Rule Amendments Relating to Corporate Governance Issues

1. This paper sets out the salient Rule amendments that have been re-considered after publication of the Consultation Conclusion Report in January 2003 and the transitional arrangements in relation to corporate governance Rule amendments.

Part A: Major Areas re-considered

Definition of "transactions" for the purpose of notifiable transactions

2. The Main Board Rules do not clearly define the term "transaction" for the purpose of notifiable transactions. To make the Main Board Rule more user-friendly, we have incorporated the definition of "transaction" under the GEM Rules into the Main Board Rules. The definition of "transaction" under the current GEM Rules includes an acquisition or disposal of assets, formation of a joint venture and the entering into or terminating of finance or operating leases, etc. It is largely based on the Main Board's current practice when applying and interpreting notifiable transaction requirements, except for two types of transactions, namely granting of financial assistance and issue of new securities by listed issuers. Although these two fall within the definition of "transaction" under the GEM Rules, they are not subject to the notifiable transaction requirements under the Main Board's existing practice.

3. We have aligned the definition of "transaction" under the Main Board Rules and GEM Rules. For the purpose of notifiable transactions, the definition of "transaction":

   (a) includes the granting of financial assistance by listed issuers except:
      (i) where the listed issuer, being a banking company, provides financial assistance in its ordinary and usual course of business; or
      (ii) where the listed issuer provides financial assistance to its subsidiaries. However, if the subsidiary falls within the definition of "connected person", the granting of financial assistance to that subsidiary will be subject to the connected transaction provisions;
   (b) excludes the issue of new securities of listed issuers for cash consideration where the shareholders' approval requirements for general mandates and specific mandates to issue securities already provide adequate safeguard for the protection of minority interests in respect of the issue of new securities to an independent third party. The GEM Rules have been amended in this regard; and
   (c) excludes any transactions of a revenue nature that are carried out in the ordinary and usual course of business of listed issuers except where a listed issuer enters into or terminates operating lease(s) which, by virtue of the dollar value or number of leases involved, represents a 200% or more increase in the scale of its existing operations conducted through such lease arrangements. The term "ordinary and usual course of business"

means the existing principal activities of the listed issuer or an activity wholly necessary for the principal activities of the listed issuer. We have included further guidance in the Rules to assist listed issuers in determining whether a transaction is of a revenue nature.

Classification of notifiable transactions

4. Under the existing Rules, listed issuers are required to assess the impact of a notifiable transaction using the assets test, profits test, consideration test and equity capital test. Based on the results of these size tests, the transaction is classified into one of the following categories: share transaction, discloseable transaction, major transaction, very substantial acquisition and (in the case of GEM) reverse takeover. In the Consultation Conclusion Report, we proposed to retain the net assets test as the norm. We proposed that listed issuers be allowed to elect to use total assets as the basis of the assets test and consideration test provided that they had valid reasons and had made proper disclosure of their election by way of announcement and in the annual report. We also proposed to adopt the turnover test as an alternative test to the profits test where the latter test produced an anomalous result due to exceptional circumstances.

5. We have re-considered the requirements for classification of notifiable transactions. We consider that, for the purpose of assessing the impact of a transaction on the listed issuer, the Rules should provide for a set of simple tests that are clear and easy for listed issuers to understand and use. The tests should make use of reliable information and should provide a meaningful measure of the relative level of activity and value of the target asset against that of the listed issuer. Unfortunately, there is no set of simple measurements that does not also have drawbacks. The size tests for classifying transactions should give sufficient confidence in assessing the impact of a transaction on a listed issuer when widely applied by listed issuers. There should be a range of alternative measures so as to overcome deficiencies in any one particular test.

6. We have adopted the following size tests to measure the impact of a transaction on a listed issuer:
   - total assets test;
   - profits test;
   - revenue test;
   - consideration test; and
   - equity capital test.

7. In the Consultation Conclusion Report, we proposed to allow listed issuers to elect net tangible assets or total assets as the basis of the assets test and consideration test. The solution proposed in the Consultation Conclusion Report represented a compromise to address the concerns of low-geared companies. We consider that this may result in a degree of confusion in the market. We have therefore introduced the total assets test as a stand-alone test to replace the net

assets test. "Total assets" of a company means the current assets plus fixed assets (including intangible assets) and non-current assets. This amendment is in line with the existing requirement under the UK Listing Rules, on which the Rules are principally based.

8. We have adopted the consideration test, which is to be calculated by comparing the consideration for the transaction with the aggregate market value of all the ordinary shares of the listed issuer based on the weighted average share price over a period of five trading days before the date of the agreement in respect of the transaction. We consider that the revised consideration test, reflecting as it does the market value of the listed issuer, or investors' perception of such value, at the time of the transaction, is preferable to the current consideration test which compares consideration to net assets.

9. In the Consultation Conclusion Report, we proposed to adopt the turnover test as an alternative test to the profits test where the latter test produced an anomalous result due to exceptional circumstances. We consider that the profits test and the turnover test serve different purposes when assessing the impact of a transaction on a listed issuer. The profits test measures the relative profitability of the target against that of the listed issuer, while the turnover test measures the relative level of activity of the target against that of the listed issuer. For this reason, we have introduced the turnover test, which will be renamed the "revenue test", as a stand-alone test to measure the relative level of activity of the target against that of the listed issuer. "Revenue" means revenue arising from the principal activities of a company and does not include those items of revenue and gains that arise incidentally.

10. In the Consultation Conclusion Report, we proposed to adjust the percentage thresholds for classifying notifiable transactions of listed issuers which had elected to use total assets as the basis of the assets test and consideration test. We have now modified our approach. We have reduced the thresholds for classifying transactions while at the same time adopting the new size tests mentioned above. This will enhance the transparency of listed issuers and provide better protection for shareholders by giving them the right to vote on material transactions. The revised thresholds are in line with international standards. The following table summarises the existing and revised thresholds for classifying share transactions, discloseable transactions, major transactions, very substantial acquisitions and very substantial disposals.

	Existing thresholds (based on the old size tests mentioned in paragraph 4)	Revised thresholds (based on the new size tests mentioned in paragraph 6)
Share transaction	Less than 15%	Less than 5%
Discloseable transaction	15% or more, but less than 50%	5% or more, but less than 25%
Major transaction	50% or more	25% or more, but less than 100% for acquisitions and less 75% for disposals
Very substantial acquisition	100% for Main Board For GEM: • 200% or more; or • 100% or more and the acquired business is different from the current principal activities of the listed issuer; or • 100% or more and there is an intention to make a major change in the principal activities of the listed issuer.	100% or more
Very substantial disposal	Not applicable – the existing Rules do not provide for this category	75% or more

Classification of connected transactions

11. Under the existing Rules, a connected transaction is exempt from any disclosure, reporting or shareholders' approval requirements if the value of the transaction falls below certain de minimis thresholds which are computed using the assets test and consideration test only. We consider that, in addition to the assets test and consideration test, the revenue test and equity capital test should be used for this purpose. This will take into account the impact of a transaction on the level of activity of the issuer. In practice, the profits test is the test most likely to produce anomalous results, particularly where the target or the listed issuer has recorded losses in their latest accounts. Therefore, we do not consider it appropriate to adopt the profits test for classifying connected transactions and have amended the Rules so that connected transactions will be subject to the same size tests (except for the profits test) as those used to classify notifiable transactions.

12. We have also adjusted the percentage thresholds for classifying connected transactions. For practical reasons, we have retained the existing de minimis thresholds of HK$1 million and HK$10 million for exempting connected transactions from the disclosure, reporting and/or shareholders' approval requirements. The following table summarises the existing and revised de

minimis thresholds for exempting connected transactions from the disclosure, reporting and/or shareholders' approval requirements.

	Existing (based on the old size tests mentioned in paragraph 4)	Revised (based on the new size tests mentioned in paragraph 6)
De minimis threshold for exemption from disclosure, reporting and shareholders' approval requirements	The consideration or value of the transaction is less than the higher of: • HK$1 million; and • 0.03% of the net tangible assets of the listed issuer.	Each of the size tests (except for the profits test) is less than 0.1%; or Each of the size tests (except for the profits test) is equal to or more than 0.1% but less than 2.5% and the consideration is less than HK$1 million.
De minimis threshold for exemption from shareholders' approval requirement	The consideration or value of the transaction is less than the higher of: • HK$10 million; and • 3% of the net tangible assets of the listed issuer.	Each of the size tests (except for the profits test) is less than 2.5%; or Each of the size tests (except for the profits test) is equal to or more than 2.5% but less than 25% and the consideration is less than HK$10 million.

Definition of "reverse takeover"

13. The GEM Rules contain the reverse takeover provisions to deal with a backdoor listing which is likely to have a significant impact on the shareholding and/or operations of a listed issuer, to prevent listed issuers from circumventing the new listing requirements and to ensure that the quality of information being disclosed to investors is of prospectus standard. In the Consultation Conclusion Report, we proposed to expand the definition of "reverse takeover" under the GEM Rules to include any acquisition of assets by a listed issuer that would lead to a fundamental change in its principal business activities. We also proposed to introduce the reverse takeover provisions under the current GEM Rules into the Main Board Rules.

14. We have re-considered the definition of "reverse takeover", particularly the following issues:
- whether we should codify the principles set out in the joint announcement published by the Exchange and the Securities and Futures Commission in 1993 (the "Joint Announcement") in relation to backdoor listings;
- whether a size test should be adopted for classifying reverse takeovers; and
- whether the definition of "reverse takeover" should include any transaction that would result in a fundamental change in the principal business activities of the listed issuer.

15. The Joint Announcement provided that a transaction should be regarded as a backdoor listing if, as a result of an acquisition of assets by a listed issuer, a purchaser acquired (a) control of or (b) a major stake in a listed issuer whereby the purchaser gained effective management control of the listed issuer, and then simultaneously or shortly thereafter injected assets into the listed vehicle. In the light of practical difficulties in determining whether there is a change in the effective management control of a listed issuer, we consider that the reverse takeover provisions should only apply to acquisitions that involve a change of a shareholder holding an interest of 30% (or any other threshold as may from time to time be specified in the Takeovers Code) or more in the listed issuer.

16. In the case of a change in control, the listed issuer is subject to the Takeovers Code requirements. We consider that the listed issuer should be required to comply with the new listing requirements under the Rules only if the assets acquired from the incoming controlling shareholder are of a significant value and have a material impact on the listed issuer. We have therefore amended the Rules so that an agreement or arrangement that involves an acquisition or series of acquisitions of assets that will result in a change in control will be treated as a reverse takeover only if the results of any of the size tests have reached the very substantial acquisition threshold.

17. We have also amended the Rules so that the reverse takeover provisions will also apply to an injection of assets by the incoming controlling shareholder after the change in control. This is a codification of the Exchange's existing practice to prevent circumvention of the Rules where the acquisition of assets does not take place at the same time as the change in control and/or the listed issuer acquires assets from the incoming controlling shareholder in a piecemeal manner after the change in control. As we have introduced the very substantial acquisition threshold for classifying reverse takeovers, we have extended our current practice of aggregating acquisitions of assets from the incoming controlling shareholder after the change in control from a period of 12 months to 24 months. The extension of the period for aggregation will act as a further deterrent against the incoming controlling shareholders circumventing the reverse takeover provisions.

18. In the Consultation Conclusion Report, we proposed to extend the definition of "reverse takeover" to cover any transaction that would result in a fundamental change in the listed issuer's principal business activities. There are views that it is difficult to distinguish a transaction that will result in a fundamental change of business from other transactions that represent organic growth within the listed issuer's business and to determine whether the newly acquired business differs from, or integrates with, the existing businesses of the listed issuer. Given the practical difficulties that may arise, we have not, for the time being, extended the definition of "reverse takeover" to cover transactions that will result in a fundamental change in the listed issuer's principal business activities.

19. In summary, the definition of "reverse takeover" includes:

(a) an agreement or arrangement that involves an acquisition or a series of acquisitions of assets which constitutes a very substantial acquisition where there is or which will result in a change in control (as defined under the Takeovers Code) of the listed issuer; or

(b) an agreement or arrangement that involves an acquisition or a series of acquisitions of assets from the incoming controlling shareholder(s) within a period of 24 months after the change in control (as defined under the Takeovers Code) that had not been regarded as a reverse takeover, which individually or together reach the threshold of a very substantial acquisition. The lower of (1) the latest published figures of the total asset value, profits and revenue and the market value of the listed issuer at the time of the change in control and (2) the latest published figures of the total asset value, profits and revenue and the market value of the listed issuer at the time of the acquisition will be used as a denominator for calculating the size tests.

20. The incoming controlling shareholder may simultaneously inject assets into the listed issuer, which may, according to the relevant arrangements, be totally independent of the change in control. We consider that, in such a case, the asset injection and the change in control of the listed issuer should not be viewed separately and the outgoing controlling shareholder should not be allowed to vote on any resolution to acquire assets from the incoming controlling shareholder. Therefore, we have amended the Rules so that, where there is a change in control and the existing controlling shareholder has disposed or will dispose of any of its shares to the incoming shareholder or an independent third party, the existing controlling shareholder will not be allowed to vote on any acquisition of assets from the incoming controlling shareholder at the time of the change in control. This will not apply if the existing controlling shareholder does not dispose of any shares and its shareholding in the listed issuer is simply diluted by virtue of the issue of new shares to the incoming shareholder.

21. There may be situations where a listed issuer has acquired assets from the incoming controlling shareholder at the time of a change in control and shortly thereafter disposes, or is granted a put option to dispose, of the existing business of the listed issuer. In such cases, it is necessary to ensure that the remaining or newly acquired business can meet the profit track record requirement under the Rules. Therefore, we have amended the Rules so that a listed issuer will be allowed to dispose of its existing business within a period of 24 months after the change in control if the assets newly acquired from the incoming controlling shareholder and other assets acquired by the listed issuer after the change in control, taken together, can meet the profit track record requirement.

Disclosure of financial information in circular on notifiable transactions

22. In the Consultation Conclusion Report, we proposed to amend the Rules to require listed issuers to prepare an accountants' report on the enlarged group for

very substantial acquisitions. Since the listed issuer and the target company (i.e. the subject of a very substantial acquisition or reverse takeover) are normally not under common control, financial information on the enlarged group cannot be prepared using the method of merger accounting. Even if the financial information on the listed issuer and the target company is prepared on a combined basis, the reporting accountants will not be able to give a true and fair view on such combined financial information. Given this issue, we have re-considered the accountants' report requirement for very substantial acquisitions and reverse takeovers.

23. For a very substantial acquisition or reverse takeover that involves an acquisition of a company or business, a listed issuer will be required to prepare an accountants' report on the target company or business for the latest three financial years. The listed issuer will be required to include in the circular to shareholders a comparative table of audited financial statements extracted from the annual reports of the listed issuer for the latest three financial years. Where the target asset of a very substantial acquisition or reverse takeover is a revenue-generating asset (other than a company or business) with an identifiable net income stream or valuation, the listed issuer must include in the circular information for the latest three financial years on the net revenue for the asset and valuation (if available).

24. The circular or listing document for a major acquisition, very substantial acquisition or reverse takeover must include financial information on a listed issuer and the target company. The current Rules do not require listed issuers to prepare financial information on a listed issuer and the target company using the same accounting policies. To enable shareholders to assess the financial information on a comparable basis, we have amended the Rules to require the financial information on the target company contained in that circulars on major acquisitions, very substantial acquisitions or reverse takeovers be prepared using accounting policies which are materially consistent with those of the listed issuer.

25. The Rules also contain accountants' report requirements for a very substantial disposal. For a very substantial disposal that involves the disposal of a company or business, a listed issuer will be required to prepare an accountants' report on the existing group for the latest three financial years with the business or company being disposed of shown separately as a discontinuing operation. Where the subject of a very substantial disposal is a revenue-generating asset with an identifiable net income stream or valuation, the listed issuer must include in the circular information for the latest three financial years on the net revenue and valuation (if available) of the asset. The listed issuer must also include a management discussion and analysis on the remaining group's performance in the circular for a very substantial disposal.

26. We have also amended the Rules to require listed issuers to disclose in the circulars of very substantial acquisitions, reverse takeovers and very substantial disposals pro-forma financial information on the listed group after the transaction.

The pro-forma financial information is to provide investors information on the impact of the transaction by illustrating how that transaction may have affected the financial information of the listed issuer presented in the circular, had the transaction been undertaken at the commencement of the period being reported on or, in the case of a pro-forma balance sheet or net asset statement, at the date reported. The pro-forma financial information presented must not be misleading, must assist investors in analysing the future prospects of the issuer and must include all appropriate adjustments.

27. For a very substantial acquisition or reverse takeover that involves an acquisition of a company or business, a listed issuer will be required to include in the circular pro-forma financial information on the enlarged group for the latest financial year. Where the subject of a very substantial acquisition or reverse takeover is a revenue-generating asset with an identifiable net income stream or valuation, a listed issuer must include in the circular a pro-forma profit and loss statement and net assets statement on the enlarged group for the latest financial year. For a very substantial disposal that involves a disposal of a company or business, a listed issuer will be required to include in the circular pro-forma financial information on the remaining group for the latest financial year. Where the subject of a very substantial disposal is a revenue-generating asset with an identifiable net income stream or valuation, a listed issuer must include in the circular a pro-forma profit and loss statement and a net assets statement on the remaining group for the latest financial year.

Definition of "associate"

28. The definition of "associate" under the Rules includes "family interests" of any directors, chief executive or substantial shareholder (being an individual). "Family interests" is defined as his spouse and any of his or her spouse's children or step-children under 18. The definition of "associate" also includes the trustees, acting in their capacity as such trustees, of any trust of which any director, chief executive or substantial shareholder (being an individual) or any of his family interests is a beneficiary or, in the case of a discretionary trust, is a discretionary object. In the Consultation Conclusion Report, we proposed to retain the definition of "associate" under the Rules. The current Rules do not treat as a connected person any company controlled by the trustees of any trust of which any director, chief executive or substantial shareholder or any of his family interests is a beneficiary. This is a potential loophole in the Rules as a director, chief executive or substantial shareholder may circumvent the Rules by establishing a company under the control of the trustee. To remove this loophole, we have extended the definition of "associate" to include:

(a) any company in the equity capital of which the trustees, acting in their capacity as such trustees, are directly or indirectly interested so as to exercise or control the exercise of 30% or more of the voting power at general meetings, or to control the composition of a majority of the board

of directors (the "trustee-controlled company") and any other company which is its subsidiary;

(b) a holding company of a trustee-controlled company or a subsidiary of any such holding company;

(c) any company in the equity capital of which:

(i) a director, chief executive or substantial shareholder;

(ii) any of his family interests;

(iii) the trustees, acting in their capacity as such trustees, of any trust of which the director, chief executive or substantial shareholder or any of his family interests is a beneficiary or discretionary object and any trustee-controlled company and any of its subsidiaries,

taken together or individually, is/are directly or indirectly interested so as to exercise or control the exercise of 30% or more of the voting power at general meetings, or to control the board composition; and

(d) any other company which is a subsidiary or holding company of the company referred to in paragraph 28(c) or a fellow subsidiary of any such holding company.

29. The beneficiaries of a trust can also be corporate bodies. Therefore, we have extended the definition of "associate" to include the following parties:

(a) the trustees, acting in their capacity as such trustees, of any trust of which the substantial shareholder of the listed issuer, being a corporate body, is a beneficiary or discretionary object and any company in the equity capital of which the trustees, acting in their capacity as such trustees, are directly or indirectly interested so as to exercise or control the exercise of 30% or more of the voting power at general meetings, or to control the composition of a majority of the board of directors (the "trustee-controlled company") and any other company which is its subsidiary;

(b) a holding company of a trustee-controlled company referred to in paragraph 29(a) or a subsidiary of any such holding company;

(c) any company in the equity capital of which:

(i) the substantial shareholder, being a corporate body, of the listed issuer;

(ii) any other company which is the substantial shareholder's subsidiary or holding company or is a fellow subsidiary of any such holding company or one in the equity capital of which it and/or such other company or companies taken together are directly or indirectly interested so as to exercise or control the exercise of 30% or more of the voting power at general meetings, or to control the composition of a majority of the board of directors; and

(iii) the trustees, acting in their capacity as such trustees, of any trust of which the substantial shareholder, being a corporate body, is a beneficiary or discretionary object and any trustee-controlled company and any of its subsidiaries,

taken together or individually, is/are directly or indirectly interested so as to exercise or control the exercise of 30% or more of the voting power at general meetings, or to control the composition of a majority of the board of directors; and

(d) any other company which is a subsidiary or holding company of the company referred to in paragraph 29(c) or a fellow subsidiary of any such holding company.

"Relatives" of a connected person as deemed associates

30. For the purpose of the connected transaction provisions, "connected person" includes associates of directors, chief executive and substantial shareholders of listed issuers. Under the connected transaction provisions, "associate" of a connected person includes "relatives" of the connected person. The Main Board Rules and GEM Rules contain different provisions for determining whether the "relatives" of a connected person should be treated as "associates" of the connected person. The Main Board Rules restrict the definition of "relatives" to certain persons, including children or step-children, parents or step-parents, brothers, sister, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law and sister-in-law. Any relative of a connected person will be treated as an "associate" of the connected person if his association with the connected person is such that, in the opinion of the Exchange, the proposed transaction should be subject to the connected transaction provisions. The GEM Rules do not contain the same restriction in the definition of "relative" as the Main Board Rules. Under the GEM Rules, any such person will be treated as an "associate" of the connected person, irrespective of whether he has a close association with the connected person.

31. We have aligned the Main Board and GEM provisions for determining which "relatives" of a connected person should be treated as his "associates". We have amended the Rules so that an "associate" of a connected person will include:

(a) his spouse (and any person cohabiting with the connected person as a spouse), parents, children (including step-children) and siblings (including step-brother and step-sister);

(b) his mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, sister-in-law, grandparents, grandchildren, uncle, aunt, cousin, nephew and niece ("close relatives"), whose association with the connected person is such that, in the opinion of the Exchange, the proposed transaction should be subject to the connected transaction provisions. Listed issuers must notify the Exchange of any proposed transactions (unless otherwise exempt from the connected transaction provisions) involving a close relative. Listed issuers must also provide information on the relationship and association of such close relative with the connected person for the Exchange to assess whether or not the transaction should be subject to the connected transaction provisions.

Financial assistance as a connected transaction

32. Under the current Rules, the provision of financial assistance by a listed issuer to a connected person or a company in which both the listed issuer and connected person are shareholders will be treated as a connected transaction. Subject to the de minimis exceptions, these financial assistance transactions are subject to disclosure, reporting and (if applicable) shareholders' approval requirements. In the Consultation Conclusion Report, we proposed that a non wholly-owned subsidiary should not be treated as a connected person, if no connected person(s) of the listed issuer (at the listed issuer's level), individually or together, held an interest of 10% or more in the non wholly-owned subsidiary. In the light of this proposed change, we have modified the connected transaction provisions in relation to the provision of financial assistance. Also, the Main Board Rules will, like the GEM Rules, include a new section on financial assistance in the Chapter on connected transactions.

33. Under the revised Rules, the provision of financial assistance by a listed issuer to a company (which is not a connected person) will be regarded as a connected transaction only if the listed issuer and its connected person(s) (at the listed issuer's level) are shareholders of the company and the connected person(s), individually or together, is/are entitled to exercise, or control the exercise of, 10% or more of the voting power in the company. Where the financial assistance provided by the listed issuer to any such company is in proportion to the listed issuer's equity interest in the company and any guarantee given by the listed issuer is on a several (and not joint and several) basis, the financial assistance will be fully exempt from the disclosure, reporting and shareholders' approval requirements for connected transactions. Where the financial assistance provided by the listed issuer to any such company is not in proportion to the listed issuer's equity interest in the company or any guarantee given by the listed issuer is not on a several basis, the financial assistance will be subject to the disclosure, reporting and (if applicable) shareholders' approval requirements unless otherwise exempt under the de minimis exception rules.

34. Under the current Rules, the granting of financial assistance by a connected person to a listed issuer is regarded as a connected transaction. We will apply the connected transaction provisions to the granting of financial assistance to a listed issuer by a company in which the listed issuer and its connected persons (at the listed issuer's level) are shareholders and the connected person(s), individually or together, is/are entitled to exercise, or control the exercise of, 10% or more of the voting power in the company. However, the granting of financial assistance to the listed issuer by any such company or a connected person will be exempt from the disclosure, announcement and shareholders' approval requirements, if the financial assistance is provided to the listed issuer on normal commercial terms and no security is provided by the listed issuer over its assets in respect of the financial assistance.

Refreshment of general mandate and limit on general mandate

35. Under the current Rules, listed issuers are allowed to issue securities representing up to 20% of their issued share capital under a general mandate approved by shareholders. There is no restriction on the number of refreshments of the general mandate. Any refreshment must be subject to shareholders' approval and no shareholders are required to abstain from voting. In the Consultation Conclusion Report, we proposed to amend the Main Board Rules to require independent shareholders' approval for any refreshments of the general mandate after the annual general meeting. We proposed to amend the GEM Rules to require independent shareholders' approval only for the second and subsequent refreshments of the general mandate after the annual general meeting.

36. We have re-considered the shareholders' approval requirement for refreshments of a general mandate. We are of the view that shareholders of Main Board issuers and GEM issuers should be given the same level of protection against material dilution of their shareholding in a listed issuer. Therefore, we have modified the proposal in the Consultation Conclusion Report to allow Main Board issuers and GEM issuers to refresh their general mandate subject to shareholders' approval once a year. Any subsequent refreshments of the general mandate will be subject to independent shareholders' approval. An exemption from this new requirement will be available to listed issuers wishing to top up the unused portion of their previous general mandate based on the enlarged share capital after a pre-emptive issue of equity securities to existing shareholders. Listed issuers merely have to obtain shareholders' approval for the purpose of such a top-up. Only refreshments of the general mandate going beyond the unused portion of the general mandate will be subject to independent shareholders' approval.

37. Under the current Rules, listed issuers are allowed to issue securities representing up to 20% of their share capital under the general mandate. We have retained the existing provision for the time being. However, subject to further market consultation, we will consider lowering the maximum number of securities that are allowed to be issued under the general mandate to bring our requirements closer to those of the United Kingdom.

Disclosure of directors' remuneration

38. The Main Board Rules require listed issuers to disclose directors' remuneration in their annual reports by bands. The GEM Rules require disclosure of directors' remuneration on an individual but "no name" basis. In the Consultation Conclusion Report, we proposed to bring the Main Board Rules into line with the GEM Rules so as to require disclosure of individual directors' remuneration on a "no name" basis. We also proposed to include a provision in the Code as a recommended best practice that listed issuers should disclose directors' remuneration on a "named" basis.

39. In the light of the recent developments, particularly the consultation proposal put forward by the Standing Committee for Company Law Reform to require disclosure of individual directors' remuneration on a "named" basis, we have re-considered our proposal in the Consultation Conclusion Report. To enhance the transparency of listed issuers and to bring our disclosure requirements into line with international standards, we have amended the Rules to require listed issuers to disclose individual directors' remuneration on a "named" basis.

Disclosure of information on proposed directors before election at the general meeting

40. Under the current Rules, the articles of association of a listed issuer must provide that the latest date for a shareholder to lodge his notice to propose a person for election as a director must not be more than seven days before the meeting appointed for such election. We consider it necessary to ensure that listed issuers have sufficient time for preparing and sending relevant information on the proposed director to shareholders. Equally, shareholders must be given sufficient time to consider the relevant information and cast their votes on the proposed director at the meeting. We have therefore amended the Rules so that the articles of association of a listed issuer must allow a period of at least seven days for shareholders to lodge such a notice and so that the period ends no later than seven days before the date of the meeting. The Rules do not prevent issuers from accepting a notice earlier. Listed issuers will be required to publish an announcement or revised or supplementary circular containing information on the proposed director immediately after receipt of the shareholder's notice to nominate the director. Listed issuers must assess the materiality of the information to determine whether it is necessary to issue a revised or supplementary circular or publish an announcement and, if need be, adjourn the general meeting in order to give shareholders at least 14 days before the general meeting to consider the information published in the announcement or revised or supplementary circular.

Part B: Transitional arrangements

41. To ensure effective implementation of the Rule amendments, we will give listed issuers a transitional period of six months from 31 March 2004 to comply with certain of the new requirements, namely the requirement that:

(a) existing independent non-executive directors ("INEDs") submit to the Exchange a confirmation of their independence with reference to the new guidelines on independence of INEDs. *No transitional period will be allowed for those INEDs appointed by listed issuers on or after 31 March 2004.* If an INED does not meet the new independence guidelines, the listed issuer will have to appoint a new INED to replace him;

(b) listed issuers appoint an INED with appropriate professional qualifications or accounting or related financial management expertise;

(c) listed issuers appoint at least three INEDs;

(d) listed issuers establish an audit committee comprising non-executive directors only, that each audit committee have at least three members with a majority of INEDs and that at least one of the members of the audit committee have appropriate professional qualifications or accounting or related financial management expertise; and

(e) listed issuers immediately inform the Exchange and publish an announcement if they fail to appoint at least three INEDs or appoint an INED with appropriate professional qualifications or accounting or related financial management expertise or fulfil the new requirements for the establishment of an audit committee.

42. The new disclosure requirements for annual and half-year results announcements, annual reports, summary financial reports, half-year reports and summary half-year reports will be effective for the accounting period commencing on or after 1 July 2004. Abolition of the two-phased publication arrangements for half-year results announcements of Main Board issuers and annual results announcements of Main Board issuers and GEM issuers will be effective for the accounting period commencing on or after 1 July 2004. However, early adoption of the new disclosure requirements by listed issuers is encouraged. Where listed issuers publish results announcement containing all the relevant new disclosure requirements on or after 31 March 2004, they will not be required to comply with the two-phased publication arrangement as currently required under the existing Rules.

43. (a) We have amended Appendix 3 to the Rules so that an issuer's articles of association must conform with the following:
   (i) (as mentioned in paragraph 40 above) the minimum seven-day period for lodgment by shareholders of the notice to nominate a director shall commence no earlier than the day after the despatch of the notice of the meeting appointed for such election and end no later than seven days before the date of such meeting;
   (ii) directors shall abstain from voting at the board meeting on any matter in which any of his associates has a material interest and are not to be counted towards the quorum of the relevant board meeting; and
   (iii) where any shareholder is, under these Rules, required to abstain from voting on any particular resolution or restricted to voting only for or only against any particular resolution, any votes cast by or on behalf of such shareholder in contravention of such requirement or restriction shall not be counted.

(b) Listed issuers must amend their articles of association to ensure compliance with the amended provisions of Appendix 3 at the earliest opportunity and, in any event, no later than the conclusion of their next annual general meeting. Where a listed issuer has despatched the notice of annual general meeting before 31 March 2004 and the general meeting will be convened on or after that date, it must amend its articles of association at the earliest opportunity after the implementation of the new Rules.

44. The following summarises specific arrangements for the application of certain of new Rules:

(a) We have amended the Rules to require voting by poll for connected transactions, transactions that are subject to independent shareholders' approval and transactions where an interested shareholder will be required to abstain from voting. This new requirement will apply to any transactions entered into by listed issuers before 31 March 2004 where the relevant general meeting is held on or after that date.

(b) We have amended the Rules to require approval of shareholders (other than shareholders who are directors with a material interest in the service contracts and their associates) for:
(i) a service contract that is to be granted to a director of the listed issuer or any of its subsidiaries for a duration that may exceed three years; or
(ii) a service contract that expressly requires the listed issuer to give a period of notice of more than one year or to pay compensation of more than a year's remuneration in order to terminate the service contract.

This new requirement will only apply to new service contracts or variations of any of the terms as to duration or payment on termination or any other material terms or renewal of an existing service contract. Accordingly, directors' service contracts which have been entered into by a listed issuer or any of its subsidiaries on or before 31 January 2004 will be exempt from the new requirement. However, the listed issuer must include particulars of any exempt service contracts in its annual reports covering the term of any such service contracts.

(c) We have amended the Rules to replace the net assets test with the total assets test and introduced the revenue test as a stand-alone test, while the consideration test will be calculated by comparing the consideration for the transaction with the aggregate market value of all the ordinary shares of the listed issuer. We have also amended the Rules so that connected transactions will be subject to the same size tests (except for the profits test) as those used to classify notifiable transactions. See paragraphs 7 to 9

and 11. We have adjusted the percentage ratios for classifying notifiable transactions and connected transactions. See paragraphs 10 and 12. The revised size tests and percentage ratios will apply to notifiable transactions and connected transactions that are entered into and announced by listed issuers on or after 31 March 2004. However, for continuing connected transactions, listed issuers are to apply the new Rules as follows:

(i) Where a waiver has been granted to a listed issuer for a fixed period, the waiver will continue to apply until the earlier of:
   (A) expiry of the waiver; and
   (B) the listed issuer failing to comply with any of the waiver condition(s) or the agreement being renewed or there being a material change to the terms of the agreement.

(ii) Where a waiver has been granted to a listed issuer for an indefinite period, the listed issuer will have to take appropriate steps to ensure compliance with the new Rules as soon as practicable after implementation of the new Rules.

(d) We have amended the Rules so that the general disclosure obligation in respect of advances to an entity and financial assistance and guarantees to affiliated companies of a listed issuer under new rules 13.13 to 13.16 (which were originally contained in Practice Note 19) of the Main Board Rules and rules 17.15 to 17.18 of the GEM Rules will be based on the revised percentage ratios. Listed issuers will have to take appropriate steps to ensure compliance with the new Rules as soon as practicable after their implementation.

(e) We have amended 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 to an independent third party in a placing and top-up subscription arrangement. This new provision will apply to top-up placing arrangements that are entered into and announced by listed issuers on or after 31 March 2004.

(f) We have amended the Rules so that the lock-up period for disposal of interests by controlling shareholders of Main Board issuers and significant shareholders and initial management shareholders of GEM issuers will commence on the date by reference to which the shareholding of the relevant shareholder is disclosed in the listing document, rather than the issue date of the listing document. This new requirement will apply to all initial listing applications in process on or after 31 March 2004, including those new listing applicants whose applications have been approved but not listed.