CONSULTATION PAPER

ON

PROPOSED AMENDMENTS TO THE LISTING RULES

RELATING TO

CORPORATE GOVERNANCE ISSUES

January 2002

Hong Kong Exchanges and Clearing Limited

CONTENTS

EXECUTIVE SUMMARY

INTRODUCTION

1. Corporate governance of issuers listed on The Stock Exchange of Hong Kong Limited (the "Exchange") is mainly regulated by:

   (a) statutory requirements contained in the Hong Kong Companies Ordinance, Securities (Disclosure of Interests) Ordinance, Securities (Insider Dealing) Ordinance; and

   (b) non-statutory requirements contained in The Rules Governing the Listing of Securities ("**Main Board Rules**") on the Exchange, The Rules Governing the Listing of Securities on the Growth Enterprise Market ("**GEM**") of the Exchange ("**GEM Rules**", and together with the Main Board Rules, the "**Rules**"), the Code on Takeovers and Mergers ("**Takeovers Code**") and the Code on Share Repurchases.

2. The Rules, together with the statutory and other non-statutory requirements, set the corporate governance standard for issuers in Hong Kong.

3. In this Consultation Paper, we look at corporate governance requirements from the perspective of the Rules. We shall review the Rules from the context of prudent corporate governance to bring them up to the best current international market practices. The areas covered are:

   (a) protection of shareholders' rights;

   (b) directors and board practices; and

   (c) corporate reporting and disclosure of information.

4. Our aim is to make our corporate governance standards for issuers in Hong Kong to be on a par with the best current international market practices, having considered the circumstances in Hong Kong. Since the current Rules closely follow the framework of the Listing Rules of the London Stock Exchange issued by the Financial Services Authority ("UK Listing Rules"), we have made reference to the relevant provisions of such rules when considering our proposals in this Consultation Paper. We consider that it is equally important that we should strike a balance between commercial practicality and protection of investors.

5. This summary should be read in conjunction with the other parts of the Consultation Paper for a fuller understanding of the proposed changes to the Rules.

SUMMARY OF PROPOSALS RELATING TO PROTECTION OF SHAREHOLDERS' RIGHTS

VOTING BY SHAREHOLDERS

1. Voting by poll (paragraphs 1.1 to 1.6 of Part B)

We will amend the Rules to require voting by way of poll for connected transactions and all resolutions requiring independent shareholders' approval.

2. Voting of "interested shareholders" in relation to very substantial acquisitions, very substantial disposals[1] and major transactions (paragraphs 2.1 to 2.4 of Part B)

We will amend the Main Board Rules to follow the approach of the GEM Rules so that any shareholder who has an interest shall not vote at a general meeting approving a very substantial acquisition, a very substantial disposal or a major transaction.

3. Voting of controlling shareholders (paragraphs 3.1 to 3.11 of Part B)

For the purpose of the Rules, we will maintain our general principle that all shareholders have the same right to vote at general meetings of an issuer, except for the approval of certain matters that have significant impact on issuers and shareholders and there were significant previous cases of abuse of minority interests (as set out in paragraph 3.4 of Part B of this Consultation Paper).

4. Waiver of requirement to hold general meetings (paragraphs 4.1 to 4.8 of Part B)

We will amend the Rules to codify our practice that a written shareholders' approval in lieu of holding a physical shareholders' meeting for the approval of major transactions or connected transactions will be allowed 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

[1] see paragraphs 16.1 to 16.6 of Part B of this Consultation Paper

(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 nominal value of the securities giving the right to attend and vote at that general meeting to approve the subject transactions.

DILUTION OF SHAREHOLDERS' INTERESTS

5. Placing of shares using the general mandate (paragraphs 5.1 to 5.10 of Part B)

We will retain the Rules which allow issuers to issue securities up to a maximum of 20% of the existing issued share capital under a general mandate. We will amend the Rules to impose a pricing restriction on the issue of securities under a general mandate. Unless an issuer can satisfy the Exchange that it is in severe financial difficulties or that there are other exceptional circumstances, it may not issue shares under a general mandate if the placing price or the subscription price under the top-up arrangements represents a discount of 20% or more to the benchmarked price set out in paragraph 5.9 of Part B of this Consultation Paper. We will also amend the Rules to require issuers to disclose additional information on placings or top-up arrangements at a deep discount to the benchmarked price under general mandates.

6. Placing and top-up subscription (paragraphs 6.1 to 6.4 of Part B)

We will amend the Rules so that 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. 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 holding.

7. Rights issues and open offers (paragraphs 7.1 to 7.10 of Part B)

We will retain the Rules that 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%. We will also clarify in the Rules on how to determine the 12 month period of rights issues and open offers that will increase the share capital or market capitalisation of the issuer by more than 50%, as well as to how to calculate such an increase.

We will also 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.

8. Exclusion of overseas shareholders from share offers (paragraphs 8.1 to 8.2 of Part B)

We will amend the Rules to allow issuers to exclude overseas shareholders in an offer of securities provided the directors of the issuers consider it necessary or expedient 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.

OTHER MATTERS AFFECTING SHAREHOLDERS

9. Material changes in nature of business (paragraphs 9.1 to 9.6 of Part B)

The Main Board Rules require independent shareholders' approval for an issuer entering into any transaction or arrangement within 12 months of listing, which would result in a material change to the general character or nature of its business as described in its first listing document. We will amend the Main Board Rules to also cover a series of transactions or arrangements entered into during the said 12 month period. We will amend the GEM Rules to also cover a series of transactions or arrangements entered into from the date of listing on GEM to the end of the first financial year and the 2 financial years thereafter.

Share repurchases

10. Restrictions on pricing and bidding (paragraphs 10.1 to 10.4 of Part B)

We will amend the Rules to prohibit repurchases on the Exchange at a price 5% higher than the average closing market price over the preceding 5 trading days on which shares were traded.

11. Dealing restrictions (paragraphs 11.1 to 11.2 of Part B)

We will amend the Rules to require the dealing restriction period for share repurchases to follow the "black out" period for securities transactions by directors for the half-year and annual results and the proposed "black out" period for quarterly reporting set out in paragraph 19.7 of Part C of this Consultation Paper.

12. 25% monthly share repurchase restriction (paragraphs 12.1 to 12.3 of Part B)

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

13. Withdrawal of primary listing on the Exchange (paragraphs 13.1 to 13.5 of Part B)

We will amend the Rules so that any withdrawal of primary listing on the Exchange 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.

14. Withdrawal of secondary listing on the Exchange (paragraphs 14.1 to 14.2 of Part B)

We will amend the Rules so that issuers with secondary listing status on the Exchange may withdraw their listing on the Exchange 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 3 months' prior notice of the proposed delisting, by way of an announcement.

NOTIFIABLE TRANSACTIONS OTHER THAN CONNECTED TRANSACTIONS

15. Very substantial acquisitions (paragraphs 15.1 to 15.9 of Part B)

We will amend the Rules so that issuers shall comply with the provisions for "very substantial acquisitions", irrespective of whether the assets being acquired are listed or not. We will amend the GEM Rules so that no shareholders will be required to abstain from voting at the shareholders' meeting approving a very substantial acquisition, unless they have a different interest from other shareholders in the transaction. We will also amend the Main Board Rules so that no written certificate of shareholders' approval shall be accepted for very substantial acquisitions.

16. Introduction of "very substantial disposals" (paragraphs 16.1 to 16.6 of Part B)

We will introduce in the Rules a new type of transaction, namely "very substantial disposals". This type of transaction will cover disposal of assets, business or company, where any of the percentage ratios under the various tests for classification of the transaction is 75% or more[2].

We will amend the Rules to 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 have a different interest from other shareholders in the transaction. No written certificate of shareholders' approval shall be accepted for very substantial disposals.

17. Reverse takeovers (paragraphs 17.1 to 17.9 of Part B)

We will amend the GEM Rules to expand the definition of "reverse takeover" to include any acquisition of assets that will lead to a fundamental change of business of issuers as a reverse takeover. We will also amend the GEM Rules so that no shareholders will be required to abstain from voting at the shareholders' meeting to approve a reverse takeover, unless they have a different interest from other shareholders in the transaction. No written certificate of shareholders' approval shall be accepted for reverse takeovers. We will amend the Main Board Rules to introduce a separate category of "reverse takeover" transaction and adopt the same requirements set out in the GEM Rules and our proposals set out in paragraphs 17.7 and 17.8 of Part B of this Consultation Paper.

18. Introduction of "total assets test" and "turnover test" (paragraphs 18.1 to 18.6 of Part B)

We will amend the Rules to adopt a new basis for the "assets test". The new "assets test" will be the total assets being the subject of the transaction divided by the total assets of the issuer. We will also amend the Rules to adopt the "turnover test" to substitute for the "profits test" when the profits test produces anomalous results due to exceptional circumstances.

19. New thresholds for notifiable transactions (paragraphs 19.1 to 19.6 of Part B)

We will amend the Rules to adjust the threshold levels for categorising notifiable transactions under all size tests.

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[2] see paragraph 19.6 of Part B of this Consultation Paper

20. Valuation of properties (paragraphs 20.1 to 20.6 of Part B)

We will 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 3 months old. We will also amend the Rules so that for the calculation of "size tests" under the notifiable transaction rules, the higher of the consideration (which in the case of a property company, will include the value of all outstanding mortgages), the book value of the assets, or the valuation of the assets will form the numerator for the "assets test".

21. Asset valuation (paragraphs 21.1 to 21.2 of Part B)

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 and will be subject to the same requirements of profit forecasts under the Rules.

22. Options granted by issuers (paragraphs 22.1 to 22.5 of Part B)

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. We will amend the Main Board Rules to follow the GEM Rules in relation to the grant, acquisition, transfer or exercise of an option.

23. Dilution of interest in subsidiaries resulting in deemed disposals (paragraphs 23.1 to 23.2 of Part B)

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

CONNECTED TRANSACTIONS

24. Definition of "connected person" (paragraphs 24.1 to 24.8 of Part B)

We will amend the GEM rules to follow the definition of "connected person" in the Main Board Rules. This includes persons who are connected by virtue of their relationship at the subsidiary level. We will also expand the definition of "connected persons" in respect of our proposal (as set out in paragraph 26.9 of Part B of this Consultation Paper) to regulate transactions between connected persons and certain associated companies. These will be associated companies over which the listed group together with the connected person(s) of an issuer have control.

25. Definition of "associate" (paragraphs 25.1 to 25.6 of Part B)

We will retain the existing definition of "associate" in the Rules.

26. Transactions between connected persons and associated companies (paragraphs 26.1 to 26.9 of Part B)

We will amend the Rules so that transactions between connected persons of an issuer and an associated company of the issuer will be regulated as connected transactions if:

(a) the issuer and/or its subsidiaries hold not less than 20% of the voting power in such an associated company; and

(b) the issuer and/or its subsidiaries together with connected person(s) of the issuer (excluding connected person(s) at the subsidiary level) have control over such an associated company. Control here shall have the same meaning as stated in paragraph 30.5 of Part B of this Consultation Paper.

27. Transactions with non wholly owned subsidiaries (paragraphs 27.1 to 27.4 of Part B)

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

28. De minimis thresholds for connected transactions (paragraphs 28.1 to 28.2 of Part B)

We will amend the Rules so that the basis for de minimis thresholds for connected transactions will refer to the total assets instead of the net tangible assets of issuers. Consequently, we will also adjust the relevant percentage level of the de minimis thresholds.

29. Continuing connected transactions (paragraphs 29.1 to 29.9 of Part B)

We will amend the Main Board Rules to introduce a new category of "continuing connected transactions". We will also amend the GEM Rules in relation to the annual review and shareholders' approval requirements for continuing connected transactions.

30. MEANING OF "SUBSIDIARY" (paragraphs 30.1 to 30.10 of Part B)

We will expand the definition of "subsidiary" for all purposes of the Rules to include any entity which is accounted for in the audited consolidated accounts of an issuer as a subsidiary under applicable accounting principles under SSAP 32 or IAS 27.

DISPOSAL OF CONTROLLING SHAREHOLDERS' INTERESTS

31. Commencement of lock-up period (paragraphs 31.1 to 31.3 of Part B)

We will amend the Rules so that the lock-up period for the disposal of securities by controlling shareholders of Main Board issuers and significant shareholders of GEM issuers shall commence from the date the listing document is issued and end upon 6 months after the commencement of dealing of the issuer's securities on the Exchange. The same lock-up period shall apply to initial management shareholders of GEM issuers, except that it will end 12 months after the date of listing. In the case of initial management shareholders holding 1% or less interest in the issuer, the lock-up period shall end 6 months after the date of listing. Offer for sale is allowed during the period from the date of the listing document to the date of listing.

32. Agreement for disposal of shares (paragraphs 32.1 to 32.3 of Part B)

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 relevant restriction periods under the Main Board Rules.

33. Deemed disposal of controlling shareholders' interests (paragraphs 33.1 to 33.5 of Part B)

We will amend the Rules to require issuers not to issue, within the first 6 months of listing, 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 6 months of listing), other than specific circumstances.

SUMMARY OF PROPOSALS RELATING TO DIRECTORS AND BOARD PRACTICES

INDEPENDENT NON-EXECUTIVE DIRECTORS ("INEDs")

1. Further guidance regarding independence (paragraphs 1.1 to 1.5 of Part C)

We will include more guidelines in the Rules to describe the independence of INEDs.

2. Qualifications of INEDs (paragraphs 2.1 to 2.3 of Part C)

We will amend the Rules to require issuers to appoint at least 1 INED who has appropriate professional qualifications or experience in financial matters.

3. Minimum number of INEDs (paragraphs 3.1 to 3.7 of Part C)

We will amend the Rules to require issuers to appoint INEDs representing not less than one-third of the members of their boards and not less than 2 in any event.

4. Independent board committees (paragraphs 4.1 to 4.6 of Part C)

We will amend the Rules so that for connected transactions that require any shareholders to abstain from voting and transactions or arrangements that require controlling shareholders to abstain from voting, issuers shall establish an independent board committee to advise shareholders and appoint an independent expert. The independent expert will recommend to the independent board committee whether the terms of the transaction or arrangement are fair and reasonable, whether the transaction or arrangement is in the interest of the issuer and its shareholders as a whole and advise shareholders on how to vote.

BOARD PRACTICES

5. Code of Best Practice (paragraphs 5.1 to 5.4 of Part C)

We will amend the Rules so that the Code of Best Practice will be set out as an appendix to the Rules and will be the minimum standard that we recommend all issuers to meet. Compliance with the minimum standard set out in the Code of Best Practice will not be a mandatory requirement. Any deviation from the minimum standard in the Code of Best Practice shall be subject to full disclosure in their reports on corporate governance in their annual reports[3].

[3] see paragraphs 6.1 to 6.3 of Part C of this Consultation Paper

6. Report on corporate governance (paragraphs 6.1 to 6.3 of Part C)

We will amend the Rules to require issuers to include a report on corporate governance practices prepared by the board of directors in their annual reports. This report shall state the corporate governance practices adopted by the issuer and provide details of any deviation from the minimum standard set out in the Code of Best Practice.

Establishment of governance committees

7. Audit committee (paragraphs 7.1 to 7.8 of Part C)

We will amend the Main Board Rules to follow the GEM Rules so that establishing an audit committee shall become a compulsory requirement. We will amend the Rules to require the audit committee to comprise at least 3 non-executive directors with a majority of INEDs and at least 1 INED with appropriate qualifications or experience.

8. Remuneration committee (paragraphs 8.1 to 8.6 of Part C)

We will amend the Code of Best Practice to recommend issuers to establish a remuneration committee comprising only INEDs and include the principal functions of the remuneration committee.

9. Nomination committee (paragraphs 9.1 to 9.8 of Part C)

We will amend the Code of Best Practice to recommend issuers to establish a nomination committee comprising a majority of INEDs and include the principal functions of the nomination committee.

DIRECTORS' DUTIES AND RESPONSIBILITIES

10. Duties and responsibilities of non-executive directors (paragraphs 10.1 to 10.3 of Part C)

We will amend the Code of Best Practice to include a general description of the duties and responsibilities of non-executive directors.

11. Chairman and chief executive officer (paragraphs 11.1 to 11.5 of Part C)

We will amend the Code of Best Practice to recommend segregation of the roles of chairman and chief executive officer as a good practice.

12. Internal controls (paragraphs 12.1 to 12.4 of Part C)

We will amend the Code of Best Practice to recommend directors to regularly conduct a review of the effectiveness of the group's system of internal controls, which should cover all controls, including financial, operational and compliance controls, and risk management and report such review in the annual reports of the issuers.

13. Voting by interested directors (paragraphs 13.1 to 13.3 of Part C)

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 and not to be counted towards the quorum of the relevant board meeting, unless the interest is immaterial.

SECURITIES TRANSACTIONS BY DIRECTORS

14. Disclosure of breaches (paragraphs 14.1 to 14.4 of Part C)

We will amend the Rules to expressly provide that any breach of the minimum standard of conduct regarding securities transactions by directors set out in the Rules 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.

15. Definition of "dealing" (paragraphs 15.1 to 15.3 of Part C)

We will amend the Rules to include a definition of "dealing".

16. Dealings by directors in "exceptional circumstances" (paragraphs 16.1 to 16.4 of Part C)

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 during the "black out" period provided he 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. The issuer shall give written notice of such dealings to us stating why it considered the circumstances to be exceptional. The issuer shall issue an announcement immediately to disclose such dealings after they are completed.

17. Directors as trustees or beneficiaries (paragraphs 17.1 to 17.4 of Part C)

We will amend the Rules to reflect the following:

(a) if the director is acting as a sole trustee, the Model Code and the GEM Rules regulating directors' securities transactions 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.

18. Securities transactions by "relevant employees" (paragraphs 18.1 to 18.3 of Part C)

We will amend the Code of Best Practice to recommend issuers to 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 transaction set out in the Rules. We will also include a definition of "relevant employee" in the Code of Best Practice.

19. "Black out" period of directors' securities transactions (paragraphs 19.1 to 19.7 of Part C)

We will amend the Rules so that for quarterly reports, the relevant "black out" period for securities transactions by directors shall commence 2 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.

DIRECTORS' CONTRACTS, REMUNERATION AND APPOINTMENTS

20. Directors' service contracts (paragraphs 20.1 to 20.8 of Part C)

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 3 years; or

(b) a service contract that requires the issuer to give a period of notice of more than 1 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).

21. Disclosure of directors' remuneration (paragraphs 21.1 to 21.3 of Part C)

Issuers shall disclose details relating to directors' remuneration and compensation packages by individual director (including INED) showing the name of each director and the amounts of remuneration and compensation in their annual reports.

22. Appointment, reappointment and removal of directors (paragraphs 22.1 to 22.4 of Part C)

We will amend the Rules to require directors to be subject to rotation at regular intervals. Retiring directors shall be eligible for re-election.

SUMMARY OF PROPOSALS RELATING TO CORPORATE REPORTING AND DISCLOSURE OF INFORMATION

QUARTERLY REPORTING

1. Quarterly reports (paragraphs 1.1 to 1.13 of Part D)

We will amend the Main Board Rules to require issuers to publish quarterly reports within 45 days of their quarter-end and to include, as a minimum, the information set out in Appendix I to this Consultation Paper in their quarterly reports. We will also amend the Main Board Rules to require audit committees to review issuers' quarterly reports. We will also amend the GEM Rules where appropriate so that the disclosure and reporting requirements for Main Board issuers will apply to GEM issuers.

2. Quarterly results announcements (paragraphs 2.1 to 2.6 of Part D)

We will amend the Main Board Rules to require issuers to publish quarterly results on the next business day following their approval by the issuers' board of directors and within 45 days of their quarter end. Main Board issuers will be required to disclose, as a minimum, the information set out in the relevant sections of Appendix I to this Consultation Paper in their quarterly results announcements. We will amend the Main Board Rules to require audit committees to review issuers' quarterly results announcements. We will also amend the GEM Rules to mirror the proposed disclosure requirements for the quarterly results announcements of Main Board issuers.

HALF-YEAR REPORTING

3. Half-year reports (paragraphs 3.1 to 3.8 of Part D)

We will amend the Rules to permit issuers to distribute summary half-year reports containing, as a minimum, the information set out in Appendix II to this Consultation Paper. We will also amend the Rules to require issuers to publish their half-year results and despatch their half-year reports within 2 months of the relevant period end.

4. Half-year results announcements (paragraphs 4.1 to 4.10 of Part D)

We will amend the Rules to require issuers to disclose in their half-year results announcements the information set out in the relevant sections of Appendix II to this Consultation Paper. We will amend the Main Board Rules to abolish the existing two-phased publication arrangement relating to simplified and full half-year results announcements.

FULL-YEAR REPORTING

5. Annual reports (paragraphs 5.1 to 5.7 of Part D)

We will amend the Main Board Rules to require issuers to publish and despatch their annual reports within 3 months of their financial year end. We will also amend the Rules to include the reference disclosures relating to corporate governance matters for issuers' annual reports set out in Appendix IV to this Consultation Paper.

6. Summary financial reports (paragraphs 6.1 to 6.2 of Part D)

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

(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.

7. Annual results announcements (paragraphs 7.1 to 7.10 of Part D)

We will amend the Rules to require issuers to disclose the information set out in Appendix V to this Consultation Paper in their annual results announcements. We will amend the Rules to abolish the existing two-phased publication arrangement relating to simplified and full annual results announcements.

CONTENTS OF CIRCULARS AND ANNOUNCEMENTS RELATING TO NOTIFIABLE TRANSACTIONS

8. Very substantial acquisitions (paragraphs 8.1 to 8.3 of Part D)

We will amend the Main Board Rules to follow the GEM Rules so that issuers shall include an accountants' report on the enlarged listed group in circulars for a very substantial acquisition.

9. General information in all announcements and circulars of notifiable transactions (paragraphs 9.1 to 9.2 of Part D)

We will amend the Rules to require issuers to disclose additional information in all announcements and circulars of notifiable transactions.

OTHERS

10. Changes in directorship (paragraphs 10.1 to 10.4 of Part D)

We will amend the Main Board Rules to require issuers to publish an announcement of any changes in directorship. We will amend the Rules to require issuers to disclose biographical details of the directors in the announcement of their appointment.

11. Despatch of notice of general meeting and circular (paragraphs 11.1 to 11.6 of Part D)

We will amend the Main Board Rules to require issuers to despatch the relevant circulars to shareholders at the same time as or before they give notice of the general meeting to approve the notifiable transaction or the connected transaction. We will amend the Rules to require issuers to publish notice of general meetings by way of an announcement.

PART A
INTRODUCTION

BACKGROUND

1.1 The Exchange reviews the Main Board Rules and the GEM Rules from time to time to ensure that they are in line with the best current market practices and international standards.

1.2 The most recent review of the Main Board Rules was conducted in May 1999 (the "1999 Review") which covered issues relating to competition, notifiable transactions and share option schemes. A number of other changes to the Main Board Rules and the GEM Rules were also made after the 1999 Review. Certain issues raised and discussed in the 1999 Review, but with no decision taken, are re-visited in view of market developments. Their relevance is reviewed in this Consultation Paper.

1.3 Although directors and management of issuers assume the responsibility of implementing good corporate governance practices, we should review and update the Rules to ensure the standard of corporate governance for issuers in Hong Kong is in line with the best international practices. Since the start of our Corporate Governance Project in 1992, we have established five working groups on corporate governance to examine and advise the Exchange on major issues and the latest development relating to corporate governance. A number of their findings and recommendations to enhance and promote corporate governance have been implemented. Our objective is to continuously improve the governance of issuers in Hong Kong while taking into account the realities of business practices in Hong Kong.

1.4 The Financial Secretary stressed the importance of corporate governance in his Budget Speeches of 2000 and 2001. A number of significant and comprehensive reports and guidelines, such as the OECD Principles of Corporate Governance[4], have been issued in recent years in relation to corporate governance standards. The Standing Committee on Company Law Reform (the "SCCLR") also issued a consultation paper in July 2001 in relation to various proposed changes to the law on corporate governance issues (the "SCCLR Paper"). We have studied these reports and reviewed the guidelines to see what can be done to further enhance the Rules to protect shareholders' rights and strengthen board practices, taking into account the common features for issuers in Hong Kong. One of the common features for issuers in Hong Kong is that many of them have a single dominant shareholder or group of shareholders controlling the issuer. In this Consultation Paper, we have highlighted the issues and current position of corporate governance practices in Hong Kong and set out our proposals thereon.

[4] issued by the Organisation for Economic Co-operation and Development in April 1999

1.5 We note that there are a number of proposals in the SCCLR Paper that may have an impact on the Rules if they are implemented. We do not propose to consider the impact of the SCCLR proposals in this Consultation Paper. We propose to consider any amendments to the Rules that may be necessary in relation to the SCCLR Paper when the recommendations are finalised.

SCOPE OF REVIEW

2.1 We have initiated this review of the Rules with an aim to enhancing the corporate governance of companies listed on the Main Board and GEM.

2.2 Whether issuers observe basic principles of good corporate governance has become an increasingly important factor for investment decisions. While the standard of corporate governance in Hong Kong is amongst the highest in Asia, it is vital to ensure that the governance and accountability of issuers in Hong Kong are in line with the best international practices. The Rules should be regularly reviewed and updated in response to changing market conditions and best current market practices in other jurisdictions. This would serve to improve the confidence of both domestic and international investors and enhance Hong Kong's position as a leading international financial centre.

LEGAL AND REGULATORY FRAMEWORK OF CORPORATE GOVERNANCE

3.1 Corporate governance practices in Hong Kong are governed by well-established legal and regulatory framework which comprises common law, statute laws, non-statutory rules and codes of practices. Statute laws include the Hong Kong Companies Ordinance which outline statutory provisions governing companies incorporated in Hong Kong, the Securities (Disclosure of Interests) Ordinance and Securities (Insider Dealing) Ordinance. Non-statutory rules including the Rules, Takeovers Code and Code on Share Repurchases apply to issuers in Hong Kong.

3.2 Building on the framework provided under the various statutes and common law, the Rules provide more detailed requirements on corporate governance matters of issuers in Hong Kong e.g. board practices, protection of shareholders' rights in material or connected transactions, and proper disclosure of information to the public. They contain the Code of Best Practice which serves as a guideline to issuers when devising their own codes of board practices. We are of the view that the Rules are most effective in improving corporate governance standards of issuers in the areas of:

(a) protection of shareholders' rights;

(b) accountability of directors and the board; and

(c) transparency and timely disclosure of information necessary for shareholders and investors to make informed investment decisions.

OVERVIEW

4.1 This Consultation Paper is divided into 3 main sections: (1) protection of shareholders' rights; (2) directors and board practices; and (3) corporate reporting and disclosure of information.

Protection of shareholders' rights (Part B of this Consultation Paper)

5.1 Our principles are that all shareholders have the same right to vote as long as they do not have different interest from other shareholders i.e. their interest is solely by virtue of a shareholding in the issuer concerned. The exceptions are in areas which have material impact on the listed group and there were significant previous cases of abuse of minority interests.

5.2 Given that the majority of the boards of directors of issuers in Hong Kong is dominated by controlling or majority shareholders, one of the main objectives of our proposals is to ensure protection of shareholders' rights.

5.3 We look at the issue of protection of shareholders' rights from the following perspectives:

(a) voting process;

(b) dilution impact;

(c) nature of transactions; and

(d) significance of value of transactions.

Directors and board practices (Part C of this Consultation Paper)

6.1 Directors and their boards are responsible for the governance of issuers and accountable to shareholders for assets and resources entrusted to them. Therefore, directors play a key role in the corporate governance of issuers and an effective board is essential for good corporate practices.

6.2 The key elements for establishing an effective board are the directors' appreciation and understanding of their duties and responsibilities, a balanced board and the adoption of good board practices.

6.3 Directors should have a thorough understanding of their duties and responsibilities. The basic responsibilities of directors stem from their stewardship role and fiduciary duties that are set out in common law. In the case of directors of issuers, the Rules also set out their responsibilities. We understand from the SCCLR Paper that action is now being taken by the Securities and Futures Commission of Hong Kong to draft a code of best practice which will serve as a guide to directors as to their duties. Therefore we consider that there is no need to elaborate on the general duties of directors in the Rules. We propose to set out additional guidelines on specific duties of directors and requirements in the Rules which we expect directors to comply with. These additional guidelines and requirements are aimed at enhancing corporate governance standards of issuers.

6.4 A balanced board comprising executive and non-executive directors (including independent non-executive directors) is another key element to an effective board. The inclusion of non-executive directors provides a variety of skills and knowledge, which enhance the effectiveness and objectivity of the board's decision-making process. Independent non-executive directors share the same duties as other directors on the board. We acknowledge that independent directors do not carry out any executive functions and therefore are not involved in the day-to-day management of issuers. One of their major contributions is to provide very important checks and balances in the board's decision-making process. Such "check and balance" role is particularly important when the independent directors are dealing with matters, such as:

(a) where different group of shareholders' interests may be different;

(b) where connected persons are involved;

(c) which have significant impact on issuers and shareholders; and

(d) regarding internal control and financial reporting system.

6.5 With the improving corporate governance standard, the "check and balance" role of independent non-executive directors becomes increasingly important. We propose to amend the Rules to strengthen the role of independent non-executive directors and to enable them to contribute their independent view and perform their functions more effectively in the decision-making process of issuers.

6.6 As regards good board practices, we generally promote a balanced and disclosure-based approach and consider that directors of issuers should have full control of their board activities. However, board practice is an important aspect of good corporate governance and also an increasingly important factor for investment decisions. To ensure that issuers in Hong Kong achieve a minimum standard of good board practices, we propose to set out in the Code of Best Practice the

minimum standard we would recommend all issuers to meet. Issuers will be required to disclose their own codes in their reports on corporate governance and to explain any deviation of their own codes from the minimum standard set out in the Code of Best Practice.

Corporate reporting and disclosure of information (Part D of this Consultation Paper)

7.1 Information disclosed by issuers, its substance, and the manner and frequency of its dissemination are all important factors for investment decisions. Enhancing the quality of information in corporate reporting and the timely disclosure of information by issuers would improve transparency of issuers' businesses and operations and are important for good corporate governance. This would allow the public to make informed investment decisions and ensure that the affairs of issuers are conducted with transparency.

7.2 We will look at the issue of corporate reporting and disclosure of information from the perspective of:

(a) frequency of timely disclosure of financial information;

(b) adequacy of information disclosed in issuers' documents including financial reports, announcements and circulars; and

(c) quality of information disclosed in issuers' documents.

CONSULTATION

8.1 This Consultation Paper discusses the rationale behind various proposed changes but does not set out the detailed changes to the Rules. After comments have been received on this Consultation Paper, we will consider making appropriate changes to the Rules. The proposed changes, if adopted, will be made to both the Main Board Rules and the GEM Rules unless otherwise stated.

8.2 We have highlighted specific questions relating to our proposals in this Consultation Paper and set out the same questions in the attached questionnaire booklet. We will analyse responses and comments on our proposals based on the completed questionnaires. You are invited to submit to us your comments on our proposals by completing and returning the questionnaire booklet. The questionnaire booklet is also available for completion and submission at the website of Hong Kong Exchanges and Clearing Limited: www.hkex.com.hk.

8.3 Comments and completed questionnaires should be addressed to Head – Listing, Regulation & Risk Management and sent by post to:

Hong Kong Exchanges & Clearing Limited
11/F, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Alternatively, respondents should complete and submit the electronic questionnaire available at the website of Hong Kong Exchanges and Clearing Limited: www.hkex.com.hk.

8.4 Responses should arrive no later than the close of business on 22 April, 2002.

PART B
PROTECTION OF SHAREHOLDERS' RIGHTS

VOTING BY SHAREHOLDERS

Voting by poll

Issues and current position

1.1 The right to vote at the general meetings is an effective means for shareholders to safeguard their own interests. In Hong Kong, the practice for voting in general meetings of issuers is by a show of hands unless a poll is demanded in accordance with the constitutional documents of issuers or required for connected transactions under the GEM Rules[5]. Voting by a show of hands does not take into account the voting power attached to securities held by shareholders attending the meeting.

1.2 The Rules do not set out mandatory requirements on voting procedures of an issuer. Issuers are allowed, as they see fit, to regulate or restrict voting procedures by inserting relevant provisions in their constitutional documents. Some common provisions for voting procedures in issuers' constitutional documents are:

(a) a poll may only be demanded by:

(i) the chairman of the meeting;

(ii) a few members present in person or by representative or by proxy, or by member(s) representing not less than one-tenth of the total voting rights which can be cast at the meeting; or

(iii) member(s) holding in aggregate, paid up shares equal to not less than one-tenth of the total paid up capital; and

(b) the chairman may adjourn the meeting for the taking of a poll.

1.3 We note comments from the market favouring the Rules to require all voting to be conducted by poll to enhance transparency and fairness and equality between members. Others argue that voting by poll would incur additional cost and administrative burden to issuers. We recognise that voting by poll would serve as an effective means to ensure protection of shareholders' rights, particularly when dealing with matters which involve conflicts of interests or connected parties or

[5] see Rule 20.15 of the GEM Rules

have significant impact on companies and shareholders. However, taking into account the cost and time that may be incurred, such method of voting may not benefit the issuer and shareholders in the same way, if required for less important matters.

Proposal

1.4 We will amend the Rules 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)[6].

Q1. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *Voting by way of poll at a general meeting should be required for all resolutions.*

☐ *Voting by way of poll should be required only if requested by shareholders pursuant to issuers' constitutional documents.*

☐ *Other views*

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

Q2. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

1.6 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.

[6] see paragraph 3.4 of Part B of this Consultation Paper

Q3. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

Voting of "interested shareholders" in relation to very substantial acquisitions, very substantial disposals[7] and major transactions

Issues and current position

2.1 We are of the view that all shareholders have the same right to vote, except:

(a) where a shareholder has a different interest from other shareholders; or

(b) for specific matters which are material to the issuer and there were significant previous cases of abuse of minority interests.

If the interests of all shareholders are the same, they will not be regarded as having an interest for this purpose. Interests of shareholders would normally be the same if they are interested solely by virtue of a shareholding in the issuer concerned.

2.2 The Main Board Rules provide that any shareholder who has a material interest in a major transaction or a very substantial acquisition shall abstain from voting at the general meeting approving the transaction[8]. The term "material interest" has proved to be difficult to define and has raised arguments.

2.3 The GEM Rules provide that any shareholder who has an interest in a major transaction or a very substantial acquisition shall abstain from voting at the general meeting approving the transaction[9]. Materiality of the interest is not considered under the GEM Rules.

Proposal

2.4 We will amend the Main Board Rules to follow the approach of the GEM Rules. Any shareholder who has an interest shall not vote at a general meeting approving a very substantial acquisition, a very substantial disposal[10] or a major transaction.

[7] see paragraphs 16.1 to 16.6 of Part B of this Consultation Paper
[8] see Rules 14.07(1) and 14.10 of the Main Board Rules
[9] see Rules 19.41 and 19.42 of the GEM Rules
[10] see paragraphs 16.1 to 16.6 of Part B of this Consultation Paper

Q4. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. The current Main Board Rules should be retained, i.e. a shareholder who has a material interest, other than as a shareholder, in the subject transaction should not vote at the general meeting. The GEM Rules should be amended to follow the Main Board Rules. Please state reason(s) for your view.*

Q5. If the term "material interest" is retained, how would you define such term for the purpose of determining whether an interested shareholder should abstain from voting at the general meeting approving the subject transaction?

Voting of controlling shareholders

Issues and current position

3.1 Our principle is that all shareholders have the same right to vote at general meetings of an issuer. Unless a shareholder has an interest in the transaction that is different from other shareholders, every shareholder should be entitled to vote.

3.2 We note that in Hong Kong most controlling shareholders actively participate in the management and decision making of the issuers. They may have different interests from the remaining shareholders in a transaction. It may be possible that even if the controlling shareholders have different interests in the transaction, it may appear on the surface that their interests are the same as the remaining shareholders. In such cases, if the controlling shareholders who can influence the management decisions on matters which are material to the issuers are given the same right to vote at the general meeting approving the relevant transaction, they may be able to achieve significant changes in the issuers' business without seeking approval of minority shareholders. There are, therefore, views that controlling shareholders should be required to abstain from voting at general meetings approving transactions that are likely to have material impact on the listed group and there were significant previous cases of abuse of minority interests.

3.3 On the other hand, it may be argued that controlling shareholders have more at stake than minority shareholders. They will likely have more concerns on the effects of the issuer's transactions on the prospects of the issuer. Unless controlling shareholders have a different interest from other shareholders, they should be given the same right to vote at general meetings of the issuer.

3.4 The Rules currently require controlling shareholders to abstain from voting at the general meetings approving certain specific matters which are material to the issuer and there were significant previous cases of abuse of minority interests. These matters are:

(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%[11];

(b) any acquisition, disposal or other transaction which would result in a material change to the general character or nature of the business of the listed group as described in the issuer's first listing document within 12 months of listing for Main Board issuers[12]. Similar restriction period for GEM issuers starts from the date of listing on GEM to the end of the first financial year and the 2 financial years thereafter[13]; 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[14].

We discuss each of these specific circumstances under paragraphs 7.1 to 7.10, 9.1 to 9.6 and 13.1 to 13.5 of Part B of this Consultation Paper.

3.5 The GEM Rules also require controlling shareholders to abstain from voting at general meetings approving very substantial acquisitions and reverse takeovers[15].

3.6 If an issuer has no controlling shareholders, its directors and/or chief executive who are closely involved in the decision-making process and management of the issuer also have significant influence over the issuer. At present, there is no restriction on voting by shareholders who are directors and/or chief executive of an issuer, except:

(a) under the Rules, directors and chief executives are required to abstain from voting at the general meeting approving the delisting of an issuer which has a primary listing on the Exchange and does not have an alternative listing on another exchange;

(b) under the GEM Rules, where there are no controlling shareholders, any shareholders who participate in the management of an issuer are required to abstain from voting at general meetings approving very substantial acquisitions and reverse takeovers; and

[11] see Rules 7.19(6) and 7.24(5) of the Main Board Rules and Rules 10.29 and 10.39 of the GEM Rules
[12] see Rules 14.41 and 14.42 of the Main Board Rules
[13] see Rule 19.71 of the GEM Rules
[14] see Rule 6.12 of the Main Board Rules and Rule 9.20 of the GEM Rules
[15] see Rules 19.42 and 19.44 of the GEM Rules

(c) under the GEM Rules, directors, chief executives, management shareholders are required to abstain from voting at the general meeting approving any transaction which will result in a material change to the general character or nature of the business of the listed group during the financial year in which dealing in its securities commenced on GEM and the 2 financial years thereafter.

We are of the view that where there are no controlling shareholders, directors or chief executive, together with their associates, who have a controlling interest (being 30% or such threshold set out in the Takeovers Code from time to time) in the issuer, should be subject to the same voting restriction as the controlling shareholders for the specific matters set out in paragraph 3.4 above.

3.7 There are also no Rules prohibiting shareholders, who were previously the controlling shareholders, directors or chief executive at the time the decision to enter into the transactions concerned was made, to vote at the general meetings approving such transactions. There may be situations where these parties, after having made the decision to enter into the transactions concerned, cease to be the controlling shareholders or management of the issuer, but are still shareholders at the time of the general meeting. Since these parties were the decision-makers at the relevant time, they may have different interests from the other shareholders in the transactions. Therefore, there may be situations where it may be necessary to require shareholders who were the controlling shareholders at the time the decision was made but not at the time of the general meeting, to abstain from voting at the relevant general meetings approving the specific matters set out in paragraph 3.4 above. Where there are no controlling shareholders, it may be necessary to require the directors or chief executive, who together with their associates had a controlling interest (being 30% or such threshold set out in the Takeovers Code from time to time) in the issuer, at the time the decision was made, to be subject to the same voting restriction as the controlling shareholders for the specific matters set out in paragraph 3.4 above.

3.8 It is our current practice to require issuers to establish an independent board committee to advise shareholders whenever independent shareholders' approval is required. In addition, issuers are required to appoint an independent expert to opine on the terms of the transactions and recommend to independent shareholders on how to vote[16]. Please refer to paragraphs 4.1 to 4.6 of Part C of this Consultation Paper for further discussion and our proposed rule amendment on independent board committees.

[16] see paragraphs 4.1 to 4.6 of Part C of this Consultation Paper

Proposal

3.9 For the purpose of the Rules, we will maintain our general principle that all shareholders have the same right to vote at general meetings of an issuer, except for the approval of certain matters that have significant impact on issuers and shareholders and there were significant previous cases of abuse of minority interests (as set out in paragraph 3.4 above).

Q6. Do you agree with our principle?

☐ *Agree*

☐ *Agree, but controlling shareholders should also abstain from voting for the following resolutions. Please specify those resolutions and state reason(s) for your view. Please also refer to questions 15, 19, 27, 34, 35, 38, 41 and 44.*

☐ *Disagree (please tick one of the following)*

☐ *Controlling shareholders should be allowed to vote in all matters in which their interests are the same as other shareholders.*

☐ *Other views*

Q7. Do you agree that in those exceptional circumstances which require controlling shareholders to abstain from voting at the general meeting, they should be allowed to vote against those resolutions?

☐ *Agree*

☐ *Disagree. In those exceptional circumstances, controlling shareholders should not be allowed to vote in favour or against the resolutions.*

3.10 We will amend the Main Board Rules so that in those exceptional circumstances which require independent shareholders' approval under the Main Board Rules, where there are no controlling shareholders, chief executive or directors (except independent non-executive directors) 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. The GEM Rules will be amended to the same effect that where there are no controlling shareholders, chief executives or directors (except independent non-executive directors) and their respective associates will be required to abstain from voting only if they together have a controlling interest in the issuer.

Q8. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *In those exceptional circumstances which require independent shareholders' approval under the Rules, chief executive or directors (except independent non-executive directors) and their respective associates should abstain from voting at the general meetings approving the relevant resolutions, regardless of the level of their interest in an issuer. Please state reason(s) for your view.*

☐ *In those exceptional circumstances which require independent shareholders' approval under the Rules, chief executive or directors (except independent non-executive directors) and their respective associates should be allowed to vote at the general meetings approving the relevant resolutions. Please state reason(s) for your view.*

☐ *Other views*

3.11 We will amend the Rules so that in those exceptional circumstances which require independent shareholders' approval under the Rules, we reserve 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, directors (except independent non-executive directors) or chief executive, who together with their associates had a controlling interest in the issuer, at the time the decision for the transaction was made or when the transaction was approved by the board.

Q9. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *In those exceptional circumstances which require independent shareholders' approval under the Rules, the parties mentioned in paragraphs 3.11(a) and (b) of Part B of this Consultation Paper should be allowed to vote at the general meetings approving the relevant resolutions.*

☐ *Other views*

Waiver of requirement to hold general meetings

Issues and current position

4.1 The Main Board Rules require shareholders' approval for an issuer to enter into a very substantial acquisition or a major transaction[17]. The GEM Rules require shareholders' approval for major transactions and independent shareholders' approval for very substantial acquisitions and reverse takeovers[18].

4.2 Under the Main Board Rules, shareholders' approval for a very substantial acquisition or a major transaction may be obtained by convening a general meeting of the issuer, or by means of a written approval for the transaction from a shareholder who holds, or a closely allied group of shareholders who together hold, more than 50% in nominal value of the securities[19]. Such shareholders must have the right to attend and vote at such general meeting. Written approval is only allowed when no shareholder is required to abstain from voting if the issuer convenes a general meeting. As the same results of approving resolutions can be achieved by obtaining such written approvals, issuers would be able to save additional cost and time incurred for holding a physical meeting for approving the resolutions.

4.3 Under the GEM Rules, written shareholders' approval is allowed for issuers to approve major transactions under the same conditions[20]. Since the GEM Rules require independent shareholders' approval for very substantial acquisitions and reverse takeovers, no written certificate is allowed.

[17] see Rules 14.07(1) and 14.10 of the Main Board Rules
[18] see Rules 19.38, 19.42 and 19.44 of the GEM Rules
[19] see Rules 14.07(1) and 14.10 of the Main Board Rules
[20] see Rules 19.39 to 19.41 of the GEM Rules

4.4 Our current practice is not to accept written approval when the transactions involve issue of securities by the issuer or its subsidiaries. This is to ensure that minority shareholders have an opportunity to exercise their voting rights and express their views at the general meetings approving the transactions. We consider that it is necessary to codify the practice in the Rules to enhance protection of shareholders' interests.

4.5 Under the GEM Rules[21] and our current practice for the Main Board, we may also grant a similar waiver to hold general meetings to approve connected transactions if no shareholder needs to abstain from voting at the relevant meetings. The condition is that the transactions do not involve issue of shares or securities convertible into shares to connected persons by the issuer or its subsidiaries.

4.6 If our proposals in paragraphs 15.9, 16.6 and 17.8 of Part B of this Consultation Paper are adopted, no written shareholders' approval will be allowed for very substantial acquisitions, very substantial disposals and reverse takeovers. We are of the view that subject to the fulfillment of certain safeguard measures, the waiver for holding general meetings should be retained so as to strike a balance between cost effectiveness and protection of shareholders' rights.

Proposal

4.7 We will amend the Rules to codify our practice that a written shareholders' approval in lieu of holding a physical shareholders' meeting for the approval of major transactions or connected transactions will be allowed 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.

[21] see Rule 20.32 of the GEM Rules

Q10. Do you agree with our proposal that a written shareholders' approval in lieu of holding a physical shareholders' meeting should be allowed only if all the three conditions set out in paragraph 4.7 of Part B of this Consultation Paper are met?

☐ *Agree*

☐ *Agree, but waivers for holding a general meeting should also be granted in the following circumstances. Please specify those circumstances and state reason(s) for your view.*

☐ *Disagree. Please state reason(s) for your view.*

Q11. Do you agree with our proposal that written shareholders' approval in lieu of holding a physical general meeting should be accepted for the approval of major transactions or connected transactions?

☐ *Agree*

☐ *Disagree (please tick one or more of the following)*

- ☐ *Written shareholders' approval in lieu of holding a physical general meeting should not be accepted for the approval of connected transactions.*
- ☐ *Written shareholders' approval in lieu of holding a physical general meeting should not be accepted for the approval of major transactions.*
- ☐ *Under no circumstances, should a written shareholders' approval in lieu of holding a physical general meeting be accepted, disregarding the nature of the subject resolution.*
- ☐ *Other views*

Please state reason(s) for your view.

4.8 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 the announcements on the transactions.

Q12. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

DILUTION OF SHAREHOLDERS' INTERESTS

Placing of shares using the general mandate

Issues and current position

5.1 The Listing Agreement between the Exchange and issuers listed on the Main Board and the GEM Rules provide that directors of issuers may allot new securities up to 20% of the existing issued share capital under a general mandate approved by shareholders[22]. All shareholders can vote at the relevant general meeting. There is no restriction on the number of refreshments of general mandates for the issue of new securities.

5.2 It is common in Hong Kong for issuers to raise capital through placing and top-up arrangements under the general mandates. Currently, issuers are required to publish announcements on placings of shares under the general mandates. Such placings are not subject to the approval of the issuers' shareholders. There have been market concerns in relation to the size and frequency of such arrangements and the price at which new shares were issued under general mandates. The impact of such placings includes a dilution effect on shareholding interests of existing shareholders. The market price of the existing shares may be adversely affected if the new shares are placed at a deep discount to the market price. Such placings may obviously not be in the interest of general shareholders. As a result, there are views that the number of shares that are allowed to be issued under a general mandate should be reduced and a limit should be imposed on the number of refreshments of the general mandate.

5.3 We note that in the UK, most issuers voluntarily comply with the Pre-emption Guidelines issued by the Association of British Insurers in respect of placings. Under the Pre-emption Guidelines, the number of shares that can be placed is subject to the following limits:

(a) 5% of the issuer's issued ordinary share capital as shown by its latest published annual accounts, in any one year; and

(b) 7.5% cumulative limit in any rolling three-year period.

[22] see paragraph 19(2) of Appendices 7a, 7b and 7i to the Main Board Rules and Rule 17.41(2) of the GEM Rules. For PRC issuers, directors may allot new securities under a general mandate up to 20% of each of the existing issued domestic shares and H Shares of the issuers.

5.4 We recognise that it is essential to establish a high standard of shareholders' protection in the Rules in order to maintain confidence of investors in our market. However, it is equally important to offer a venue to issuers to raise funds for their potential business opportunities. This will, in turn, enhance growth of the issuer and will be beneficial to the shareholders. We consider that this is particularly important in the context of our market. In Hong Kong, many issuers, especially the GEM ones, are relatively small in size and rely on external funds to develop their operations. The existing general mandate arrangements under the Rules allow issuers to raise capital quickly in a cost-effective way. Given that placings under general mandates are extensively used in Hong Kong as a means of raising funds quickly, we consider that the limits contained in the Pre-emption Guidelines to be too restrictive for our market. Therefore, we do not propose to make any changes to the Rules in relation to the number of shares that can be issued under a general mandate.

5.5 The UK Listing Rules provide that placing at a discount of more than 10% is not allowed unless the UK Listing Authority is satisfied that the issuer is in severe financial difficulties or that there are other exceptional circumstances. We also note that in the UK, most of the issuers voluntarily comply with the Pre-emption Guidelines issued by the Association of British Insurers. Under the Pre-emption Guidelines, the discount of the placing price to the market price should not be more than 5% of the average of the best bid and offer share prices immediately prior to the announcement of the issue.

5.6 We recognise that determination of the placing price is a business decision for the board of directors. Given the time constraint in placing arrangements, we recognise that shareholders' approval requirement may result in some practical problems. Issuers may not be able to raise capital quickly given the time required to convene a general meeting. They may lose fund-raising opportunities if shareholders disapprove the placing.

5.7 However, in order to safeguard shareholders' interest from being diluted unfairly, we propose to follow the UK Listing Rules to disallow placings at a deep discount unless the issuer can satisfy the Exchange that it is in severe financial difficulties or that there are other exceptional circumstances. We consider that it will be in the interests of shareholders to impose additional disclosure requirements when shares are placed at a deep discount. Shareholders should be informed of the details of placees and the shareholding structure subsequent to the placing.

Proposal

5.8 We will retain the Rules which allow issuers to issue securities up to a maximum of 20% of the existing issued share capital under a general mandate.

Q13. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Issuers should be allowed to issue securities under a general mandate up to a limit of (please tick one of the following):*

☐ *No limit at all*

☐ *5 % of issued share capital*

☐ *10 % of issued share capital*

☐ *15 % of issued share capital*

☐ *Other. Please specify: _____.*

Please state reason(s) for your view.

Q14. The Rules do not impose any restriction on the number of refreshments of general mandates during a financial year. Based on your answer to question 13 regarding the limit on the number of securities that can be issued under a general mandate, how many times do you think an issuer should be allowed to refresh its general mandate for the issue of securities in any 1 financial year (please tick one of the following)?

☐ *None*

☐ *1 time*

☐ *2 times*

☐ *3 times*

☐ *Other. Please specify: _____.*

☐ *Unlimited*

Q15. The Rules require shareholders' approval for refreshment(s) of general mandates by the issuer. Do you agree that no independent shareholders' approval should be required for the refreshment(s) of general mandates?

☐ *Agree*

☐ *Disagree (Please tick one of the following)*

☐ *Independent shareholders' approval should be required for the issuer's refreshment(s) of general mandates.*

☐ *Other views*

Q16. Do you agree to set a cumulative limit for the issue of securities in any rolling 3 year period?

☐ *Agree (please tick one of the following)*

☐ *5% of issued share capital as at the date of commencement of any rolling 3 year period*

☐ *7.5% of issued share capital as at the date of commencement of any rolling 3 year period*

☐ *10% of issued share capital as at the date of commencement of any rolling 3 year period*

☐ *Other. Please specify: _____.*

Please state reason(s) for your view.

☐ *Disagree. Issue of securities should not be subject to any such cumulative limit.*

5.9 We will amend the Rules to impose a pricing restriction on the issue of securities under a general mandate. Unless an issuer can satisfy the Exchange that it is in severe financial difficulties or that there are other exceptional circumstances, it may not issue shares under a general mandate if the placing price or the subscription price under the top-up arrangements represents a discount of 20% or more to the benchmarked price, being the higher of:

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

(b) the average closing price in the 5 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.

Q17. Do you agree with the proposed basis of the benchmarked price set out in paragraph 5.9 of Part B of this Consultation Paper?

☐ *Agree*

☐ *Disagree. Please specify the alternative benchmarked price you think is appropriate and state reason(s) for your view.*

Q18. Do you agree with the proposed trigger discount level (i.e. 20% to the benchmarked price) at which an issuer will not be allowed to issue securities under a general mandate unless it can satisfy the Exchange that it is in severe financial difficulties or that there are other exceptional circumstances?

☐ *Agree*

☐ *Disagree. The trigger discount level should be set at the following level (please tick one of the following):*

☐ *a discount of 3% or more to the benchmarked price*

☐ *a discount of 5% or more to the benchmarked price*

☐ *a discount of 10% or more to the benchmarked price*

☐ *Other. Please specify: _____.*

Please state reason(s) for your view.

Q19. Do you agree with our proposal 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 or above the trigger discount level?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *Shareholders' approval should be required and no shareholder (except for shareholders who have different interests from other shareholders in the placing or top-up arrangement) should be required to abstain from voting at the general meeting approving the relevant resolution, if an issuer issues securities at or above the trigger discount level. Please state reason(s) for your view.*

☐ *Specific independent shareholders' approval should be required, if an issuer issues securities at or above the trigger discount level. Please state reason(s) for your view.*

☐ *Issuers should not 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 a general mandate at or above the trigger discount level. No shareholders' approval requirement should be imposed on the issue of securities under a general mandate, regardless of the percentage discount of the placing price or the subscription price under the top-up arrangement to the market price. Please state reason(s) for your view.*

☐ *Other views*

5.10 We will amend the Rules to require an issuer 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 above. 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.

Q20. Do you agree with our proposal?

☐ *Agree*

☐ *Agree, but the following information should also be disclosed in the announcement. Please specify those information and state reason(s) for your view.*

☐ *Disagree. Additional disclosure requirement should be imposed (please tick one of the following):*

☐ *irrespective of the discount*

☐ *if the placing or subscription price is at a discount of (please tick one of the following):*

☐ *3% or more to the benchmarked price*

☐ *5% or more to the benchmarked price*

☐ *10% or more to the benchmarked price*

☐ *Other. Please specify: _____.*

Placing and top-up subscription

Issues and current position

6.1 To facilitate the raising of capital through placing and top-up subscription arrangements by issuers, the Rules have an exemption for shareholders' approval for connected transactions[23]. The exemption allows a connected person to place some of his holdings to an independent third person. The connected person can then subscribe for new securities up to his percentage interest in such securities immediately before the placing. As a result, the interest of other shareholders will be diluted while the connected person will be able to maintain his percentage interest in the issuer. The connected person can also subscribe for a larger number of shares that he placed if he maintains the same percentage interest. This is clearly not in the interest of the shareholders especially if the shares are issued at a deep discount.

[23] see Rule 14.24(6)(a) of the Main Board Rules and Rule 20.23(3)(d) of the GEM Rules

6.2 The exemption under the Main Board Rules applies when securities are issued to a connected person within 14 days after he has reduced his percentage interest by placing some of his holding to an independent third person[24]. It does not clearly specify how the 14-day period is computed. The current practice is that the securities have to be issued within 14 days after such connected person has executed an agreement to reduce his holding. This is expressly set out under the GEM Rules[25].

Proposal

6.3 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 a third party in a placing and top-up subscription arrangement.

Q21. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *The Rules on the exemption from shareholders' approval for a placing and top-up subscription arrangement should be retained. A connected person should be allowed to subscribe for new securities up to his percentage interest in such securities immediately before the placing.*

☐ *Other views*

6.4 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 holding.

Q22. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

[24] see Rule 14.24(6)(a) of the Main Board Rules
[25] see Rule 20.23(3)(d) of the GEM Rules

Rights issues and open offers

Issues and current position

7.1 Under the Rules, issuers are allowed to effect rights issues or open offers to increase their issued share capital or market capitalisation by more than 50% if the issuers have obtained approval from independent shareholders[26]. The percentage is aggregated with any other rights issues or open offers made in the previous 12 months.

7.2 Based on the underlying principle that all shareholders have the same right to vote at general meetings of an issuer, controlling shareholders should be entitled to the same voting right as other shareholders in rights issues or open offers. Under the Rules, there are no pricing restrictions on rights issues or open offers. In addition, connected persons are allowed to act as the underwriter of rights issues or open offers of an issuer. No shareholders' approval is required for such rights issues if there are excess application arrangements in place, in which case such securities must be available for subscription by all shareholders and allocated on a fair basis.

7.3 There are views that controlling shareholders may underwrite rights issues or open offers that are at a steep premium to market price, as a means to increase their shareholding in the issuer. In addition, controlling shareholders may be able to increase their shareholding cheaply in the issuer whose share price performance is poor if they underwrite or sub-underwrite rights issues or open offers that are at a deep discount to market price. The impact of the rights issue or open offer on the share price of the issuer is to decrease it further. Consequently, minority shareholders are unlikely to take up their rights shares, resulting in unfair dilution of their interests. Therefore, we consider that the existing independent shareholders' approval requirement under the Rules should be retained in order to safeguard minority shareholders' interests.

7.4 The Rules do not take into account the dilution of shareholders' interests by the issue of any bonus securities, warrants or other convertible securities granted to shareholders as part of the proposed rights issues or open offers made in the last 12 months. We consider that such bonus securities and rights issues should be taken into account to avoid any material dilution of shareholders' interests without shareholders' approval.

[26] see Rules 7.19(6) and 7.24(5) of the Main Board Rules and Rules 10.29 and 10.39 of the GEM Rules

7.5 The Rules do not specify how the 12 month period mentioned in paragraph 7.1 above is to be computed. To avoid confusion or argument on how this period should be computed, this point should be clarified in the Rules. This period shall be the 12 months commencing on the first day of dealing of 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.

7.6 Under the Rules, if a rights issue 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, the rights issue is not subject to shareholders' approval. However, arrangements must be made 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[27]. There is no similar requirement for open offers. We consider that such shareholders' approval requirement shall also apply to open offers. Shareholders who have a different interest in such open offers should abstain from voting at the general meeting.

Proposal

7.7 We will retain the Rules that 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%.

Q23. Do you agree with our proposal?

☐ *Agree (please answer questions 25 and 26)*

☐ *Disagree (please tick one of the following)*

☐ *No shareholders' approval should be required for rights issues or open offers that would increase the issued share capital or market capitalisation of the issuer by more than 50%. Please state reason(s) for your view.*

☐ *All shareholders including controlling shareholders should be allowed to vote at the general meetings approving rights issues or open offers that would increase the issued share capital or market capitalisation of the issuer by more than 50%. Please state reason(s) for your view.*

[27] see Rule 7.21 of the Main Board Rules and Rule 10.31 of the GEM Rules

Q24. If you consider that the requirement of independent shareholders' approval for rights issues or open offers that would increase the issued share capital or market capitalisation of the issuer by more than 50% should be removed, do you agree that rights issues or open offers which are underwritten or sub-underwritten by a connected person of the issuer should be subject to shareholders' approval?

☐ *Agree. Rights issues or open offers which are underwritten or sub-underwritten by a connected person of the issuer should be subject to shareholders' approval. The connected person(s) acting as an underwriter or sub-underwriter or having a different interest from other shareholders in the transactions should be required to abstain from voting at the general meeting.*

☐ *Disagree. The Rules should be retained so that rights issues or open offers which are underwritten or sub-underwritten by a connected person of the issuer should still be exempt from shareholders' approval requirement. Please specify your view on how to safeguard the interest of minority shareholders and state reason(s) for your view.*

7.8 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.

Q25. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

7.9 We will also amend the Rules to specify that the 12 month period shall be the 12 months commencing on the first day of dealing of 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.

Q26. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please indicate your view on how the 12 month period should be computed and state reason(s) for your view.*

7.10 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[28], 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 who have a different interest in the open offer shall abstain from voting at the general meeting.

Q27. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *Controlling shareholders should be required to abstain from voting at the general meeting approving such resolution as set out in our proposal.*

☐ *Other views*

Exclusion of overseas shareholders from share offers

Issues and current position

8.1 Under the Rules, an allotment, issue or grant of securities pursuant to an offer made to shareholders pro rata to their existing shareholdings does not require shareholders' approval[29]. Overseas shareholders may be excluded from an offer of securities on a pro rata basis if local laws do not permit such offer. Offers of securities to overseas shareholders can be time-consuming and burdensome for issuers. It is common practice for an issuer making such an offer to exclude shareholders who reside overseas even when such an offer may be permitted under the local laws and regulations.

[28] see Rule 7.21 of the Main Board Rules and Rule 10.31 of the GEM Rules for the similar requirement for rights issues

[29] see paragraph 19(2) of Appendices 7a and 7b to the Main Board Rules and Rule 17.41 of the GEM Rules

Proposal

8.2 We will amend the Rules:

(a) to allow issuers to exclude overseas shareholders in an offer of securities provided the directors of the issuers consider it necessary or expedient 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 issuers to include explanation(s) for exclusion of overseas shareholders from the share offers in the relevant offer document; and

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

Q28. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

OTHER MATTERS AFFECTING SHAREHOLDERS

Material changes in nature of business

Issues and current position

9.1 The Main Board Rules provide that within 12 months of listing, an issuer shall not effect any acquisition, disposal or other transaction which would result in a fundamental change in the issuer's main undertaking as described in the listing document issued at the time of its listing. We may grant the issuer a waiver if we are satisfied that the circumstances surrounding the proposed fundamental change are exceptional and the approval of independent shareholders has been obtained[30].

9.2 The GEM Rules set out similar provisions. An issuer may not enter into any transaction which would result in a material change to the general character or nature of the business as described in the listing document[31]. The restriction starts from the date of listing on GEM to the end of the first financial year and the 2 financial years thereafter. Changes are only allowed with the prior approval of independent shareholders of the issuer at a general meeting.

[30] see Rules 14.41 and 14.42 of the Main Board Rules
[31] see Rule 19.71 of the GEM Rules

9.3 The reason for these provisions is because investors may have relied on the general character or nature of the business of an issuer as disclosed in its listing document when making investment decisions. It may not be in their interest for any material change to the issuer's business to take place shortly after the new listing.

9.4 We recognise that issuers may change their general character or nature of business as a result of entering into a series of transactions or arrangements. Following the same rationale as mentioned in paragraph 9.3 above, independent shareholders' approval requirements should be extended to cover a series of transactions or arrangements which are completed within a short period of time after the initial listing if such transactions or arrangements have a combined effect of materially changing the general character or nature of business of an issuer. This will further enhance the protection for shareholders in this regard.

9.5 We appreciate that there may be circumstances that justify material changes in the business nature of an issuer within a short period of time after the initial listing. We may consider granting a waiver in exceptional circumstances and may impose appropriate conditions. The issuer should first consult us before entering into any such transaction or arrangement or a series of transactions or arrangements.

Proposal

9.6 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 during the said 12 month period. We will amend the GEM Rules to also cover a series of transactions or arrangements entered into from the date of listing on GEM to the end of the first financial year and the 2 financial years thereafter.

Q29. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

Share repurchases

Restrictions on pricing and bidding

Issues and current position

10.1 The Main Board Rules have no provision regulating the price of share repurchases by issuers and have limited provisions regulating the timing of the repurchases as set out in paragraph 11.1 of Part B of this Consultation Paper. Share repurchases, while they could be beneficial to the issuer and shareholders, should not be conducted with any distortion to normal market activities, such as artificially setting the share prices.

10.2 Under the GEM Rules[32], issuers shall not:

(a) repurchase shares at a price higher than the latest (or current) independent bid price or the last independent sale (contract) price quoted or reported on the trading system, whichever is the higher; and

(b) make the opening bid nor any bid in the last 30 minutes before the close of normal trading hours.

10.3 We consider that it is necessary to impose a pricing restriction for share repurchases on the Exchange. We note that some other markets regulate the price of share repurchases by benchmarking to the closing price of the issuers' shares. We consider this alternative pricing restriction is much easier for issuers to ensure compliance.

Proposal

10.4 We will amend the Rules to prohibit repurchases on the Exchange at a price 5% higher than the average closing market price over the preceding 5 trading days on which shares were traded.

Q30. Do you agree with the proposed cap of 5% of the average closing market price over the preceding 5 trading days on which shares were traded?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *No pricing restriction should be imposed on share repurchases.*

☐ *Other. Please specify:* _____.

[32] see Rule 13.11(6) of the GEM Rules

Q31. Do you agree with the proposed basis of the benchmarked price (i.e. the average closing market price over the preceding 5 trading days on which shares were traded)?

☐ *Agree*

☐ *Disagree. The basis of the benchmarked price should be the average closing market price over (please tick one of the following):*

☐ *the preceding trading day*

☐ *the preceding 10 trading days*

☐ *the preceding 20 trading days*

☐ *the preceding 30 trading days*

☐ *Alternative benchmark for pricing restriction. Please specify the alternative benchmark you think is appropriate and state reason(s) for you view.*

Dealing restrictions

Issues and current position

11.1 Under the Rules, issuers may not repurchase shares during the period of 1 month immediately preceding either the preliminary announcement of annual results or the publication of the half-year results or quarterly results (for GEM only)[33]. Problems may arise in relation to the calculation of the relevant period if there is any delay in the publication of the results announcements. Under the Rules, the restriction period for securities transactions by directors (the "black out" period) has been amended to take into account issuers' delay in publication of their results announcements. We consider that the same restriction period of directors' dealing in securities of issuers should apply to share repurchases.

[33] see Rule 10.06(2)(e) of the Main Board Rules and Rule 13.11(4) of the GEM Rules

Proposal

11.2 We will amend the Rules to require the dealing restriction period for share repurchases to follow the current "black out" period for securities transactions by directors for the half-year and annual results, and the proposed "black out" period for quarterly reporting set out in paragraph 19.7 of Part C of this Consultation Paper.

Q32. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the restriction period for share repurchases you think is appropriate and state reason(s) for your view.*

25% monthly share repurchase restriction

Issues and current position

12.1 The Main Board Rules provide that an issuer shall not purchase more than 25% of the total number of its own shares traded on the Exchange in the preceding calendar month[34]. The restriction has created difficulties for shares with a low share trading volume. The GEM Rules do not contain such a restriction and we note that such a restriction is uncommon in other major markets.

12.2 We consider that the combined effect of the following requirements provide sufficient safeguards in respect of share repurchases by issuers:

(a) the restriction on repurchases by issuers of more than 10% of the issued share capital;

(b) issuers are required to maintain public float of not less than 25% of their issued share capital; and

(c) the proposed pricing restrictions on share repurchases[35].

[34] see Rule 10.06(2)(a) of the Main Board Rules
[35] see paragraphs 10.1 to 10.4 of Part B of this Consultation Paper

Proposal

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

Q33. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. The 25% monthly share repurchase restriction should be retained in the Main Board Rules and introduced in the GEM Rules.*

Withdrawal of primary listing on the Exchange

Issues and current position

13.1 The Rules allow an issuer that has primary listing on the Exchange, with no alternative listing, to withdraw its listing on the Exchange if it has obtained approval of at least 75% in value of the shareholders present at the general meeting[36]. The directors, chief executives and any controlling shareholders or any of their associates are not allowed to vote at the meeting to approve the resolution.

13.2 Withdrawal of primary listing may be part of a privatisation proposal. In a privatisation, the offeror will often be the controlling shareholders and the disinterested shareholders will be shareholders other than the controlling shareholders and their associates and persons acting in concert with any of them.

13.3 The threshold for delisting in the Rules is lower than that for privatisation under the Takeovers Code. There have been cases where privatisation offers made by controlling shareholders to the minority shareholders were made at a deep discount to the underlying value of the shares. The lower the threshold for shareholders' approval, the larger the risk of minority shareholders having to face the choice of becoming shareholders of an unlisted company which will be subject to less regulatory scrutiny. Minority shareholders will hold shares that have much lower or virtually no liquidity after the privatisation. They may not be in a position to refuse the unfavourable offer.

13.4 We propose to change the Rules so that they are consistent with the proposed changes to the Takeovers Code[37].

[36] see Rule 6.12 of the Main Board Rules and Rule 9.20 of the GEM Rules

[37] see the Consultation Paper on a Review of the Codes on Takeovers and Mergers and Share Repurchases published by the Securities and Futures Commission in April 2001

Proposal

13.5 We will amend the Rules so that any withdrawal of primary listing on the Exchange 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.

Q34. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the approval threshold you think is appropriate and state reason(s) for your view.*

Withdrawal of secondary listing on the Exchange

Issues and current position

14.1 The current Rules do not provide for withdrawal of listing by issuers with secondary listing status on the Exchange. We consider that sufficient notice should be given to shareholders regarding withdrawal of secondary listing on the Exchange.

Proposal

14.2 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 3 months' prior notice of the proposed delisting, by way of an announcement.

Q35. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one or more of the following)*

☐ *Voluntary withdrawal of secondary listing on the Exchange should be subject to independent shareholders' approval. Please state reason(s) for your view.*

☐ *The period of notice should be: _____ month(s) (please specify). Please state reason(s) for your view.*

NOTIFIABLE TRANSACTIONS OTHER THAN CONNECTED TRANSACTIONS

Very substantial acquisitions

Issues and current position

15.1 The Rules provide that "very substantial acquisitions" only apply if substantially all of such assets, businesses or companies are not listed. This has created considerable confusion and argument as to what constitutes "assets substantially all of which are not listed". Does it only apply to the shares of the issuer or does it extend to assets held within the listed group, including subsidiaries of the issuer? It also raises difficult questions when an issuer attempts to circumvent the requirements in the Rules by acquiring an asset, on the basis that it is a listed asset, from another issuer which has held the asset for a short period of say one month before the disposal.

15.2 The requirements for "very substantial acquisitions" are aimed at regulating transactions, which will have a very substantial impact on the listed group. No distinction needs to be drawn between assets which are listed and those which are not listed.

15.3 Where the acquisition relates to listed securities in a hostile or contested takeover, we may consider granting a waiver for shareholders' approval for "very substantial acquisitions" under special circumstances. Such waivers will only be granted on a case by case basis on appropriate terms. The circumstances must be exceptional. The issuer must be able to establish and demonstrate to us that compliance with "very substantial acquisitions" requirements may jeopardise the hostile or contested takeover if shareholders' approval is required.

15.4 Taking into account the significant impact of a very substantial acquisition on the listed group, the Rules require shareholders' approval for very substantial acquisitions. The GEM Rules further require controlling shareholders to abstain from voting at the general meeting approving a very substantial acquisition[38]. Where there are no controlling shareholders, those shareholders who participate in the management of the issuer shall abstain from voting at such general meeting[39]. The rationale is that controlling shareholders, which often control the board of directors, and/or shareholders participating in the management of an issuer may be able to achieve significant changes in the issuer's business without seeking approval of minority shareholders. We are of the view that our principle that all shareholders have the same right to vote at general meetings should be followed in the case of very substantial acquisitions. We therefore propose to maintain the Main Board Rules so that no shareholders, except for those who have a different interest from other shareholders in the very substantial transaction, should be required to abstain from voting at the general meeting. The GEM Rules should be amended in this regard.

15.5 Under the Main Board Rules, written certificate of shareholders' approval is allowed if it is given by shareholder(s) holding more than 50% in nominal value of the securities giving the right to attend and vote at such general meeting. Given the potential significant impact of very substantial acquisitions on the issuer, shareholders should be given an opportunity to exercise voting rights and to express their views at the general meetings approving the very substantial acquisitions. Therefore, a written certificate of shareholders' approval should not be acceptable.

Proposal

15.6 We will amend the Rules so that issuers shall comply with the provisions for "very substantial acquisitions", irrespective of whether the assets being acquired are listed or not.

Q36. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

15.7 We will amend the Rules so that some relaxation in the form of a waiver for "very substantial acquisitions" from shareholders' approval in a hostile or contested takeovers situation may be granted.

[38] see Rule 19.42 of the GEM Rules
[39] see Rule 19.42 of the GEM Rules

Q37. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

15.8 We will amend the GEM Rules so that no shareholders will be required to abstain from the voting at the shareholders' meeting approving a very substantial acquisition, unless they have a different interest from other shareholders in the transaction.

Q38. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *The existing GEM Rules should be retained so that independent shareholders' approval will be required for all very substantial acquisitions. The Main Board Rules will be amended to follow the GEM Rules in this regard. Please state reason(s) for your view.*

☐ *Other views*

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

Q39. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *Written certificate of shareholders' approval should be accepted for very substantial acquisitions. Please state reason(s) for your view.*

☐ *Other views*

Introduction of "very substantial disposals"

Issues and current position

16.1 The current Rules on "very substantial acquisitions" regulate issuers' acquisitions of assets, including business, company or companies, that have a substantial impact on the listed group. The Rules do not cover very substantial disposals of assets by issuers. For a disposal of assets by an issuer where any of the percentage ratios for the classification of the transaction is 100% or more, it is classified as a major transaction under the Rules.

16.2 A disposal of assets, business or company, with any of the percentage ratios being 75% or more, may have a significant impact on the remaining business of the issuer and its prospects. In a very substantial acquisition, the existing business of the issuer will constitute less than half of the enlarged business after the acquisition. Therefore, logically, a very substantial disposal should apply when over half of the business has been sold, thus the threshold should be a figure above 50%. For practical reasons, we propose a threshold of 75% for very substantial disposals.

16.3 The requirements for "very substantial acquisitions", except for the thresholds for the classification of the transactions, should be applied to "very substantial disposals" which cover disposals of assets, business or company that have a significant impact on the issuer. Shareholders' approval should be required for "very substantial disposals" and no written certificate of shareholders' approval should be accepted.

Proposal

16.4 We will introduce in the Rules a new type of transaction, namely "very substantial disposals". This type of transaction will cover disposal of assets, business or company, where any of the percentage ratios under the various tests for classification of the transaction is 75% or more[40].

Q40. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. There is no need to specifically address very substantial disposals.*

[40] see paragraph 19.6 of Part B of this Consultation Paper

16.5 We will amend the Rules to 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 have a different interest from other shareholders in the transaction.

Q41. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *Independent shareholders' approval should be required for all very substantial disposals. Please state reason(s) for your view.*

☐ *Other views*

16.6 No written certificate of shareholders' approval shall be accepted for very substantial disposals.

Q42. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *Written certificate of shareholders' approval should be accepted for very substantial disposals. Please state reason(s) for your view.*

☐ *Other views*

Reverse takeovers

Issues and current position

17.1 The GEM Rules have specific provisions to prevent attempts to circumvent the requirements for new listing applicants by way of what is commonly known as backdoor listing[41]. The GEM Rules classify an acquisition of assets by an issuer as a "reverse takeover" when:

(a) the acquisition would result in, or is part of a transaction or arrangement or series of transactions or arrangements which would result in, a change in control of the issuer; or

[41] see Rule 19.06 (5) of the GEM Rules

(b) the acquisition constitutes an attempt to achieve a listing of the assets to be acquired and a means to circumvent the requirements for new applicants.

The acquisition of assets refers to a business, company or companies which are not listed on the Main Board or on GEM.

17.2 There may also be situations where issuers acquire assets that lead to a fundamental change of business. Such acquisition should also be treated as a reverse takeover and be subject to the approval of the Exchange as a new listing. This would ensure that the assets acquired are suitable for listing. We consider that the definition of "reverse takeovers" under the GEM Rules should be expanded to cover acquisitions that lead to a fundamental change of business of issuers.

17.3 Under the GEM Rules, issuers engaged in transactions leading to a "reverse takeover" will be treated as new applicants for listing purpose. They must comply with all new listing procedures and listing requirements, including issuing a listing document that includes all information required for a new listing. The GEM Rules require controlling shareholders to abstain from voting at the general meeting approving a reverse takeover[42]. Where there are no controlling shareholders, those shareholders who participate in the management of the issuer shall abstain from voting at such general meeting[43].

17.4 The Main Board Rules do not specifically address reverse takeover situations in detail. An acquisition which would result in a change in control through the introduction of a majority holder or group of holders is regarded as a "very substantial acquisition" and may be treated as a new listing. There may be situations where issuers make acquisitions which result in a change of control of the issuers or listing of the assets to be injected into the issuers without complying with the requirements for new listing applicants. The Main Board Rules follow our general voting principle that all shareholders are entitled to vote at general meetings approving such an acquisition. No shareholders, except for those who have a different interest from other shareholders in the transaction, are required to abstain from voting at the general meeting approving the transaction. We are of the view that the GEM Rules should be amended to follow our general voting principle.

17.5 Given the significant impact of the reverse takeover on the issuer and its shareholders, we consider that shareholders should be given an opportunity to exercise voting rights and to express their views at the general meeting approving the reverse takeover. Therefore, a written certificate of shareholders' approval should not be acceptable.

[42] see Rule19.44 of the GEM Rules
[43] see Rule19.44 of the GEM Rules

Proposal

17.6 We will amend the GEM Rules to expand the definition of "reverse takeover" to include any acquisition of assets that will lead to a fundamental change of business of issuers as a reverse takeover.

Q43. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

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

Q44. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *The existing GEM Rules should be retained so that independent shareholders' approval will be required for reverse takeovers. The Main Board Rules will be amended to follow the GEM Rules in this regard. Please state reason(s) for your view.*

☐ *Other views*

17.8 No written certificate of shareholders' approval shall be accepted for reverse takeovers.

Q45. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *Written certificate of shareholders' approval shall be allowed for reverse takeovers. Please state reason(s) for your view.*

☐ *Other views*

17.9 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 and our proposals set out in paragraphs 17.6 to 17.8 above.

Q46. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *There is no need to have a separate category of transactions called "reverse takeover". The current Main Board Rules on when to treat a very substantial acquisition as a new listing should be retained.*

☐ *Other views*

Introduction of "total assets test" and "turnover test"

Issues and current position

18.1 Under the Rules, the "assets test" and the "consideration test" for notifiable transactions are computed by reference to the value of the net assets or consolidated net assets of issuers[44]. In certain circumstances, this has restricted the ability of an issuer with relatively low net asset level, but significant total assets, to acquire healthy entities with relatively high net asset value but much less significant total assets than the issuer. We consider that a comparison with the total assets or total consolidated assets of an issuer instead of the net assets would give a more appropriate assessment of the value of the company acquired or disposed of by the issuer. It would present a more accurate reflection of the importance of the transaction to the issuer.

18.2 We also note that in certain exceptional circumstances, the "profits test" may produce anomalous results for some issuers. The profits test may sometimes be affected by exceptional factors. The Rules recognise this by expressly providing that the Exchange may be prepared to disregard the profits test if the comparison is affected by exceptional factors without which the profits ratio will not exceed the relevant threshold[45]. Where the profits test is waived under the existing Rules, the applicable thresholds may only be determined by comparing net assets or the consideration of the entities to be acquired or disposed of by the issuer against net assets of the issuer. This result is inflexible because it fails to take into account revenue or total turnover of the issuer and the entities to be acquired or disposed of by the issuer.

[44] see Rules 14.06, 14.09, 14.12(1) and 14.20 of the Main Board Rules and Rule 19.07 of the GEM Rules
[45] see Rule 14.09 of the Main Board Rules and Rule 19.15 of the GEM Rules

18.3 We note that the UK Listing Rules adopt the "total assets test" and "turnover test" when assessing the size of assets, business or company to be acquired or disposed of by an issuer.

Proposal

18.4 We will amend the Rules to adopt a new basis for the "assets test". The new "assets test" will be the total assets being the subject of the transaction divided by the total assets of the issuer. The total assets of the issuer mean the total fixed assets, including intangible assets, plus the total current and non-current assets of the issuer. We will also make similar changes to certain provisions under the Rules which have made references to "net tangible assets" or "net assets", where appropriate. We will use "total assets" as the new basis for the relevant tests.

Q47. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *The existing "assets test" using net assets as the basis of calculation should be retained.*

☐ *Other views*

18.5 We will amend the Rules so that if issuers can satisfy us that the anomalous results of profits test are due to exceptional circumstances, we may allow the adoption of a "turnover test" to 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.

Q48. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *"Turnover test" should be an additional standalone test, rather than a substitute test for the "profits test". Please state reason(s) for your view.*

☐ *"Turnover test" should not be used as a test for classification of notifiable transactions. Please state reason(s) for your view.*

18.6 We will amend the Rules to use total assets as the denominator for the "consideration test". The total assets of the issuer mean the total fixed assets, including intangible assets, plus the total current and non-current assets of the issuer.

Q49. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *The existing "consideration test" using net assets as the basis of calculation should be retained.*

☐ *Other views*

New thresholds for notifiable transactions

Issues and current position

19.1 The proposed changes in relation to the basis of calculation of "assets test" and "consideration test" by reference to the value of total assets will represent a change of the existing "assets test" and "consideration test". The relevant percentage ratios for categorisation of notifiable transactions under these two size tests need to be adjusted in order to maintain a suitable level of protection for shareholders. Although we do not propose to change the basis of computation of "profits test" and "equity test" under the Rules, the same proposed threshold percentage ratios for "assets test" and "consideration test" should apply to those two size tests for ease of application of the Rules.

19.2 We are of the view that issuers should be required to apply the threshold percentage ratio of 100% for "very substantial acquisitions" which is currently adopted under the Main Board Rules.

19.3 The existing GEM Rules[46] have additional thresholds for very substantial acquisitions, which are:

(a) any percentage ratio which is 100% or more and the business or company being acquired is different from the current principal activities of the issuers; or

(b) any percentage ratio which is 100% or more and there is an intention to make a major change in the principal activities of the issuers.

A transaction where any of the percentage ratio is 100% or more will be covered by the above proposed threshold of "very substantial acquisitions". Any acquisition that will result in a fundamental change of the issuers' business will be addressed by the proposed definition of "reverse takeover"[47]. As a result, we will remove these 2 additional thresholds from the definition of "very substantial acquisition" in the Rules.

19.4 Compared with the Main Board issuers, most GEM issuers have shorter operating histories. Most GEM issuers may also have "total assets" which are more or less the same as their "net assets" possibly because they have not yet expended the funds raised on listing. It may also be possible that GEM issuers have not yet sought borrowing as they are still in the early stages of development of their business operation. Therefore, there may be concerns that the adoption of the total assets test and the adjustment of percentage ratios for categorising transactions may result in more transactions of GEM issuers being categorised as "very substantial acquisitions". Consequently, there are views that the GEM Rules should retain the existing net assets test and maintain the respective percentage ratio for very substantial acquisitions at the 200% level.

19.5 As GEM issuers continue to develop and expand their businesses, they are more likely to raise and source additional funding by way of debt financing. While their asset base will be enhanced through their expansion of business, GEM issuers are likely to have lower net assets than total assets. If the existing asset test and the percentage ratios under the GEM Rules are retained, GEM issuers may eventually face the same problems associated with the net assets test as mentioned in paragraph 18.1 above. In view of the long-term growth of GEM issuers, we are of the view that the total assets test and the respective adjustment of the percentage ratios should also apply to GEM issuers.

[46] see Rule19.06(4) of the GEM Rules
[47] see paragraph 17.6 of Part B of this Consultation Paper

Proposal

19.6 We will adjust the threshold levels of relevant tests under the Rules, which have made references to "net tangible assets" or "net assets", where appropriate. For categorisation of notifiable transactions, the threshold levels of all size tests will be adjusted as follows:

(a) Share transaction – a transaction where all percentage ratios is less than 5% but the transaction involves issue of securities for which listing will be sought as consideration;

Q50. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the percentage level you think is appropriate and state reason(s) for your view.*

(b) Discloseable transaction – a transaction where any of the percentage ratios is 5% or more but each is less than 25%;

Q51. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the percentage level you think is appropriate and state reason(s) for your view.*

(c) Major transaction – a transaction where any of the percentage ratios is 25% or more, but each is less than 100% for an acquisition transaction or less than 75% for a disposal transaction;

Q52. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the percentage level you think is appropriate and state reason(s) for your view.*

(d) Very substantial acquisition – an acquisition where any of the percentage ratios is 100% or more; and

Q53. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the percentage level you think is appropriate and state reason(s) for your view.*

(e) Very substantial disposal – a disposal where any of the percentage ratios is 75% or more.

Q54. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the percentage level you think is appropriate and state reason(s) for your view.*

Valuation of properties

Issues and current position

20.1 Our practice in relation to disposal of a property or a property company by an issuer is to use the higher of the consideration received or its published valuation for the purpose of determining the size of the transaction under the Rules. This practice is to avoid instances where the issuer attempts to circumvent the requirements in the Rules by selling the property at undervalue to cause the disposal to fall below the relevant percentage ratios for categorisation of notifiable transactions which may otherwise be applicable. If the valuation of the property is not current, the valuation may not reflect the value of the relevant property at the time of the transaction. A current valuation would ensure that the value of property is professionally assessed for the purposes of classification of the transaction and provide relevant information to shareholders for making investment decisions.

20.2 Under the Rules, a valuation report is normally required for an acquisition or realisation of any property or a property company whose assets consist solely or mainly of properties, when the consideration payable for the acquisition or realisation exceeds 50% of the assets of the acquiring or realising group[48]. A valuation report is also required in the case of an acquisition or a disposal of any property from or to a connected person.

20.3 It is considered that the Rules should be more flexible so as to enable the Exchange to require valuation reports to be prepared in appropriate circumstances, not limited to the above situations.

[48] see Rule 5.02 of the Main Board Rules and Rule 8.02 of the GEM Rules

Proposal

20.4 We will 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 3 months old.

Q55. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

20.5 We will amend the Rules so that for the calculation of "size tests" under the notifiable transaction rules, the higher of the consideration (which in the case of a property company, will include the value of all outstanding mortgages), the book value of the assets, or the valuation of the assets will form the numerator for the "assets test".

Q56. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

20.6 We propose to change the threshold level for the requirement of a valuation report to 25%, in light of the adjusted thresholds for categorisation of notifiable transactions under all size tests[49].

Q57. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the threshold level you think is appropriate and state reason(s) for your view.*

[49] see paragraph 19.6 of Part B of this Consultation Paper

Asset valuation

Issues and current position

21.1 Issuers may acquire assets or businesses, the consideration of which may be determined with reference to valuations performed by qualified valuers. Such valuations may be based on discounted cash flow, projections of profits, earnings or cash flows or other valuation methods. Details of valuations of assets or businesses including the principal assumptions and future profit streams of the assets or businesses acquired are not subject to any disclosure requirements under the Rules. We consider that such information would be useful for shareholders to evaluate the fairness of the terms of the transactions and the future prospect of the issuer after acquisition of the assets or businesses, particularly for a major transaction or a very substantial acquisition. To promote transparency and to enhance corporate governance standards, we consider that issuers should disclose information on the valuation method used in the relevant announcements or circulars to the shareholders. In addition, we will consider such valuations to be profit forecasts, which is in line with the requirement for asset valuation under the proposed Takeovers Code[50].

Proposal

21.2 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 consultant accountants. Any financial adviser mentioned in the circulars to shareholders shall also report on the forecasts.

Q58. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *Valuation of assets or businesses acquired by the issuers based on discounted cash flows or projections of profits, earnings or cash flow should not be regarded as a profit forecast. However, the Exchange should be allowed to reserve the right to treat such asset or business valuation as a profit forecast.*

☐ *Valuation of assets or businesses acquired by the issuers based on discounted cash flows or projections of profits, earnings or cash flow should not be regarded as a profit forecast in any event.*

☐ *Other views*

[50] see the Consultation Paper on a Review of the Codes on Takeovers and Mergers and Share Repurchases published by the Securities and Futures Commission in April 2001

Options granted by issuers

Issues and current position

22.1 The GEM Rules have codified the Exchange's current practice to treat the grant, acquisition, transfer or exercise of an option by an issuer as a notifiable transaction. The basic principles of the GEM Rules are as follows:

(a) where the exercise of the option is not at the discretion of the issuer, on the grant of the option, the transaction will be classified as if the option had been exercised. The issuer should then comply with all the relevant requirements of notifiable transactions up-front; and

(b) where the exercise of the option is at the discretion of the issuer, the acquisition of the option and the exercise of the option will be considered as two transactions subject to the size tests. On the acquisition of the option, only the premium will be used for the purpose of computing the size tests. Where the premium is 15% or more of the sum of the premium and the exercise price, the sum of the premium and the exercise price (instead of only the premium) will be used for the purpose of computing the "consideration test". In addition, the value of the underlying assets and the profits attributable to such assets will be used for the calculation of the "assets test" and the "profits test", respectively. When the option is exercised, the exercise price, the value of the underlying assets and the profits attributable to such assets will be used for classification of the transaction.

The GEM Rules also set out certain disclosure requirements for the exercise of options (where the issuer has no discretion on such exercise) and the non-exercise of options. The treatment for connected transactions involving options are similar to that for notifiable transactions described above. However, there is an additional requirement in that if an issuer decides not to exercise an option involving a connected person, the non-exercise of the option will be classified as if the option had been exercised.

22.2 The Main Board Rules do not contain similar requirements as the GEM Rules in relation to options. We intend to amend the Main Board Rules to follow the GEM Rules in order to codify our current practice for the Main Board.

22.3 In relation to acquisition of an option which is exercisable at the discretion of the issuer, we will reduce the relevant premium threshold level which triggers the use of the sum of premium and the exercise price (instead of only the premium) for the calculation of the "consideration test" so as to enhance protection of shareholders' interest.

Proposal

22.4 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.

Q59. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the premium threshold you think is appropriate and state reason(s) for your view.*

22.5 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 set out in paragraph 22.1 above as amended by the proposal in paragraph 22.4 above.

Q60. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

Dilution of interest in subsidiaries resulting in deemed disposals

Issues and current position

23.1 Consolidated subsidiaries and entities which are equity accounted for by an issuer or issuer's group may cause allotments of share capital to be made. This may result in a reduction of percentage equity interest of the issuer in such entity. Such allotments give rise to deemed disposals, profits or losses may be recorded on such transactions and such transactions may be treated as notifiable transactions. The Rules deal with such situations and set out how the size tests are applied to such transactions[51]. However, the wording of the Rules refers only to allotments of share capital for "cash consideration". The relevant Rules should apply to allotment of share capital for any kind of consideration and should not be limited to allotments of share capital for cash consideration only.

[51] see paragraph 4.1 of Practice Note 13 to the Main Board Rules and Rule 19.27 of the GEM Rules

Proposal

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

Q61. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

CONNECTED TRANSACTIONS

Definition of "connected person"

Issues and current position

24.1 Under the Main Board Rules, a person may be regarded as a connected person if he is a director, chief executive or substantial shareholder of a subsidiary within the listed group. However, under the GEM Rules, a person who is a director, chief executive or substantial shareholder of a subsidiary will not be regarded as a connected person.

24.2 The reason behind this difference traces back to the 1999 Review. In that review, the Exchange advanced the view that the connected transaction rules are intended to safeguard against directors, chief executives and substantial shareholders taking advantage of their positions to the detriment of the minority shareholders of an issuer. Hence, in respect of a person who is only connected at the subsidiary level, it is not necessary to bring that person within the definition of "connected person" as such a person plays no role in the decision making process of the issuer.

24.3 We consider that the approach adopted under the Main Board Rules and the GEM Rules in interpreting connected transactions should be consistent. The option therefore is either to bring the Main Board Rules into line with the GEM Rules or, if it is considered appropriate, to revisit whether the GEM Rules should in fact be brought into line with the Main Board Rules by tightening the regulation of connected persons.

24.4 The GEM Rules are targeted at regulating connected persons who may be able to influence decision-making at the listed holding company level. However, a large number of decisions are in fact taken at the operating subsidiary level or intermediate holding company level. Only certain significant decisions or matters are dealt with at the listed holding company level. We have to review the need to regulate connected persons of a subsidiary within the listed group and their transactions with the issuer. This will safeguard against the risk that whilst such persons may not be able to influence decisions of the issuer, they may be able to influence decisions of its subsidiary or associated company.

24.5 We note that in the UK Listing Rules, the definition of related party includes a director of a subsidiary undertaking[52] or parent undertaking or a fellow subsidiary undertaking of its parent undertaking.

24.6 We consider that one significant aspect of corporate governance relates to the regulation of connected persons and their transactions or arrangements with the listed group and its undertakings. As many decisions are not taken at the listed holding company level, it is important to ensure that decisions taken at the subsidiary level are made from the perspective of the issuer's corporate interests.

Proposal

24.7 We will maintain the existing regulatory approach to the definition of "connected person" in the Main Board Rules. This includes persons who are connected by virtue of their relationship at the subsidiary level. We will amend the GEM Rules to bring that into line with the Main Board Rules.

Q62. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *The definition of "connected person" under the GEM Rules should be retained. The Main Board Rules should be amended to follow the GEM Rules in this regard.*

☐ *Other views*

[52] see paragraph 30.8 of Part B of this Consultation Paper for the definition of "subsidiary undertaking"

24.8 If the proposal in relation to regulating transactions between connected persons and certain associated companies over which the listed group together with the connected person(s) of an issuer have control is adopted[53], we will amend the Rules to extend the definition of "connected person" to cover a director, chief executive or substantial shareholder of such an associated company or any of their respective associates.

Q63. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

Definition of "associate"

Issues and current position

25.1 One important issue in corporate governance is the regulation of connected transactions and in this respect, it is important to identify who are the associates of directors, chief executives and controlling shareholders of an issuer.

25.2 The concept of the definition of "associate" in the Rules is broadly similar to that in the UK Listing Rules. Under the Rules, an "associate" means:

(a) in relation to any director, chief executive and substantial shareholder being an individual,

(i) his family members;

(ii) 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

(iii) any company in which he and/or family members altogether have a controlling interest, its subsidiary, holding company and a fellow subsidiary of such holding company; and

[53] see paragraph 26.9 of Part B of this Consultation Paper

(b) in relation to a substantial shareholder being a company, its subsidiary, holding company, a fellow subsidiary of such holding company, and any company in which the company and such other company or companies altogether have a controlling interest.

25.3 In Hong Kong, it is quite common for an individual to hold an indirect interest in a company or exercise indirect control over a company through his direct or indirect shareholding in holding companies or cross-shareholding arrangements. An individual may also exercise significant influence over a company by virtue of his capacity as a beneficiary or settlor of a trust which has a direct or indirect interest in the company. There may be instances where a director of an issuer has an indirect controlling interest in a company which enters into a transaction with the issuer. Due to the complex shareholding structure of such company, the director may not be known to be its ultimate beneficial owner and therefore not identified as a party to the transaction. As a result, the transaction may not be regarded as a connected transaction and subject to the respective disclosure and/or shareholders' approval requirements under the Rules.

25.4 Therefore, there are views that the definition of "associate" should be extended so as to lift the corporate veil of a company being a party to a transaction with the issuer and identify its ultimate beneficial owners. There are views that the definition of "associate" should be extended to include:

(a) in relation to any director, chief executive or substantial shareholder being an individual, the settlors and beneficiaries of any trust of which such individual or any of his family interests is a beneficiary or a discretionary object; and

(b) in relation to a substantial shareholder being a company, the ultimate beneficial owners of such company.

25.5 We recognise an extension of the definition of "associate" may further enhance protection of shareholders' interest. However, we note that it may create undue practical difficulties for issuers to identify all the associates of their directors, chief executives and substantial shareholders, particularly when significant international conglomerates are involved in the transactions.

Proposal

25.6 We will retain the existing definition of "associate" in the Rules.

Q64. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. The definition of "associate" should be extended to cover the following (please tick one or more of the following):*

☐ *in relation to any director, chief executive or substantial shareholder being an individual, settlors and beneficiaries of any trust of which such individual or any of his family interests is a beneficiary or a discretionary object, and any companies controlled by any such trust;*

☐ *in relation to a substantial shareholder being a company, the ultimate beneficial owners who control 30% or more of the voting power at general meetings or control the composition of a majority of the board of directors of such company;*

☐ *in relation to a substantial shareholder being a company, the ultimate beneficial owners who control 30% or more of the voting power at general meetings or control the composition of a majority of the board of directors of such company. Where the ultimate shareholders are corporates, this will also include the ultimate individual beneficial owners who control more than 50% of the voting power at general meetings or control the composition of a majority of the board of directors of such corporates;*

☐ *persons with controlling interests in companies that are controlled by a director, chief executive or substantial shareholder and other companies controlled by these persons;*

☐ *any company whose directors are accustomed to act in accordance with the directions and instructions of a substantial shareholder (being a company) of the issuer; and*

☐ *any other individuals or companies you think are appropriate to be included in the definition of "associate". Please specify those individuals or companies and state reason(s) for your view.*

Transactions between connected persons and associated companies

Issues and current position

26.1 The Rules regulate connected transactions between connected persons and the issuer and its subsidiaries. However, the Rules do not regulate transactions between connected persons and companies in which the issuer has a shareholding interest but which are not subsidiaries of the issuer.

26.2 The Main Board Rules provide that a new applicant must have an adequate trading record under substantially the same management. For the purpose of assessing this trading record, operations from associated companies and other entities whose results are equity accounted for, will not be taken into account.

26.3 The GEM Rules require a new applicant must carry on an active business. If the active business is not carried on by the new applicant it must be carried on by the applicant's subsidiary or subsidiaries.

26.4 The requirements set out in paragraphs 26.2 and 26.3 above only relate to new applicants or for the duration covered by the statement of business objectives of newly listed companies as required under the GEM Rules. As a consequence, it is possible for a major undertaking or business of a listed group to be represented by an investment in an associated company after its listing.

26.5 We appreciate that practical problems may arise if the Rules regulate transactions between associated companies and connected persons where the issuer does not have control over such parties. For example, an associated company may proceed with a transaction requiring shareholders' approval of the issuer notwithstanding objections of the issuer's shareholders. It will not be meaningful for the issuer to obtain approval of shareholders for this transaction. It will also be unfair, in such circumstances, to regard the issuer as having acted in breach of the Rules.

26.6 However, given the potential importance of associated companies within a listed group, we are of the view that associated companies should be brought within the regulatory net for the purpose of connected transactions. The Rules governing connected transactions should be extended to cover transactions between connected persons and associated companies.

26.7 We are of the view that our proposal to expand the definition of "subsidiary" to cover entities that are regarded or accounted for as subsidiaries under the appropriate accounting principles[54] would have covered some of the transactions between connected persons and the associated companies which are accounted for as a subsidiary of an issuer under SSAP 32 or IAS 27. To further address the issue and take into account any practical problems that may arise, we consider it is necessary to include appropriate provisions in the Rules to deal with transactions between connected persons of the issuer and an associated company of the issuer.

[54] see paragraph 30.10 of Part B of this Consultation Paper

26.8 Transactions between connected persons of the issuer and an associated company of the issuer should be regarded as connected transactions if the listed group and connected person(s) together have control over such an associated company. Control here should have the same meaning as stated in paragraph 30.5 of Part B of this Consultation Paper.

Proposal

26.9 We will amend the Rules so that transactions between connected persons of an issuer and an associated company of the issuer will be regulated as connected transactions if:

(a) the issuer and/or its subsidiaries hold not less than 20% of the voting power in such associated company; and

(b) the issuer and/or its subsidiaries together with connected person(s) of the issuer (excluding connected person(s) at the subsidiary level) have control over such associated company. Control here shall have the same meaning as stated in paragraph 30.5 of Part B of this Consultation Paper.

Q65. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *Issuers will not be able to comply with the proposal even if the issuer and/or its subsidiaries together with connected person(s) of the issuer (excluding connected person(s) at the subsidiary level) have control over such an associated company.*

☐ *Other views*

Please state reason(s) for your view.

Transactions with non wholly owned subsidiaries

Issues and current position

27.1 The Main Board Rules set out the criteria under which a transaction with a non wholly owned subsidiary is exempt from all connected transactions requirements.[55] It implies that transactions between the issuer and any of its non wholly owned subsidiaries are connected transactions. It is unclear as to whether and how a non wholly owned subsidiary is treated as a connected person.

[55] see Rules 14.24(4) of the Main Board Rules

27.2 The GEM Rules define a non wholly owned subsidiary of an issuer as a connected person if any shareholder of that subsidiary, other than the issuer, is a director, chief executive or substantial shareholder of the issuer or an associate of any such person. Under this definition, if any such person holds say 1 share in the non wholly owned subsidiary, such subsidiary will be a connected person.

27.3 We are of the view that a connected person of the issuer who has a significant shareholding interest in a non wholly owned subsidiary may benefit from the transactions between the issuer or any of its wholly owned subsidiaries and the non wholly owned subsidiary concerned. The potential for a conflict of interest in such situations is obvious when the connected person with an interest in a non wholly owned subsidiary is also in a position of influence over the issuer by virtue of a directorship or shareholding interest. However, the same potential for conflict of interest does not exist where other shareholders of the non wholly owned subsidiary are independent of the issuer. In such cases, the non wholly owned subsidiary should not be treated as a connected person.

Proposal

27.4 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 shall not be regulated as connected transactions.

Q66. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

De minimis thresholds for connected transactions

Issues and current position

28.1 The Rules provide that if a connected transaction falls below certain de minimis thresholds, the transaction will be exempt from compliance with certain reporting, announcement and/or shareholders' approval requirements which would otherwise be applicable to connected transactions[56]. These de minimis thresholds which currently refer to the net tangible assets of issuers need to be adjusted to achieve consistency with the proposed changes to the "assets test".

[56] see Rules 14.24 and 14.25 of the Main Board Rules and Rules 20.23 and 20.24 of the GEM Rules

Proposal

28.2 We will amend the Rules so that the basis for the de minimis thresholds for connected transactions will refer to the total assets instead of the net tangible assets of issuers. Consequently, we will also adjust the relevant percentage level of the de minimis thresholds. The revised Rules will provide the following de minimis thresholds:

(a) a connected transaction will normally be exempt from all the relevant reporting, announcement and shareholders' approval requirements if it is on normal commercial terms where the total consideration or value is less than the higher of:

(i) HK$1,000,000; or

(ii) 0.01% of the total assets of the issuer; and

Q67. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the threshold level you think is appropriate and state reason(s) for your view.*

(b) a connected transaction will normally be subject to the reporting and announcement requirements if it is on normal commercial terms where the total consideration or value is less than the higher of:

(i) HK$10,000,000; or

(ii) 1% of the total assets of the issuer.

Q68. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the threshold level you think is appropriate and state reason(s) for your view.*

Continuing connected transactions

Issues and current position

29.1 The GEM Rules specifically address situations where issuers enter into connected transactions on a continuing or recurring basis and the transactions are expected to extend over a period of time[57]. The transactions involve the provision of goods or services. Continuing connected transactions that meet the requirements of the relevant GEM Rules would qualify for exemptions from the reporting, announcement and shareholders' approval requirements. Where the annual consideration or value of a continuing connected transaction is less than the higher of HK$1,000,000 or 0.03% of the net tangible assets of the issuer, it will be exempt from reporting, announcement and shareholders' approval requirements. Annual re-approval by shareholders is also required if the cap for these transactions is greater than the higher of HK$10,000,000 or 3% of the net tangible assets of the issuer.

29.2 The Main Board Rules do not specifically address continuing connected transactions of issuers. Our practice has been to grant appropriate waivers to issuers from the requirements of such connected transactions in order to ease the burden of complying with the requirements each time a connected transaction which is a part of a continuing series takes place. Waivers granted for the continuing connected transactions of Main Board issuers are subject to the following de minimis thresholds:

(a) issuers are exempt from all the relevant reporting, announcement and shareholders' approval requirements if the continuing connected transaction is on normal commercial terms and the respective annual consideration or cap amount is less than the higher of:

(i) HK$1,000,000; or

(ii) 0.03% of the net tangible assets of the issuer; and

(b) issuers are exempt from shareholders' approval requirement if the continuing connected transaction is on normal commercial terms and the respective annual consideration or cap amount is less than the higher of:

(i) HK$10,000,000; or

(ii) 3% of the net tangible assets of the issuer.

[57] see Rules 20.13 and 20.25 to 20.30 of the GEM Rules

29.3 One major difference between the existing Main Board practice and the GEM Rules is that the latter adopts a lower threshold level (i.e. less than the higher of HK$1,000,000 or 0.03% of net tangible assets of the issuer) for shareholders' approval for continuing connected transactions. In addition, the GEM Rules require that, where the cap of a continuing connected transaction in any year is greater than the higher of HK$10,000,000 or 3% of the net tangible assets of the issuer, the transaction and the cap are subject to review and re-approval by shareholders at the annual general meeting following the initial approval. The review and re-approval is required at each subsequent annual general meeting so long as the transaction continues[58]. We note that the annual review and re-approval requirements have created practical problems for issuers. We therefore consider approval of the transactions will only be required at the time when the issuer enters into the agreement and when the agreement is renewed or there is a material change to the terms of the agreement.

Proposal

29.4 We will amend to the Main Board Rules to introduce a new category of "continuing connected transactions".

Q69. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

29.5 We will amend the Rules to the effect that:

(a) a continuing connected transaction on normal commercial terms will normally be exempt from reporting, announcement and shareholders' approval requirements when the annual total consideration or value of the transaction is less than the higher of:

(i) HK$1,000,000; or

(ii) 0.01% of the total assets of the issuer;

Q70. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the threshold level you think is appropriate and state reason(s) for your view.*

[58] see Rule 20.30 of the GEM Rules

(b) a continuing connected transaction on normal commercial terms will normally be exempt from shareholders' approval requirements when the annual total consideration or value of the transaction is less than the higher of:

(i) HK$10,000,000; or

(ii) 1 % of the total assets of the issuer;

Q71. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify the threshold level you think is appropriate and state reason(s) for your view.*

(c) a continuing connected transaction shall be subject to shareholders' approval if the annual total consideration or value of the transaction exceeds the limit set out in (b) above. Any connected person interested in the continuing connected transaction shall abstain from voting at the general meeting approving the transaction.

Q72. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

29.6 We will amend the Main Board Rules so that issuers proposing to enter into continuing connected transactions falling under paragraph 29.5(b) or 29.5(c) above must:

(a) in respect of each connected transaction, enter into agreement(s) with the connected person, the period for which shall not exceed 3 years;

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

Q73. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

29.7 We will also amend the Rules to require shareholders' approval for the continuing connected transactions at the time when an issuer first enters into the transactions and when the agreement is renewed or there is a material change to the terms of the agreement. Any shareholders who have a different interest from other shareholders in the transactions will be required to abstain from voting.

Q74. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

29.8 We will amend the GEM Rules to remove the requirements of annual review and re-approval of the transactions and the cap by shareholders (other than those who have a different interest from other shareholders in the transactions) at annual general meetings following the initial approval.

Q75. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

29.9 We will amend the Rules so that in circumstances where an issuer had entered into an agreement with a person involving continuing transactions, and such person subsequently became a connected person, the issuer shall treat such transactions as continuing connected transactions. The issuer must take appropriate actions to comply with the requirements of the Rules as soon as reasonably practicable.

Q76. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

MEANING OF "SUBSIDIARY"

Issues and current position

30.1 There are various provisions under the Rules which regulate or apply to subsidiaries of an issuer. The obvious example relates to notifiable transactions with the issuer and its subsidiaries. There are other regulations such as, for instance, share option schemes and dilution of interests in material subsidiaries. The definition of "subsidiary" is therefore important.

30.2 Under the Rules, subsidiaries are defined in the same way as under the Hong Kong Companies Ordinance. This had not given rise to any particular problems before 1 January 2001 when Hong Kong accounting standards (SSAP 7 applied before 1 January 2001) defined subsidiaries in the same way as under the Hong Kong Companies Ordinance. However, the Hong Kong accounting standards have been revised to meet international accounting standards (SSAP 32 is modelled on IAS 27). The revisions became effective on or after 1 January 2001. SSAP 32 provides an extended definition of "subsidiary". This has created a somewhat curious result. For Hong Kong incorporated companies, their group accounts must be prepared on the basis of the definition of subsidiary under the Hong Kong Companies Ordinance. For overseas incorporated companies, their group accounts may now be prepared in accordance with SSAP 32 or IAS 27. In short, reporting enterprises in Hong Kong now apply two different sets of rules in presenting their group accounts and in determining whether a company is a subsidiary or not. Therefore, consolidating a company into the group's account depends on whether or not it is incorporated in Hong Kong.

30.3 From a regulatory perspective, there is no basis to differentiate regulatory treatment on account of the place of incorporation of a company. An issuer using applicable accounting principles is not a good reason why that company should fall outside of the regulatory net applicable to subsidiary companies.

30.4 Under the Hong Kong Companies Ordinance, a company is regarded as a subsidiary of another company if the other company controls over 50% of the voting rights exercisable in general meetings of the company or is entitled to remove or appoint a majority of the board of the company.

30.5 Under SSAP 32, emphasis is placed not on the legal form but the substance of the relationship. Whether an entity is a subsidiary is determined by whether an enterprise has "control" over it. "Control" here means the power to govern the finance and operating policies of an entity "so as to obtain benefits from its activities". Control is presumed to exist if more than 50% of voting power is held. However, even if it owns 50% or less of the voting rights, control also exists where:

(a) by virtue of an agreement with other investors, it has the power over more than 50% of voting rights;

(b) it has the power to appoint or remove a majority of the board (or the equivalent governing body);

(c) it has the power to cast a majority of votes at board meetings (or meetings of the equivalent governing body); or

(d) it has the power to govern the finance and operating policies of the enterprise under statute or pursuant to an agreement.

30.6 The Hong Kong Companies Ordinance covers the situations referred to in sub-paragraphs (a) to (c) above. The situation referred to in sub-paragraph (d) above falls outside of the definition of subsidiary of the Hong Kong Companies Ordinance.

30.7 SSAP 32 makes special provisions for special purpose entities requiring them to be consolidated. It is common to find such regulatory restrictions in joint ventures where control of an entity is done through an agreement or other document. These instruments control the sphere of activities of the entity which are regulated in certain ways to meet the special needs of the parent company. SSAP 32 takes into account the substantive reality of such situations and defines the entity as a subsidiary in this circumstance.

30.8 The Standing Committee on Company Law Reform is currently considering adopting the United Kingdom Companies Act 1985's definition of "subsidiary undertaking" for the purpose of group accounts into the Hong Kong Companies Ordinance, in order to ensure compliance with the definition of "subsidiary" in the IAS[59]. Under the United Kingdom Companies Act 1985, a company is regarded as a "subsidiary undertaking" of a parent undertaking, inter alia, if:

(a) the parent undertaking holds a majority of the voting rights in the company;

(b) the parent undertaking is a member of the company and has the right to appoint or remove a majority of its board of directors;

(c) the parent undertaking has the right to exercise a dominant influence over the company:

(i) by virtue of provisions contained in the company's memorandum or articles, or

[59] 17th Annual Report (2000/2001) of the Standing Committee on Company Law Reform

(ii) by virtue of a control contract;

(d) the parent undertaking is a member of the company and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the company;

(e) the parent undertaking has a participating interest in the company and (i) actually exercises a dominant influence over the company; or (ii) the parent undertaking and the company are managed on a unified basis; or

(f) the company is a subsidiary undertaking of an undertaking which is itself a subsidiary undertaking of the parent undertaking.

30.9 The Rules should be appropriately amended to deal with the regulatory anomaly described above. We are of the view that once an entity is treated and accounted for as a subsidiary and consolidated into an issuer's accounts, it should be regarded as a subsidiary of the issuer for all purposes of the Rules.

Proposal

30.10 Under the Rules, the definition of "subsidiary" includes any entity which is regarded as a subsidiary under the Hong Kong Companies Ordinance. We will 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.

Q77. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

DISPOSAL OF CONTROLLING SHAREHOLDERS' INTERESTS

Commencement of lock-up period

Issues and current position

31.1 Under the Main Board Rules, a person or group of persons shown in the listing document as controlling shareholder of the issuer is prohibited from disposing of any of the issuer's securities within 6 months from the date on which dealings in the issuer's securities commence trading on the Exchange[60]. Under the GEM Rules, the same restriction period applies to the significant shareholders of GEM issuers[61]. The initial management shareholders of GEM issuers are subject to the similar restriction period of 12 months. In the case of initial management shareholders holding 1% or less interest in the issuer, the lock-up period restriction is for 6 months after the date of listing.

31.2 There are no express rules prohibiting controlling shareholders of Main Board issuers and management shareholders and significant shareholders of GEM issuers from disposing of their shareholdings in the issuers between the date of issue of the listing document and the first day of dealing in the securities on the Exchange. Although our position is not expressly covered, we are of the view that any such disposal, unless fully disclosed in the listing document, should be clearly disallowed. Nevertheless, it will be helpful to have express provisions setting out the prohibitions. The lock-up period of controlling shareholders of Main Board issuers and significant shareholders and initial management shareholders of GEM issuers should extend to cover the period between the date of the listing document and the date of listing.

Proposal

31.3 We will amend the Rules so that the lock-up period for the disposal of securities by controlling shareholders of Main Board issuers and significant shareholders of GEM issuers shall commence from the date the listing document is issued and end upon 6 months after the commencement of dealing of the issuer's securities on the Exchange. The same lock-up period shall apply to the initial management shareholders of GEM issuers, except that it will end upon 12 months after the date of listing. In the case of initial management shareholders holding 1% or less interest in the issuer, the lock-up period will end upon 6 months after the date of listing. Offer for sale as disclosed in a listing document shall be allowed during the period from the date of the listing document to the date of listing.

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[60] see Rule 10.07(1)(a) of the Main Board Rules
[61] see Rule 13.17 of the GEM Rules

Q78. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

Agreement for disposal of shares

Issues and current position

32.1 The Main Board Rules disallow controlling shareholders from disposing of their shares of an issuer during the first 6 months of listing and disposal of their controlling interest in the issuer during the following 6 months. However, there is no provision expressly prohibiting controlling shareholders from entering into agreements for the disposal of such shares or controlling interest to take place after the restriction periods[62]. We take the view that any agreement to dispose of interests, including the creation of any option, rights or interests, during the restriction periods, should be expressly prohibited. This provision is available in the GEM Rules[63].

Proposal

32.2 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 relevant restriction periods under the Main Board Rules.

Q79. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

32.3 We will retain the current exceptions set out in the Rules including, in particular, a pledge or charge to an authorised institution as security for a bona fide commercial loan.

[62] see Rule 10.07 of the Main Board Rules. However, see Series 28 of the Listing Decisions, in which the Exchange ruled that any such agreements or arrangements would also constitute a breach of Rule 10.07 of the Main Board Rules.

[63] see Rules 13.15(5), 13.16(2) and 13.18(2) of the GEM Rules

Q80. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

Deemed disposal of controlling shareholders' interests

Issues and current position

33.1 The GEM Rules provide that an issuer may not issue or agree to issue any shares or securities convertible into equity securities within the first 6 months of listing. This does not apply to capitalisation issue or any consolidation, sub-division or capital reduction of shares[64].

33.2 Although the Main Board Rules do not contain similar provisions, we have ruled that an issuer should not proceed with a proposed share placing which, if carried out, would result in a deemed disposal by the issuer's controlling shareholders within 6 months of the issuer's listing[65].

33.3 The GEM Rules allow an issuer to issue new securities to acquire assets which complement its focused line of business provided that certain criteria are met. We consider that it is not appropriate to include such provisions contained in the GEM Rules in the Main Board Rules. We are of the view that issuers on the Main Board, with proven track records, are more mature than GEM issuers. GEM issuers tend to be high-growth companies, and need flexibility to raise funds. Main Board issuers should be able to foresee their capital needs at the time of application for listing.

33.4 The GEM Rules do not allow for the issue of shares pursuant to the exercise of share options and warrants outstanding during the first 6 months of commencement of dealing on the GEM Board. We consider it unfair to the option and warrant holders to be deprived of their rights to exercise their options or warrants during that period.

[64] see Rule 17.29 of the GEM Rules

[65] see Series 1 of the Listing Decisions, in which the Exchange ruled that an issuer should not proceed with a proposed share placing which, if carried out, would result in a deemed disposal by the issuer's controlling shareholder within 6 months' of the issuer's listing and would be in breach of Rule 10.07 of the Main Board Rules.

Proposal

33.5 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 6 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 6 months of listing), other than:

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

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

(c) capitalisation issue or any 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[66].

Q81. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

[66] see Rule 17.29 of the GEM Rules

PART C
DIRECTORS AND BOARD PRACTICES

INDEPENDENT NON-EXECUTIVE DIRECTORS ("INEDs")

Further guidance regarding independence

Issues and current position

1.1 One of the main contributions of INEDs is their independent view which plays a check and balance role on the board's decisions, particularly on matters that involve conflicts of interest or connected persons or have significant impact on the issuers and shareholders. We believe that INEDs should be able to demonstrate that they are able to exercise their independent judgement and their appointments must be perceived to be fair. Generally, any relationship with the issuer, or any personal interests, direct or indirect, that could prevent or significantly hinder directors from objectively exercising their judgement will bring into question their independence.

1.2 The Rules provide that a director will normally not be considered independent if he receives shares of an issuer as a gift from or by means of other financial assistance from a connected person of the issuer.[67] However, there are other situations where the independence of a director could be questioned. The situations are:

(a) The Rules do not prohibit receiving shares of an issuer as gifts from the issuer and this raises the question of the person's interest in the issuer.

(b) The Rules do not prohibit appointment of a person as an INED even if he is or was a professional adviser of the issuer[68].

(c) The Rules do not prohibit appointment of a person as an INED after his ceasing to be an executive or an executive director of the issuer. Such a person may still have a material interest in the issuer and his independence could be questioned.

1.3 We consider any person who receives shares as gifts or other financial assistance as in the case of (a) above, or provides a professional service to the issuer in (b), or is a former executive or a former executive director as in the case of (c) may hinder a person's independent judgement. Such a person may not be perceived as suitable for appointment as an INED of the issuer.

[67] see Rule 3.11(1) of the Main Board Rules and Rule 5.06(1) of GEM Rules
[68] see Series 19 of the Listing Decisions in which the Exchange has decided that a professional adviser who acted in an issuer's initial public offering would not be eligible to act as an INED

Proposal

1.4 We will include more guidelines in the Rules to describe the independence of INEDs. Although none of the factors below would necessarily be conclusive on the independence of a director, we consider that independence is more likely to be questioned if the INED[69]:

(a) holds more than 5% of any class of the issuer's issued share capital[70];

Q82. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *No restriction should be imposed on INED's holding of securities of the issuer. Please state reason(s) for your view.*

☐ *The percentage limit on shareholding in the issuer should be (please tick one of the following):*

☐ *1%*

☐ *2%*

☐ *3%*

☐ *4%*

☐ *Other. Please specify: _____.*

Please state reason(s) for your view.

(b) has received an interest in securities of the issuer as gift from or by means of other financial assistance from a connected person of the issuer or from the issuer itself.

[69] these criteria are largely based on the Exchange's recommended practice issued on 22 November 1994

[70] the current Rules provide that a shareholding interest in the issuer of not more than 1 % of the total issued share capital will not normally be treated by the Exchange as a bar to independence: see Rule 3.11(1) of the Main Board Rules and Rule 5.06(1) of the GEM Rules. In line with the recent relaxation of the Main Board Rules in relation to the granting of share options of INEDS, we propose to relax the threshold from 1% to 5%. Please see the announcement of the Exchange dated 23 August 2001 for details of the relaxation.

However, the INED will still be considered to be independent if:

(i) he receives shares or interests in securities from the issuer or its subsidiaries (but not from connected persons) as part of his normal remuneration package or pursuant to share option schemes established in accordance with the Rules; and

(ii) the total number of shares held does not exceed 5% of the total issued share capital of the issuer;

Q83. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *The limit of issued shares should be (please tick one of the following):*

☐ *1%*

☐ *2%*

☐ *3%*

☐ *4%*

☐ *Other. Please specify: _____.*

Please state reason(s) for your view.

☐ *Other views*

(c) is a director, partner or principal of a professional adviser which currently provides, or has within the preceding 2 years provided services, or an employee of such professional adviser who is or was involved in providing such services, to:

(i) the issuer's group;

(ii) the issuer's controlling shareholders or where the issuer has no controlling shareholders, those shareholders who are chief executive or directors (except INEDs); and

(iii) any person who was the issuer's controlling shareholder, chief executive or director (except INED);

Q84. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *The restriction period should be (please tick one of the following):*

☐ *1 year*

☐ *3 years*

☐ *4 years*

☐ *5 years*

☐ *Other. Please specify: _____.*

Please state reason(s) for your view.

☐ *Other views*

(d) 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;

Q85. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

(e) owes allegiance to a particular shareholder or group of shareholders;

Q86. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

(f) is on the board specifically to protect the interests of certain parties whose interests are not the same as shareholders as a whole;

Q87. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

(g) is or was connected to a director, the chief executive or substantial shareholder of the issuer within the preceding 2 years;

Q88. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *The restriction period should be (please tick one of the following):*

☐ *1 year*

☐ *3 years*

☐ *4 years*

☐ *5 years*

☐ *Other. Please specify: _____.*

Please state reason(s) for your view.

☐ *Other views*

(h) 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 2 years; or

Q89. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *The restriction period should be (please tick one of the following):*

☐ *1 year*

☐ *3 years*

☐ *4 years*

☐ *5 years*

☐ *Other. Please specify: _____.*

Please state reason(s) for your view.

☐ *Other views*

(i) receives his or her remuneration as a director of the issuer, its holding company or their respective subsidiaries, which constitutes a principal source of his or her income.

Q90. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

1.5 We will amend the Rules to codify the existing practice and require an INED to provide us with 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 us if there is any change of circumstances which may affect their independence.

Q91. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

Qualifications of INEDs

Issues and current position

2.1 The Rules provide that every director of an issuer must satisfy us that he has the character, experience and integrity, and is able to demonstrate a standard of competence commensurate with his position as a director of an issuer[71]. The Rules also provide that every non-executive director must ensure that he can give sufficient time and attention to the affairs of the issuer and should not accept the appointment if he cannot do so[72]. However, the Rules do not provide minimum benchmarks to qualifications for appointment as an INED. This makes judgment on who is qualified to be an INED difficult.

2.2 Major responsibilities of INEDs include providing an objective view on the assessment of the financial statements of the issuer, connected transactions and transactions which require independent shareholders' approval and participating in the audit committee. The increasing importance of the role of INEDs to improve the standard of corporate governance in Hong Kong highlights the need for INEDs to contribute their professional knowledge to the board. Issuers will benefit from having an INED, who has professional knowledge and is able to appreciate and perform his duties and functions under the Rules effectively.

Proposal

2.3 We will amend the Rules to require issuers to appoint at least 1 INED who has appropriate professional qualifications or experience in financial matters[73].

Q92. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

[71] see Rule 3.09 of the Main Board Rules and Rule 5.02 of the GEM Rules
[72] see paragraph 10 of Appendix 14 to the Main Board Rules and Rule 5.08 of the GEM Rules
[73] see paragraph 7.5 of Part C of this Consultation Paper

Minimum number of INEDs

Issues and current position

3.1 Under the Rules, every issuer must have at least 2 INEDs[74].

3.2 If an issuer has only 2 INEDs, the board may not have a sufficient number of INEDs present to offer an independent view at the board meetings or advise on a transaction where an independent board committee to advise independent shareholders is necessary. This can happen if one of them is absent from the board meeting or has a different interest in a connected transaction or a transaction which requires independent shareholders' approval. We consider that issuers with a larger board should appoint more INEDs to cater for sufficient board representation. There are comments from the market that it might be difficult for issuers to appoint additional suitable INEDs. We consider that it is necessary to allow phased-in implementation for issuers to appoint a sufficient number of INEDs on their boards, if our proposal set out in paragraph 3.5 below is adopted.

3.3 Under the GEM Rules, if an issuer fails to have the minimum number of INEDs on the board of directors, the issuer is required to make disclosure of the situation[75]. The Main Board Rules do not contain a similar requirement. Main Board issuers are only required to announce the changes of directors[76]. There is no specific requirement that the public must be notified if the number of INEDs falls below the requirement of the Main Board Rules.

3.4 The Rules do not specify a period within which an issuer must appoint a sufficient number of INEDs to meet the minimum requirement after the number of INEDs has fallen below the minimum number required. There may be instances where the appointments are outstanding for a long period of time before issuers take action to fill the vacancy.

Proposal

3.5 We will amend the Rules so that INEDs shall represent not less than one-third of the members of the board of an issuer to ensure that their views will carry significant weight in the board's decision, irrespective of the size of the board. The number of INEDs shall not be less than 2 in any event.

[74] see Rule 3.10 of the Main Board Rules and Rule 5.05 of the GEM Rules
[75] see Rule 17.51 of the GEM Rules
[76] see paragraph 14(2) of Appendices 7a, 7b and 7i to the Main Board Rules

Q93. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *There should be no requirement for the minimum number of INEDs.*

☐ *The existing minimum requirement of 2 INEDs under the Rules should be retained.*

☐ *Other views. Please specify the minimum number of INEDs you think is appropriate and state reason(s) for your view.*

Q94. If you support the proposal set out in paragraph 3.5 of Part C of this Consultation Paper, what period of lead time do you consider necessary before the requirement for the number of INEDs representing not less than one-third of the members of the board should become effective?

☐ *6 months*

☐ *12 months*

☐ *18 months*

☐ *24 months*

☐ *Other period: _____ (please specify)*

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

Q95. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

3.7 We will also amend the Rules to specify a period of 3 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.

Q96. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

Independent board committees

Issues and current position

4.1 The Rules require shareholders' approval for certain connected transactions that are not exempt under the de minimis provisions. Shareholders who have a different interest from other shareholders in such connected transactions are required to abstain from voting. The Rules require the minutes of the board meeting approving such connected transactions to reflect whether or not such transactions were on normal commercial terms and to note the views of INEDs. The Rules only require the circular to shareholders to contain an opinion, in the form of a separate letter, from an independent expert acceptable to us as to whether the transactions are fair and reasonable so far as the shareholders of the issuer are concerned. However, there is no requirement that an independent board committee must be formally established and that the independent board committee should issue a letter to the shareholders advising them on the transactions.

4.2 There are other situations where controlling shareholders or management shareholders are required to abstain from voting to approve the transactions. While the practice has been to establish independent board committees to consider such matters, there is no express requirement in the Rules that an independent board committee must be established.

4.3 Where INEDs who are shareholders of an issuer have a different interest from other shareholders in connected transactions or transactions or arrangements requiring approval by independent shareholders, it is not appropriate for the INEDs to advise shareholders on how to vote. Although the market practice is that such interested INEDs would not be a member of the independent board committee, this is not expressly stated in the Rules.

Proposal

4.4 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[77]. 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; 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, whether such a transaction or arrangement is in the interest of the issuer and its shareholders as a whole and advise shareholders on how to vote;

Q97. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

4.5 We will clarify in the Rules that the independent board committee shall not consist of INEDs who are shareholders of an issuer and have a different interest from other shareholders in the relevant transactions or arrangements. The independent board committee may consist of only 1 INED if all other INEDs are interested in the relevant transactions or arrangements. If all the INEDs have a different interest from other shareholders in the relevant transactions or arrangements, 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.

Q98. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

[77] see paragraphs 3.1 to 3.11 of Part B of this Consultation Paper

4.6 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, whether the transaction or arrangement is in the interest of the issuer and its shareholders as a whole and advise shareholders on how to vote.

Q99. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

BOARD PRACTICES

Code of Best Practice

Issues and current position

5.1 The GEM Rules set out the minimum standard of good practice concerning the general management responsibilities of the board of directors[78]. The provisions in the GEM Rules are derived from and essentially the same as the Code of Best Practice in the Main Board Rules[79].

5.2 We consider that a balanced and disclosure-based approach should be adopted in this regard, which is in line with most major international markets. The Combined Code in the UK Listing Rules sets out principles of good governance and a code of best practice to provide issuers in the UK guidelines on their adoption of corporate governance practices. Issuers in the UK are required to disclose their governance practices, confirm compliance with the Combined Code provisions and explain any special circumstances applying to them, which have led to a particular approach. In line with the approach adopted in the UK Listing Rules, we will set out the minimum standard of board practices that we recommend all issuers to meet in the Code of Best Practice. Issuers will be allowed to deviate from the minimum standard in the Code of Best Practice. However, they will be required to disclose

[78] see Rules 5.29 to 5.39 of the GEM Rules
[79] see Appendix 14 to the Main Board Rules

details of any deviation from the minimum standard in their annual reports. If an issuer adopts its own code that exceeds the minimum standard set out in the Code of Best Practice, such issuer may draw attention to such fact in its annual reports.

Proposal

5.3 We will amend the Rules so that the Code of Best Practice will be set out as an appendix to the Rules and will be the minimum standard that we recommend all issuers to meet. Compliance with the minimum standard set out in the Code of Best Practice will not be a mandatory requirement. Issuers will be allowed to deviate from such minimum standard. Issuers shall disclose any deviation from the minimum standard in the Code of Best Practice in their reports on corporate governance[80] in their annual reports.

Q100. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one or more of the following)*

☐ *Compliance with the Code of Best Practice should be made mandatory.*

☐ *Issuers should not be required to disclose any deviation from the minimum standard in the Code of Best Practice in their annual reports.*

☐ *Other views*

5.4 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.

Q101. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

[80] see paragraphs 6.1 to 6.3 of Part C of this Consultation Paper

Report on corporate governance

Issues and current position

6.1 The Rules currently do not require issuers to include a report on corporate governance in their annual reports.

6.2 A report on corporate governance would promote transparency of an issuer and facilitate shareholders and investors to make an informed assessment of the corporate governance position concerning the issuer.

Proposal

6.3 We will amend the Rules to require issuers to include a report on corporate governance practices prepared by the board of directors in their annual reports. The Rules will not dictate the contents of the report since the circumstances of each issuer are different. However, the report shall be comprehensive and shall, at least, include the following information:

(a) the corporate governance practices, particularly in relation to directors, board practices and shareholders' rights, adopted by the issuer;

(b) whether the issuer meets the minimum standard in the Code of Best Practice and its own code; and

(c) in the event of any deviation from the minimum standard in the Code of Best Practice, details of such deviation during the financial year.

If the proposals set out in paragraphs 7.8, 8.6, 9.8, 11.5 and 12.4 of Part C of this Consultation Paper are adopted, information that must be disclosed under these proposals shall form part of the report on corporate governance of the issuers.

Q102. Do you agree with our proposal?

☐ *Agree*

☐ *Agree, but the report on corporate governance should also include the following additional item(s). Please specify those item(s) and state reason(s) for your view.*

☐ *Agree, but the report on corporate governance should not require disclosure of the following item(s). Please specify those item(s) and state reason(s) for your view.*

☐ *Disagree. Issuers should not be required to include a report on corporate governance in their annual reports.*

Establishment of governance committees

Audit committee

Issues and current position

7.1 The Code of Best Practice contained in Appendix 14 to the Main Board Rules (introduced in 1993 and amended in 1998) provides that issuers should establish an audit committee with written terms of reference stating its authority and duties clearly. The requirement to establish an audit committee is compulsory under the GEM Rules[81].

7.2 We consider that issuers with an audit committee would be more efficient in overseeing their financial reporting procedures and implementing appropriate internal controls. The effectiveness of an audit committee would be enhanced if one of its members has appropriate professional qualifications or experience in financial matters. The person could play an important role in facilitating the committee's dealings with the management and the external auditors.

Proposal

7.3 We will amend the Main Board Rules to follow the GEM Rules so that establishing an audit committee shall become a compulsory requirement.

Q103. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

7.4 We will amend the Rules to require the audit committee to comprise at least 3 non-executive directors with a majority of INEDs.

Q104. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please describe the composition of the audit committee you think is appropriate, specify the minimum number of audit committee members, and state reason(s) for your view.*

[81] see Rule 5.23 of the GEM Rules

Q105. Do you agree that the chairman of the audit committee should be an INED?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

7.5 We will amend the Rules to require the audit committee to have at least 1 committee member with appropriate qualifications or experience in financial reporting, if the proposal of appointment of at least 1 INED who has appropriate professional qualifications or experience in financial matters is adopted[82].

Q106. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

7.6 We will amend the Rules to provide 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 us immediately and publish an announcement in this regard.

Q107. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

7.7 We will set out a list of the duties and responsibilities of the audit committee in the Rules to provide further guidance to issuers. The list shall include the following:

(a) to consider the appointment of the external auditor, the audit fee, and any questions of resignation or dismissal;

(b) to discuss with the external auditor the nature and scope of the audit before the audit commences;

(c) to review from time to time the cost effectiveness of the audit and the independence and objectivity of the external auditor;

[82] see paragraph 2.3 of Part C of this Consultation Paper

(d) to review the quarterly, half-year and annual financial statements before submission to the board of directors, focusing particularly on:

(i) any changes in accounting policies and practices
(ii) major judgmental areas
(iii) significant adjustments resulting from audit
(iv) going concern assumption
(v) compliance with accounting standards
(vi) compliance with the Rules and other legal requirements;

(e) to discuss, in the absence of management where necessary, problems and reservations arising from the quarterly and half-year reviews or annual audits, and any matters the auditor may wish to raise;

(f) to review the external auditor's management letter and management's response;

(g) to discuss with the management the system of internal controls and that management has discharged its duties in having an effective internal control system;

(h) where an internal audit function exists, to ensure co-ordination between the internal and external auditors, and that the internal audit function is adequately resourced and has appropriate standing within the issuer;

(i) to consider any findings of major investigations of internal control matters and management's response;

(j) to review the group's operating, financial and accounting policies and practices;

(k) to consider other topics, as defined by the board of directors; and

(l) to report on all of the above matters to the board of directors.

Q108. Do you agree with our proposal?

☐ *Agree. Please specify any item(s) you think should be added to or deleted from the list of duties and responsibilities of the audit committee set out in paragraph 7.7 of Part C of this Consultation Paper. Please also state reason(s) for your view.*

☐ *Disagree*

7.8 We will amend the Rules to require issuers to disclose the following information relating to the audit committee in their annual reports:

(a) its role and function;

(b) its composition;

(c) the number of audit committee meetings held during the year and record of attendance of members during the year;

(d) a report on the work performed by the audit committee during the year, including its findings on review of the quarterly/half-year/annual results, adequacy and effectiveness of issuer's internal control systems, etc; and

(e) significant issues addressed by the audit committee during the year.

Q109. Do you agree with our proposal?

☐ *Agree. Please specify any information you think should be added to or deleted from the list of disclosure items set out in paragraph 7.8 of Part C of this Consultation Paper. Please also state reason(s) for your view.*

☐ *Disagree*

Remuneration committee

Issues and current position

8.1 Currently, we do not require issuers to establish remuneration committees for directors and the Rules are silent on this issue.

8.2 There may be a conflict of interest when board members are asked to decide their own remuneration packages. The responsibility for determining remuneration of directors should be allocated to a group of people with good knowledge of the issuer and who are responsive to shareholders' interests, with no personal financial interests in the remuneration decisions they make.

8.3 We support the principle that no director should be involved in determining his own remuneration. We note that in various international markets, the establishment of remuneration committees comprising INEDs to determine the remuneration of directors or top executives is recommended. Such committees provide a mechanism for setting remuneration for directors by reference to fair and objective standards.

We take the view that this is particularly relevant in the Hong Kong context where controlling shareholders in management tend to have significant influence on the board. We are of the view that a remuneration committee may be more appropriate for large issuers or issuers with widespread shareholding structure. It may not be appropriate to impose such a requirement on issuers with smaller boards.

Proposal

8.4 We will amend the Code of Best Practice to recommend issuers to establish a remuneration committee only comprising INEDs. We do not propose to make this a mandatory requirement.

Q110. Do you agree with our proposal?

- ☐ *Agree*
- ☐ *Disagree (please tick one of the following)*
  - ☐ *There is no need for issuers to establish a remuneration committee.*
  - ☐ *Establishing a remuneration committee should be a compulsory requirement. Please state reason(s) for your view.*
  - ☐ *Other views*

Q111. Do you agree that a remuneration committee (if any) should comprise INEDs only?

- ☐ *Agree*
- ☐ *Disagree. Please describe the composition of a remuneration committee you think is appropriate and state reason(s) for your view.*

8.5 We will amend the Code of Best Practice to include the principal functions of the remuneration committee. These include establishing a formal and transparent procedure for developing policy on directors' remuneration and for fixing the remuneration packages of individual directors, and ensuring that no director is involved in deciding his or her own remuneration.

Q112. Do you agree with our proposal?

☐ *Agree. Please specify any other duties and functions of the remuneration committee you think are appropriate and state reason(s) for your view.*

☐ *Disagree*

8.6 We will amend the Rules to require issuers to disclose the following information in their annual reports:

(a) the role, function and composition of the remuneration committee (if any) or the reason for not having a remuneration committee;

(b) the number of meetings held by the remuneration committee or the board of directors (if there is no remuneration committee) during the year to discuss remuneration related matters and the attendance record of members at meetings held during the year;

(c) a summary of the work, including determining the policy for the remuneration of executive directors and approving the terms of executive directors' service contracts, performed by the remuneration committee or board of directors (if there is no remuneration committee) during the year; and

(d) significant remuneration related issues addressed by the remuneration committee or the board of directors (if there is no remuneration committee) during the year.

Q113. Do you agree with our proposal?

☐ *Agree. Please specify any information you think should be added to or deleted from the list of disclosure items set out in paragraph 8.6 of Part C of this Consultation Paper. Please also state reason(s) for your view.*

☐ *Disagree*

Nomination committee

Issues and current position

9.1 The Rules do not make any reference to the establishment of a nomination committee.

9.2 We note that major international markets recommend issuers to establish nomination committees to make recommendations to the board for new appointments or re-appointments of executive or non-executive directors. Normally, a nomination committee would have a majority of INEDs. Requirements vary as to whether executive directors may qualify to be admitted as members of the nomination committee.

9.3 We consider that a nomination committee could be of considerable assistance to the board in making appointments or re-appointments of directors and ensuring a formal and transparent procedure for making such appointments or re-appointments. The establishment of a nomination committee may enhance the composition of the board through the quality of directors' appointments. A nomination committee, not subject to executive representation, may select fewer affiliated outsiders on the board. Internal guidelines may be adopted to address competing time commitments that directors serving on multiple boards may face. A nomination committee may also be formally vested with the responsibility to consider whether existing directors should be re-appointed by having due regard to their contribution and performance.

9.4 We fully endorse the view that appointments or re-appointments of directors should be a transparent and formal process. We also support the principles behind the establishment of nomination committees. If nomination committees are able to function in accordance with such principles, it would go some way in addressing the influence which controlling shareholders may have on the composition of the board of directors of issuers in Hong Kong.

9.5 We appreciate that a nomination committee may not be appropriate for issuers with smaller boards. In addition, the enhancement of corporate governance standards should be a progressive process.

Proposal

9.6 We will amend the Code of Best Practice to recommend issuers to establish a nomination committee comprising a majority of INEDs. We do not propose to make this a mandatory requirement.

Q114. Do you agree with our proposal?

- ☐ *Agree*
- ☐ *Disagree (please tick one of the following)*
  - ☐ *There is no need for issuer to establish a nomination committee.*
  - ☐ *Establishing a nomination committee should be a compulsory requirement. Please state reason(s) for your view.*
  - ☐ *Other views*

Q115. Do you agree that a nomination committee (if any) should comprise INEDs only?

- ☐ *Agree*
- ☐ *Disagree. Please describe the composition of a nomination committee you think is appropriate and state reason(s) for your view.*

9.7 We will amend the Code of Best Practice to include the principal functions of the nomination committee. These include making recommendations to the board on all directors' appointments, evaluating the performance of the directors and assessing the independence of INEDs.

Q116. Do you agree with our proposal?

- ☐ *Agree. Please specify any other duties and functions of a nomination committee you think are appropriate and state reason(s) for your view.*
- ☐ *Disagree*

9.8 We will also amend the Rules to require issuers to disclose the following information in their annual reports:

(a) the role, function and composition of a nomination committee (if any) or the reason for not having a nomination committee;

(b) the nomination procedures adopted by and a summary of the work, including determining the policy for the nomination of directors, performed by the nomination committee or the board of directors (if there is no nomination committee) during the year; and

(c) significant issues in relation to the nomination of directors addressed by the nomination committee or the board of directors (if there is no nomination committee) during the year.

Q117. Do you agree with our proposal?

☐ *Agree. Please specify any information you think should be added to or deleted from the list of disclosure items set out in paragraph 9.8 of Part C of this Consultation Paper. Please also state reason(s) for your view.*

☐ *Disagree*

DIRECTORS' DUTIES AND RESPONSIBILITIES

Duties and responsibilities of non-executive directors

Issues and current position

10.1 All directors are equally responsible in law for the board's actions and decisions. Certain directors may have particular functions or responsibilities for which they are held accountable to the board. As there is a view that non-executive directors should have less onerous duties than executive directors, we wish to clarify that we expect non-executive directors of issuers to have the same duties. Non-executive directors may have different functions from those of executive directors. They do not have any executive functions but they may be required to sit on audit committees and/or remuneration committees. Non-executive directors are appointed for various reasons, which include making positive contributions as equal board members to the development of the company's strategy, as well as giving the board the benefit of skills and expertise from diverse backgrounds. They could also provide a balanced and independent view to the board.

10.2 Currently, there are no clear guidelines in the Rules in respect of the duties and responsibilities of non-executive directors. Such directors may not be aware of their functions in the board of directors of issuers.

Proposal

10.3 We will amend the Code of Best Practice to include a general description of the duties and responsibilities of non-executive directors, which shall include:

(a) participating in board meetings of the issuer to bring an independent judgement to bear on issues of strategy, performance, resources, key appointments and standards of conduct;

(b) protecting the interests of shareholders, particularly minority or independent shareholders if the issuer is controlled by a single shareholder or group of shareholders, including inquiring into any unusual matters or decisions which may be detrimental to the interests of such shareholders; and

(c) participating in the audit committee and other governance committees where applicable.

Q118. Do you agree with the proposal?

☐ *Agree. Please specify any other duties and functions of non-executive directors you think are appropriate and state reason(s) for your view.*

☐ *Disagree*

Chairman and chief executive officer

Issues and current position

11.1 Chairmen and chief executive officers of issuers serve two distinctive roles. Chairmen are primarily responsible for the running of the board and ensuring that all directors, executive and non-executive, perform their functions and contribute to the board. The role of chief executive officers is to operate the business of the issuer and to implement policies and strategies adopted by the board.

11.2 The importance of these two key roles represents a considerable concentration of power if they are combined in one person. Such concentration of power is likely to result in an individual or a group of individuals controlling the decision making process of the board. In the Hong Kong context, controlling shareholders often participate in management and the high level of executive representation on the board of directors of many issuers. Therefore, there is a definite advantage in

segregating the roles of chairman and chief executive officer to avoid such concentration of power. However, an argument often raised in favour of a joint leadership structure is that it has the advantage of a strong and consistent leadership which is able to make and implement decisions quickly.

11.3 We accept the principles behind segregating the roles of chairman and chief executive officer. There should be a clear division of responsibilities at the head of the issuer, which will ensure a balance of power and authority such that no one individual has unfettered powers of decision. However, we also recognise that there may be practical difficulties in implementing this in Hong Kong. Firstly, a significant number of issuers currently have these two roles combined in one person because the controlling shareholder wants active participation in management. Secondly, there is a need to ensure that the segregation of roles is actually implemented in practice rather than merely having in name the positions held by two different persons.

Proposal

11.4 We will amend the Code of Best Practice to recommend segregation of the roles of chairman and chief executive officer as a good practice. However, in view of the practical issues in relation to the segregation of these two roles, we do not propose make this a mandatory requirement.

Q119. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *There is no need for the issuer to segregate the roles of chairman and chief executive officer.*

☐ *Segregation of the roles of chairman and chief executive officer should be made mandatory.*

☐ *Other views*

11.5 We will amend the Rules to require issuers to disclose in their annual reports whether or not these two roles are segregated.

Q120. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

Internal controls

Issues and current position

12.1 Issuers should have a sound system of internal controls over their financial, operational and compliance matters and risk management in order to safeguard the issuers' assets. These matters should be reviewed by the board and reported to shareholders on a regular basis.

12.2 The Rules do not make any reference to internal controls. We consider that appropriate internal control requirements in the Rules would enhance management accountability. We expect the audit committee to work closely with the board with regard to internal control systems. Although the responsibility for the establishment and implementation of an effective system of internal controls still rests with the board, the audit committee has to ensure that the board has discharged its duties.

Proposal

12.3 We will amend the Code of Best Practice to recommend directors of issuers to regularly conduct a review of the effectiveness of the group's system of internal controls. We do not propose make this a mandatory requirement. The review should cover all controls, including financial, operational and compliance controls, and risk management.

Q121. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

12.4 We will also amend the Rules 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. The report shall disclose:

(a) a statement that the directors are responsible for the system of such review internal controls;

(b) details of any significant areas of concern which may affect shareholders;

(c) an explanation of how the system of internal controls has been defined for the issuer;

(d) procedures and internal controls for the dissemination of price sensitive information;

(e) whether the issuer has an internal audit function;

(f) the period which the review covers;

(g) how often internal controls are reviewed;

(h) significant views or proposals put forward by the audit committee; and

(i) a statement that the directors have reviewed the effectiveness of the system of internal controls.

Q122. Do you agree with our proposal?

☐ *Agree. Please specify any information you think should be added to or deleted from the list of disclosure items set out in paragraph 12.4 of Part C of this Consultation Paper. Please also state reason(s) for your view.*

☐ *Disagree*

Voting by interested directors

Issues and current position

13.1 The Rules set out mandatory requirements relating to the constitutional documents of issuers. The constitutional documents must have a general prohibition against a director voting on any contract or arrangement or any other proposal in which he has a material interest, and from being counted towards the quorum at the relevant board meeting[83]. The Rules also set out certain exceptions to the general voting prohibition[84].

13.2 We consider that the decision of a director may be affected if any of his associates is interested in a matter to be voted on by the board, and that the scope of the general prohibition should be extended to prohibit a director from voting in such circumstances.

Proposal

13.3 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

[83] see paragraph 4(1) of Appendix 3 to both the Main Board Rules and the GEM Rules
[84] see note 1 of Appendix 3 to the Main Board Rules and note 5 of Appendix 3 to the GEM Rules

relevant interest is immaterial. The existing exceptions to the general voting prohibition as currently provided in the Rules will continue to apply[85].

Q123. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

SECURITIES TRANSACTIONS BY DIRECTORS

Disclosure of breaches

Issues and current position

14.1 The Model Code for Securities Transactions by Directors of Listed Companies set out in the Main Board Rules (the "Model Code") and the GEM Rules set out the minimum standard of conduct regarding securities transactions by directors[86]. Under the Model Code and the GEM Rules, a director is prohibited from dealing in any securities of the issuer during the "black out" period, unless the circumstances are exceptional such as when there is a pressing financial commitment to be met[87]. The "black out" period commences 1 month immediately preceding the earlier of the date of the board meeting for the approval of the issuer's results for any year, half-year or (for GEM issuers only) quarter-year and the deadline for the issuer to publish an announcement of such results as set out in the Rules. It ends on the date of the results announcement.

14.2 The standard of conduct set out in the Rules represents the minimum standard that we expect all directors of issuers to comply with. The minimum standard of conduct is of great importance in upholding a proper standard for securities transactions by the directors. We consider that investors should be informed of any breach of the standard. The current Rules do not require issuers to disclose any breach of such standard of conduct to their shareholders and the public.

Proposal

14.3 We will amend the Rules to expressly provide that any breach of such minimum standard set out in the Rules 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

[85] see note 1 of Appendix 3 to the Main Board Rules and note 5 of Appendix 3 to the GEM Rules
[86] see the Model Code contained in Appendix 10 to the Main Board Rules and Rules 5.41 to 5.59 of the GEM Rules
[87] see paragraph A.3 of the Model Code and Rule 5.51 of the GEM Rules

such code will not be regarded as a breach of the Rules provided that the minimum standard contained in the Rules is met.

Q124. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

14.4 In order to promote transparency, 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.

Q125. Do you agree with our proposal?

☐ *Agree. Please specify any information you think should be added to or deleted from the list of disclosure items set out in paragraph 14.4 of Part C of this Consultation Paper. Please also state reason(s) for your view.*

☐ *Disagree*

Definition of "dealing"

Issues and current position

15.1 The Rules do not set out the definition of "dealing" in relation to the minimum standard of conduct regarding securities transactions by directors. It is necessary to explain more clearly in the Rules under what circumstances a transaction constitutes directors' dealing in securities of an issuer so as to avoid possible breaches of the Rules.

Proposal

15.2 We will amend the Rules to include a definition of "dealing". "Dealing" shall mean 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.

Q126. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

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

Q127. Do you agree with our proposal?

☐ *Agree. Please specify any other instances you think should be regarded as "dealings" and state reason(s) for your view.*

☐ *Disagree*

Dealings by directors in "exceptional circumstances"

Issues and current position

16.1 Directors' dealing in exceptional circumstances must comply with specific procedures set out in the Model Code and the GEM Rules. The director concerned must first notify the chairman of the board or the board of directors at a board meeting or other director(s) appointed for the purpose of such dealing. He must receive a dated written acknowledgement prior to dealing[88].

16.2 We consider that in order to prevent abuse of the exception for a director to sell securities of the issuer under exceptional circumstances, the director shall give prior notice to the chairman of the board or a director designated by the board, of the exceptional circumstances. The director must satisfy the chairman or the designated director that the circumstances are exceptional. The director should only be allowed to sell, but not purchase, securities of the issuer in such circumstances.

[88] see paragraph B.5 of the Model Code and Rule 5.53 of the GEM Rules

Proposal

16.3 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.

Q128. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

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

Q129. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

Directors as trustees or beneficiaries

Issues and current position

17.1 The Model Code and the GEM Rules regulating securities transactions by directors do not set out clear guidelines dealing with the situation where a director acts as a co-trustee. Difficulties could arise where a decision is made by other co-trustees to deal in the securities of an issuer, but the decision is made without the participation or agreement of the director who is one of the co-trustees.

17.2 Under the Model Code and the GEM Rules, restrictions on dealings by a director are applicable to any dealings by the director's spouse or any infant children of the director[89]. Under the Securities (Disclosure of Interests) Ordinance, the director is or is to be treated as interested in any dealings they may make. Where a director is acting as a sole trustee of a trust, he should not be dealing in the securities of the issuer in his capacity as sole trustee as he would be prohibited to deal in the securities on account of his position as a director of the issuer. However, according to the Securities (Disclosure of Interests) Ordinance, any dealing by co-trustees, even without the participation or agreement on the part of a director as one of the co-trustees, will be regarded as a dealing by the director himself. In such circumstances, the director should not be regarded as having acted in breach of the Model Code or the relevant provisions in the GEM Rules where he is not, and none of his associates are, a beneficiary or a discretionary object under the trust.

17.3 The Model Code and GEM Rules impose an obligation on the part of any director, who acts as a trustee, to inform his co-trustees of the identity of any issuer of which he is a director. Conversely, any director who is a beneficiary has to make sure that the trustees are aware of the issuers of which he is a director. This is to avoid possible difficulties arising under any dealings in securities by the co-trustees or the trustees of the relevant trusts. However, the Rules should contain provisions to deal with the situation where the director deals in the securities of an issuer in his capacity as a co-trustee, but he has not participated in, or influenced, the decision to deal in the securities of the issuer and he is not, and none of his associates are, a beneficiary or a discretionary object under the trust.

Proposal

17.4 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.

[89] see paragraph A.4 of the Model Code and Rule 5.52 of the GEM Rules

Q130. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

Securities transactions by "relevant employees"

Issues and current position

18.1 The Model Code of the Main Board and the GEM Rules provide that directors should endeavour to ensure that any employee of an issuer or its subsidiaries, who is likely to be in possession of unpublished price-sensitive information in relation to any companies listed on the Exchange, does not deal in those securities at a time when he would be prohibited from dealing as if he were a director[90]. However, the relevant provisions do not directly apply to such employee. While the statutory restrictions on insider dealings are applicable, there is no prohibition in the Rules against such employee acting in a way that would be prohibited as if the employee were a director.

18.2 The Rules do not have any jurisdiction over issuers' employees. However, as a good corporate governance practice, issuers should devise their own codes 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.

Proposal

18.3 We will amend the Code of Best Practice to recommend issuers to 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 do not propose to make this a mandatory requirement. We will also include a definition of "relevant employee" in the Code of Best Practice. A "relevant employee" is 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.

[90] see paragraph B.10 of the Model Code and Rule 5.58 of the GEM Rules

Q131. Do you agree with our proposal to recommend issuers to 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?

☐ *Agree*

☐ *Disagree*

Q132. Do you agree with the proposed definition of "relevant employee"?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

"Black out" period of directors' securities transactions

Issues and current position

19.1 The Rules require issuers to disclose to the public any price-sensitive information. Directors are not allowed to deal in their companies' securities when they are in possession of unpublished price-sensitive information. In addition, directors are not allowed to deal in the issuers' securities during the period commencing 1 month immediately preceding the earlier of the date of the board meeting for approving the issuers' half-year or annual results, and the deadline for the issuers to publish the relevant results announcements in accordance with the Rules (i.e. "black out" period).[91] Such "black out" period would end on the date of the issuers' results announcements.

19.2 Currently, Main Board issuers are not required to publish their results quarterly. To improve transparency and promote better corporate governance standards, we propose that Main Board Rules shall follow the GEM Rules and require issuers to publish their results quarterly[92].

19.3 The Securities (Insider Dealing) Ordinance governs insider dealing transactions of listed companies in Hong Kong. The Securities (Disclosure of Interests) Ordinance requires prompt disclosure of directors' dealing in the issuers' securities within 5 days after the transactions. In view of the regulations already in place, there are arguments that the "black out" period should be removed or shortened.

[91] see paragraph A.3 of the Model Code and Rule 5.51 of the GEM Rules
[92] see paragraphs 1.1 to 1.13 of Part D of the Consultation Paper

19.4 Under the UK Listing Rules, directors are not allowed to deal in the issuers' securities for:

(a) a period of 2 months immediately before the preliminary announcement of annual results, or if shorter, the period from the relevant financial year end up to and including the time of the announcement;

(b) a period of 2 months immediately before publication of the half-year report, or if shorter, the period from the relevant financial period end up to and including the time of such publication; and

(c) a period of 1 month immediately before the announcement of quarterly results or if shorter, the period from the relevant financial period end up to and including the time of such announcement, where the issuers report on a quarterly basis.

19.5 We note that the concept of the "black out" period under the Rules is in line with the practices of other major markets in common law jurisdiction. Under the US Securities Exchange Act of 1934, if a director purchases the issuers' securities within 6 months of a sale or sells the issuer's securities within 6 months of a purchase, any profits from these "short swing" transactions must be forfeited to the issuer. Given that there are no statute laws in Hong Kong that govern "short-swing" transactions of directors, there are views that the "black out" period under the Rules is an important measure to ensure protection of shareholders' interests.

19.6 There are views that the "black out" period is not very meaningful given that directors cannot deal in securities of issuers if they are in possession of price sensitive information. In order to strike a balance between opposing market views, we are of the view that the existing restriction period under the Rules in relation to directors' dealings in securities of the issuers (i.e. 1 month before publication of their annual or half-year results) should remain unchanged. However, a shorter "black out" period may be justified for the announcement of quarterly results.

Proposal

19.7 We will amend the Rules so that for quarterly reports, the relevant "black out" period for securities transactions by directors in the Rules will be 2 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.

Q133. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *The "black out" period for half-year, annual and quarterly reporting should be removed and disclosure by way of announcement by issuers on the next business day after dealing is sufficient. Please state reason(s) for your view.*

☐ *The "black out" period for half-year and annual results in the Rules should be retained. The "black-out" period for quarterly reporting should also be 1 month immediately preceding the preliminary announcement of the quarterly results. Please state reason(s) for your view.*

☐ *The "black out" period should follow the UK Listing Rules, whereby directors are not allowed to deal in the issuers' securities for:*

(a) a period of 2 months immediately before the preliminary announcement of annual results, or if shorter, the period from the relevant financial year end up to and including the time of the announcement;

(b) a period of 2 months immediately before publication of the half-year report, or if shorter, the period from the relevant financial period end up to and including the time of the publication; and

(c) a period of 1 month immediately before the announcement of quarterly results, or if shorter, the period from the relevant financial period end up to and including the time of such announcement, where the issuers report on a quarterly basis.

Please state reason(s) for your view.

☐ *Other views*

Q134. Do you agree 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 announcement?

☐ *Agree*

☐ *Disagree*

DIRECTORS' CONTRACTS, REMUNERATION AND APPOINTMENTS

Directors' service contracts

Issues and current position

20.1 The Main Board Rules provide that a Main Board issuer may grant a service contract to a director for a term of less than 10 years without shareholders' approval[93]. Given that compensation would have to be paid by issuers for terminating a fixed term service contract prior to its expiration, we consider that this is unreasonably lax.

20.2 The GEM Rules have a more stringent requirement than the Main Board Rules on this issue. Any director or proposed director of a GEM issuer, or any of its subsidiaries, procuring a service contract for 3 years or longer should have the prior approval of shareholders of the issuer at a general meeting. The relevant director should also not vote on the matter[94].

20.3 In addition to regulating the length of a service contract, it is also important to regulate the period of notice required to terminate a service contract. If a service contract requires an extended period of notice to be given, for example, more than 1 year, payment in lieu of notice has to be paid by the issuer. We consider that there is a strong case for setting notice periods at, or reducing them, to 1 year or less.

20.4 Under the Rules, issuers are normally required to disclose the particulars of directors' existing or proposed service contracts with any member of the group in circulars to shareholders. This excludes contracts expiring or terminable by the employer within 1 year without payment of compensation other than statutory compensation, or an appropriate negative statement. However, there is no requirement for shareholders' approval in relation to entering into new service contracts with notice period that exceeds 1 year. If it is necessary to offer longer notice periods to new directors recruited from outside, the notice periods should be reduced after the initial contract period.

[93] see paragraph 33 of Appendices 7a, 7b and 7i to the Main Board Rules
[94] see Rule 17.90 of the GEM Rules

20.5 We are aware that there have been concerns about the amount of remuneration paid to directors and the lack of scrutiny for increases in directors' remuneration. This is relevant in situations where directors receive significant increases in remuneration despite the issuers' disappointing performance and business outlook. There have been suggestions that directors' remuneration proposals or increases in directors' remuneration exceeding a certain percentage level should be subject to shareholders' approval.

20.6 We do not consider that it is appropriate to impose a rigid monetary value or percentage increase over which the approval of shareholders should be obtained. The difficulties lie in setting an objective benchmark for issuers of different sizes and circumstances and directors with different background and experience. We consider that directors' remuneration is essentially a commercial decision of the issuer. The board of directors should have the flexibility to attract, reward and motivate its directors and employees by compensation packages that the board considers appropriate. We consider it is more appropriate to adopt a disclosure-based approach in this regard. The board should decide on these issues provided that a suitable monitoring mechanism and disclosure requirements are in place to protect the interests of shareholders[95].

Proposal

20.7 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 3 years; or

Q135. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *No shareholders' approval should be required, regardless of the length of the service contract.*

[95] see our proposals in relation to remuneration committee and disclosure of directors' remuneration in paragraphs 8.4 to 8.6 and 21.3 of Part C of this Consultation Paper respectively.

☐ *Shareholders' approval should be obtained if the length of the service contract is more than (please tick one of the following):*

☐ *1 year*

☐ *2 years*

☐ *5 years*

☐ *10 years*

☐ *Other. Please specify: _____ .*

(b) a service contract that requires the issuer to give a period of notice of more than 1 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).

Q136. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree (please tick one or more of the following)*

☐ *No shareholders' approval should be required, regardless of the length of period of notice or the amount of compensation.*

☐ *Shareholders' approval should be obtained if the service contract requires issuers to give a period of notice of more than:_____ month(s) (please specify).*

☐ *Shareholders' approval should be obtained if the service contract requires issuers to pay compensation of more than:_____ month(s) (please specify).*

20.8 The remuneration committee of the issuer (if any) or an independent board committee should 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.

Q137. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

Disclosure of directors' remuneration

Issues and current position

21.1 There are views from the market that the Rules, which require disclosure of directors' remuneration in annual reports by bands, provide little meaningful information to shareholders. In order to promote transparency and facilitate accountability of directors to the shareholders, the issuer should disclose more details regarding directors' remuneration. This will also facilitate shareholders in their assessment of an issuer's remuneration policies in the context of the issuer's performance.

21.2 We consider that corporate governance measures should be introduced progressively and we do not intend to extend the proposal set out in paragraph 21.3 below to key employees of issuers at this stage. The requirement of disclosure of the remuneration of the 5 highest paid individuals by bands in annual reports will therefore be retained.

Proposal

21.3 We will amend the Rules to remove the current requirement of disclosure of directors' remuneration by bands and require issuers to disclose the following information relating to directors' remuneration and compensation packages in their annual reports:

(a) directors' remuneration and compensation packages by individual director (including INEDs) showing the name of each director and the amounts of remuneration and compensation;

(b) remuneration policy and long-term incentive schemes;

(c) details of the basis on which fees and other benefits for INEDs are determined; and

(d) information on share options held by directors as required in the Rules.

Q138. Do you agree with our proposal?

- ☐ *Agree. Please specify any information you think should be added to or deleted from the list of disclosure items set out in paragraph 21.3 of Part C of this Consultation Paper. Please also state reason(s) for your view.*
- ☐ *Agree, but the information should be disclosed on a no-name basis.*
- ☐ *Disagree. The Rules which require disclosure of directors' remuneration by bands should be retained. There is no need to disclose such information by individual directors showing the name of each director and the amounts of remuneration and compensation.*

Appointment, reappointment and removal of directors

Issues and current position

22.1 Under the GEM Rules, all non-executive directors of the issuers must be appointed for a specific term. The same provision is set out as a guideline in the Code of Best Practice of the Main Board Rules. The Rules do not set out any other requirements for appointment, reappointment and removal of directors. In addition, the Rules do not require directors of issuers to be subject to rotation at regular intervals. There are comments from the market that the effectiveness and objectivity of directors will decline with length of service. Issuers incorporated in Hong Kong may adopt in their articles of associations the requirements under the Hong Kong Companies Ordinance on retirement and rotation of directors. Issuers incorporated under other jurisdictions may not have the similar statutory rotation provisions.

22.2 We also note comments that INEDs should be appointed or removed by minority shareholders so as to ensure that INEDs are not influenced by controlling shareholders and they have taken into account the interests of minority shareholders when discharging their duties.

22.3 We are of the view that directors should subject themselves to rotation and retiring directors should be eligible for re-election. This will promote effective boards and recognise shareholders' rights to elect directors and monitor the performance of individual directors. The procedures of appointment, reappointment and removal of directors should be the same for all directors including INEDs. Such procedures should remain to be governed by the issuers' articles of association and/or their own constitutions. A harmonised board is an essential element for an effective board. The

major role of INEDs is to provide their objective views on board decisions. We do not consider that it is necessary to require appointment or reappointment of INEDs to be subject to independent shareholders' approval. In addition, we recognise that a reasonably long period on the board can give directors a deeper understanding of the issuer's business and enable them to make a more effective contribution. It may not be in the interest of the issuer not to re-elect such directors.

Proposal

22.4 We will amend the Rules to require directors to be subject to rotation at regular intervals. Retiring directors shall be eligible for re-election.

Q139. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

Q140. Do you agree to require appointment, reappointment and removal of INEDs to be subject to independent shareholders' approval?

☐ *Agree*

☐ *Disagree*

PART D
CORPORATE REPORTING
AND
DISCLOSURE OF INFORMATION

QUARTERLY REPORTING

Quarterly reports

Issues and current position

1.1 The Rules require issuers to report on their financial position on a half-year and annual basis. In addition, the GEM Rules require issuers to publish quarterly reports[96]. At present, the Main Board Rules do not contain such a requirement. We are of the view that an issuer's board of directors should account for its stewardship and report on the issuer's financial performance on a more frequent basis than presently required under the Main Board Rules. This would enhance issuers' standard of corporate governance and provide shareholders with timely information for them to assess issuers' financial performance. This would be of long-term benefit to issuers.

1.2 There are concerns on the potential incremental costs, which would be incurred by issuers as a result of quarterly reporting. There are also concerns on the practicality of providing quarterly reports within a short time-frame following a quarter-end, especially if the level of detailed information expected to be disclosed in a quarterly report is the same as that required under the current Main Board Rules for half-year and annual reporting.

1.3 Given today's technology and provided that an effective internal financial reporting system is in place, an issuer should be able to produce timely financial information. We are of the view that both the establishment of an effective internal financial reporting system and the production of timely financial information for management decision-making are essential for quality management and good corporate governance practices.

1.4 We are of the view nevertheless that, in the interest of timeliness, the level of disclosure for quarterly reporting need not be the same as that required for half-year and annual reporting. A quarterly report should contain the key information which would enable users of the report to make a reasonable assessment of an issuer's financial performance and position. We are of the view that a quarterly report

[96] see Rule 18.66 of the GEM Rules

should contain as a minimum the information set out in Appendix I to this Consultation Paper. This includes the following, among other, information:

(a) a consolidated income statement;

(b) key balance sheet information (including an analysis of total bank borrowings);

(c) a fair review of business developments during the financial period and the financial position at the end of the period;

(d) details of important events which have occurred since the end of the financial period; and

(e) an indication of likely future business developments.

1.5 We are of the view that the disclosure requirements for quarterly reports of Main Board and GEM issuers should be consistent. In light of the proposed disclosure requirements outlined in paragraph 1.4 above and set out in detail in Appendix I to this Consultation Paper, we propose to amend the existing disclosure requirements for quarterly reports under the GEM Rules. The principal changes to the GEM Rules requirements for quarterly reports will be as follows:

(a) inclusion of balance sheet information, as set out in section A(2) of Appendix I to this Consultation Paper, in quarterly reports;

(b) inclusion of a fair review of business developments during the financial period and the financial position at the end of the period;

(c) inclusion of details of important events which have occurred since the end of the financial period;

(d) inclusion of an indication of likely future business developments; and

(e) removal of the requirement to disclose Securities Disclosure of Interests ("SDI") information in quarterly reports.

1.6 There are different views from the market as to whether quarterly reporting should be undertaken on a cumulative year-to-date basis or only on a current quarter basis. Under the GEM Rules, a quarterly report should contain information relating to the current quarter, as well as the financial year-to-date. This would enable users of the reports to have a better understanding of an issuer's financial performance.

1.7 In addition to the information relating to the current quarter and the financial year-to-date, the current GEM Rules require that a quarterly report should contain

comparative information of the corresponding quarter of the previous financial year. There are comments that a quarterly report containing information of the last quarter rather than the corresponding quarter of the previous financial year is more helpful to users of the report for comparative purposes. This would facilitate analysis of fluctuations in issuers' financial performance from one quarter to another. Taking into account the possible seasonal fluctuations of issuers' business, we nevertheless consider that comparative information of the corresponding quarter of the previous financial year provides more meaningful and useful information for shareholders and investors and that it should therefore be retained.

1.8 We are of the view that the existing financial reporting framework of the GEM Rules (i.e. quarterly reporting for the first and third quarters of a financial year, half-year reporting for the first half of a financial year and annual reporting for the financial year) should be retained and applied to the Main Board Rules. We consider that the financial reporting framework for quarterly and half-year reporting should be separate and distinct from each other, as currently adopted under the GEM Rules.

1.9 Main Board issuers are at present encouraged, but not required, under the Code of Best Practice in the Main Board Rules to establish an audit committee. Our proposal set out in paragraph 7.3 of Part C of this Consultation Paper will make establishment of an audit committee mandatory. If this proposal is adopted, we consider that audit committees should review issuers' quarterly reports, half-year and annual reports, as this should form an important part of their responsibilities.

1.10 Disclosure of financial information is useful to shareholders only if it is communicated to them on a timely basis. The GEM Rules presently require issuers to publish their quarterly results and despatch their quarterly reports within 45 days of the relevant quarter-end. We consider that the same reporting deadline should be imposed for the quarterly reporting of Main Board issuers.

Proposal

1.11 We will amend the Main Board Rules to require issuers to publish quarterly reports within 45 days of the quarter-end.

Q141. Do you agree with our proposal to require Main Board issuers to publish their financial results on a quarterly basis?

☐ *Agree*

☐ *Agree, but subject to comments relating to disclosure content and/or timeliness of reporting in questions 142 and 144 to 146 below.*

☐ *Disagree. Please state reason(s) for your view.*

Q142. Do you agree with our proposal to require issuers to publish their quarterly results and despatch their quarterly reports within 45 days after the end of the relevant quarterly period?

☐ *Agree*

☐ *Disagree. The reporting deadline for quarterly reporting should be (please tick one of the following):*

☐ *1 month*

☐ *2 months*

☐ *Other. Please specify: _____.*

Q143. Do you agree that the financial reporting framework should be quarterly reporting for the first and third quarters of a financial year, half-year reporting for the first half of a financial year and annual reporting for the financial year?

☐ *Agree*

☐ *Disagree (please tick one of the following)*

☐ *Quarterly reporting for each of the first, second and third quarters of an issuer's financial year and annual reporting for its financial year.*

☐ *Other views*

1.12 We will amend the Main Board Rules to require issuers to include as a minimum the information set out in Appendix I to this Consultation Paper in their quarterly reports. We will amend the GEM Rules where appropriate so that the same disclosure requirements will apply to GEM issuers.

Q144. Do you agree with our proposal that quarterly reports should contain as a minimum the information set out in Appendix I?

☐ *Agree*

☐ *Disagree. Please specify those items which should be added to or deleted from Appendix I to this Consultation Paper and state reason(s) for your view.*

Q145. Do you agree that quarterly reports should contain the following comparative income statements, or in the case of a group, comparative consolidated income statements:

(a) for the comparable quarter of the immediately preceding financial year; and

(b) for the comparable year to date period of the immediately preceding financial year?

☐ *Agree*

☐ *Agree, except that a comparative consolidated income statement for the immediately preceding quarter should replace item (a) above.*

☐ *Disagree. Please state reason(s) for your view.*

Q146. Do you agree that that the same disclosure requirements should apply to Main Board and GEM issuers?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

1.13 We will amend the Main Board Rules to require audit committees to review their issuers' quarterly reports.

Q147. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

Quarterly results announcements

Issues and current position

2.1 We consider that an issuer's quarterly results announcement should disclose, in principle, the same information as contained in its quarterly report. If our proposal set out in paragraph 1.12 of Part D of this Consultation Paper is adopted, a quarterly results announcement should contain as a minimum the information set out in Appendix I to this Consultation Paper, except for the following:

(a) a consolidated statement of changes in equity;

(b) relevant information required to be disclosed under Practice Note 19 to the Main Board Rules; and

(c) an analysis of an issuer's total bank borrowings.

2.2 We are of the view that the disclosure requirements for the quarterly results announcements of Main Board and GEM issuers should be consistent. In light of the proposed disclosure requirements for quarterly reports as set out in paragraph 1.12 of Part D of this Consultation Paper, the principal additional disclosure requirements for quarterly results announcements of GEM issuers will be as follows:

(a) balance sheet information, as set out in section A(2) of Appendix I to this Consultation Paper;

(b) a fair review of business developments during the financial period and the financial position at the end of the period;

(c) details of important events which have occurred since the end of the financial period; and

(d) an indication of likely future business developments.

2.3 We consider that audit committees should review quarterly results announcements of issuers, as this forms an important part of their responsibilities.

Proposal

2.4 We will amend the Main Board Rules to require issuers to publish their quarterly results announcements on the next business day following their approval by the board of directors and within 45 days of the quarter-end.

Q148. Do you agree with our proposal?

☐ *Agree*

☐ *Agree, but subject to comments relating to disclosure content in question 149 below.*

☐ *Disagree. Please state reason(s) for your view.*

2.5 We will amend the Main Board Rules to require issuers to disclose as a minimum the information set out in the relevant sections of Appendix I to this Consultation Paper in their quarterly results announcements. We will also amend the GEM Rules to mirror the proposed disclosure requirements for the quarterly results announcements of Main Board issuers.

Q149. Do you agree with our proposal that quarterly results announcements should contain as a minimum the information set out in the relevant sections of Appendix I?

☐ *Agree*

☐ *Disagree. Please specify those items which should be added to or deleted from the relevant sections of Appendix I to this Consultation Paper and state reason(s) for your view.*

2.6 We will amend the Main Board Rules to require audit committees to review their issuers' quarterly results announcements.

Q150. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

HALF-YEAR REPORTING

Half-year reports

Issues and current position

3.1 Under the Rules, issuers are presently required to publish full half-year reports containing a set of financial statements comprising a balance sheet, income statement, cash flow statement, statement of movements in equity, accounting policies and explanatory notes[97]. As explained in Part C of this Consultation Paper, we propose to amend the Rules to enhance corporate governance practices of issuers and also to enhance issuers' disclosures in this regard, in particular relating to directors and board practices. We will amend the Rules to require issuers to disclose information in respect of directors' securities transactions in their half-year reports, as set out in paragraph 14.4 of Part C of this Consultation Paper.

[97] see paragraph 37 of Appendix 16 to the Main Board Rules and Rule 18.55 of the GEM Rules

3.2 Following recent amendments to the Hong Kong Companies Ordinance, issuers incorporated in Hong Kong are now permitted to distribute summary financial reports in place of a full annual report to their shareholders. We will amend the Rules shortly to permit all issuers to distribute summary financial reports in place of an annual report, provided that they ascertain the wishes of individual shareholders and comply with the relevant legal requirements of their own jurisdictions and provisions of their memorandum and articles of association. A summary financial report summarises the key information in an annual report. It is more accessible and user-friendly for ordinary investors and more environmentally friendly than an annual report.

3.3 We consider that issuers should similarly be permitted to distribute summary half-year reports in place of a full half-year report, provided that they ascertain the wishes of individual shareholders. We are of the view that the proposed disclosure requirements for summary half-year reports will provide shareholders and investors with the essential information necessary to appraise an issuer's financial performance during the financial period and financial position at the end of a half-year period. Such summary half-year reports should contain the information set out in Appendix II to this Consultation Paper and would include the following, among other, information:

(a) a consolidated income statement;

(b) a consolidated balance sheet;

(c) a fair review of business developments during the financial period and the financial position at the end of the period;

(d) details of important events which have occurred since the end of the financial period and an indication of likely future business developments; and

(e) whether issuers have met the minimum standard in the Code of Best Practice and any substantial change in their own corporate governance practices since the publication of their latest annual report.

3.4 The main differences of minimum disclosure content between a full half-year report and a summary half-year report include the following:

(a) a summary half-year report will not include a consolidated cash flow statement and a consolidated statement of changes in equity which are required to be disclosed in a full half-year report of an issuer;

(b) a summary half-year report will contain a fair review of business developments which will be less detailed than the management discussion and analysis required for a full half-year report. However, such review of business developments should still enable an user to gain an understanding of the underlying trends in an issuer's business; and

(c) a summary half-year report will not have to contain SDI information as required for a full half-year report.

3.5 The recent amendments to the Companies Ordinance permitting issuers to distribute summary financial reports in place of a full annual report envisage that shareholders will still be entitled to receive a copy of the full annual report, if they wish to receive one. Therefore, a summary half-year report should also include a statement as to how a shareholder may obtain a copy of the full half-year report. We are of the view that issuers should follow the same procedures to ascertain the wishes of shareholders as those set out in the Companies (Summary Financial Reports of Listed Companies) Regulation in respect of summary financial reports. These procedures are summarised as follows:

(a) an issuer will send a notice to all shareholders to ascertain their wishes, giving them 30 days to notify the issuer of their wishes; and

(b) an issuer will be considered to have sufficiently ascertained the wishes of a shareholder, if it has sent a notice but does not receive a response within 30 days, in which case a shareholder is considered to have agreed to receive a summary half-year report in place of a full half-year report.

3.6 Main Board issuers are presently required to publish their half-year results and despatch their half-year reports within 3 months of the relevant period end. The reporting deadline for GEM issuers is 45 days after the financial period end. We are of the view that the deadline for publication of half-year results announcements and the despatch of half-year reports should be longer than what we propose for quarterly reporting as set out in paragraphs 1.11 and 2.4 of Part D of this Consultation Paper (i.e. 45 days), but shorter than what we propose for annual reporting as set out in paragraph 5.6 of Part D of this Consultation Paper (i.e. 3 months). We believe that the reporting requirements for Main Board and GEM issuers in this regard should be consistent. We therefore intend to require Main Board and GEM issuers to publish their half-year results and despatch their half-year reports within 2 months of the relevant period end.

Proposal

3.7 We will amend the Rules to permit issuers to distribute summary half-year reports containing, as a minimum, the information set out in Appendix II to this Consultation Paper.

Q151. Do you agree with our proposal to permit issuers to distribute summary half-year reports?

☐ *Agree*

☐ *Agree, but subject to comments relating to disclosure content in question 152.*

☐ *Disagree. Please state reason(s) for your view.*

Q152. Do you agree with our proposal that summary half-year reports should contain, as a minimum, the information set out in Appendix II to this Consultation Paper?

☐ *Agree*

☐ *Disagree. Please specify those items which should be added to or deleted from Appendix II to this Consultation Paper.*

3.8 We will amend the Rules to require issuers to publish their half-year results and despatch their half-year reports within 2 months of the relevant period end.

Q153. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. The reporting deadline for half-year reporting should be (please tick one of the following):*

☐ *1 month*

☐ *45 days*

☐ *3 months*

☐ *The existing requirements for Main Board and GEM issuers to publish their half-year results and despatch their half-year reports within 3 months and 45 days respectively should be retained.*

☐ *Other. Please specify: _____.*

Half-year results announcements

Issues and current position

4.1 Main Board issuers are presently required to disclose in their half-year results announcements (among other information) a consolidated income statement, consolidated balance sheet and detailed management discussion and analysis. There are concerns from the market that it might not be practicable to disclose all the above information required to be disclosed upon publication of a half-year results announcement on the next business day following board approval of the results. Therefore, the Main Board Rules presently permit a two-phased publication arrangement, under which issuers may publish a simplified half-year results announcement. Main Board issuers subsequently submit a full version of the results announcement to us for publication on our website within 21 days of publication of the simplified results announcement, but no later than 3 months following the financial period end. The disclosure requirements for simplified results announcements do not include certain information which is required to be disclosed in full half-year results announcements, such as balance sheet information, particulars of any purchase, sale or redemption by the issuer or its subsidiaries of its listed securities during the financial period and compliance with the Code of Best Practice.

4.2 As discussed in paragraphs 3.1 to 3.8 of Part D of this Consultation Paper, we will amend the Rules to permit issuers to distribute summary half-year reports. In light of our proposal, we have reviewed the existing disclosure requirements and publication arrangements for half-year results announcements of issuers. We are of the view that an issuer's half-year results announcement should contain, in principle, the same information as disclosed in its summary half-year report. Details of these disclosure requirements are set out in the relevant sections of Appendix II to this Consultation Paper and would include the following, among other, information:

(a) a consolidated income statement;

(b) a consolidated balance sheet;

(c) a fair review of business developments during the financial period and the financial position at the end of the period;

(d) details of important events which have occurred since the end of the financial period;

(e) an indication of likely future business developments; and

(f) whether issuers have met the minimum standard in the Code of Best Practice and any substantial change in their own corporate governance practices since the publication of their latest annual report.

4.3 For Main Board issuers, if the proposal relating to disclosure content in paragraph 4.2 above is adopted, the main changes compared with the existing disclosure requirements for simplified half-year results announcements will be as follows:

(a) inclusion of a consolidated balance sheet; and

(b) the detailed management discussion and analysis will be replaced by a fair review of business developments, which although less detailed should still enable a user to gain an understanding of the underlying trends in an issuer's business.

4.4 If the proposal relating to disclosure content in paragraph 4.2 above is adopted, the main change compared with the existing disclosure requirements for full half-year results announcements will be that the detailed management discussion and analysis will be replaced by a fair review of business developments.

4.5 The existing disclosure requirements for the half-year results announcements of GEM issuers differ at present from those of Main Board issuers (for example GEM issuers are not required to disclose a consolidated balance sheet). We are of the view that the disclosure requirements for the half-year results announcements of Main Board and GEM issuers should be consistent.

4.6 For GEM issuers, if the proposal relating to disclosure content in paragraph 4.2 above is adopted, the major changes to the existing disclosure requirements for half-year results announcements will be as follows:

(a) inclusion of a consolidated balance sheet;

(b) the detailed management discussion and analysis will be replaced by a fair review of business developments, which although less detailed should still enable a user to gain an understanding of the underlying trends in an issuer's business; and

(c) an issuer will be required to disclose whether the half-year results announcement has been reviewed by its audit committee.

4.7 The most important effect of the proposal set out in paragraph 4.2 above is the inclusion of a consolidated balance sheet in half-year results announcements. We are of the view that a consolidated balance sheet is essential to enable shareholders and investors to appraise an issuer's financial position. We believe that a consolidated balance sheet must have been readily available upon release of a results announcement as the preparation of management accounts would as a minimum include a balance sheet and an income statement. An income statement and a balance sheet are fundamental financial information and they are usually prepared simultaneously under basic accounting principles. Any professional accountant would reasonably accept that no income statement could be reliable without the preparation of the balance sheet, irrespective of whether the balance sheet is required to be published or not. Many issuers have actually published their consolidated balance sheets in their half-year results announcements on the next business day following board approval of the half-year results.

4.8 If the proposal relating to disclosure content in paragraph 4.2 above is adopted, the existing two-phased publication arrangements for half-year results announcements for Main Board issuers will be abolished.

Proposal

4.9 We will amend the Rules to the effect that issuers will disclose in their half-year results announcements, in principle, the same information as disclosed in a summary half-year report. Details of these disclosure requirements are set out in the relevant sections of Appendix II to this Consultation Paper.

Q154. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify those items you think should be added to or deleted from the list set out in Appendix II to this Consultation Paper.*

☐ *Disagree. The current disclosure requirements should be retained.*

4.10 If the proposal in paragraph 4.9 above is adopted, we will amend the Main Board Rules to abolish the existing two-phased publication arrangement for half-year results announcements.

Q155. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

Q156. If you disagree with our proposals set out in paragraphs 4.9 and 4.10 of Part D of this Consultation Paper and prefer to retain the Main Board Rules' existing disclosure requirements and two-phased publication arrangement in relation to half-year results announcements, how many days should be given to Main Board issuers to submit to us the full half-year results announcement following the publication of the simplified results announcement (please tick one of the following)?

☐ *1 day*

☐ *7 days*

☐ *14 days*

☐ *21 days (existing requirement)*

☐ *Other. Please specify the period you think is appropriate and state reason(s) for your view.*

FULL-YEAR REPORTING

Annual reports

Issues and current position

5.1 The disclosure content of issuers' annual reports is determined primarily by the disclosure requirements of the Rules, the Companies Ordinance and the relevant accounting standards under which issuers' annual accounts are compiled.

5.2 The disclosure requirements of the Rules seek to promote a high standard of financial disclosure in issuers' annual reports and to enhance the ability of shareholders and investors to appraise issuers' financial performance and position.

5.3 As explained in Part C of this Consultation Paper, we propose to amend the Rules to enhance corporate governance practices of issuers and also to enhance issuers' disclosures in this regard, in particular relating to directors and board practices. The additional disclosure requirements, are summarised in Appendix III to this Consultation Paper for ease of reference.

5.4 In addition to the disclosure requirements set out in paragraph 5.3 above, we will also provide for issuers' reference certain disclosures relating to corporate governance matters in their annual reports. These reference disclosures are not intended to be exhaustive or mandatory. They are rather intended to provide general guidance on matters, which we consider issuers should refer to in their annual

reports. The level of detail, with which such commentary is provided, will vary depending on the nature and complexity of issuers' business activities. The reference disclosures are set out in Appendix IV to this Consultation Paper and cover the following areas:

(a) remuneration of senior management;

(b) investor relations; and

(c) additional commentary on management discussion and analysis.

5.5 Main Board issuers are presently required to publish their annual results announcements and despatch their annual reports within 4 months of their financial year end. The reporting deadline for GEM issuers is 3 months after their financial year end. We are of the view that the market wishes to have more timely release of annual results and despatch of annual reports by Main Board issuers to meet the increasing expectations of shareholders and investors. As discussed in paragraphs 1.1 to 1.13 and 2.1 to 2.6 of Part D of this Consultation Paper, we propose to require Main Board issuers to publish their quarterly results and despatch their quarterly reports within 45 days following the end of the relevant quarter. If the proposals are adopted, we are of the view that quarterly reporting would facilitate more timely reporting of annual results, as an issuer's quarterly results up to the end of the third quarter of its financial year will already have been publicly disclosed. Moreover, it does not appear to be logical that an issuer's annual results might only be released shortly before the release of results relating to the first quarter of the following financial year. We are of the view that the requirements for Main Board and GEM issuers in this regard should be consistent. We thus intend to amend the requirement of the Main Board Rules to the effect that Main Board issuers will be required to publish their annual results announcements and despatch their annual reports within 3 months following their financial year end.

Proposal

5.6 We will amend the Main Board Rules to follow the GEM Rules and require issuers to publish and despatch their annual reports within 3 months of their financial year end.

Q157. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

5.7 We will amend the Rules to include the reference disclosures relating to corporate governance matters for issuers' annual reports set out in Appendix IV to this Consultation Paper.

Q158. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

Summary financial reports

Issues and current position

6.1 As discussed in paragraph 3.2 of Part D of this Consultation Paper, we will shortly amend the Rules to allow all issuers to distribute summary financial reports in place of a full annual report to their shareholders, provided that they ascertain the wishes of individual shareholders and comply with the relevant legal requirements of their own jurisdictions and provisions of their memorandum and articles of association.

Proposal

6.2 Further to the amendment described in paragraph 6.1 above, we will also 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.

Q159. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

Annual results announcements

Issues and current position

7.1 There is at present a two-phased publication arrangement for annual results announcements of Main Board issuers, which is similar to that for half-year results

announcements (see paragraph 4.1 of Part D of this Consultation Paper). The disclosure requirements for simplified results announcements do not include certain information which is required to be disclosed in full annual results announcements, including a consolidated balance sheet, a consolidated cash flow statement, a statement of movements in equity and notes to the accounts, auditors' report and particulars of dealing of an issuer or its subsidiaries in its securities during the financial year.

7.2 Similarly, GEM issuers are permitted to publish a simplified annual results announcement on the GEM website on the next business day following board approval of the results. Those GEM issuers, which choose to do so, are subsequently required to provide a copy of their annual report to the Exchange for publication on the GEM website.

7.3 As discussed in paragraph 6.1 of Part D of this Consultation Paper, we will amend the Rules shortly to permit all issuers to distribute summary financial reports in place of a full annual report, provided that they ascertain the wishes of individual shareholders. In light of our proposal, we have reviewed the existing disclosure requirements and publication arrangements for issuers' annual results announcements. We are of the view that an issuer's annual results announcement should contain, in principle, the same financial information as disclosed in its summary financial report. Detailed disclosure requirements are set out in the relevant section of Appendix V to this Consultation Paper and would include the following, among other information:

(a) a consolidated income statement;

(b) a consolidated balance sheet;

(c) a fair review of business developments during the financial year and the financial position at the end of the year;

(d) details of important events which have occurred since the end of the financial year;

(e) an indication of likely future business developments;

(f) any deviation from the minimum standard in the Code of Best Practice;

(g) particulars of any purchase, sale or redemption by the issuer or any of its subsidiaries, of its listed securities during the year, or an appropriate negative statement; and

(h) details of any qualifications and/or modifications in the auditors' report on the issuer's audited accounts.

7.4 For Main Board and GEM issuers, if the proposal relating to disclosure content in paragraph 7.3 above is adopted, the main changes compared with the existing disclosure requirements for simplified annual results announcement will be as follows:

(a) inclusion of a consolidated balance sheet;

(b) the detailed management discussion and analysis will be replaced by a fair review of business developments, which although less detailed should still enable a user to gain an understanding of the underlying trends in an issuer's business; and

(c) inclusion of a statement on whether the annual results announcement has been reviewed by their audit committees.

7.5 If the proposal relating to disclosure content in paragraph 7.3 above is adopted, the main changes compared with the existing disclosure requirements for full annual results announcements relate to the following items:

(a) exclusion of a consolidated cash flow statement, statement of movements in equity and notes to the accounts;

(b) exclusion of the auditors' report on the issuer's accounts; and

(c) the detailed management discussion and analysis will be replaced by a fair review of business developments, which although less detailed should still enable a user to gain an understanding of the underlying trends in an issuer's business.

7.6 As discussed in paragraph 4.7 of Part D of this Consultation Paper, we are of the view that an issuer's audited consolidated balance sheet must have been readily available upon the announcement of its audited annual results. As a consolidated balance sheet is essential to enable shareholders and investors to appraise an issuer's financial position, a few listed issuers actually voluntarily disclose additional information, among others, including their audited consolidated balance sheets in their simplified annual results announcement.

7.7 Following enactment of the Companies (Amendment) Ordinance 2001, Section 129C(4) of the Companies Ordinance exempts issuers from the requirement of Section 129C(3) for a balance sheet to be included in an issuer's summary financial report. As the financial information to be disclosed in an annual results announcement will mirror that contained in an issuer's summary financial report, we are of the view that issuers should likewise be permitted to publish an audited consolidated balance sheet in their annual results announcement in the same manner as it would be published in its summary financial report.

7.8 If the proposal in paragraph 7.3 above is adopted, the existing two-phased publication arrangements for annual results announcements for Main Board and GEM issuers will be abolished.

Proposal

7.9 We will amend the Rules to the effect that issuers will 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 this Consultation Paper.

Q160. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please specify those items you think should be added to or deleted from the list set out in Appendix V to this Consultation Paper.*

☐ *Disagree. The current disclosure requirements should be retained.*

7.10 If the proposal in paragraph 7.9 above is adopted, we will amend the Rules to abolish the existing two-phased publication arrangement for annual results announcements.

Q161. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree. Please state reason(s) for your view.*

Q162. If you disagree with the proposals set out in paragraphs 7.9 and 7.10 of Part D of this Consultation Paper and prefer to retain the existing disclosure requirements and two-phased publication arrangement of the Main Board Rules and GEM Rules in relation to annual results announcements, how many days should be given to issuers to submit to us the full annual results announcements (for Main Board issuers) and the annual reports (for GEM issuers) following the publication of the simplified results announcement (please tick one of the following)?

☐ *1 day*

☐ *7 days*

☐ *14 days*

☐ *21 days*

☐ *Other. Please specify the period you think is appropriate and state reason(s) for your view.*

CONTENTS OF CIRCULARS AND ANNOUNCEMENTS RELATING TO NOTIFIABLE TRANSACTIONS

Very substantial acquisitions

Issues and current position

8.1 The GEM Rules require issuers to include an accountants' report on the enlarged group in their circulars to shareholders in relation to very substantial acquisitions or reverse takeovers[98].

8.2 There is no such requirement under the Main Board Rules. In the case of a very substantial acquisition, an issuer is required to include in its circular to shareholders an accountants' report on the business, company or companies being acquired[99]. Despite being provided with such information relating to the assets being acquired, shareholders of the issuer may not be able to see the overall financial impact on the issuer after the acquisition or the financial position of the group upon completion of the transaction.

Proposal

8.3 We will amend the Main Board Rules to follow the approach in the GEM Rules to require an accountants' report on the enlarged group to be included in such circulars.

Q163. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

General information in all announcements and circulars of notifiable transactions

Issues and current position

9.1 The Rules require certain information to be disclosed in announcements and circulars of notifiable transactions. However, there are views that the existing requirements under the Rules are not always sufficient to enable investors to make an informed investment decision.

[98] see Rule 19.56(4) of the GEM Rules
[99] see Rule 14.16(4) of the Main Board Rules

Proposal

9.2 We will amend the Rules to require issuers to disclose the following information in all announcements and circulars of notifiable transactions:

(a) book value of the assets being acquired or realised;

(b) the identity of the counter-party except for a counter-party who is an independent third party and wishes to remain anonymous. We agree that the identity of the third party and its activities are not relevant to the particular transaction;

(c) details of any guarantee and/other security given and required as part of the transaction;

(d) reasons for entering into the transaction[100];

(e) the business valuation report of a business or company and/or traffic study report in respect of an infrastructure project or project company to be incorporated in the circulars should include:

(i) crucial assumptions for the business valuation including discount rate/ growth rate used;

(ii) sensitivity analysis based on different discount rates and growth rates; and

(iii) if the business valuations are based on profit forecasts, the accounting policies and calculations for the forecasts must be examined and reported on by the auditors or consultant accountants. Any financial adviser mentioned in the circular must also report on the forecasts. Please also refer to paragraphs 21.1 to 21.2 of Part B of this Consultation Paper for our proposal for asset valuation;

(f) the original acquisition cost of the assets which will be sold to connected persons where the issuer has held such assets for a period of 12 months or less; and

(g) if the transaction involves a disposal of an interest in a subsidiary by an issuer, a declaration as to whether the subsidiary will continue to be a subsidiary of the issuer following the transaction.

[100] this requirement is already contained in Rule 19.52(4) of the GEM Rules

Q164. Do you agree with our proposal?

☐ *Agree. Please specify any information you think should be added to or deleted from the list of disclosure items set out in paragraph 9.2 of Part D of this Consultation Paper. Please also state reason(s) for your view.*

☐ *Disagree*

Q165. Do you agree that the identity of the counter-party being an independent third party and its activities should be disclosed in the announcement and circular of the transaction?

☐ *Agree. Such information is relevant to the transaction and should be disclosed in the respective announcement and circular.*

☐ *Disagree. Such information is not relevant to the transaction and the issuer should not be required to disclose it in the respective announcement and circular.*

OTHERS

Changes in directorship

Issues and current position

10.1 The GEM Rules require issuers to publish an announcement of any changes in directorship.[101] The Main Board Rules only require issuers to issue a press release, rather than a formal announcement, in relation to any changes in directorship. It is noted that Main Board issuers quite often do not publish announcements relating to the resignation and appointment of directors prominently.

10.2 There are no disclosure requirements set out in the Rules relating to the announcements of appointment of directors. Those announcements often give minimal information on the background and details of the directors.

Proposal

10.3 We will amend the Main Board Rules to require issuers to publish an announcement of any changes in directorships.

[101] see Rule 17.51 of the GEM Rules

Q166. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

10.4 We will amend the Rules to require issuers to disclose biographical details of the newly appointed directors in the announcement of their appointment, including:

(a) the full name and age;

(b) positions held with the issuers and other members of the issuers' group;

(c) previous experience and qualifications held;

(d) length or proposed length of service with the issuers;

(e) relationships with any directors, senior management or substantial or controlling shareholders;

(f) their interests in shares of the issuers within the meaning of the Securities (Disclose of Interests) Ordinance; and

(g) other information of which shareholders should reasonably be made aware.

We will amend the Rules to require issuers to also disclose biographical details of the newly appointed directors in the notice of meeting, if such appointments are subject to shareholders' approval at the issuers' annual general meeting.

Q167. Do you agree with our proposal?

☐ *Agree. Please specify any other information you think should be disclosed in the announcement and state reason(s) for your view.*

☐ *Disagree*

Despatch of notice of general meeting and circular

Issues and current position

11.1 Where shareholders are required to approve a notifiable transaction or a connected transaction, an issuer must give notice to its shareholders of the general meeting to be held. Depending on the articles of association of the issuer and the type of the meeting, 14 to 21 days' notice for the meeting is normally required.

11.2 The Rules require that a circular for a notifiable transaction or a connected transaction to be sent to shareholders within 21 days after the announcement of the transaction.

11.3 The GEM Rules further require such circular to be despatched to the shareholders of the issuer at the same time as or before the issuer gives notice of the general meeting to be held[102]. The Main Board Rules do not contain the same requirement. At present it is possible that shareholders of Main Board issuers may receive the circular only a few days before the holding of the general meeting. Shareholders may not have sufficient time to assess the information on the transactions as disclosed in the circular.

11.4 Timely publication of the notice of general meetings may improve corporate communication between issuers and their shareholders.

Proposal

11.5 We will amend the Main Board Rules to follow the GEM Rules so that issuers shall despatch the relevant circulars to shareholders at the same time as or before they give notice of the general meeting to approve the notifiable transaction or the connected transaction concerned.

Q168. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

11.6 We will amend the Rules to require issuers to publish notice of general meetings by way of an announcement.

Q169. Do you agree with our proposal?

☐ *Agree*

☐ *Disagree*

[102] see Rule 19.38 of the GEM Rules

SUMMARY OF DISCLOSURE REQUIREMENTS FOR QUARTERLY REPORTS AND QUARTERLY RESULTS ANNOUNCEMENTS

Quarterly reports

Each quarterly report shall contain at least the following information in respect of the issuer:

A. Financial information

(1) Income statement for the current 3-month period and cumulatively for the current financial year to date, with comparative figures for the comparable periods of the immediately preceding financial year, containing as a minimum the following components:

(a) turnover;

(b) profit (or loss) before taxation, including the share of profit (or loss) of affiliated companies with separate disclosure of any items included therein which are exceptional because of size and incidence;

(c) taxation on profits (Hong Kong and overseas) in each case indicating basis of computation with separate disclosure of the taxation on share of affiliated companies' profits;

(d) profit (or loss) attributable to minority interests;

(e) profit (or loss) attributable to shareholders;

(f) rates of dividend paid or proposed on each class of shares (with particulars of each such class) and amounts absorbed thereby (or an appropriate negative statement);

(g) earnings per share;

(h) investment and other income;

(i) cost of goods sold;

(j) interest on borrowings;

(k) depreciation/amortisation; and

(l) profit (or loss) on sale of investments or properties.

(2) Balance sheet as at the end of the current 3-month period, with comparative figures for the balance sheet as at the end of the immediately preceding financial year, containing as a minimum the following components:

(a) fixed assets;

(b) intangibles;

(c) current assets;

(d) current liabilities;

(e) non-current liabilities;

(f) minority interests; and

(g) capital and reserves.

Additional information in respect of the group's total bank borrowings as at the end of the relevant period shall be separately disclosed. Any such information must be analysed into the aggregate amounts repayable:

(i) on demand or within a period of not exceeding 1 year; and

(ii) within a period of more than 1 year.

(3) statement of changes in equity, with comparative figures for the comparable year-to-date period of the immediately preceding financial year; and

(4) in preparation of the quarterly report, the Exchange expects issuers to comply with the principles for recognition and measurement as prescribed in SSAP 25 or IAS 34 where appropriate. A statement of that fact should be made.

B. Particulars of any purchase, sale or redemption by the issuer or any of its subsidiaries, of its listed securities during the relevant period, or an appropriate negative statement.

C. A business review covering the following:

(a) a fair review of business developments during the financial period and the financial position at the end of the period;

(b) details of important events which have occurred since the end of the financial period; and

(c) an indication of likely future business developments.

D. Any supplementary information which in the opinion of the directors of the issuer is necessary for a reasonable appreciation of the results for the relevant period.

E. Each quarterly report must state whether or not the information provided therein has been audited (and if so, it must set out a copy of the auditors' report thereon). In the event that any auditors' report thereon (if any) has been qualified or modified, details of such qualification or modification must be set out in the quarterly report.

F. If applicable, the information required to be disclosed under Practice Note 19 of the Main Board Rules or Rule 17.22 to Rule 17.24 of the GEM Rules relating to on-going financial exposure to borrowers and other on-going matters of relevance.

G. An issuer's audit committee must review the quarterly report. In the event that the audit committee disagreed with an accounting treatment which had been adopted, full details of such disagreement must be disclosed in the quarterly report.

Note: It is the responsibility of the audit committee of the issuer to determine the scope and extent of the review. In reviewing a quarterly report, the audit committee may refer to relevant statements of auditing standards and auditing guidelines in relation to review of interim financial reports for guidance.

Quarterly results announcements

Each quarterly results announcement shall contain at least the information set out under items A(1), A(2), B, C, D and E in respect of the listed group. Within item A(2), however, issuers shall not be required to disclose additional information in respect of the issuer's total bank borrowings.

SUMMARY OF DISCLOSURE REQUIREMENTS FOR SUMMARY HALF-YEAR REPORTS AND HALF-YEAR RESULTS ANNOUNCEMENTS

Summary half-year reports

Each summary half-year report shall contain at least the following information in respect of the issuer:

A. Financial information

Income statement for the current half-year period, with comparative figures for the comparable period of the immediately preceding financial year, and balance sheet as at the end of the half-year period, with comparative figures for the balance sheet as at the end of the immediately preceding financial year. The income statement and balance sheet should be as they appear in an issuer's full half-year report and should conform with the relevant disclosure requirements of Appendix 16 of the Main Board Rules and Chapter 18 of the GEM Rules.

B. Particulars of any purchase, sale or redemption by the issuer or any of its subsidiaries, of its listed securities during the relevant period, or an appropriate negative statement.

C. A business review covering the following:

(a) a fair review of business developments during the financial period and the financial position at the end of the period;

(b) details of important events which have occurred since the end of the financial period; and

(c) an indication of likely future business developments.

D. A statemment as to whether issuers have met the minimum standard in the Code of Best Practice and whether there has been any substantial change in their own corporate governance practices since the publication of their latest annual report

E. Names of the director(s) who have signed the full half-year report on behalf of the board of directors of the issuer.

F. A statement to the effect that the summary half-year report only gives a summary of the information and particulars contained in the issuer's full half-year report.

G. A statement as to how an entitled person of the issuer may obtain free of charge a copy of the issuer's full half-year report from which the report is derived.

H. A statement as to the manner in which an entitled person may in future notify the issuer of his wishes in relation to the sending to the person of a copy of a summary half-year report in place of a copy of the full half-year report from which it is derived.

I. Where the accounting information contained in a summary half-year report has been audited by the issuer's auditor, the summary half-year report of an issuer shall contain:–

(a) where the auditors' report in the listed issuer's half-year financial statements is qualified or modified (whether or not it is qualified), details of the qualification or modification; and

(b) an opinion from the issuer's auditors as to whether the summary half-year report is consistent with the full half-year report from which it is derived.

Half-year results announcements

Each half-year results announcement shall contain at least the information set out under items A, B, C, D and I(a) in respect of the listed group and in addition a statement as to whether the half-year results announcement has been reviewed by the issuer's audit committee.

SUMMARY OF NEW DISCLOSURE REQUIREMENTS RELATING TO BOARD PRACTICES FOR ANNUAL REPORTS

This section summarises the new disclosure requirements relating to corporate governance matters for issuers' annual reports, which are explained in detail in Part C of this Consultation Paper.

(i) Corporate governance practices

An issuer's annual report shall contain a report on corporate governance practices including the following information:

(a) the corporate governance practices, particularly in relation to directors, board practices and shareholders' rights, adopted by the issuer;

(b) whether the issuer meets the minimum standard in the Code of Best Practice and its own code; and

(c) in the event of any deviation from the minimum standard in Code of Best Practice, details of such deviation during the financial year.

(ii) Audit committee

An issuer shall disclose the following information in relation to its audit committee:

(a) its role and function;

(b) its composition;

(c) the number of audit committee meetings held during the year and record of attendance of members during the year;

(d) a report on the work performed by the audit committee during the year, including its findings on review of the quarterly/half-year/annual results, adequacy and effectiveness of issuer's internal control systems, etc; and

(e) significant issues addressed by the audit committee during the year.

(iii) Remuneration committee

An issuer shall disclose the following information in relation to its remuneration committee:

(a) the role, function and composition of the remuneration committee (if any) or the reason for not having a remuneration committee;

(b) the number of meetings held by the remuneration committee or the board of directors (if there is no remuneration committee) during the year to discuss remuneration related matters and attendance record of members at meetings held during the year;

(c) a summary of the work, including determining the policy for the remuneration of executive directors and approving the terms of executive directors' service contracts, performed by the remuneration committee or board of directors (if there is no remuneration committee) during the year; and

(d) significant remuneration related issues addressed by the remuneration committee or the board of directors (if there is no remuneration committee) during the year.

(iv) Nomination committee

An issuer shall disclose the following information in relation to its nomination committee:

(a) the role, function and composition of the nomination committee (if any) or the reason for not having a nomination committee;

(b) the nomination procedures adopted by and a summary of the work, including determining the policy for the nomination of directors, performed by the nomination committee or the board of directors (if there is no nomination committee) during the year; and

(c) significant issues in relation to the nomination of directors addressed by the nomination committee or the board of directors (if there is no nomination committee) during the year.

(v) Segregation of roles of chairman and chief executive

An issuer shall disclose in its annual report whether or not the roles of chairman and chief executive are segregated.

(vi) Internal controls

An issuer which has conducted a review of its system of internal controls shall include a report on such review in its annual report. The report shall include the following information:

(a) a statement that the directors are responsible for the system of internal controls;

(b) details of any significant areas of concern which may affect shareholders;

(c) an explanation of how the system of internal controls has been defined for the issuer;

(d) procedures and internal controls for dissemination of price sensitive information;

(e) whether the issuer has an internal audit function;

(f) the period which the review covers;

(g) how often internal controls are reviewed;

(h) significant views or proposals put forward by the audit committee; and

(i) a statement that the directors have reviewed the effectiveness of the system of internal controls.

(vii) Directors' securities transactions

An issuer's annual report shall contain the following information in respect of directors' securities transactions:

(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.

(viii) Directors' remuneration

We will amend the Rules to remove the current requirement of disclosure of directors' remuneration by bands and to require issuers to disclose the following information relating to directors' remuneration and compensation packages in their annual reports:

(a) directors' remuneration and compensation packages by individual director (including INEDs) showing the name of each director and the amounts of remuneration and compensation;

(b) remuneration policy and long-term incentive schemes;

(c) details of the basis on which fees and other benefits for INEDs are determined; and

(d) information on share options held by directors as required in the Rules.

(ix) Auditors' remuneration

The disclosure of auditors' remuneration in the annual report shall be analysed into those in respect of audit service and those in respect of non-audit service.

SUMMARY OF REFERENCE DISCLOSURES RELATING TO CORPORATE GOVERNANCE MATTERS IN ANNUAL REPORTS

The following disclosures relating to corporate governance matters are provided for issuers' reference. They are not intended to be exhaustive or mandatory: they are rather intended to set out the areas which we consider issuers may comment on in their annual reports. The level of detail, with which such commentary is provided, will vary depending on the nature and complexity of issuers' business activities.

(i) Remuneration of senior management

The annual report may include the following information:

(a) the number of shares held by senior management (i.e. those individuals whose biographical details are disclosed in the annual report); and

(b) the aggregate of salaries, the aggregate of bonuses, share options of senior management together with their remuneration policy.

Note: where the above information of senior management is disclosed, the disclosure of the remuneration of the 5 highest paid individuals by band in the annual report shall exclude senior managers whose remuneration is disclosed under remuneration of senior management.

(ii) Investor relations

The annual report may include the following information:

(a) any significant changes in the issuer's articles of association during the year;

(b) the way in which shareholders convene an extraordinary general meeting;

(c) the procedures by which enquiries may be put to the board;

(d) the procedures for putting forward proposals at shareholders' meetings;

(e) details of top 10 shareholders;

(f) review of shareholders by type;

(g) the number and identity of shareholders holding more than a 5% shareholding;

(h) details of last shareholders' meeting;

(i) calendar of important shareholders' dates; and

(j) public float capitalisation as at the end of the year.

(iii) Additional commentary on management discussion and analysis

The annual report may include the following information:

(a) efficiency indicators (e.g. return on equity, working capital ratios) indicating the bases of computation;

(b) industry specific ratios indicating the bases of computation;

(c) a discussion of the issuer's corporate strategy;

(d) an overview of trends in the issuer's industry;

(e) a discussion on business risks and risks management policy;

(f) a discussion on the issuer's environmental policies and performance, including compliance with the relevant laws and regulations; and

(g) a discussion on the issuer's policies and performance on social, ethical and reputational issues.

SUMMARY OF DISCLOSURE REQUIREMENTS FOR ANNUAL RESULTS ANNOUNCEMENTS

Each annual results announcement shall contain at least the following information in respect of the issuer:

A. Financial information

Income statement for the financial year, with comparative figures for the immediately preceding financial year, and balance sheet as at the end of the year, with comparative figures for the balance sheet as at the end of the immediately preceding financial year. The income statement and balance sheet should contain all the information and particulars as they appear in an issuer's annual report.

B. Particulars of any purchase, sale or redemption by the issuer or any of its subsidiaries, of its listed securities during the relevant year, or an appropriate negative statement.

C. A business review covering the following:

(a) a fair review of business developments during the financial year and the financial position at the end of the year;

(b) details of important events which have occurred since the end of the financial year; and

(c) an indication of likely future business developments.

D. Any supplementary information which in the opinion of the directors of the issuer is necessary for a reasonable appreciation of the results for the relevant year.

E. Where the auditors' report on the issuer's annual financial statements is qualified or modified (whether or not it is qualified), details of the qualification or modification.

F. A statement of compliance with and details of any deviation from the minimum standard in the Code of Best Practice.

G. A statement as to whether the annual results announcement has been reviewed by the issuer's audit committee.