREE.
  - We believe proper application of the deeming provisions under the over-arching principle of targeting those who can exercise significant influence over an issuer would be a better more effective way to address the potential risk of abuse.

#### **E(c) Remove Paragraphs (ii) to (iv) of the Rule (paragraphs 31 and 32 of the Guide**

Question 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)?

HKIoD Response:

- AGREE.
  - We believe proper application of the deeming provisions under the over-arching principle of targeting those who can exercise significant influence over an issuer would be a better more effective way to address the potential risk of abuse.

### **Chapter V: Connected Transaction Requirements**

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

Question 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? If not, what information should be disclosed in announcements and circulars?

HKIoD Response:

- YES.

Question 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 issuer and its minority shareholders?

HKIoD Response:

- YES.
  - However, a monetary cap creates unnecessary restrictions but does not necessarily help (minority) shareholders understand and be assured that the CCTs are on normal commercial terms. A cap expressed as a percentage of some financial statement items might be more useful. See also our response to Q18.

#### **F(1) Written agreements**

Question 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?

HKIoD Response:

- AGREE.

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

- (a) Do you agree to limit the mandate period to not more than 3 years?
- (b) Do you agree with the waiver conditions described in paragraph 151 of the Consultation Paper?

HKIoD Response:

- As to 17(a), AGREE.
- As to 17(b), AGREE.

#### **F(2) Annual cap**

Question 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?

HKIoD Response:

- AGREE.
  - For CCTs of a revenue nature, a cap expressed as a percentage of some financial statement items might be more useful.



- For CCTs of a financial assistance nature, or CCTs not offered in the ordinary course of business, we believe a cap expressed as a percentage of some financial statement items would still be more useful than an absolute monetary amount.

### **F(3) Auditors' confirmation letter**

Question 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?

HKIoD Response:

- AGREE.

### **G. Requirements for connected transactions involving option arrangements**

#### **G(1) Transfer or non-exercise of option**

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

HKIoD Response:

- AGREE.

#### **G(2) Termination of option**

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

HKIoD Response:

- As to (a), AGREE.
- As to (b), AGREE.
  - However, if the value of the option assets as prepared by the independent expert is found to be below certain de minimis threshold, we do not think the issuer

should be required to procure the confirmation from the independent financial advisor.

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

Question 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?

HKIoD Response:

➤ AGREE.

### **Chapter VI: Exemptions for Connected Transactions**

#### **I. De minimis exemptions**

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

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*)?

HKIoD Response:

➤ DISAGREE.

- A limit expressed as a percentage of some financial statement items might be more useful.

Question 24: Do you agree that we should retain the monetary limit of HK\$10 million for connected transactions exempt from the shareholder approval requirements? If not, what is the appropriate limit?

HKIoD Response:

➤ DISAGREE.

- A limit expressed as a percentage of some financial statement items might be more useful.

## **J. Exemption for provision of consumer goods or services**

Question 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?

HKIoD Response:

➤ YES.

## **K. Exemption for provision of director's indemnity**

Question 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?

HKIoD Response:

➤ AGREE.

- The Listing Rules should permit an issuer to provide indemnities for liabilities incurred by directors in the course of performing their duties, so long as it does not contravene any law of the issuer's place of incorporation. We note also that the New Companies Ordinance will permit Hong Kong companies to provide indemnities for directors.
- While directors should conscientiously equip themselves to perform and to act with diligence to discharge their duties, they must also be properly shielded from liability. The uncertainty over the right to be indemnified against liabilities may deter competent persons from accepting directorships and is therefore undesirable. For good policy reasons, the indemnity would not be permitted if the liabilities are in connection with negligence, default, breach of duty or breach of trust in relation to the issuer.

Question 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?

HKIoD Response:

➤ AGREE.

- To cover situations where indemnity from the issuer is not permissible, or where an indemnity from the issuer may become worthless such as when the issuer is insolvent, it is crucial that directors have available to them proper insurance coverage. HKIoD advocates insurance coverage for all board members. See also our response to Q26.

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

HKIoD Response:

➤ NO, not at this time.

- End -