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27 June 2013

Corporate and Investor Communication Department
Hong Kong Exchanges and Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street, Central
Hong Kong

By Fax & By Mail : (852)2524 0149

Dear Sirs,

Re: Consultation Paper on Review of Connected Transaction Rules

We refer to the Consultation Paper on Review of Connected Transaction Rules.

We welcome and support the proposals in the Consultation Paper which are introduced with a view to improving the clarity of the Rules and the ease of compliance for issuers. Our response to the consultation is attached.

The companies legislation in Hong Kong and the Rules are separate regulatory regimes and issuers incorporated in Hong Kong have to comply with both. You may like to take this opportunity to consider whether alignment of the Rules with the statutory provisions is necessary for Hong Kong incorporated companies.

We note that the Consultation Paper has made reference to the restrictions in the Companies Ordinance (Cap. 32) relating to a company's transactions with

its directors and his connected entities and to the rewrite of the Companies Ordinance. We therefore believe that the Exchange in making the proposals have taken into consideration the provisions in the new Companies Ordinance (No. 28 of 2012) in particular those relating to connected transactions.

Part 11 of the new Companies Ordinance governs fair dealing by directors and the connected transactions between a company and its directors and/or entities connected with the directors. Section 486 of the new Companies Ordinance is a new provision which defines the scope of a director's connected entities. Sections 487 and 488 are ancillary to section 486 and define respectively a director's family member and a body corporate associated with a director, both of which are regarded as connected entities. The new Companies Ordinance is expected to commence operation in 2014.

We note that in various parts of the Rules, references are made to the Companies Ordinance and the provisions thereof. We believe the Exchange will in due course make consequential / related amendments to such references in anticipation of the commencement of the new Companies Ordinance. Should you require any further information about the new Companies Ordinance or its implementation, please let us know.

We are considering another Consultation Paper on Proposed Changes to Align the Definitions of Connected Person and Associate in the Listing Rules and would request for an extension of a further 14 days to send you our comments.

Yours faithfully,

A solid black rectangular box used to redact the signature of the Registrar of Companies.

for Registrar of Companies

CR's response

HKEx Consultation Paper on Review of Connected Transaction Rules

Introduction

1. The connected transaction Rules were last amended in June 2010 following the consultation in 2009. The HKEx Consultation Paper on Review of Connected Transaction Rules (the "Paper") presents a number of proposals to amend the connected transaction Rules to refine the scope of connected transactions and to fine tune the framework for continuing connected transactions.
2. A Hong Kong listed issuer which is incorporated in Hong Kong must comply with both the Exchange Listing Rules (the "Rules") and the Companies Ordinance ("CO"). Paragraph 29 of the Paper states that in addition to the Rules, issuers making loans to or having similar transactions with their directors (or entities related to the directors) are also subject to the restrictions set out in the CO. We have considered the proposals in the Paper in the light of the connected transaction provisions in Part 11 of the new CO.

Plain Language Amendments

Proposal 1: Simplify the language of the connected transaction Rules by replacing the current Chapter 14A with the "Guide on Connected Transaction Rules" issued in April 2012 [paragraphs 63 – 65 at page 20]

3. We have no comments.

Scope of Connected Persons

Proposal 2: There is no need to extend the definition of connected person to the directors of an issuer's controlling shareholder/holding company [paragraphs 76 – 80 at pages 26 – 27]

4. The current Rules exclude directors at the controlling shareholder/holding company level from the definition of connected person. The Exchange consider this suitable as it is less likely that an individual director of the holding

company can, acting alone, unduly influence the issuer. The Exchange believe that their definition of connected person at the issuer level is sufficiently broad and covers persons that pose a higher risk of potential abuse. Extending the Rules to directors of the controlling shareholder/holding company may create substantial compliance burdens on issuers without much additional benefits.

Comments:

5.1 In Part 11 (Fair Dealing by Directors) of the new CO, loan transactions and payments for loss of office entered into or made by a company in favour of its directors or the directors of its holding company (and their respective connected entities) are subject to shareholders' approval. The categories of person caught by the relevant provisions in Part 11 include a director (and his connected entities) connected with the subject company by virtue of their relationship with the company's holding company. This is also the current position in the CO in so far as it relates to the prohibition of loan transactions under section 157H.

5.2 The Exchange consider that the key corporate governance risk in respect of listed issuers is the possible expropriation of minority shareholders by the dominant shareholder who controls the issuer. The connected transaction provisions in Part 11 of the new CO apply to all types of companies incorporated in Hong Kong while the Rules apply to listed companies. For unlisted companies, the actual and potential conflicts between the duties and personal interests of directors is one of the major corporate governance concerns. In the premises, the proposal to retain the exclusion of directors of holding company from the definition of connected person in the Rules should not have any bearing on the scope of connected persons and the connected transaction provisions in the new CO as the targets of the respective regulatory regimes are different.

Proposal 3: Introduce further exemptions for connected persons at the subsidiary level [paragraphs 81 -90 at pages 28 – 33]

6. The exemptions proposed are —

6.1 Exempt transactions with persons connected only at the subsidiary level from the independent shareholder approval requirement.

6.2 Exempt all transactions between the issuer group and persons connected at the subsidiary level, other than transactions between a subsidiary (or any subsidiary below it) and the person connected with that subsidiary.

7. Comments:

Under the CO and the new CO, a key concern about connected transactions is that connected persons may take advantage of their positions through transactions with the company or its subsidiaries at the cost of its minority shareholders. A director of the company or of its holding company and his connected entities are caught by the relevant provisions in Part 11 of the new CO because they can exert significant influence over the company's actions and affect the minority shareholders' interests. For a director (or his connected entities) of the company's subsidiary, his/their influence in the company is less obvious. Therefore, the categories of persons caught by the relevant provisions in Part 11 do not include a director (and his connected entities) connected with the subject company by virtue of their relationship with the company's subsidiaries. This proposal for relaxing the exemption for connected persons at subsidiary level would not affect the scope of connected entities or the connected transaction provisions in the new CO.

Proposal 4: Clarify that the provision in the Rules for deeming certain types of person as connected will cover a shadow director and de facto controlling shareholder of the issuer and a person who is accustomed to acting according to a connected person's directions or instructions [paragraphs 91 - 96 at pages 33 - 34]

8. Comments: A shadow director of a company is regarded as a director in the application of the provisions in Divisions 1, 2, 3, 4 and 5 of Part 11. If a body corporate's directors are accustomed to act according to the directions or instructions of a director of a company and/or his connected entities, the body corporate will be regarded as an associated body corporate and thereby falls within the definition of connected entities in Part 11 of the new CO. De facto controlling shareholder of a company is not a connected entity under the new CO. Unlike the Rules, the connected transactions provisions in the CO and the new CO target at directors instead of shareholders. This proposal does not conflict with the new CO provisions governing shadow directors and associated body corporate.

Proposal 5: Refine the definition of connected person to exclude certain persons who are unlikely to control or exert significant influence over the issuer [paragraphs 97 – 111 at pages 34 – 38]

9. Persons proposed to be exempted —

9.1 All persons connected only because of its relationship with the issuer's insignificant subsidiaries. The Exchange consider the risk of abuse would be low as these transactions would still be subject to the notifiable transaction Rules.

9.2 Any trustee of an employee share scheme or occupational pension scheme if the connected persons' interests in the scheme are less than 10%. For issuers listed in Hong Kong, it is already the Exchange's practice to adopt a purposive approach in applying the Rules and they would not treat the trustees of the said schemes as the connected persons' associates if a scheme is established for a wide scope of participants and most of the participants are not connected persons. The proposal is to codify the existing practice.

9.3 Clarify that the exemption in Note 1 to Rule 14A.11(4) that an entity would not be treated as an associate if the connected person holds an interest in the entity only through his/its shareholding in the issuer would apply, if the connected person and his associate's interest in the entity (other than those held through the issuer) are less than 10%.

10. Comments:

10.1 Comments in paragraph 7 above apply to the proposal of exempting persons connected only because of its relationship with the issuer's insignificant subsidiaries (paragraph 9.1 above).

10.2 Section 486(1)(e) in Part 11 of the new CO excludes trustee of a trust for the purpose of an employee share scheme or a pension scheme, of which a director or any of his connected entities is a beneficiary. The proposal to exempt trustee interests (see paragraph 9.2 above) is generally in line with such exclusion of trustee interests in the new CO.

- 10.3 The clarification of the exemption in Note 1 to Rule 14A.11(4) (see paragraph 9.3 above) does not have any impact on the relevant provisions in the new CO.

Scope of connected transaction

Proposal 6: Exclude from the connected transaction Rules certain transactions involving the issuer group buying or selling interests in target companies from or to third parties where the risks of abuse by the controllers is limited [paragraphs 121 – 131 at pages 40 – 45]

11. Transactions proposed to be excluded —

11.1 Transactions with third parties involving target companies partly owned by controllers at the subsidiary level.

11.2 Disposals of interests in a target company in which a controller is a substantial shareholder.

11.3 Issuer's transactions with any third party if the transactions involve the issuer (or its controller) acquiring interests in a target company in a very specific circumstances where the controller has an insignificant (< 10%) interest in the target company.

12. Comments: Under the Rules, transactions between an issuer group and connected persons are connected transactions. Connected transactions also include transactions between the issuer group and third parties that may confer benefit on connected persons. The purpose is to prevent the controllers from using the issuer's resources to enhance their control over the target companies. As Part 11 of the new CO does not have any provisions restricting transactions involving controllers' interests, the proposed exemptions do not have any implication on the provisions in Part 11 of the new CO.

Connected transaction requirements

Proposal 7: Make minor amendments to the regulatory framework for continuing connected transactions ("CCTs") [paragraphs 150 – 161 at pages 54 –

13. Proposed minor amendments —

13.1 Codify in the Rules that the Exchange would allow the issuer to seek a mandate from its shareholders for CCTs over a period of time in lieu of a framework agreement in circumstances where compliance with the requirement would be unduly onerous.

13.2 For CCTs of a revenue nature (other than financial assistance not provided in the issuer's ordinary and usual course of business), allow the annual cap to be expressed as a percentage of the issuer's annual revenue or other financial items in its published accounts (as an alternative to the current requirement for a monetary cap).

13.3 Modify the Rules relating to auditors' confirmation on CCTs to remove inconsistencies with Practice Note 740 issued by the HKICPA.

14. Non-exempt CCTs are subject to certain requirements imposed by the Rules including the signing of a written agreement setting out the specified details and obtaining of independent shareholder approval.

15. Comments: There are no similar provisions in Part 11 of the new CO that govern CCTs as those in the Rules. The proposed minor amendments to the regulatory framework for CCTs under the Rules are not relevant to the regulatory regime of fair dealing by directors under Part 11 of the new CO.

Proposal 8: Revise the requirements for transfer, non-exercise or termination of option [paragraphs 162 – 171 at pages 58 - 60]

16. Currently under the Rules, a transfer or non-exercise of an option is a connected transaction classified as if the option is exercised. The termination of an option involving a connected person is also defined as a connection but the Rules do not require it be classified as if the option is exercised and do not specify how the size tests should be calculated. The proposed revisions are —

16.1 Introduce alternative classification Rules for the transfer or non-exercise of an option granted by a connected person.

16.2 Align the requirements for the termination of an option with those applicable to the transfer or non-exercise of the option.

17. Comments: There are no provisions in Part 11 of the new CO that impose requirements for transfer, non-exercise and termination of options. The proposed revisions do not have any implication on the new CO.

Proposal 9 : Minor change to clarify the requirements relating to the independent board committee's opinion on connected transactions [paragraphs 172 – 173 at page 61]

18. The details of the proposal are set out in paragraphs 172 and 173 of the Paper (at page 61).

Exemption for connected transactions

Proposal 10 : Remove the 1% cap on transaction value which is a condition for the exemption for provision or receipt of consumer goods or services [paragraphs 178 – 181 at pages 65 – 66]

19. The Exchange consider that the other conditions under the current exemption are stringent enough to provide sufficient safeguard for minority shareholders and there are already de minimis exemptions for immaterial connected transactions, they therefore propose to remove the 1% cap (i.e. the total consideration or value of the goods or services must not be less than 1% of the group's total revenue or total purchases).
20. Comments: There is no such exemption in respect of loan transactions in Part 11 of the new CO. Whilst there are other exemptions in the new CO, the nature and the applicable conditions of the respective exemptions in the Rules and the new CO are quite different, but there is no apparent need for alignment of the different provisions.

Proposal 11 : Introduce exemptions for provision of indemnities to directors against liabilities incurred in the course of performing their duties [paragraphs 182 – 186 at pages 66 – 68]

21. Exemptions introduced are —

21.1 Codify the practice by introducing a specific exemption for an issuer granting indemnity to a director against liabilities that may be incurred in the course of the director performing his duties, which does not contravene any law of the issuer's place of incorporation.

21.2 Specific exemption for 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.

22. Comments: Footnote 35 to the Paper (at page 67) gives a brief description of the reforms in the new CO relating to directors' indemnities. As the proposed exemptions will be subject to the law of the issuer's place of incorporation, there would be no conflict between the proposed exemptions and the new CO provisions relating to directors' indemnities.