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PREAMBLE

1. The Stock Exchange of Hong Kong Limited (the "Exchange") plays an important role in the regulation of corporate behaviour by companies listed in Hong Kong. The Listing Rules set out mandatory requirements regulating corporate processes and actions of issuers to ensure the protection of shareholders' rights and the proper disclosure of information to the public. They also contain a set of guidelines and minimum standards on corporate governance for issuers.

2. Over the years, the Exchange has undertaken a series of initiatives to enhance the standards of corporate governance amongst issuers in Hong Kong. These include a complete revamp of the Listing Rules in 1991, the introduction of the Code of Best Practice of directors and the requirement for independent non-executive directors in 1993. We also set up our own ad hoc corporate governance working groups. The disclosure requirements in financial statements were expanded in 1994, 1998 and 2000. As part of our on-going effort to enhance the standards of corporate governance of issuers, we published a consultation paper in January 2002 containing a number of proposed amendments to the Listing Rules relating to corporate governance issues.

3. In addition to the Listing Rules, company and securities legislation has a significant role to play in the corporate governance regulatory framework in Hong Kong. The Exchange's efforts have been complemented by developments to enhance the statutory obligations on listed companies through the introduction of revised standards in the Securities and Futures Ordinance, in particular the enhanced disclosure of interests in securities and the requirement for dual filing, and by proposals from The Standing Committee on Company Law Reform including proposals for a statutory requirement for disinterested shareholder approval of connected transactions, a derivative right of action and strengthening the unfair prejudice remedy.

4. In the light of global developments in the field of corporate governance since publication of the Consultation Paper in January 2002, the Exchange recognises that the new policies arising from the conclusions to this consultation exercise are a partial response to the current prevailing issues and work remains to be done by the Exchange and others as part of the effort to enhance standards in Hong Kong.

5. Good corporate governance practices can help to ensure the protection of shareholders' rights, enhance the effectiveness of a company's board and improve transparency of an issuer's business and performance. Good practices can also bring benefits to a company and to the market in general. The perceived quality of a company's corporate governance can influence its share prices as well as its ability and cost of raising capital. The quality of corporate governance in a market is also closely linked to its development, international reputation and competitiveness as a financial centre. International investors prefer to use markets whose standards of corporate governance are seen to be high. Quality issuers are generally drawn to markets with good reputation.

6. In promoting transparency on a timely basis and high standards of corporate governance, the Exchange and other regulators can assist by setting standards and through enforcement. However, ultimately success will only follow if these efforts are matched by commitment from companies and their directors.

7. The experience of other jurisdictions in assessing the results of similar proposals suggests that it may take some time before the full impact of the new policies arising from this consultation exercise becomes apparent. We will continue to monitor international developments and the development of practice and other regulations in Hong Kong, consider the effectiveness of the proposals introduced through this consultation, and, where appropriate, consult on further targeted proposals.

PART A
INTRODUCTION

BACKGROUND

8. In January 2002, we published a consultation paper inviting views on our proposed amendments to The Rules Governing the Listing of Securities on the Exchange (the "Main Board Rules") and The Rules Governing the Listing of Securities on the Growth Enterprise Market of the Exchange (the "GEM Rules", together the "Rules") relating to various corporate governance issues (the "Consultation Paper"). The Consultation Paper included a number of proposals (the "Consultation Proposals") focusing on the following three areas:

   (a) protection of shareholders' rights;

   (b) directors and board practices; and

   (c) corporate reporting and disclosure of information.

9. The main objective of the Consultation Paper was to strengthen the corporate governance practices of issuers in Hong Kong and bring our standards in line with the best current international market practices, after having regard to Hong Kong's particular circumstances. By raising the local standards of corporate governance, we aim at enhancing investors' confidence in the Hong Kong stock market and reinforcing our status as an international financial centre.

10. The consultation period closed on 24 May, 2002. We received a total of 167 responses coming from a variety of market sectors, including 13 submissions from professional and trade associations and one from a political party. There was also a submission representing near identical responses from 337 individuals who submitted their views to us indirectly via a website operated by a financial analyst. For the purpose of our statistical analysis, this submission has been treated as a single

response. In considering how to proceed, we have had regard to a number of factors in addition to the level of sentiment expressed for individual proposals. Foremost was the substance of arguments put forward in submissions. We also took account of the standing of the respondent. For example, where an organisation responded with the collective views of its members, such a response commanded comparatively greater consideration than the response of an individual.

11. For those Consultation Proposals on which respondents have diverse views, we have looked into the concerns raised by respondents and taken into account comments from different respondent categories, so as to achieve a balance between investor protection including safeguarding shareholders' rights and commercial practicality. We have also had regard to the regulatory practices, experience and developments in other overseas markets in considering how to move our standards of corporate governance towards the current international best practices. In particular, we have made reference to the UK Listing Rules on which our Rules are principally based. We have taken into account other factors such as past history of significant abuses of minority interests and practical issues that may arise from implementing the Consultation Proposals, so as to reflect the characteristics of the Hong Kong market.

12. A statistical analysis of responses to each Consultation Proposal together with a profile of the respondents, are available on the website of Hong Kong Exchanges and Clearing Limited ("HKEx") at www.hkex.com.hk.

13. This Consultation Conclusion Report summarises the views and issues raised in response to the consultation exercise and the final conclusions of the Main Board and GEM Listing Committees (together the "Listing Committees") on the Consultation Proposals.

Result of the market consultation

14. Respondents generally support most of the Consultation Proposals. They also put forward many constructive comments on the Consultation Proposals for our consideration. We are very grateful to all the respondents for their comments and contributions to this consultation exercise.

15. Respondents submit diverse views on some of the Consultation Proposals, particularly on those involving potentially controversial issues. They express concern over the practical issues that may arise from implementing the proposals. We will modify some of these Consultation Proposals so as to reflect the respondents' views, clarify the proposed Rule changes and address the respondents' concerns. We will not adopt certain Consultation Proposals, in the light of the respondents' views and the practical issues that may arise from adopting the proposals.

16. Part B of this Consultation Conclusion Report sets out detailed discussion on the responses received, together with our conclusion on those Consultation Proposals that involve potentially controversial issues and where the respondents have diverse views.

17. Part C of this Consultation Conclusion Report summarises the Consultation Proposals that will be adopted with modifications. Part D of this Consultation Conclusion Report summarises all the Consultation Proposals that will be adopted without modifications. Part E of this Consultation Conclusion Report sets out all the Consultation Proposals that will not be adopted.

18. All the proposed Rule changes set out in this Consultation Conclusion Report apply to both Main Board and GEM Rules, unless otherwise specified.

19. This Consultation Conclusion Report should be read in conjunction with the Consultation Paper. Both papers are available on HKEx's website at www.hkex.com.hk.

NEXT STEPS

20. The objective of this Consultation Conclusion Report is to provide new applicants, existing issuers and market practitioners an overview of our conclusions on the Consultation Proposals and to give a general direction of the proposed Rules changes that will be implemented by the Exchange to enhance the corporate governance practices of issuers.

21. We are currently drafting the revised Rules relating to the Consultation Proposals, which will be subject to approval by the Board of the Exchange and the Securities and Futures Commission. We understand that each of the proposed Rule changes will have different degree of impact on new applicants, existing issuers and market practitioners. **In order to ensure effective implementation of the Consultation Proposals, we intend to implement all the necessary changes to the Rules by the end of the first half of this year. We will announce details of the implementation of the proposed Rule amendments in due course and will give issuers a sufficient transitional period to comply with the new requirements, where considered necessary.**

22. We consider that the proposed Rule changes set out in this Consultation Conclusion Report will enhance our existing Rules and Code of Best Practice, particularly from the perspective of protecting shareholders' rights, strengthening board practices and increasing transparency of issuers. Given the recent corporate governance issues that have arisen, we consider that there are still areas for further improvement so as to bring our standards of corporate governance in line with the current international best practices. We believe that enhancement of the Rules is an ongoing process. We will continue to review the Rules from time to time to ensure that they are in line with the best current market practices and international standards and to take into account the market developments in corporate governance.

PART B
DISCUSSION ON SPECIFIC CONSULTATION PROPOSALS

PROPOSALS WITH DIVERSE VIEWS

23. In the Consultation Paper, we put forward a number of proposals that involve potential controversial issues. The major areas are:

    (a) voting by poll;

    (b) placing of shares using the general mandate;

    (c) introduction of "total assets test";

    (d) new thresholds for notifiable transactions and connected transactions;

    (e) definition of "associate";

    (f) transactions between connected transactions and associated companies;

    (g) minimum number of independent non-executive directors;

    (h) disclosure of directors' remuneration; and

    (i) quarterly reporting.

24. Respondents have divergent views and raise different points and arguments on these Consultation Proposals. In this section, we include detailed discussion on the responses and set out our conclusion on these Consultation Proposals.

Voting by poll

25. The existing Rules do not set out mandatory requirements for voting by poll, except for connected transactions of GEM issuers and the grant of share options to a substantial shareholder or independent non-executive director of issuers, which are subject to shareholders' approval. In most cases, voting at general meetings of issuers is by a show of hands, unless a poll is demanded in accordance with the constitutional documents of the issuers or is required under the Rules.

Consultation Proposal

26. There are views that it is necessary to enhance transparency and fairness of the issuers' voting procedure, particularly when dealing with matters which involve conflicts of interests or have a significant impact on issuers and shareholders. In the Consultation Paper, we proposed to require voting by way of poll for connected transactions and all resolutions requiring independent shareholders' approval (i.e. where controlling shareholders are required to abstain from voting) *(Consultation Proposal B.1.4)*.

Respondents' comments

27. Respondents have diverse views on the Consultation Proposal. Most respondents that disagree with the proposal are issuers. Respondents from professional and trade associations generally support voting by poll. However, they have different views on when voting by poll should be required. Some of them support our proposal to require voting by poll for connected transactions and all resolutions requiring independent shareholders' approval. Others consider that voting by poll should be required for all resolutions. There are also suggestions that voting by poll should be required for all resolutions that require any shareholders to abstain from voting.

28. Most respondents that support voting by poll raise concerns about the shortfalls of the existing practice of voting by a show of hands. They consider that voting by a show of hands does not take into account the voting power attaching to the shares held by shareholders attending the general meetings. As all the votes of shareholders that hold their shares through the Central Clearing and Settlement System ("CCASS") would

be counted as a single vote at the general meeting, the voting rights of these shareholders are disenfranchised. Most issuers' constitutional documents contain certain provisions that enable shareholders to demand a poll and include certain conditions (e.g. the level of shareholding interest and/or the number of shareholders attending the general meetings) for demanding a poll. Some respondents consider that since most retail investors hold their shares through the CCASS, it is very difficult for a shareholder that wishes to demand a poll to fulfil the respective conditions. They suggest that the Rules should include less stringent conditions for shareholders to demand a poll. Respondents further suggest that the poll should be scrutinised by the appointed auditor which should certify the voting results.

29. Respondents that do not support the Consultation Proposals hold different views. A number of respondents consider that voting by poll requires additional time and is costly, particularly where the voting result would be a foregone conclusion, regardless of whether the voting procedure is carried out by way of poll or by a show of hands. Some respondents comment that the existing company laws and issuers' constitutional documents already provide a sufficient channel for shareholders to demand a poll, if considered necessary. Therefore, it is not necessary to introduce further requirements for voting by poll in the Rules. Others comment that shareholders holding shares through the CCASS always have the option to withdraw their shares from the CCASS, if they consider voting by poll is necessary. Therefore, shareholders are free to exercise their right to demand a poll in accordance with the issuers' constitutional documents or the company laws.

Conclusion

30. Given the broad support of various professional and trade associations, we will adopt the Consultation Proposal to require voting by poll for connected transactions and transactions that require controlling shareholders to abstain from voting. We will also extend the requirement of voting by poll to transactions requiring any interested shareholders to abstain from voting. In Hong Kong, most issuers are controlled by a single shareholder or family, or a small group of closely related shareholders. The attendance and participation of minority or public shareholders at general meetings remain low. For the protection

of minority shareholders' rights, we consider that voting by poll should be required for matters that involve conflicts of interests, in which case, interested shareholders should be required to abstain from voting.

31. Given the additional time and costs that may be incurred by issuers, we consider that it may not be justifiable to require voting by poll for all resolutions. The Rules currently set out the conditions for the chairman of the meeting to demand a poll.[1] To further protect the rights of minority shareholders, we will adopt the proposal to require issuers to disclose the procedure of demanding a poll by shareholders pursuant to their constitutional documents (see paragraph 168). Such disclosure must be made in the circulars to shareholders, when voting by poll is not a mandatory requirement under the Rules and in the issuers' constitutional documents. We also propose to include in the revised Code of Best Practice that as a good board practice, the chairman of the meeting should reiterate the procedure of demanding a poll by shareholders at the relevant general meetings. We consider that the enhanced disclosure requirement will promote transparency as to shareholders' rights on demanding a poll at general meetings. We note that relatively few issuers, shareholders and market practitioners are aware of the obligations of the chairman of the meeting to demand a poll under the existing Main Board Listing Agreements and GEM Rules[2]. To promote good board practices, we propose to restate such obligations in the revised Code of Best Practice.

Placing of shares using the general mandate

32. In Hong Kong, it is common for issuers to raise capital through placing of shares using the general mandate. The existing Rules allow issuers to issue securities under a general mandate up to a maximum of 20% of their existing issued share capital. There are no restrictions on the number of refreshments of the general mandate or the price at which securities can be issued under the general mandate.

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[1] Under paragraph 40(3) of Appendix 7A to the Main Board Rules and the GEM Rule 17.47, if the Chairman of the meeting and/or the directors individually or collectively hold proxies in respect of shares holding 5% or more of the total voting rights at the particular meeting, and if on a show of hands a meeting votes in the opposite manner to that instructed in those proxies, the Chairman and/or directors and the Chairman holding proxies as aforesaid collectively shall demand a poll; provided that if it is apparent from the total proxies held that a vote taken on a poll will not reverse the vote taken on a show of hands (because the votes represented by those proxies exceed 50%, 75% or any other relevant percentage, as the case may be, of the total issued share entitled to vote on the resolution in question,) then the directors and/or the Chairman shall not be required to demand a poll.

[2] See footnote 1

33. There have been market criticisms and investor complaints about abuse of the general mandate by some issuers in the repeated issues of shares under the general mandate at a deep discount to the market price. This had resulted in a substantial dilution of the minority shareholders' interest or a significant drop in the share prices.

Consultation Proposal – Number of shares that can be issued under the general mandate

34. In the Consultation Paper, we proposed to retain the existing 20% limit on the issue of securities under the general mandate and to allow unlimited refreshments of the general mandate *(Consultation Proposal B.5.8)*. We also sought views on whether independent shareholders' approval should be required for refreshments of the general mandate and whether a cumulative limit should be imposed on the issue of securities in any rolling three-year period.

Respondents' comments

35. A majority of the respondents which are mainly issuers, support the Consultation Proposal to retain the existing 20% limit for issue of securities under general mandate. Certain respondents consider that given the existing practice of voting by a show of hands and the low attendance rate of minority shareholders at shareholders' meetings, the existing Rules on general mandate have been subject to abuse by controlling shareholders of issuers. Professional and trade associations have diverse views on the Consultation Proposal.

36. Respondents that do not support the Consultation Proposal raise concern over the past abuses of the general mandates by certain controlling shareholders, which have resulted in material and unfair dilution of minority interests. They consider that amendments to the Rules should be made to reduce the maximum number of securities that can be issued under the general mandate and to restrict the number of times that the general mandate can be refreshed.

37. However, there are opposing views that the existing Rules should be retained in order to give issuers flexibility to raise funds in the market. One respondent recommends that the Rules be amended to follow the UK approach and draw a distinction between cash and non-cash issues of securities and between pre-emptive and non pre-emptive issues for cash. In the UK, the Association of British Insurers published a guideline advising members to approve a special resolution for the disapplication of pre-emptive rights, provided that it is restricted to 5% of issued ordinary share capital (as shown in the issuer's latest published annual accounts) and that a company should not make use of more than 7.5% of issued ordinary share capital (as shown the issuer's latest published annual accounts) by way of non pre-emptive issues for cash for any rolling three-year period. Such percentage limits are relevant only to equity securities issued for cash. In practice, most issuers in the UK comply with the 5% limit, and in most cases, they comply with the 7.5% cumulative limit. Issuers in the UK are not allowed to issue shares for non-cash consideration (except for a shares swap or a merger), unless they comply with certain requirements under the UK Companies Act, which include obtaining an expert valuation. They must also comply with the relevant UK Listing Rules requirements for acquisition and disposal transactions.

38. In the Consultation Paper, we sought views on whether our Rules on general mandate should follow the UK approach by imposing a cumulative limit on the issue of securities in any rolling three-year period. A majority of the respondents consider that issue of securities should not be subject to any such cumulative limit. Most of them consider that issuers should be free to raise capital and any such cumulative limit would dampen the fund raising opportunities for issuers to develop their businesses.

39. In the Consultation Paper, we also sought views on whether the number of refreshments of the general mandate should be restricted. A majority of the respondents (mostly issuers) consider that there should not be any restrictions on the number of times that the general mandate can be refreshed so as to give issuers flexibility to raise capital. The fund raising activities of issuers will be dampened and their flexibility curtailed if the number of refreshments of the general mandate is restricted under the Rules.

40. There are opposing views that refreshments of the general mandate should be restricted. Some respondents consider that the existing 20% limit is already sufficient which is evidenced in the practice that most issuers have not refreshed the general mandate after their annual general meetings. Others suggest that refreshments of the general mandate should be subject to independent shareholders' approval.

41. In the Consultation Paper, we sought views on whether refreshments of the general mandate should be subject to independent shareholders' approval. The majority of the respondents (mostly issuers) consider that refreshments of the general mandate should not be subject to independent shareholders' approval. Some respondents comment that since all shareholders have the same interest in refreshments of the general mandate, they should have an equal right to vote. The requirement for independent shareholders' approval to refresh a general mandate would deprive controlling shareholders of their right to vote, thus deviating from the general principle of "one share one vote".

42. According to the responses and commentaries received, in most past cases of abuse of general mandates, the main problem stemmed from issuers' repeated refreshments of the 20% general mandate and issues of shares at a deep discount to the market price. We therefore consider it more appropriate to impose restrictions on refreshments of the general mandate and/or the placing discounts, rather than to lower the existing limit on securities that can be issued under the general mandate.

Conclusion

43. Taking into account the diverse views of respondents, we will adopt a balanced approach by:

    (a) retaining the existing 20% limit on the issue of securities under the general mandate;

    (b) not imposing any restriction on the number of refreshments of the general mandate; and

(c) imposing a limit on the placing discounts to the market price (see paragraphs 53 to 54).

44. Although a majority of the respondents disagree with the independent shareholders' approval requirement, taking into account the past cases of abuse of general mandates, we consider that refreshments of the general mandate (other than at the annual general meetings) should be an additional exceptional circumstance that justifies departure from the general principle of "one share one vote" and therefore be subject to independent shareholders' approval. Since we will retain the existing 20% limit and will not restrict the number of refreshments of the general mandate, we consider that the independent shareholders' approval requirement, together with the placing discount restriction (see paragraphs 53 to 54), will serve as an effective means to safeguard minority interests and address respondents' concerns arising from the placing of shares using the general mandate. This would also strike a balance between the protection of shareholders' rights and commercial practicality.

45. Most GEM issuers are emerging companies that rely on external funds to develop their businesses. In recognition of the different characteristics of GEM and to give more flexibility to GEM issuers to raise funds in the market, we will amend the GEM Rules to require independent shareholders' approval for the second and subsequent refreshments of the general mandate after the annual general meeting. Main Board issuers which, in general, are in a more mature state of development will be required to obtain independent shareholders' approval for any refreshments of the general mandate after the annual general meeting.

46. Similar to other transactions that are subject to independent shareholders' approval, issuers shall establish an independent board committee and appoint independent financial advisers to opine on the reasonableness of the refreshments of the general mandate, which are subject to independent shareholders' approval. Issuers shall also disclose information relating to their past general mandates including the amount of proceeds raised from the issue of securities using those previous mandates, their use of proceeds and other relevant financial information, in their announcements and/or circulars to shareholders.

47. We consider that the Rules on general mandate should cover both cash and non-cash issues of securities, which is different from the UK approach set out in paragraph 37. We consider that since transactions with non-cash issues may also have a significant impact on issuers and may result in a material dilution of interests of the existing shareholders, it is not appropriate to exclude non-cash issues of securities from the Rules on issue of securities under the general mandate.

Consultation Proposal – Restriction on the placing discounts

48. In the Consultation Paper, we also proposed to require issuers to satisfy the Exchange that they are in severe financial difficulties or that there are other exceptional circumstances if they issue securities under a general mandate at a discount of 20% or more to the benchmarked price, being the higher of:

(a) the closing price on the date of signing the placing agreement; or

(b) the average closing price in the five trading days prior to the earlier of:

(i) the date of announcement of placing;

(ii) the date of placing agreement; or

(iii) the date on which the placing price is fixed.

(Consultation Proposal B.5.9)

Respondents' comments

49. A majority of the respondents (mostly issuers) agree with the benchmarked price set out in the Consultation Proposal.

50. In general, the majority of the respondents support the proposed trigger discount level. Professional and trade associations have diverse views on the proposed trigger discount level of 20%.

51. Respondents that do not support the proposed 20% trigger discount have mixed views. Certain respondents consider that the proposed 20% trigger discount is too high and will not prevent abuses of general mandates in the future. They make reference to the UK Pre-emption Guidelines which impose a limit of 5% discount to the market price. However, some respondents consider that issuers should be free from any restriction when setting the placing price. They consider that the placing of shares is a commercial decision of issuers and therefore argue that the placing price should be governed solely by market forces and not be subject to any regulatory intervention.

52. A majority of the respondents consider that issuers should be required to satisfy the Exchange that they are in severe financial difficulties or that there are other exceptional circumstances, if they issue securities under the general mandate at a deep discount to the market price. Some respondents ask for further guidance on how to determine whether or not issuers are in severe financial difficulties.

Conclusion

53. Given the majority support from the respondents, we will adopt the proposed benchmarked price as set out in paragraph 48. In relation to the trigger discount level, we consider that it is reasonable to adopt the proposed trigger discount of 20% in order to strike a balance among the diverse views. We will review the trigger discount level from time to time in view of market developments.

54. In order to address respondents' concerns over the circumstances under which the Exchange will allow the issue of securities at a deep discount to the market price, we will modify the Consultation Proposal set out in paragraph 48. Issuers will be required to satisfy the Exchange that they are in a serious financial position and the only way they can be saved is by an urgent rescue operation, or there are other exceptional circumstances, if they issue securities under a general mandate at a discount of 20% or more to the proposed benchmarked price. This approach is similar to the existing Takeovers Code provisions on granting waivers to the rescuer of a company which is in need of rescue, from the mandatory offer requirements.

Introduction of "total assets test"

55. Under the existing Rules, the "assets test" is computed with reference to the value of the consolidated net tangible assets of the issuer. There have been cases where the Exchange has granted waivers from strict compliance with the "assets test" to issuers with negative or negligible net tangible asset value. The waivers were granted to strike a balance between investor protection and allowing these issuers appropriate flexibility to carry on their business activities whilst providing the market with sufficient information to appraise the position of such issuers. Without such waivers, many otherwise small transactions of these issuers would have been subject to disclosure and/or shareholders' approval under the Rules.

Consultation Proposal

56. In the Consultation Paper, we proposed to adopt total assets as the new basis for the "assets test". Total assets would be defined as total fixed assets, including intangible assets, plus the total current and non-current assets of the issuer *(Consultation Proposal B.18.4)*.

Respondents' comments

57. A majority of the respondents agree with the Consultation Proposal. However, a number of respondents have reservations on the proposed definition of "total assets", particularly on the inclusion of intangible assets as part of the total asset value. There are views that the value of intangible assets is less certain than fixed assets and is subject to issuers' manipulation by using different accounting methods. Certain respondents consider that cash, bank deposits and short-term investments should be excluded from the definition of "total assets". This would avoid situations where issuers inflate their total asset value by obtaining significant loans and depositing the borrowed funds into their bank accounts or investing in bonds or securities.

58. Respondents that do not support the Consultation Proposal have diverse views. Some respondents consider that the existing "net assets test" should be retained. They argue that the total asset value does not reflect the net worth of an issuer or the target company, and therefore should not be used as the basis of the "assets test". There are also views that issuers with low gearing will be penalised, whereas high-gearing issuers which are more risky in nature, will be subject to less stringent requirements, if the "total assets test" and our proposal to lower the thresholds for notifiable transactions are adopted.

59. Some respondents that disagree with the Consultation Proposal suggest to adopt the higher of the size test results of the "net assets test" and "total assets test" for categorising notifiable transactions, because both tests may produce anomalous results. Others suggest that issuers should be allowed to choose between "net assets test" and "total assets test", depending on their gearing ratio. This would take into account various financial structures of issuers. There are also suggestions to adopt the "total assets test" as an additional standalone size test, so as to enhance transparency and disclosure of transactions.

Conclusion

60. Taking into account the diverse views, we will retain the "net assets test" as the norm for the "assets test" under the Rules. However, issuers will be allowed to elect to use total assets as the basis for their "assets test", if they have valid reasons to do so.

61. Issuers will generally be allowed to elect to use the "total assets test" at the time of publication of their annual reports if they have valid reasons to do so. Once such election has been made, issuers will continue to apply the elected "total assets test" until they opt to revert to the norm "net assets test". The Exchange may grant waivers, on a case by case basis, to issuers which, after publication of their annual reports, elect to use the "total assets test", provided they have valid reasons to do so. To promote transparency, issuers which have elected to use the "total assets test" will have to publish an announcement on that election and disclose the reasons for their election in the announcement. Issuers that have elected to use the "total assets test" at the time of publication of their annual report will also be required to disclose the reasons for their

election in their annual report. Issuers will be required to disclose that they have elected to use the "total assets test" in their subsequent annual reports, until they revert to the norm "net assets test". Where an issuer intends to change back to the norm "net assets test", it must have valid reasons to do so and the circumstances that caused the issuer to elect to use the "total assets test" should no longer exist. The issuer must inform the Exchange and the market of its decision.

62. For the purpose of the "total assets test", we will define "total assets" as the total fixed assets, including intangible assets, plus the total current and non-current assets of the issuer, as proposed in the Consultation Paper. Issuers that have elected to use the "total assets test" should apply the total asset value as disclosed in their latest audited accounts. As mentioned in paragraph 57, some respondents disagree with our proposed definition of "total assets", particularly our proposal to include intangible assets as part of the total asset value. The size test calculations under the existing Rules are principally based on the UK Listing Rules. Our proposal to include intangible assets in the definition of the "total assets" is also in line with the approach adopted under the UK Listing Rules.

63. For consistency, issuers that have elected to use the total asset value as the basis for their "assets test" calculation shall use the same asset basis for their "consideration test", de minimis provisions for connected transactions and other provisions of the Rules that have reference to "net tangible assets" or "net assets".

New thresholds for notifiable transactions and connected transactions

64. The Main Board Rules set out four categories of notifiable transactions, namely share transactions, discloseable transactions, major transactions and very substantial acquisitions. In addition to these four categories of notifiable transactions, the GEM Rules contain a separate category of transactions known as "reverse takeover" which deals with backdoor

listing. Under the Rules, classification of notifiable transactions is determined by comparing the size of a transaction with the size of the issuer proposing to enter into the transaction. The existing thresholds for categorising notifiable transactions (other than "reverse takeover" transaction under the GEM Rules) under the size tests are summarised in the following table.

	For all size tests (i.e. net assets test, profits test, consideration test and equity test)	
	Main Board Rules	GEM Rules
Share transaction	Less than 15%	Less than 15%
Discloseable transaction	15% or more, but less than 50%	15% or more, but less than 50%
Major transaction	50% or more but less than 100%	50% or more
Very substantial acquisition	100% or more, or there will be a change in control	• 200% or more; or • 100% or more and the acquired business is different from the current principal activities of issuers; or • 100% or more and there is an intention to make a major change in the principal activities of issuer.

65. The Rules also set out the following de minimis thresholds for connected transactions which are exempt from the requirements of disclosure, reporting and/or shareholders' approval.

	Adopting the net tangible asset value as the basis
De minimis threshold for exemption from disclosure, reporting and shareholders' approval requirements	Less than the higher of: (i) HK$ 1 million; or (ii) 0.03% of the net tangible assets of the issuer.
De minimis threshold for exemption from shareholders' approval requirement	Less than the higher of: (i) HK$ 10 million; or (ii) 3% of the net tangible assets of the issuer.

Consultation Proposal

66. In view of our proposal to adopt the "total assets test", we proposed in the Consultation Paper to adjust the thresholds of the relevant size tests and the de minimis thresholds for connected transactions *(Consultation Proposals B.19.6 and B.28.2)*. The proposed thresholds are summarised as follows.

Notifiable transactions (for both Main Board and GEM Rules)

	For all size tests (i.e. total assets test, profits test, turnover test, consideration test and equity test)
Share transaction	Less than 5%
Discloseable transaction	5% or more, but less than 25%
Major transaction	• 25% or more, but less than 100% (for acquisition) • 25% or more, but less than 75% (for disposal)
Very substantial disposal	75% or more
Very substantial acquisition	100% or more

Connected transactions and continuing connected transactions (for both Main Board and GEM Rules)

	Adopting the total asset value as the basis
De minimis threshold for exemption from disclosure, reporting and shareholders' approval requirements	Less than the higher of: (i) HK$ 1 million; or (ii) 0.01% of the total assets of the issuer.
De minimis threshold for exemption from shareholders' approval requirement	Less than the higher of: (i) HK$ 10 million; or (ii) 1% of the total assets of the issuer.

Respondents' comments

67. Respondents have diverse views on the proposed thresholds for share transactions, discloseable transactions and major transactions. Some respondents do not support these proposed thresholds because they disagree with adopting the "total assets test" in the first place. They consider that adopting the "total assets tests" and lowering the thresholds would penalise issuers with low gearing. There are also views that the proposed thresholds are too onerous for GEM issuers.

We note that among the respondents that support adopting the "total assets test", a majority of them also support the proposed thresholds for share transactions, discloseable transactions and major transactions as set out in the Consultation Paper.

68. A majority of the respondents support the proposed thresholds of 100% for very substantial acquisitions ("VSAs") and 75% for very substantial disposals ("VSDs").

Conclusion

69. In view of the adoption of the proposal on the "total assets test" as modified in paragraphs 60 to 63, we will adopt all the proposed thresholds for classifying transactions using the "total assets test". We will retain all the existing thresholds for classifying transactions using the net assets test, profits test and equity test under the Rules (except for the threshold for classifying VSAs using the net assets test). Issuers will be required to adopt the thresholds they have used for classifying transactions using the elected "assets test", for their consideration test. Similarly, we will adopt the proposed de minimis thresholds for issuers which have elected to use the "total assets test" and retain the existing de minimis thresholds for issuers that have retained the "net assets test", for connected transactions and continuing connected transactions which are exempt from the disclosure, reporting and/or shareholders' approval requirements.

70. For classifying VSAs using the net assets test, the Main Board Rules currently adopt the threshold of 100%. The GEM Rules adopt thresholds of 100% or 200%, depending on whether or not the transaction will result in a major change in the principal activities of the issuer, or the acquired assets are different from the current principal activities of the issuer. As we will implement Rule changes to introduce the reverse takeover Rules to Main Board to regulate transactions that involve a change in control (see paragraph 194), VSAs will purely be a size test for classifying notifiable transactions. As we are adopting the proposed threshold of 75% for VSD transactions (see paragraph 71) and the proposed threshold of 100% for VSA transactions using the "total assets test" (see paragraphs 69 and 73), we consider that it is appropriate to adopt the threshold of 150% for VSAs under the net assets test.

71. We will adopt the proposed threshold of 75% for classifying VSDs using the "total assets test", given the majority support from the respondents. For practical reasons, we will adopt the same threshold for classifying VSDs using all other size tests.

72. In the Consultation Paper, we proposed to change the threshold level for requiring a valuation report to 25% (i.e. the proposed threshold for major transactions), given the adjusted thresholds for categorisation of notifiable transactions under all size tests *(Consultation Proposal B.20.6)*. In line with the existing requirements for valuation reports, we will modify the threshold level for requiring valuation reports to follow the major transaction thresholds under the Rules. As discussed in paragraphs 69 and 73, the major transaction thresholds for "net assets test" and "total assets test" will be 50% and 25%, respectively.

73. The following table summarises all the thresholds we will adopt for classifying notifiable transactions, connected transactions and continuing connected transactions using different size tests.

Notifiable transactions (for both Main Board and GEM Rules)

	Adopting the total asset value as the basis of the "assets test" and consideration test	Adopting the net tangible asset value as the basis of the "assets test" and consideration test	Profits test/ turnover test/ equity test
Share transaction	Less than 5%	Less than 15%	Less than 15%
Discloseable transaction	5% or more, but less than 25%	15% or more, but less than 50%	15% or more, but less than 50%
Major transaction	25% or more, but less than 100% (for acquisition) or less than 75% (for disposal)	50% or more, but less than 150% (for acquisition) or less than 75% (for disposal)	50% or more, but less than 100% (for acquisition) or less than 75% (for disposal)
VSA	100% or more	150% or more	100% or more
VSD	75% or more	75% or more	75% or more

Connected transactions and continuing connected transactions (for both Main Board and GEM Rules)

	Adopting the total asset value as the basis of the "assets test"	Adopting the net tangible asset value as the basis of the "assets test"
De minimis threshold for exemption from disclosure, reporting and shareholders' approval requirements	Less than the higher of: (i) HK$ 1 million; or (ii) 0.01% of the total assets of the issuer.	Less than the higher of: (i) HK$ 1 million; or (ii) 0.03% of the net tangible assets of the issuer.
De minimis threshold for exemption from shareholders' approval requirement	Less than the higher of: (i) HK$ 10 million; or (ii) 1% of the total assets of the issuer.	Less than the higher of: (i) HK$ 10 million; or (ii) 3% of the net tangible assets of the issuer.

Definition of "associate"

74. Under the Rules, an "associate" in relation to any directors, chief executive and substantial shareholder of an issuer, being an individual, means:

(a) his family members;

(b) the trustees of any trust of which he or any of his family members is a beneficiary or, in the case of a discretionary trust, is a discretionary object; and

(c) any company in which he and/ or family members together have a controlling interest, its subsidiary, holding company and a fellow subsidiary of such holding company.

In relation to a substantial shareholder which is a company, an "associate" means its subsidiary, holding company, a fellow subsidiary of such holding company, and any company in which the company and such other company or companies together have a controlling interest. Under the Rules, "controlling interest" refers to 30% or more of the voting power at general meetings of the issuer or who is or are in a position to control the composition of a majority of the board of directors of the issuer.

75. There have been comments on whether the definition of "associate" under the Rules should be extended to cover any parties that may exercise significant influence over the issuer, as well as settlors and beneficiaries of any trust of which a director, chief executive or substantial shareholder or any of his family members is a beneficiary.

Consultation Proposal

76. In the Consultation Paper, we proposed to retain the definition of "associate" under the Rules *(Consultation Proposal B.25.6)*. We also sought views on whether the existing definition of "associate" should be extended to other parties.

Respondents' comments

77. Respondents have diverse views on the Consultation Proposal. Respondents that support retaining the existing definition of "associate" under the Rules consider that the existing definition of "associate" is already very wide. Issuers will encounter practical difficulties in ensuring compliance with the Rules if the existing definition of "associate" is extended. Some respondents suggest that it is illogical to apply the concept of "connected persons" to settlors and beneficiaries of any trust of which a connected person or any of its associates is a beneficiary or discretionary object, since these parties may not necessarily be controlled by the connected person.

78. There are also opposing views that it is necessary to extend the definition of "associate" to lift the corporate veil of the ultimate controlling shareholders of the issuer. Some respondents suggest that the definition of "associate" should cover the following parties:

    (a) any trustee of a trust into which any director, chief executive or substantial shareholder has settled or transferred shares of the issuer other than for full value, which has been paid to him and which was not directly or indirectly provided, secured or guaranteed by him; and

(b) in relation to a substantial corporate shareholder, any person or concert party who controls 30% or more of a corporate substantial shareholders, whether directly or through a chain of such shareholdings.

79. Certain respondents consider that there are practical difficulties in establishing whether the connected person in question has control over a particular associate. They consider that applying a threshold of more than 50% is more sensible for the purpose of establishing control over a company. They suggest that whilst one can use the definition of "control" under the Takeovers Code to establish prima facie control and determine whether a particular entity should be regarded as an associate, this can be rebutted if one can show that there is no de facto control.

Conclusion

80. Given the diverse respondents' concerns and the practical issues that may arise if the Consultation Proposal is adopted, we consider it necessary to further study and review the definition of "associate" before finalising our conclusion thereon. For the time being, we will retain the existing definition of "associate" under the Rules.

Transactions between connected persons and associated companies

81. The Rules regulate connected transactions between connected persons and the issuer or its subsidiaries. However, the Rules do not regulate transactions between connected persons and associated companies (in the accounting sense) of the issuer. In this context, "connected persons" include directors, chief executives and substantial shareholders of a listed group and any of their associates.

82. There have been views suggesting that associated companies in the accounting sense which are of significant importance to a listed group should be brought within the regulatory net of connected transaction Rules.

Consultation Proposal

83. In the Consultation Paper, we proposed to extend the Rules to regulate transactions between connected persons and associated companies. The connected transaction provisions will only apply if the listed group, together with the connected persons of the issuer, have control over such associated companies. The term "control" was defined in the Consultation Paper as having the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Such control may exist even if the issuer owns 50% or less of the voting rights in another entity *(Consultation Proposal B.26.9)*.

84. We also proposed to extend the definition of "connected person" to include a director, chief executive or substantial shareholder of such an associated company or any of their respective associate, if the proposal set out in paragraph 83 is adopted *(Consultation Proposal B.24.8)*.

Respondents' comments

85. A majority of the respondents including various professional and trade associations are not in favour of the Consultation Proposal to regulate transactions between connected persons and certain associated companies.

86. Certain respondents consider that transactions between associated companies and connected persons may have significant impact on an issuer, given the amount of funding provided by the issuer to the associated companies. In order to enhance protection of minority interest, the Rules governing notifiable transactions should also apply to "off-balance sheet vehicles" proportionate to the issuers' percentage interest in such vehicles.

87. Respondents that do not support the Consultation Proposal express concerns that issuers will encounter practical difficulties in monitoring transactions between connected persons and associated companies and ensuring that these transactions comply with connected transaction Rules. Some respondents suggest that since an issuer does not have control over its associated companies, such companies may enter into a transaction with connected persons without bringing it to the issuer's attention. Also, the outcome of the respective shareholders' meeting held by the issuer would have no impact on the transaction between an

associated company and a connected person of the issuer. The transaction can still proceed even if it has been voted down by shareholders of the issuer. Others consider that connected persons may not necessarily act in accordance with the direction of the issuer or be controlled by the issuer. Therefore, it is not appropriate to aggregate interests of the issuer and its connected persons to determine whether the issuer has control over its associated company.

Conclusion

88. Taking into account the majority views and practical concerns of the respondents, we will not adopt the Consultation Proposal to regulate transactions between connected persons and associated companies for the time being. Accordingly, we will not extend the scope of "connected persons" to cover directors, substantial shareholders and chief executive of the associated companies over which an issuer and/or its subsidiaries, together with connected persons of the issuer, have control, and any of their associates.

89. We will review our position on the regulation of transactions between connected persons and associated companies from time to time in the light of market developments.

Minimum number of independent non-executive directors

90. Independent non-executive directors ("INEDs") play a pivotal role in the corporate governance of issuers, particularly in overseeing the internal control and financial reporting systems of issuers, and providing checks and balances over the board's decision-making on significant transactions or transactions involving conflicts of interests. They also provide valuable contribution to the board of issuers by bringing their knowledge, experience, expertise and insights to the board in the formulation of policies, development of strategies and resolution of issues. Under the Rules, every issuer must have at least two INEDs.

Consultation Proposal

91. Given the increasingly important role of INEDs and to ensure that the views of INEDs carry significant weight in the board's decisions, we proposed in the Consultation Paper that issuers shall appoint INEDs representing at least one-third of the members of the board and a minimum of two INEDs in any event *(Consultation Proposal C.3.5)*.

Respondents' comments

92. A majority of the respondents which are mainly issuers, disagree with the Consultation Proposal. Respondents' support for the Consultation Proposal and the existing requirement for a minimum of two INEDs are more or less tied.

93. A number of the respondents that do not support the Consultation Proposal, have no specific view on the appropriate number of INEDs that should be appointed by issuers. These respondents as well as those that support retaining the existing requirement for two INEDs raise practical concern over the limited supply of qualified INEDs in the market. They argue that the Consultation Proposal would probably impose additional burden on issuers, particularly the smaller ones, to appoint sufficient INEDs to the board. This may result in a compromise in the quality of INEDs. Some respondents argue that issuers may find it difficult to re-arrange their board compositions in order to meet the proposed requisite percentage of INEDs on the board. Others consider that the existing requirement of two INEDs is sufficient to safeguard the interest of minority shareholders. Some respondents argue that issuers should focus on independence, quality and calibre of INEDs, rather than the number of INEDs on their board.

94. Some respondents have concerns over the increasing responsibilities of INEDs as proposed in the Consultation Paper. They suggest that it is necessary to increase the number of INEDs so that there are sufficient INEDs to properly discharge the duties and responsibilities of those newly established specialised governance committees. Other respondents consider that given the limited supply of suitably qualified INEDs in the market, the personal liability for INEDs should be reduced and the responsibilities for executive directors should be heightened in order to develop the role of INEDs as an effective check and balance on the boards of issuers and to strengthen corporate ethical and cultural standards within executive management.

Conclusion

95. We consider that the quality and independent state of mind of INEDs are essential for ensuring effectiveness of their check and balance role. We also recognise that issuers, particularly the smaller ones, may encounter practical difficulties in finding suitably qualified INEDs to comply with the respective requirement under the Rules. In order to deal with the issue of limited supply of qualified INEDs in the Hong Kong market, we are considering introducing some long-term measures to help raise the overall quality of directors and increase the number of qualified INED candidates in Hong Kong.

96. Given the increasing responsibilities under the proposed amendments to the Code of Best Practice and as a move towards our long-term aim to increase the number of INEDs on the board, we will amend the Rules to require issuers to appoint at least three INEDs. In order to further enhance the corporate governance practices of issuers and to bring our standards in line with the international best market practices, we will recommend in the revised Code of Best Practice as a recommended good practice (see paragraph 129) that issuers should appoint INEDs representing at least one-third of their board. The "one-third" should be "rounded down" to the nearest whole number.

97. We will allow a transitional period of one year for issuers to comply with the new requirement for the minimum number of INEDs. We will further review such requirement in two to three years in the light of the experience after amendments to the Rules and the Code of Best Practice.

Disclosure of directors' remuneration

98. There have been concerns about the level of remuneration paid to the directors of issuers and the lack of scrutiny for increase in directors' remuneration. There are views that directors of certain issuers have received significant increases in remuneration notwithstanding the issuers' disappointing performance and business outlook. Under the Main Board Rules, issuers are required to disclose directors' remuneration

in annual reports by bands. GEM issuers are required to disclose directors' remuneration on an individual but "no name" basis. There are views that such information is not sufficient for shareholders to assess issuers' remuneration policies in the context of the issuers' performance.

Consultation Proposal

99. To promote transparency and facilitate accountability of directors to shareholders, we proposed in the Consultation Paper that issuers shall be required to disclose directors' remuneration and compensation packages in their annual reports on an individual, named basis *(Consultation Proposal C.21.3)*.

Respondents' comments

100. A majority of the respondents (mostly issuers) do not support the Consultation Proposal and consider that the existing requirement of disclosing directors' remuneration by bands should be retained.

101. Respondents that support the Consultation Proposal consider that disclosure of directors' remuneration on an individual, named basis would increase transparency of issuers and bring our standards in line with the best practices of other international markets. This would also provide useful information for shareholders to assess the reasonableness of directors' remuneration based on their performance.

102. Respondents that do not support the Consultation Proposal generally consider that the proposal would result in disclosure of commercially sensitive information, which may cause issuers difficulties in retaining talented directors. There are also concerns that disclosure of directors' remuneration on a named basis may invade privacy and affect the personal safety of directors. Some respondents consider that the current disclosure of directors' remuneration by bands already provides sufficient information for shareholders to assess the reasonableness of the amount of directors' remuneration. They consider that the Consultation Proposal would not provide any additional benefit to promote good corporate governance of issuers.

Conclusion

103. On balance, we consider it more important to promote transparency on remuneration matters so that shareholders would be in a better position to assess the reasonableness of the issuers' remuneration policy. To address respondents' concern over the privacy of directors, we have modified our Consultation Proposal. We will amend the Main Board Rules to require issuers to disclose directors' remuneration on an individual but "no name" basis. The existing GEM Rules already have this disclosure requirement. To promote transparency, we will include the requirement for disclosure of directors' remuneration on an individual, named basis in the revised Code of Best Practice as a recommended good practice (see paragraph 129). Issuers will not have to give explanation in their report on corporate governance if they do not adopt such practice.

104. We will clarify in the Rules that issuers will be required to give a general description of the remuneration policy and long-term incentive schemes and the basis on which INEDs' remuneration are determined.

Quarterly reporting

105. The GEM Rules require issuers to publish quarterly results announcements and despatch quarterly reports to shareholders within 45 days of the quarter end. The Main Board Rules do not contain any quarterly reporting requirements.

Consultation Proposal

106. To promote transparency, we proposed to amend the Main Board Rules to follow the GEM Rules and require Main Board issuers to publish their quarterly results announcements and despatch their quarterly reports within 45 days of the quarter end *(Consultation Proposals D.1.11 and 2.4)*. We also proposed to amend the Main Board Rules to require audit committees to review their issuers' quarterly reports and quarterly results announcements *(Consultation Proposals D.1.13 and 2.6)*.

107. In relation to the disclosure requirements for quarterly reporting, we proposed to amend the Rules to require Main Board and GEM issuers to include as a minimum the information set out in Appendix I to the Consultation Paper in their quarterly reports and quarterly results announcements *(Consultation Proposals D.1.12 and 2.5)*.

108. We also proposed to amend the Rules so that for quarterly reporting, the relevant "black out" period for securities transactions by directors in the Rules will be two weeks immediately preceding the earlier of the date of the board meeting approving the quarterly results and the deadline of publication of the results announcement, and end on the date of the results announcement. No amendments to the Rules will be made for the relevant "black out" period for half-year and annual results *(Consultation Proposal C.19.7)*.

Respondents' comments

109. A majority of the respondents (mostly issuers) disagree with quarterly reporting for Main Board issuers. Professional associations and organisations have diverse views on the Consultation Proposal to require Main Board issuers to publish their quarterly results.

110. Respondents that support the Consultation Proposal consider that quarterly reporting would increase transparency and bring our reporting standards in line with the international practices.

111. Respondents that do not support quarterly reporting for Main Board issuers express concerns over the practical issues that may arise from implementing the Consultation Proposal. They consider that quarterly reporting is time-consuming and would create a significant cost burden on Main Board issuers, particularly for those with complex corporate structure and diverse geographical operations. This may affect the quality of financial reporting and divert issuers' resources from other important matters. Some respondents are concerned that quarterly reporting might lead investors and management to focus on short-term financial performance, possibly at the expense of longer term financial performance, of issuers. For those issuers with their businesses which are subject to seasonal fluctuations, their quarterly financial results could be misleading and may increase volatility of their share prices. There are also views that the existing disclosure and reporting requirements for half-year and annual reporting, price-sensitive information and notifiable transactions under the Main Board Rules are already sufficient for the timely dissemination of information relating to significant business developments of issuers. Some respondents argue that the Rules should emphasise on quality, rather than frequency of disclosure of issuers' financial information.

112. There are views that quarterly reporting should only be a recommended practice and not a mandatory requirement for Main Board issuers. Some respondents comment that since GEM issuers and Main Board issuers have different business characteristics, the financial reporting requirements under the Main Board Rules and the GEM Rules need not be the same. Therefore, they consider that it is not necessary to introduce quarterly reporting to the Main Board.

Conclusion

113. We note that although certain markets in Asia have adopted quarterly reporting, the UK Listing Rules, on which our Rules are principally based, do not require quarterly reporting and reliance is placed on the continuing disclosure obligations to ensure a timely flow of relevant information to the market. In the light of the majority views and respondents' concerns over the practical issues that may arise from implementing the Consultation Proposal, we will not make quarterly reporting a mandatory requirement for Main Board issuers for the time being. In addition to meeting the disclosure obligations for price sensitive information, we consider to promote greater transparency that it would be a good practice for Main Board issuers to adopt quarterly reporting. We will therefore encourage Main Board issuers to adopt quarterly reporting as a recommended good practice in the revised Code of Best Practice (see paragraph 129). For those Main Board issuers which adopt quarterly reporting, their quarterly results announcements and quarterly reports must be subject to review by their audit committees.

114. We understand that the European Union proposes to introduce quarterly reporting in its member states from 2005 onwards. In the light of the developments in major markets elsewhere, in particular in the UK, and experience gained after amendments to the Code of Best Practice, we will review annually the appropriateness of requiring Main Board issuers to adopt quarterly reporting by 2005.

115. The existing GEM Rules require issuers to publish quarterly results and despatch quarterly financial reports to shareholders within 45 days of the quarter end. Most GEM issuers do not have proven profit track record upon their initial listing on the Exchange and many of them are engaged in businesses that are associated with higher risks. Since GEM

is based on a strong disclosure regime with emphasis on more frequent and timely disclosure, we consider that it is appropriate to retain the existing quarterly reporting requirements (including the financial reporting deadline and disclosure requirements) under the GEM Rules.

116. In relation to the "black out" period, a majority of the respondents support our proposal to impose a two-week "black out" period for quarterly reporting. Since we will not make quarterly reporting a mandatory requirement for Main Board issuers, we will not adopt such proposal. Also, as only a few GEM issuers have expressed concerns over the existing one-month "black out" period for quarterly reporting under the GEM Rules, we consider it more appropriate to retain the existing requirement.

117. A few respondents consider that the "black out" period for half-year, annual and quarterly reporting should commence from the end of the respective financial year or period, and end on the date of the publication of the results announcements. While we consider that their views do have some merit, the Model Code for Securities Transactions by Directors of Listed Companies (the "Model Code") and the GEM Rules already prohibit directors from dealing when they are in possession of price-sensitive information. The Securities (Insider Dealing) Ordinance also governs insider dealing transactions of issuers' securities. Therefore, we propose not to commence the "black out" period from the financial period end. No amendments to the Rules will be made for the relevant "black out" period for half-year and annual reporting.

OTHER PROPOSALS

Voting of controlling shareholders

118. The underlying voting principle of the Rules is that all shareholders have the same right to vote at general meetings of an issuer, except for those that are interested in the relevant transactions. The Rules also require controlling shareholders to abstain from voting at general meetings in exceptional circumstances where the subject matter has a

significant impact on issuers and shareholders and there were previous cases of significant abuse of minority interests. These exceptional circumstances include:

(a) rights issues and open offers when either the issued share capital or the market capitalisation of the issuer will increase by more than 50%. In the Consultation Paper, we sought views on the proposal to retain the existing independent shareholders' approval requirement for such rights issues and open offers *(Consultation Proposal B.7.7)*. Given the wide support from respondents, we will retain the existing independent shareholders' approval requirement (see paragraph 174);

(b) transactions which would result in a material change to the general character or nature of the business of the listed group as described in the issuers' first listing document within 12 months of listing for Main Board issuers. Similar restriction period for GEM issuers starts from the date of listing on GEM to the end of the first financial year and the two financial years thereafter. As discussed in paragraph 179, we will amend the Rules to extend the independent shareholders' approval requirement to a series of transactions or arrangements that would result in a material change to the general character or nature of the business of the listed group during the prescribed period; and

(c) voluntary withdrawal of listing where the issuer has a primary listing on the Exchange and does not have an alternative listing on another exchange. We will amend the Rules for the approval thresholds required for withdrawal of primary listing from the Exchange as set out in paragraph 183.

Under the existing GEM Rules, controlling shareholders are also required to abstain from voting at general meetings approving very substantial acquisitions and reverse takeovers.

119. In the Consultation Paper, we proposed to maintain the general principle of "one share one vote" *(Consultation Proposal B.3.9)*. In view of the majority support from respondents, we will maintain this general voting principle in the Rules. In addition to the exceptional circumstances set out in paragraph 118, we will amend the Main Board Rules to include

any refreshments of the general mandate after the annual general meetings as an exceptional circumstance that require independent shareholders' approval. For GEM issuers, the second and subsequent refreshments of the general mandate after the annual general meeting will be subject to independent shareholders' approval. Please refer to paragraphs 44 to 46 for discussion on the independent shareholders' approval requirement for refreshments of the general mandate.

120. Given the majority views of respondents, we will adopt the Consultation Proposals *(Consultation Proposals B.15.8 and B.17.7)* so that controlling shareholders of GEM issuers will no longer be required to abstain from voting at the shareholders' meetings approving a very substantial acquisition or reverse takeover, unless they have an interest in the transaction and hence their interest is different from other shareholders (see paragraphs 187 and 192).

121. In the Consultation Paper, we proposed to amend the Rules so that in the exceptional circumstances (see paragraphs 118 to 120) which require independent shareholders' approval and there are no controlling shareholders, chief executive or directors (except INEDs) and their respective associates, who together have a controlling interest (being 30% or such threshold set out in the Takeovers Code from time to time) in the issuer, shall abstain from voting at the general meetings approving the relevant resolutions. *(Consultation Proposal B.3.10)*.

122. Despite the majority support from respondents, we will modify the Consultation Proposal so that in the exceptional circumstances (see paragraphs 118 to 120) where independent shareholders' approval is required and there are no controlling shareholders, all shareholders who participate in the management of the issuer (primarily directors and chief executive) and their associates, regardless of their shareholding interest in the issuer (instead of only those together having a controlling interest in the issuer), will be required to abstain from voting. We consider that this would take into account the influential role of directors and chief executive in the decision-making process of issuers and further enhance protection of minority interests. As controlling shareholders would be required to abstain from voting where independent shareholders' approval is necessary, we consider that the same result should apply to shareholders who participate in the management of issuers, when there are no controlling shareholders.

123. Similarly, we will modify the Consultation Proposal *(Consultation Proposal B.3.11)* so that in the exceptional circumstances (see paragraphs 118 to 120) which require independent shareholders' approval under the Rules, the Exchange reserves the right to require the following parties to abstain from voting at the general meetings approving the relevant resolutions:

(a) controlling shareholders at the time the decision for the transaction was made or when the transaction was approved by the board, who cease to be the controlling shareholders but are still shareholders at the time of the general meeting; or

(b) where there are no controlling shareholders, all shareholders who participated in the management of the issuer (primarily directors and chief executive) at the time the decision for the transaction was made or when the transaction was approved by the board, and their associates, regardless of their shareholding interest in the issuer (instead of only those who together had a controlling interest in the issuer).

124. There are views that all directors and chief executive may not always share the same views on a particular resolution. Also, where an issuer has two controlling shareholders, they may not necessarily have the same stance on all resolutions. We will therefore amend the Rules to allow controlling shareholders and other relevant parties who will be required to abstain from voting at the general meetings approving transactions that require independent shareholders' approval, to vote against the resolutions.

125. As mentioned in paragraphs 214 to 216, we will amend the Rules to codify our existing practice so that for any transactions that require independent shareholders' approval, issuers shall establish an independent board committee which must consist of at least one INED who has no interest in the transaction, to advise shareholders on the transaction. Issuers shall also appoint an independent financial adviser to recommend to the independent board committee whether the terms of the subject transaction are fair and reasonable and in the interest of the issuers and advise their shareholders on how to vote. Issuers shall send to their shareholders a circular containing letters from the independent board committee and the independent financial adviser, which include their recommendation and advice to shareholders as to how to vote.

Code of Best Practice

126. We consider that directors and management of issuers should be accountable for implementing a high standard of board practices. The Code of Best Practice in the Main Board Rules currently sets out guidelines for issuers to devise their own code of board practices. The GEM Rules contain the minimum standards of board practices that are derived from and essentially the same as the Code of Best Practice.

127. Since issuers vary in size, business nature and operational structure, we proposed in the Consultation Paper to adopt a balanced and disclosure-based approach to regulate their board practices. This involves setting out minimum standards of board practices in the Code of Best Practice and recommending all issuers to meet those standards *(Consultation Proposal C.5.3)*. Compliance with the Code will not be a mandatory requirement. However, issuers shall include a report on corporate governance in their annual reports and disclose information relating to their corporate governance practices in the report on corporate governance. Issuers shall disclose any deviation from those minimum standards in their report on corporate governance *(Consultation Proposal C.6.3)*. This balanced and disclosure-based approach is in line with most international market practices.

128. In view of the wide support from respondents, we will amend the Rules to adopt the balanced and disclosure-based approach (as described in paragraph 127) to regulate board practices of issuers and require issuers to include a report on corporate governance in their annual reports. Based on the responses received so far from the consultation exercise, we propose to modify the Consultation Proposal and include two tiers of recommended board practices in the revised Code of Best Practice. The first tier will contain minimum standards of board practices. Issuers will be required to disclose any deviation from the minimum standards in their report on corporate governance. In summary, the first tier of recommended board practices will include, amongst other things, the following provisions:

(a) establishment of a remuneration committee comprising a majority of INEDs (see paragraph 147);

(b) certain duties and functions of audit committees, remuneration committees and non-executive directors (see paragraphs 146, 223 and 227);

(c) segregation of chairman and chief executive officers (see paragraph 228);

(d) directors' review of internal control on a regular basis (see paragraph 230);

(e) establishment of a guideline for employees' securities transactions, which should be on no less exacting terms than the Model Code (see paragraph 238);

(f) INEDs should be financially independent of the issuer, its holding company or their respective subsidiaries (see paragraph 144); and

(g) directors should be subject to rotation at regular intervals and retiring directors shall be eligible for re-election (see paragraphs 153 to 156).

129. The second tier of recommended board practices will be the recommended good practices, serving as guidelines for issuers' reference. Issuers that have not adopted the recommended good practices, will not be required to disclose such deviation in their report on corporate governance. In summary, the second tier of recommended board practices will include, amongst other things, the following provisions:

(a) appointment of INEDs representing at least one-third of the board (see paragraph 96);

(b) establishment of a nomination committee comprising a majority of INEDs (see paragraph 148);

(c) certain duties and functions of audit committees, remuneration committees, nomination committees and non-executive directors (see paragraphs 146, 223, 225 and 227);

(d) disclosure of a formal report on the directors' internal control review (see paragraphs 149 to 150);

(e) disclosure of directors' remuneration on an individual, named basis (see paragraph 103); and

(f) quarterly reporting by Main Board issuers (see paragraph 113).

PART C
SUMMARY OF CONSULTATION PROPOSALS ADOPTED WITH MODIFICATIONS

130. In addition to the Consultation Proposals set out in Part B of this Consultation Conclusion Report, we will modify other Consultation Proposals so as to reflect the respondents' views, address their concerns and clarify the proposed Rule changes. This section summarises all other Consultation Proposals that we will adopt with modifications. Most of these Consultation Proposals are supported by a majority of respondents. The proposed Rule changes apply to both Main Board and GEM Rules, unless otherwise specified in our discussion below.

Voting of "interested shareholders" in relating to VSAs, VSDs and major transactions (Consultation Proposal B.2.4)

131. In the Consultation Paper, we proposed to amend the Main Board Rules to follow the GEM Rules and remove the term "material" from the provision that restrict any shareholders who have a material interest from voting at the general meetings approving VSAs and major transactions. Given the majority views of the respondents, we will retain the Main Board Rules so that those shareholders that have a material interest in VSAs, VSDs and major transactions shall abstain from voting at the general meetings. We will also amend the GEM Rules to follow the Main Board Rules.

132. We will further elaborate what "material interest" normally refers to in the Rules to avoid misinterpretation of the respective requirements. A person should be considered having a material interest in a transaction, if he or she has a direct interest in, or is a party to the transaction. There is no benchmark on materiality of an interest, and such interest is not meant to be necessarily quantifiable.

Reverse takeovers (Consultation Proposal B.17.6)

133. In the Consultation Paper, we proposed to expand the definition of "reverse takeovers" under the GEM Rules to include any acquisition of assets that will lead to a fundamental change of the business of issuers. For practical reasons, we will modify the Consultation Proposal so that

the definition of "reverse takeover" will only extend to a fundamental change of issuers' principal lines of businesses. As we proposed to introduce a separate category of "reverse takeover" transactions in the Main Board Rules based on the GEM Rules *(Consultation Proposal B.17.9)*, a similar modification will be made to the Main Board Rules (see paragraph 194).

Valuation of properties (Consultation Proposal B.20.5)

134. In the Consultation Paper, we proposed to require issuers to use the higher of the consideration (including the value of all outstanding mortgages in the case of a property company), book value or valuation of the assets as the numerator for "assets test". We will modify the Consultation Proposal so that where an issuer will assume repayment obligations for the outstanding mortgages or loans, such outstanding amounts will be aggregated to the consideration for the numerator of the "assets test". This is in line with our application of the existing Rules.

135. Since it is also very common for shipping and aircraft companies to acquire vessels or aircraft that are financed by mortgages, we will extend the proposed requirement as set out in paragraph 134 to shipping and aircraft companies.

Continuing connected transactions (Consultation Proposals B.29.6 and 29.9)

136. In the Consultation Paper, we proposed to amend the Main Board Rules so that issuers proposing to enter into continuing connected transactions with the annual value or consideration exceeding the de minimis thresholds, must:

(a) in respect of each connected transaction, enter into agreement(s) with the connected person, the period for which shall not exceed three years;

(b) in respect of each connected transaction, set a maximum aggregate annual value which must be acceptable to the Exchange; and

(c) comply with the relevant reporting, announcement and/or the shareholders' approval requirements if required. If the relevant cap is exceeded, the issuer must again comply with the relevant reporting, announcement and/or the shareholders' approval requirements.

Having considered the respondents' comments, we will adopt the Consultation Proposal except that the annual cap amount (as stated in item (b) above) need not be subject to the Exchange's approval. However, issuers will be required to disclose the basis of such maximum aggregate annual value to the market. Any maximum aggregate annual cap amount that exceeds the de minimis thresholds under the Rules shall be subject to the relevant reporting, announcement and/or shareholders' approval requirements. The GEM Rules will be amended accordingly.

137. In the Consultation Paper, we proposed to require a continuing transaction to be subject to connected transaction Rules after the party to the continuing transaction has become a connected person. We will modify the Consultation Proposal to require issuers to disclose such transaction only when the connection is as a result of the issuers' corporate actions including appointment of directors. Such transaction shall be subject to the applicable connected transaction Rules if there are any subsequent variations to or renewal of the existing agreements.

Meaning of "subsidiary" (Consultation Proposal B.30.10)

138. In the Consultation Paper, we proposed to amend the Rules to expand the definition of "subsidiary" for all purposes of the Rules to include an entity which is accounted for in the audited consolidated accounts of an issuer as a subsidiary under the applicable accounting principles under SSAP 32 or IAS 27. We will modify the Consultation Proposal and extend the definition of "subsidiary" to an entity which is consolidated in the audited consolidated accounts of an issuer under the applicable SSAP or IAS. For avoidance of doubt, a subsidiary that is not consolidated in the issuer's audited consolidated account due to the legal constraint as explained in SSAP 32 will not be included in the expanded definition of "subsidiary".

Commencement of lock-up period for disposal of controlling shareholders' interests (Consultation Proposal B.31.3)

139. To further enhance the protection of minority shareholders, we will modify the Consultation Proposal so that the lock-up period for disposal of interests by controlling shareholders of Main Board issuers and significant shareholders and initial management shareholders of GEM issuers shall commence from the latest practicable date of the listing document, rather than from the issue date of the listing document as proposed in the Consultation Paper. There will be no amendments to the expiry date of the respective lock-up period as prescribed under the existing Rules.

140. Offer for sale as disclosed in a listing document will be allowed during the period from the latest practicable date of the listing document to the date of listing.

Further guidance regarding independence of INEDs (Consultation Proposals C.1.4 (a), (b), (c), (e) and (i))

141. In the Consultation Paper, we proposed to include more guidelines in the Rules to describe independence of INEDs. The guidelines include a restriction on the proposed INED's shareholding in the issuer of 5%. Some respondents consider that the shareholding limit of 5% is too high and an INED holding a substantial shareholding interest in an issuer, might not be able to exercise checks and balances over the board's decision-making processes properly and protect the interest of minority shareholders. Taking into account the respondents' concerns and the recent reduction of the disclosure threshold for substantial shareholding under the Securities and Futures Ordinance from 10% to 5%, we will retain the existing shareholding limit of 1% for INEDs. However, for an issuer that wants to appoint an INED holding interests of more than 1% but less than 5%, it will have to satisfy the Exchange prior to the appointment that such candidate is independent.

142. In the Consultation Paper, we proposed to impose a cooling-off period of two years for the appointment of professional advisers as INEDs. Given the diverse views and the respondents' concern over the limited supply of suitably qualified INEDs in the market, we will reduce the cooling-off period to one year. We will review such cooling-off period at a later date.

143. In the Consultation Paper, we suggested that independence of an INED will more likely be in question if he owes allegiance to "a particular shareholder or group of shareholders". In order to reduce ambiguity in the Rules, we will modify the Consultation Proposal and specify that such "a particular shareholder or group of shareholders" will normally refer to a substantial shareholder of the issuer.

144. In the Consultation Paper, we proposed that independence of an INED will more likely be in question if the amount of his remuneration as a director of the issuer, its holding company or their respective subsidiaries constitutes a principal source of his income. A number of respondents express concerns that this Consultation Proposal will restrict issuers from appointing retired persons as INEDs since the directors' remuneration payable to a retired person is likely to constitute a principal source of his income. This will therefore limit the supply of qualified INEDs in the market. Taking into account the concerns raised by respondents, we will modify the Consultation Proposal and provide in the revised Code of Best Practice that INEDs should maintain their financial independence of the issuer, its holding company or their respective subsidiaries, as a minimum standard of board practices.

145. Please also refer to paragraph 209 for our conclusion on other proposed guidelines on independence of INEDs.

Audit committee (Consultation Proposal C.7.7)

146. In the Consultation Paper, we proposed to set out a list of the duties and responsibilities of the audit committee in the Rules to provide further guidance to issuers. Respondents generally agree with the proposal. However, there are diverse views on the proposed duties and responsibilities to be included in the Rules. Some respondents consider that issuers should be allowed to exercise their discretion to determine the duties and responsibilities of their audit committees. Others raise concerns that the audit committee members may not have the expertise or resource to discharge the proposed duties and responsibilities. To address the respondents' concerns, we will modify the Consultation Proposal to recommend that certain duties and responsibilities of the audit committee will be included as minimum standards and recommended good practices in the revised Code of Best Practice (see paragraph 128 and 129).

Remuneration committee (Consultation Proposal C.8.4)

147. In the Consultation Paper, we proposed to recommend as a minimum standard in the Code of Best Practice that issuers should establish a remuneration committee only comprising INEDs. Respondents generally support establishing a remuneration committee as a recommended board practice. However, a majority of them do not agree that the remuneration committee should only comprise INEDs. They consider that since INEDs do not participate in the daily operations of issuers and monitor daily performance of directors, they may not be able to fairly assess the performance of directors. Hence, INEDs are not in the best position to determine directors' remuneration. Taking into account the majority views, we will modify the proposal so that issuers are recommended to establish a remuneration committee comprising a majority of INEDs, as a minimum standard in the Code of Best Practice.

Nomination committee (Consultation Proposal C.9.6)

148. In the Consultation Paper, we proposed to recommend as a minimum standard in the Code of Practice that issuers should establish a nomination committee comprising a majority of INEDs. A majority of the respondents disagree with the Consultation Proposal. There are views that the proposal would disenfranchise the rights of controlling shareholders to appoint and remove directors, stemming from statutes or issuers' constitutional documents. Some respondents consider that since most issuers in Hong Kong are family-owned and controlled companies, it may not be realistic to assume that those controlling shareholders will give up their right to appoint board members. Taking into account the respondents' comments and the practical issues that may arise from having a nomination committee, we will modify the Consultation Proposal by recommending establishing a nomination committee comprising a majority of INEDs as a recommended good practice in the revised Code of Best Practice (see paragraph 129). Issuers will not be required to disclose the reasons for not establishing a nomination committee in their report on corporate governance.

Internal control (Consultation Proposal C.12.4)

149. In the Consultation Paper, we proposed to require issuers which have conducted a review of their system of internal controls, to include a report on such review in their annual reports. A majority of the respondents disagree with the Consultation Proposal. Some of them raise concerns on the proposed disclosure requirements set out in the Consultation Proposal. Some respondents consider that the Consultation Proposal would result in excessive disclosure and may involve disclosure of price-sensitive information by issuers. There are also views that the Consultation Proposal would discourage issuers from conducting a regular internal control review because disclosure relating to internal controls will not be required if directors have not reviewed the internal control system.

150. We consider that if the directors have prepared a report on the issuers' internal control system, they should be encouraged to disclose the effectiveness of internal controls to shareholders. We do not necessarily agree that the disclosure would be excessive and may involve disclosure of price-sensitive information. Under the existing Rules, any price-sensitive information must be disclosed to shareholders. Given the majority views of the respondents, we propose to modify the Consultation Proposal by encouraging directors to report to shareholders on the effectiveness of the issuers' internal control system, in the report on corporate governance in the annual report. This will be included as a recommended good practice in the Code of Best Practice (see paragraph 129).

Securities transactions by directors

Definition of "dealing" (Consultation Proposal C.15.2)

151. In the Consultation Paper, we proposed that the term "dealing" shall be defined as any sale or purchase of any securities, or offer or agreement to sell or purchase any securities, and the grant, acceptance, acquisition, disposal, exercise or discharge of any option (whether for a call, or put, or both) or other right or obligation, present or future, conditional or unconditional, to acquire or dispose of securities, or any interest in securities, of the issuer and "deal" shall be construed accordingly. The restriction on "dealing" will extend to cover any pledge of securities of the issuer by its directors.

152. We will modify the proposed definition of "dealing" as follows:

- replace the terms "sale or purchase" with "acquisitions or disposals" in order to cover transfers of securities for no consideration;

- extend the definition of "dealing" to cover dealings in interests in a special purpose vehicle which only holds shares of an issuer;

- exclude taking up or allowing to lapse entitlements under a rights issue, except for excess rights from the definition of "dealing";

- exclude the acceptance of and undertaking to accept general offers from the definition of "dealing"; and

- exclude from the definition of "dealing" the exercise of share options or warrants or acceptance of an offer for shares pursuant to an agreement entered into by the directors and issuers before the "black out" period, with pre-determined prices. Directors will not be allowed to sell shares of the issuer during the "black out" period.

Appointment, reappointment and removal of directors (Consultation Proposal C.22.4)

153. In the Consultation Paper, we proposed to amend the Rules to require directors to be subject to rotation at regular intervals and retiring directors shall be eligible for re-election. A majority of the respondents supported the Consultation Proposal. There are views that rotation of directors should be subject to issuers' bye-laws or articles of associations and should not be mandated by the Rules. Some respondents argue that the existing provisions under issuers' constitutional documents already enable shareholders to remove directors with unsatisfactory performance. Others consider that mandatory rotation of directorship may interrupt the continuation of directors' stewardship and functions, particularly when the policies or decisions made by a director may span a number of years.

154. We consider that although the directors' rotation requirement can be included in the issuers' bye-laws, issuers incorporated in overseas jurisdictions may not have similar rotation provisions. In view of various comments and concerns of the respondents, we will modify the Consultation Proposal by recommending in the Code of Best Practice as a minimum standard of board practice that directors should rotate on a regular basis.

155. In the Consultation Paper, we sought views on whether appointment, reappointment and removal of INEDs should be subject to independent shareholders' approval. A majority of the respondents do not agree with independent shareholders' approval for changes in directorship of INEDs. They consider that the independent shareholders' approval requirement would result in substantial increases in administrative cost and workload of issuers. Some respondents argue that such requirement would disenfranchise the right of controlling shareholders to appoint directors, which stems from statutes and issuers' constitutional documents. Others consider that the existing Rules and the proposed guideline on independence of INEDs set out in Part C of the Consultation Paper are sufficient enough to ensure independence of INEDs. There are opposing views that the independent shareholders' approval requirement would promote independence of INEDs, further enhance INEDs' credibility and ensure sufficient protection for minority shareholders.

156. Taking into account the respondents' views and based on the "one share one vote" principle, we consider that all shareholders should be entitled to the same right to appoint and remove directors. Hence we propose not to require independent shareholders' approval for changes in directorship of INEDs.

Half-year reporting (Consultation Proposals D.3.7 and 4.9)

157. We will adopt the Consultation Proposal to permit issuers to distribute summary half-year reports to their shareholders. We will adopt the Consultation Proposal to require issuers to include, as a minimum, the

information set out in Appendix II to the Consultation Paper, in their summary half-year reports, subject to the following modifications:

– the Rules will clarify that in the issuers' business reviews, disclosure of information relating to the issuers' likely future business developments must also cover the issuers' prospect of the current financial year;

– issuers will be required to disclose whether or not the summary half-year report has been reviewed by their external auditors or audit committees;

– issuers will be allowed to include a negative statement in relation to the disclosure content of their business reviews in the summary financial reports, if they have no material changes in their business operations since their publication of the most recent annual reports; and

– the existing requirement for disclosure of full details relating to audit committees' disagreement with the accounting treatment adopted by the issuers (if any) in the interim reports, will also apply to the summary half-year reports.

These modifications aim at further enhancing transparency and clarifying the proposed disclosure requirements.

158. We will also adopt the proposed disclosure requirement for half-year result announcements as set out in the Consultation Paper, subject to the modifications in paragraph 157.

General information in all announcements and circulars of notifiable transactions (Consultation Proposal D.9.2)

159. We will adopt the Consultation Proposal relating to disclosure of additional information in all announcements and circulars of the notifiable transactions.

160. However, in relation to the disclosure requirement for business valuation reports, we will amend the Rules so that such requirement will only apply to major transactions, connected transactions, VSAs and VSDs. This is in line with the existing requirements for preparation of valuation reports under the Rules.

161. We will also modify the Consultation Proposal so that issuers will not be required to disclose the identity of the counter party to the transaction unless it is not an independent third party. However, issuers shall confirm in the respective announcements and circulars that the ultimate beneficial shareholders of the counterparty to the transactions are independent of the issuer and its connected persons. Under the dual filing requirements of the Securities and Futures Ordinance, issuers will be required to submit their announcements and circulars to the Exchange and the Securities and Futures Commission. In cases where the statement confirming independence of the ultimate beneficial shareholders of the counterparty is incorrect, issuers will be subject to the appropriate regulatory actions.

Changes in directorship (Consultation Proposals D.10.3 and 10.4)

162. We will adopt the Consultation Proposal to require Main Board issuers to publish an announcement for any changes in directorship. We will also amend the Rules so that both Main Board and GEM issuers will have to include in an announcement on directors' resignation, the reasons for their resignation including any information relating to directors' disagreement with the issuer, and a statement as to whether there are any matters that need to be brought to the attention of shareholders.

163. We will adopt the Consultation Proposal relating to disclosure of biographical details of the newly appointed directors in the announcement of their appointment. However, we will modify the proposal to require disclosure of the biographical details of directors who are re-elected or newly appointed at any general meetings (including annual general meetings) in the notice of meetings to shareholders.

Despatch of notice of general meeting and circular (Consultation Proposals D.11.5 and 11.6)

164. We will adopt the Consultation Proposal to amend the Main Board Rules and require Main Board issuers to despatch circulars to shareholders at the same time as or before they give notices of the general meeting to approve the relevant transactions. We will also amend the Rules to require issuers to despatch any supplementary circulars or provide any material information (by way of announcement) on the subject matters to be considered at the general meetings, to the shareholders at least 14 days before the date of the general meetings. Issuers will be required to postpone the general meetings to ensure that they comply with the 14-day requirement.

165. We will adopt the Consultation Proposal to require issuers to publish notices of general meetings by way of an announcement. We will also extend such requirement to notices of court meetings for approval of schemes of arrangement, capital reduction and other corporate actions of issuers.

PART D
SUMMARY OF CONSULTATION PROPOSALS ADOPTED WITHOUT MODIFICATIONS

166. This section summarises all the Consultation Proposals, in addition to those set out in Part B of this Consultation Conclusion Report, that we will adopt without modifications. Most of these Consultation Proposals have received support from a majority of the respondents. The proposed Rule changes apply to both Main Board and GEM Rules, unless otherwise specified in our discussion below.

Voting by poll (Consultation Proposals B.1.5 and B.1.6)

167. We will amend the Rules to require issuers to publish the results of the poll on the business day following the meeting.

168. We will amend the Rules to require issuers to disclose the procedure of demanding a poll by shareholders pursuant to their constitutional documents in the circulars to shareholders, when voting by poll is not a mandatory requirement for approving the transactions concerned under the Rules and in the issuers' constitutional documents.

Waiver of requirement to hold general meetings (Consultation Proposals B.4.7 and 4.8)

169. We will amend the Rules to codify our practice to accept a written shareholders' approval in lieu of holding a physical shareholders' meeting for the approval of major transactions or connected transactions only if the following conditions are met:

(a) the transactions do not involve issues of securities by the issuer or its subsidiaries;

(b) no shareholder is required to abstain from voting if the issuer convenes a general meeting for the approval of the subject transactions; and

(c) the written shareholders' approval has been obtained from a shareholder or a closely allied group of shareholders who together hold more than 50% in the nominal value of the securities giving the right to attend and vote at that general meeting to approve the subject transactions.

170. We will amend the Rules to require issuers to disclose details of the written approval given by the respective shareholders, including a description of the closely allied group of shareholders, in announcements on the transactions. We will elaborate the meaning of "closely allied group of shareholders" in the Main Board Rules, based on the existing definition under the GEM Rules. We will also reiterate that where an issuer gives undisclosed price sensitive information to shareholders in confidence to solicit written shareholders' approval, the issuer must be satisfied that such shareholders are aware that they must not deal in the issuer's securities before the relevant undisclosed price sensitive information has been made available to the public.

Placing of shares using the general mandate (Consultation Proposal B.5.10)

171. We will amend the Rules to require issuers to issue an announcement on any placing of shares, once the shares are placed, if the placing price is at a discount of 20% or more to the benchmarked price set out in paragraph 5.9 of Part B of the Consultation Paper. The announcement shall disclose, among other things, a generic description of the 10 largest placees who in aggregate subscribe to 50% or more of the total number of shares placed. The information shall also contain the number of shares subscribed by each of the placees.

Placing and top-up subscription (Consultation Proposals B.6.3 and B.6.4)

172. We will amend the Rules so that the exemption from shareholders' approval will only apply if the number of new securities subscribed by a connected person does not exceed the number of securities placed by him or her to an independent third party in a placing and top-up subscription arrangement.

173. We will amend the Main Board Rules to follow the GEM Rules and specify that the exemption from shareholders' approval will only apply when securities are issued within 14 days after the connected person has executed an agreement to reduce his shareholding.

Rights issue and open offers (Consultation Proposals B.7.7, 7.8, 7.9 and 7.10)

174. We will maintain the existing Rules to require independent shareholders' approval for any rights issues or open offers that would increase the issued share capital or market capitalisation of the issuer by more than 50%.

175. We will amend the Rules to clarify how the 50% threshold should be determined. The latest rights issue or open offer shall be aggregated with:

(a) any other rights issues or open offers made in the previous 12 months; and

(b) any bonus securities, warrants or other convertible securities (assuming full conversion) granted to shareholders as part of the rights issues or open offers in the previous 12 months.

176. We will amend the Rules to specify that the 12 month period shall be the 12 months commencing on the first day of dealing in fully paid shares issued under the earliest rights issue or open offer (as set out in the relevant circular) up to the date of announcement of the latest proposed rights issue or open offer.

177. We will amend the Rules to clarify that an open offer which is wholly or partly underwritten or sub-underwritten by a director, chief executive or substantial shareholder of the issuer (or any associate of any of them) shall not be subject to shareholders' approval, if there are arrangements in place for the disposal of securities not subscribed by the allottees by means of excess application forms, in which case such securities must be available for subscription by all shareholders and allocated on a fair basis. Where shareholders' approval is required for the open offer, any shareholders that have a different interest in the open offer shall abstain from voting at the general meeting.

Exclusion of overseas shareholders from share offers (Consultation Proposal B.8.2)

178. We will amend the Rules:

(a) to allow an issuer to exclude overseas shareholders in an offer of securities provided its directors consider it necessary to do so on the account either of the legal problems under the laws of the relevant place or the requirements of the relevant regulatory body or stock exchange;

(b) to require an issuer to include explanation(s) for the exclusion of overseas shareholders from share offers in the relevant offer document; and

(c) to require an issuer to ensure that the offer document shall, subject to compliance with the local laws and regulations, also be made available to the overseas shareholders.

We will also clarify in the Rules that the issuer should make appropriate enquiries as to what overseas laws and regulations actually require. The issuer should only disenfranchise overseas shareholders on the basis, having made such enquiry, that it would be necessary to do so.

Material changes in nature of business (Consultation Proposal B.9.6)

179. The Main Board Rules require independent shareholders' approval for an issuer entering into any transaction or arrangement within the period of 12 months from the commencement of dealings in the securities, which would result in a material change to the general character or nature of the business of the issuer or its group as described in the listing document issued when it first applied for listing. We will amend the Main Board Rules to also cover a series of transactions or arrangements entered into by an issuer that would result in a material change to the general character of the business of the listed group as described in its initial listing document, during the said 12-month period. We will amend the GEM Rules to cover a series of transactions or arrangements entered into by an issuer from the date of listing on GEM to the end of the first financial year and the two financial years thereafter.

Share repurchase (Consultation Proposals B.10.4, 11.2 and 12.3)

180. We will amend the Rules to prohibit repurchase on the Exchange at a price 5% higher than the average closing market price over the preceding five trading days on which shares were traded. Although respondents have diverse views on the Consultation Proposal to impose a price restriction over share repurchases by issuers, we consider it necessary to adopt the proposal in order to prevent issuers from manipulating share prices by repurchasing their shares from the market and to ensure sufficient protection of shareholders' interest. As highlighted in the Consultation Paper, we consider that the proposed price restriction would be easier for issuers to comply with than the existing GEM Rule requirement. The proposed cap of 5% and the basis for the benchmarked price as set out in the Consultation Paper are in line with the share repurchase rules adopted in the other international markets, including the UK, Australia and Singapore.

181. We will amend the Rules to require the dealing restriction period for share repurchases to follow the current "black out" period for securities transactions of directors for half-year and annual reporting for Main Board and GEM issuers and quarterly reporting for GEM issuers.

182. We will abolish the 25% monthly share repurchase restriction under the Main Board Rules.

Withdrawal of primary listing on the Exchange (Consultation Proposal B.13.5)

183. We will amend the approval thresholds under the Rules for any withdrawal of primary listing on the Exchange so that such withdrawal shall be subject to:

(a) the approval of at least 75% of the votes attaching to the shares held by independent shareholders cast either in person or by proxy in a general meeting of independent shareholders; and

(b) the number of votes cast against the resolution must not be more than 10% of the votes attaching to all the shares held by independent shareholders.

Withdrawal of secondary listing on the Exchange (Consultation Proposal B.14.2)

184. We will amend the Rules so that issuers with secondary listing status on the Exchange may withdraw their listing status if:

(a) they have complied with all relevant laws, regulations and listing rules of their home jurisdiction; and

(b) they have provided shareholders with at least three months' prior notice of the proposed delisting, by way of an announcement.

Very substantial acquisitions (Consultation Proposals B.15.6, 15.7, 15.8 and 15.9)

185. We will amend the Rules to require issuers to comply with the provisions for "very substantial acquisitions", irrespective of whether the assets being acquired are listed or not.

186. We will amend the Rules to allow some relaxation in the form of a waiver from shareholders' approval for "very substantial acquisitions" in a hostile or contested takeovers situation.

187. We will amend the GEM Rules to follow the Main Board Rules so that no shareholders will be required to abstain from the voting at the shareholders' meeting approving a very substantial acquisition, unless they are interested in the transaction and hence have different interest from other shareholders.

188. We will amend the Main Board Rules to follow the GEM Rules so that no written certificate of shareholders' approval shall be accepted for very substantial acquisitions.

Introduction of "very substantial disposals" (Consultation Proposals B.16.4, 16.5 and 16.6)

189. We will introduce a new type of transaction, namely "very substantial disposals" in the Rules. This type of transaction will cover disposal of assets, business or company by an issuer, where any of the percentage ratios under the various size tests for classification of the transaction is 75% or more.

190. The Rules will require shareholders' approval for all very substantial disposals. No shareholders will be required to abstain from voting at the shareholders' meeting approving a very substantial disposal, unless they are interested in the transaction and hence have different interest from other shareholders.

191. No written certificate of shareholders' approval will be accepted for very substantial disposals.

Reverse takeovers (Consultation Proposals B.17.7, 17.8 and 17.9)

192. We will amend the GEM Rules so that no shareholders will be required to abstain from voting at the shareholders' meeting approving a reverse takeover, unless they are interested in the transaction and hence have different interest from other shareholders.

193. We will retain the GEM Rules so that no written certificate of shareholders' approval shall be accepted for reverse takeovers.

194. We will amend the Main Board Rules to introduce a separate category of "reverse takeover" transaction and adopt the same requirements for "reverse takeover" under the GEM Rules as amended by the proposed Rule changes set out in paragraphs 133, 192 and 193.

Introduction of "turnover test" (Consultation Proposal B.18.5)

195. We will amend the Rules so that if issuers can satisfy the Exchange that the anomalous results of their profits tests are due to exceptional circumstances, the Exchange may allow the "turnover test" as a substitute for the "profits test". The "turnover test" will only apply if the "profits test" is not applicable. The "turnover test" is the turnover attributable to the assets being the subject of the transaction divided by the turnover of the issuer. Please refer to paragraph 73 for the thresholds for classifying notifiable transactions using the turnover test.

Assets valuation (Consultation Proposal B.21.2)

196. We will amend the Rules so that any valuation of assets or businesses acquired by the issuers based on discounted cash flows or projections of profits, earnings or cash flows will be regarded as a profit forecast. Such valuations will be subject to the same requirements of profit forecasts under the Rules. This includes disclosure of details of the principal assumptions of the valuations and obtaining reports on the forecasts from the auditors or reporting accountants. Any financial adviser mentioned in the circulars to shareholders shall also report on the forecasts.

197. Although a majority of the respondents do not support the proposed requirement for asset valuation, we will adopt the proposal in principle, so as to enhance transparency of issuers. As stated in the Consultation Paper, the Consultation Proposal and respective Rule changes will principally follow the Takeovers Code requirements on asset valuation.

Options granted by issuers (Consultation Proposals B.22.4 and 22.5)

198. We will amend the GEM Rules to reduce the premium threshold from 15% to 10% for computing the size tests for notifiable transactions and the de minimis thresholds for connected transactions, which involve options that are exercisable at the discretion of issuers.

199. We will amend the Main Board Rules to follow the GEM Rules in relation to the grant, acquisition, transfer or exercise of an option by an issuer, as amended by the proposed Rule change in paragraph 198.

Dilution of interest in subsidiaries resulting in deemed disposals (Consultation Proposal B.23.2)

200. We will amend the Rules so that the existing requirements in relation to deemed disposal of interest in subsidiaries shall apply to allotments of share capital for any consideration and not limited to "cash consideration" only.

Definition of "connected person" (Consultation Proposal B.24.7)

201. We will maintain the existing regulatory approach relating to the definition of "connected person" in the Main Board Rules, which includes persons who are connected by virtue of their relationship at the subsidiary level. We will amend the GEM Rules to bring them in line with the Main Board Rules.

Transactions with non wholly owned subsidiaries (Consultation Proposal B.27.4)

202. We will amend the Rules so that non wholly owned subsidiaries shall not be treated as "connected persons" under the Rules, if no connected person(s) of the issuer (excluding connected person(s) at the subsidiary level) are together a substantial shareholder (i.e. holding 10% or more interest) in such non wholly owned subsidiaries. Transactions between issuers or their subsidiaries and such non wholly owned subsidiaries will not be regulated as connected transactions under the Rules.

Continuing connected transactions (Consultation Proposals B.29.4, 29.7 and 29.8)

203. We will amend the Main Board Rules to follow the GEM Rules and introduce a new category of "continuing connected transactions".

204. We will amend the Rules to require shareholders' approval for a continuing connected transaction at the time when an issuer first enters into the transaction and when the agreement is renewed or there is a material change to the terms of the agreement. Any shareholder that is interested in the transaction and hence has a different interest from other shareholders, shall abstain from voting.

205. We will amend the GEM Rules to remove the existing requirements of annual review and re-approval of the continuing connected transactions and the relevant caps by shareholders (other than those who are interested in the transactions and hence have different interest from other shareholders) at annual general meetings following the initial shareholders' approval of the continuing connected transactions.

Agreement for disposal of shares (Consultation Proposals B.32.2 and 32.3)

206. We will amend the Main Board Rules so that controlling shareholders shall be prohibited from entering into any agreement to dispose of shares of an issuer, including creation of any option, rights or interests in relation to their shares, during the restriction periods after the initial listing of the issuer, as prescribed under the Main Board Rules.

207. We will retain the current exceptions set out in the Rules relating to the restriction of controlling shareholders from disposing of the shares of an issuer and their controlling interest in the issuer during the restriction periods after the initial listing of the issuer, as prescribed under the Rules. Those exceptions include, in particular, a pledge or charge to an authorised institution as security for a bona fide commercial loan.

Deemed disposal of controlling shareholders' interests (Consultation Proposal B.33.5)

208. We will amend the Main Board Rules to codify the current practice to prevent a deemed disposal of controlling interest by controlling shareholders. This would disallow issuers, within the first six months of listing, to issue shares or securities convertible into equity securities or agree to such an issue (whether or not such issue of securities will be completed within the first six months of listing), other than:

    (a) the issue of shares, the listing of which have been approved by the Exchange, pursuant to a share option scheme;

    (b) the exercise of conversion rights of warrants issued as part of the initial public offering; and

    (c) any capitalisation issue or consolidation, sub-division or capital reduction of shares.

    We will amend the GEM Rules to allow for the issue of shares in (a) and (b) above, in addition to the existing provisions.

Further guidance regarding independence of independent non-executive directors ("INEDs") (Consultation Proposals C.1.4 (d), (f), (g) and (h) and 1.5)

209. We will amend the Rules to include more guidelines to determine the independence of INEDs. Although none of the factors below would necessarily be conclusive on the independence of a director, the Exchange considers that independence is more likely to be questioned if the INED:

(a) has an interest in any business activity of or is involved in any business dealings with the issuer, its holding company or their respective subsidiaries, or connected persons of the issuer, which is material *(Consultation Proposal C.1.4(d))*;

(b) is on the board specifically to protect the interests of certain parties whose interests are not the same as shareholders as a whole *(Consultation Proposal C.1.4(f))*;

(c) is or was connected to a director, the chief executive or substantial shareholder of the issuer within the preceding two years *(Consultation Proposal C.1.4(g))*; and

(d) is a former or current executive or a former or current director of the issuer or a member of the issuer's group or its connected persons within the preceding two years *(Consultation Proposal C.1.4(h))*.

Please also refer to paragraphs 141 to 144 for more guidelines on independence of INEDs.

210. We will amend the Rules to codify the existing practice to require an INED to provide the Exchange a confirmation in respect of the factors concerning his independence and any other factors that may affect his independence. INEDs will also be required to inform the Exchange if there is any change of circumstances which may affect their independence.

Qualifications of INEDs (Consultation Proposal C.2.3)

211. We will amend the Rules to require issuers to appoint at least one INED who has appropriate professional qualifications or experience in financial matters.

Minimum number of INEDs (Consultation Proposals C.3.6 and 3.7)

212. We will amend the Main Board Rules to follow the GEM Rules and require an issuer to inform the Exchange and publish an announcement immediately if the number of its INEDs falls below the minimum requirement set out in the Rules.

213. We will amend the Rules to specify a period of three months within which an issuer shall appoint a sufficient number of INEDs to meet the minimum requirement under the Rules after the number of INEDs has fallen below the minimum number required.

Independent board committees (Consultation Proposals C.4.4, 4.5 and 4.6)

214. We will amend the Rules to codify the existing practice in respect of connected transactions that require any shareholders to abstain from voting and transactions or arrangements that require controlling shareholders to abstain from voting. Issuers shall:

(a) establish an independent board committee to advise shareholders on the transaction or arrangement, taking into account the recommendations of the independent expert (see (b) below); and

(b) appoint an independent expert to recommend to the independent board committee whether the terms of the subject transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole, and advise shareholders on how to vote.

215. We will amend the Rules to clarify that the independent board committee shall not consist of INEDs who are shareholders of an issuer and have an interest in the relevant transaction or arrangement and therefore their interests are different from other shareholders. The independent board committee may consist of only one INED if all other INEDs are interested in the relevant transaction or arrangement. If all INEDs have an interest in the relevant transaction or arrangement and therefore their interests are different from other shareholders, no independent board committee can be formed. The independent expert shall make its recommendation to shareholders in its letter set out in the circular to shareholders.

216. We will specify in the Rules that the circular to shareholders shall contain:

(a) a separate letter from the independent board committee advising shareholders on the transaction or arrangement, taking into account the recommendations of the independent expert; and

(b) a separate letter from the independent expert to recommend to the independent board committee whether the terms of the transaction or arrangement are fair and reasonable and in the interest of the issuer and its shareholders as a whole, and advise shareholders on how to vote.

Code of Best Practice (Consultation Proposal C.5.4)

217. We will amend the Rules to require issuers to disclose the following information in their half-year reports:

(a) whether they have met the minimum standard in the Code of Best Practice; and

(b) any substantial changes in their own corporate governance practices since the publication of their latest annual reports.

Audit committee (Consultation Proposals C.7.3, 7.4, 7.5, 7.6 and 7.8)

218. We will amend the Main Board Rules to make establishing an audit committee a compulsory requirement.

219. We will amend the Rules to require issuers to establish an audit committee comprising at least three non-executive directors, with a majority of INEDs. The chairman of the audit committee must be an INED.

220. We will amend the Rules to require the audit committee to have at least one committee member with appropriate qualifications or experience in financial reporting.

221. We will amend the Rules so that if an issuer fails to constitute an audit committee, or at any time has not appointed a sufficient number of non-executive directors and INEDs to the audit committee, it must inform the Exchange immediately and publish an announcement in this regard.

222. We will amend the Rules to require issuers to disclose information relating to their audit committees in the annual reports. We will adopt in principle the proposed disclosure requirement as set out in the Consultation Proposal.

Remuneration committee (Consultation Proposals C.8.5 and 8.6)

223. We will include the principal functions of the remuneration committee in the Code of Best Practice. We will adopt in principle the proposed functions of the remuneration committee as set out in the Consultation Proposal, which will be included as minimum standards and recommended good practices in the revised Code of Best Practice.

224. We will amend the Rules to require issuers to disclose information relating to their remuneration committees in the annual reports. We will adopt in principle the proposed disclosure requirement as set out in the Consultation Proposal.

Nomination committee (Consultation Proposals C.9.7 and 9.8)

225. We will include the principal functions of the nomination committee in the Code of Best Practice. We will adopt in principle the proposed functions of the nomination committee as set out in the Consultation Proposal, which will be included as recommended good practices in the revised Code of Best Practice.

226. We will amend the Rules to require issuers to disclose information relating to their nomination committees in the annual reports. We will adopt in principle the proposed disclosure requirement as set out in the Consultation Proposal.

Duties and responsibilities of non-executive directors (Consultation Proposal C.10.3)

227. We will include the duties and responsibilities of non-executive directors as minimum standards and recommended good practices in the revised Code of Best Practice.

Chairman and chief executive officer (Consultation Proposals C.11.4 and C.11.5)

228. We will recommend segregation of roles of chairman and chief executive officer as a minimum standard in the Code of Best Practice.

229. We will amend the Rules to require issuers to disclose in their annual reports whether these two roles are segregated.

Internal controls (Consultation Proposal C.12.3)

230. We will include as a minimum standard in the Code of Best Practice that directors should regularly conduct a review of the effectiveness of the group's system of internal controls. The review should cover all controls, including financial, operational and compliance controls and risk management.

Voting by interested directors (Consultation Proposal C.13.3)

231. We will amend the Rules to require a director to abstain from voting on any matter in which he or any of his associates (as defined in the Rules) has any interest which is different from other shareholders and not to be counted towards the quorum of the relevant board meeting. There will be an exception to the general prohibition if the relevant interest is immaterial. The existing exceptions to the general voting prohibition as currently provided in the Rules will continue to apply.

Securities transactions by directors

Disclosure of breaches (Consultation Proposal C.14.3 and 14.4)

232. We will amend the Rules to expressly provide that any breach of the minimum standard in relation to directors' dealing in securities as set out in the Model Code will be regarded as a breach of the Rules. If an issuer sets its own code at a standard higher than that contained in the Rules, any breach of such code will not be regarded as a breach of the Rules provided that the minimum standard contained in the Rules is met.

233. We will amend the Rules to require issuers to disclose in their annual and half-year reports:

(a) whether the issuer has adopted a code of conduct regarding securities transactions at a higher standard than the standard set out in the Rules;

(b) whether its directors have complied with or whether there has been any non-compliance with the minimum standard set out in the Rules and its code of conduct regarding securities transactions; and

(c) in the event of any non-compliance with the minimum standard set out in the Rules, details of such non-compliance.

Definition of "dealing" (Consultation Proposal C.15.3)

234. We will amend the Rules to clarify that an acquisition of qualification shares by directors will not be regarded as "dealing" in the issuers' securities for the purposes of the Rules.

Dealings by directors in "exceptional circumstances" (Consultation Proposals C.16.3 and 16.4)

235. We will amend the Model Code and the GEM Rules relating to the procedures for directors' dealing in the issuers' securities under exceptional circumstances during the "black out" period. A director will be allowed to sell, but not acquire, securities of the issuer under exceptional circumstances during the "black out" period. This would only be allowed provided the director has submitted a prior written notice to and received

a dated written acknowledgement from the chairman of the board or a director designated by the board. The director shall satisfy the chairman or the designated director that the circumstances are exceptional before he can deal in the securities. Failure to comply with these requirements will constitute a breach of the Rules.

236. We will amend the Rules to require an issuer to give written notice of such dealings to the Exchange stating why it considers the circumstances to be exceptional. The issuer shall issue an announcement to disclose such dealings immediately after they are completed. The announcement shall state that the chairman or the designated director is satisfied that there were exceptional circumstances for such disposal of the issuer's securities by the director.

Directors as trustees or beneficiaries (Consultation Proposal B.17.4)

237. We will amend the Rules to reflect the following:

(a) if the director is acting as a sole trustee, the relevant Rules will apply to all dealings of the trust as if he were dealing on his own account (unless the director is a bare trustee, in which case the relevant Rules will not apply); and

(b) when the director deals in the securities of an issuer in his capacity as a co-trustee and he has not participated in or influenced the decision to deal in the securities, and he is not, and none of his associates are, a beneficiary or a discretionary object under the trust, the dealings by the trust will not be regarded as his dealings.

Securities transactions by "relevant employees" (Consultation Proposal C.18.3)

238. We will include as a minimum standard in the Code of Best Practice that issuers should establish a guideline for their employees' securities transactions, which should be on no less exacting terms than the minimum standard of conduct for directors' securities transactions set out in the Rules. We will also define the term "relevant employee" in the Code of Best Practice as any employee of an issuer, or director or employee of a subsidiary or parent company of the issuer who, because of his office, is likely to be in possession of unpublished price-sensitive information in relation to the issuer.

Directors' service contracts (Consultation Proposals C.20.7 and 20.8)

239. We will amend the Rules to require approval of shareholders (other than shareholders who are the directors with an interest in the service contracts and their associates) for:

(a) a service contract that is to be granted to a director of the issuer or any of its subsidiaries for a duration exceeding three years; or

(b) a service contract that requires the issuer to give a period of notice of more than one year or to pay compensation of more than a year's remuneration (other than solely on account of an early termination by the issuer of a fixed term contract).

240. We will amend the Rules so that the remuneration committee of the issuer (if any) or an independent board committee will be required to form a view in respect of service contracts that require shareholders' approval and advise shareholders (other than shareholders who are directors with an interest in the service contracts and their associates) on how to vote.

Half-year results announcements (Consultation Proposal D.4.10)

241. As mentioned in paragraph 158, we will adopt the Consultation Proposal relating to the disclosure requirement for half-year results announcements in principle. We will amend the Main Board Rules to abolish the existing two-phased publication arrangement for half-year results announcements.

242. There are concerns from respondents that issuers may not be able to meet the existing reporting deadline as a result of adopting the new disclosure requirements for half-year results announcements and abolishing the existing two-phased publication arrangement. To address these concerns, an appropriate transitional period will be given for issuers to prepare themselves to comply with the new disclosure and reporting requirements.

Full-year reporting

Annual reports (Consultation Proposal D.5.7)

243. We will amend the Rules to provide for issuers' reference certain disclosures relating to corporate governance matters for issuers' annual reports, as set out in Appendix IV to the Consultation Paper. We note that there are views that certain proposed reference disclosure items should be standard disclosure obligations. We will closely monitor the market developments and introduce Rule amendments, where necessary.

Summary financial reports (Consultation Proposal D.6.2)

244. We will amend the Rules to require issuers to disclose the following information in their summary financial report:

(a) a statement of compliance with and details of any deviation from the minimum standard set out in the Code of Best Practice; and

(b) particulars of any purchase, sale or redemption by the issuer or any of its subsidiaries, of its listed securities during the financial year or an appropriate negative statement.

Annual results announcements (Consultation Proposals D.7.9 and 7.10)

245. We will amend the Rules to require issuers to disclose in their annual results announcements, in principle, the same financial information as disclosed in a summary financial report. Details of the disclosure requirements are set out in Appendix V to the Consultation Paper.

246. We will amend the Rules to abolish the existing two-phased publication arrangement for annual results announcements for Main Board and GEM issuers.

247. To address the respondents' concerns that issuers may not be able to meet the existing reporting deadline as a result of adopting the new disclosure requirements for annual results announcements and abolishing the existing two-phased publication arrangement, an appropriate transitional period will be given for issuers to prepare themselves to comply with the new disclosure and reporting requirements.

Content of circulars and announcements relating to notifiable transactions

Very substantial acquisitions (Consultation Proposal D.8.3)

248. We will amend the Main Board Rules to require an accountants' report on the enlarged group be included in circulars on very substantial acquisitions.

PART E
SUMMARY OF CONSULTATION PROPOSALS THAT WILL NOT BE ADOPTED

249. As discussed in Part B of this Consultation Conclusion Report, we will not adopt Consultation Proposals relating to:

- extending the definition of "connected person" to cover a director, chief executive or substantial shareholder of associated companies over which the listed group together with the connected person(s) of an issuer have control *(Consultation Proposal B.24.8)* (see paragraph 88);

- regulating transactions between connected persons and associated companies over which the listed group together with the connected person(s) of an issuer have control *(Consultation Proposal B.26.9)* (see paragraph 88);

- quarterly reporting for Main Board issuers and disclosure requirements for quarterly reporting by both Main Board and GEM issuers *(Consultation Proposals D.1.11 to 1.13 and D.2.4 to 2.6)* (see paragraphs 113 to 115); and

- the proposed two-week "black out" period for securities transactions by directors for quarterly reporting *(Consultation Proposal C.19.7)* (see paragraphs 116 to 117).

This section summarises all other Consultation Proposals that we will not adopt based on the results of the consultation exercise. Respondents generally do not support these proposals and express concern over the practical issues that may arise from implementing the proposals.

Valuation of properties (Consultation Proposal B.20.4)

250. In the Consultation Paper, we proposed to amend the Rules so that we reserve the right to require valuation reports to be prepared in appropriate circumstances, including circumstances where there are already existing valuation reports less than three months old. A majority of the respondents oppose the proposal. A number of

respondents raise the need to include further guidance in the Rules on the "appropriate circumstances" under which the Exchange would require issuers to prepare valuation reports even when there are already existing valuation reports that are less than three months old. Some respondents consider that the requirement for valuation reports under the existing Rules already provide sufficient protection for shareholders. Issuers might have to incur unnecessary time and costs to prepare valuation reports for immaterial transactions or when they have already got a valuation report which is less than three months old.

251. In view of the majority opposition and the existing Rules already require valuation reports of three months or less, we will not adopt the Consultation Proposal.

Half-year reporting deadline (Consultation Proposal D.3.8)

252. In view of our Consultation Proposal to introduce quarterly reporting to Main Board, we also proposed that both Main Board and GEM issuers shall publish their half-year results announcements and despatch their half-year reports within two months of the relevant financial period end. Respondents have diverse views over the proposed deadline for half-year reporting. A majority of the respondents that disagree with the Consultation Proposal are Main Board issuers. They consider that the proposed two-month deadline is too tight and will result in practical difficulties, particularly for issuers with diverse geographical operations or small issuers with limited resources. There are opposing views that the Consultation Proposal should be adopted to promote timely disclosure of information for shareholders and investors to make informed investment decisions.

253. In the Consultation Paper, we have not consulted the market on whether or not the proposed two-month deadline should be adopted if the proposal for quarterly reporting by Main Board issuers is not implemented. Taking into account the diverse views and quarterly reporting will not be mandatory for Main Board issuers for the time being, we will retain the existing deadline of three months for half-year reporting under the Main Board Rules for the time being. We will review the half-year reporting deadline from time to time in view of market developments.

254. Based on the result of the consultation exercise, we note that there are only a few GEM issuers that have concerns over the half-year reporting deadline of 45 days within the financial period end under the existing GEM Rules. Therefore, we will also retain the existing half-year reporting deadline under the GEM Rules so as to ensure timely disclosure of financial information to the market by GEM issuers.

Full year reporting deadline (Consultation Proposal D.5.6)

255. In the Consultation Paper, we proposed to amend the Main Board Rules to follow the GEM Rules and require issuers to publish annual results within three months of their financial year end, in view of our proposal to introduce quarterly reporting to the Main Board Rules.

256. A majority of the respondents, which are mainly Main Board issuers, disagree with the Consultation Proposal. They mainly have practical concerns over the proposal and consider that the proposed deadline is too tight for them to prepare the annual report and complete the annual audit.

257. In the Consultation Paper, we have not consulted the market on whether to adopt proposed three-month deadline if our proposal for quarterly reporting by Main Board issuers is not implemented. Given that we will not implement quarterly reporting for the Main Board issuers for the time being (see paragraph 113) and a majority of the respondents did not agree with the Consultation Proposal, we will retain the reporting deadlines for annual reporting under the existing Main Board Rules (within four months from the year end) and GEM Rules (within three months from the year end). We will review the full year reporting deadline from time to time in view of market developments.