



HKEx  
香港交易所

## Connected transactions

*Listing Division, HKEx*

## Agenda

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- I. General
- II. Who are connected persons
- III. What are connected transactions
- IV. Connected transaction requirements
- V. Exemptions for connected transactions

## I. General

## Purpose of CT Rules

- Ensure issuers take into account interests of shareholders as a whole when entering into connected transactions
  
- Safeguard against connected persons taking advantage of their positions
  - Shareholders are informed
  - Independent directors and independent financial adviser opine on significant transactions
  - Independent shareholders can vote on significant transactions

## Rules and guidelines

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- June 2010      Amendments to connected transaction Rules
- April 2012     Plain Language Guide on Connected Transaction Rules

[http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/Documents/ctguide\\_e.pdf](http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/Documents/ctguide_e.pdf)

## Rule amendments in June 2010

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- Major changes included
  1. Increased threshold for requiring shareholders' approval from 2.5% to 5%
  2. Increased threshold for requiring announcements from 0.1% to 1% for transactions with persons connected at the subsidiary level only
  3. Introduced an insignificant subsidiary exemption

## Reduction of reportable connected transactions after Rule amendments

	<u>2011</u>	<u>2009</u>	<u>% change</u>
<b>No. of connected transactions announced</b>			
- Subject to announcement and shareholder approval (1)	622 (33%)	838 (41%)	-26%
- <b>Subject to announcement only (2)</b>	1,255 (67%)	1,195 (59%)	+5%
<b>Total</b>	1,877 (100%)	2,033 (100%)	-8%
 <b>No. of issuers involved</b>	 584	 602	 -3%
 <b>No. of issuers at the beginning of the year</b>	 1,413	 1,261	 +12%

## Reduction of reportable connected transactions after Rule amendments

	<b>2011</b>		<b>2009</b>	
	<u>Number</u>	<u>%</u>	<u>Number</u>	<u>%</u>
Persons connected at issuer level	1,574	83.8%	1,423	70.0%
Persons connected only at subsidiary level	248	13.2%	507	24.9%
Other	55	3.0%	103	5.1%
	<u>1,877</u>	<u>100%</u>	<u>2,033</u>	<u>100%</u>

## Profile of connected transactions

### Transactions with persons connected at the issuer level and subsidiary level

	2011		2009	
	<u>Number</u>	<u>%</u>	<u>Number</u>	<u>%</u>
Director	189	10.4%	183	9.5%
Substantial shareholder				
- At the issuer level	1,403	77.0%	1,214	62.9%
- At the subsidiary level	220	12.1%	470	24.4%
Other	10	0.5%	63	3.2%
	<u>1,822</u>	<u>100%</u>	<u>1,930</u>	<u>100%</u>

## Profile of connected transactions

### Revenue transactions

<u>Transaction nature</u>	<u>2011</u>		<u>2009</u>	
	<u>Number</u>	<u>%</u>	<u>Number</u>	<u>%</u>
Sales and Purchases	340	18.1%	363	17.9%
Leases	278	14.8%	226	11.1%
Others (e.g. provision/ receipt of management, advisory or other services)	600	32.0%	623	30.6%
	<u>1,218</u>	<u>64.9%</u>	<u>1,212</u>	<u>59.6%</u>
<u>Transaction size</u>				
Subject to announcement only	868	46.2%	825	40.6%
Subject to announcement and shareholder approval	350	18.7%	387	19.0%
	<u>1,218</u>	<u>64.9%</u>	<u>1,212</u>	<u>59.6%</u>

## Profile of connected transactions

### Capital transactions

<u>Transaction nature</u>	2011		2009	
	<u>Number</u>	<u>%</u>	<u>Number</u>	<u>%</u>
Acquisitions and disposals	418	14.7%	544	18.4%
Financial assistance	131	7.0%	104	5.1%
Issue of securities	41	2.2%	78	3.8%
Others (e.g. JV formation, grant of options)	69	3.6%	95	4.7%
	<u>659</u>	<u>35.1%</u>	<u>821</u>	<u>40.4%</u>
 <u>Transaction size</u>				
Not a notifiable transaction	461	24.6%	347	17.1%
Share transaction	1	0.1%	-	-
Discloseable transaction	110	5.8%	173	8.5%
Major transaction	56	3.0%	247	12.1%
VSA/ VSD	31	1.6%	54	2.7%
	<u>659</u>	<u>35.1%</u>	<u>821</u>	<u>40.4%</u>

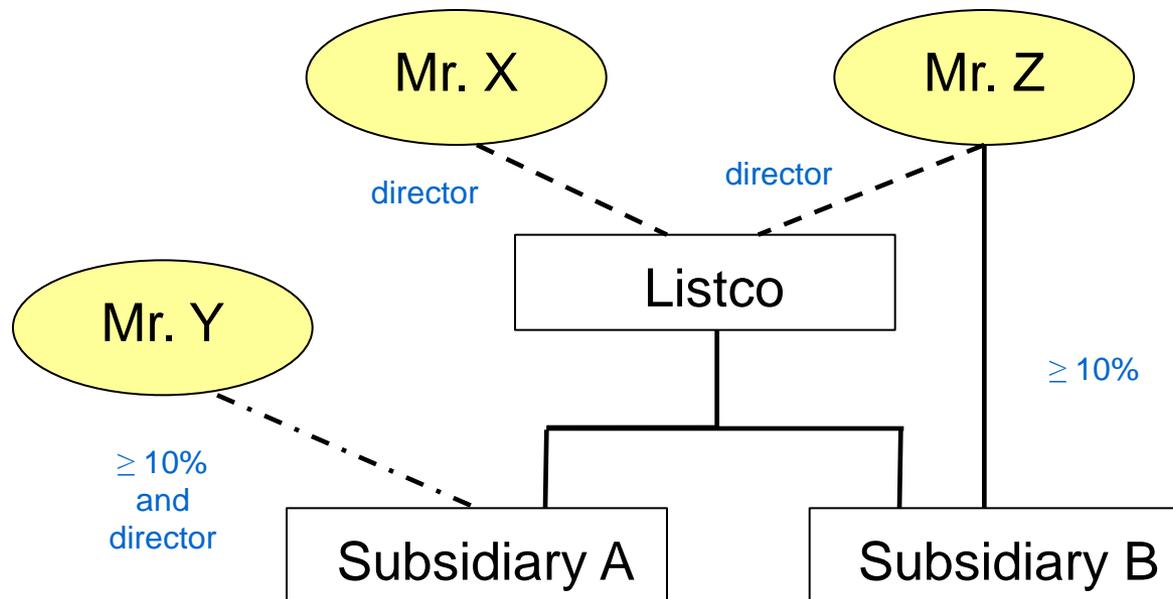
## Plain language guide on connected transaction Rules

- Benefits of the Guide
- Sections
  - I. Who are connected persons
  - II. What are connected transactions
  - III. Requirements for connected transactions
  - IV. Content requirements – announcements; circulars; annual reports
  - V.&VI. Exemptions & Waivers

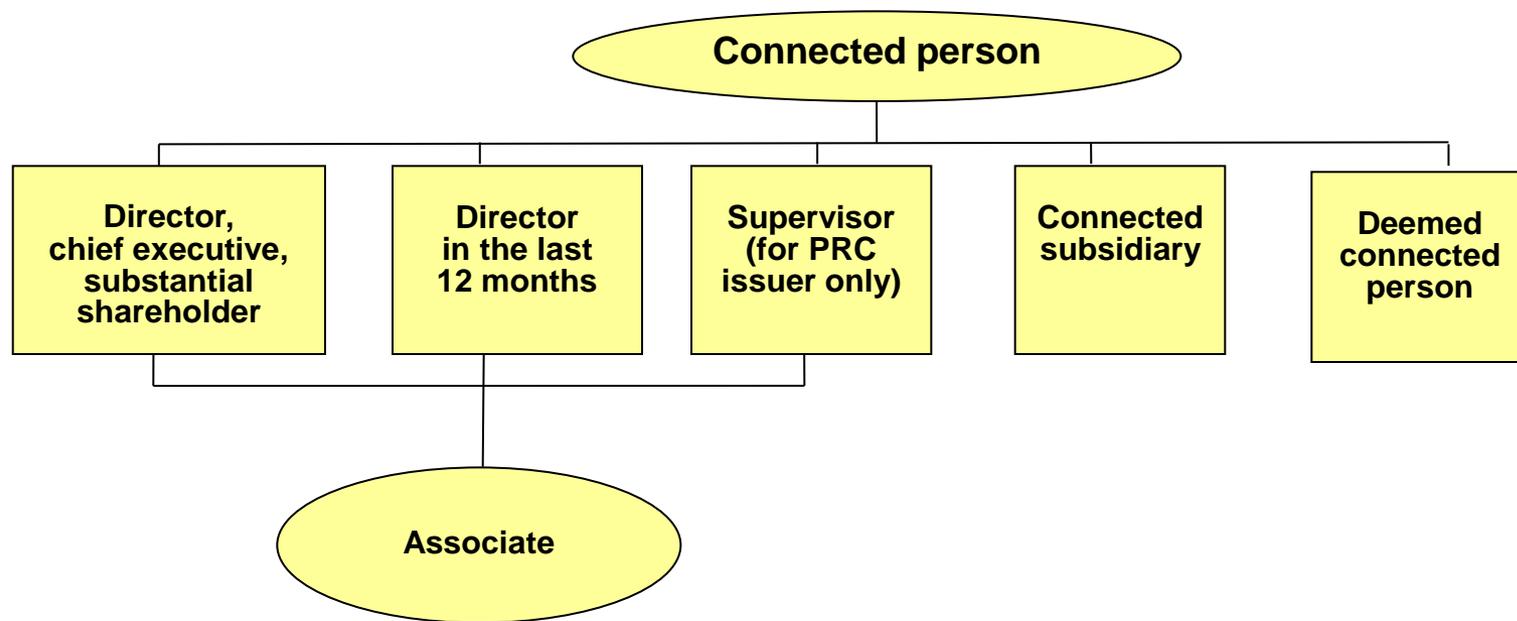
## II. Who are connected persons

Connected persons include:

- persons connected at the issuer level
- persons connected at the subsidiary level

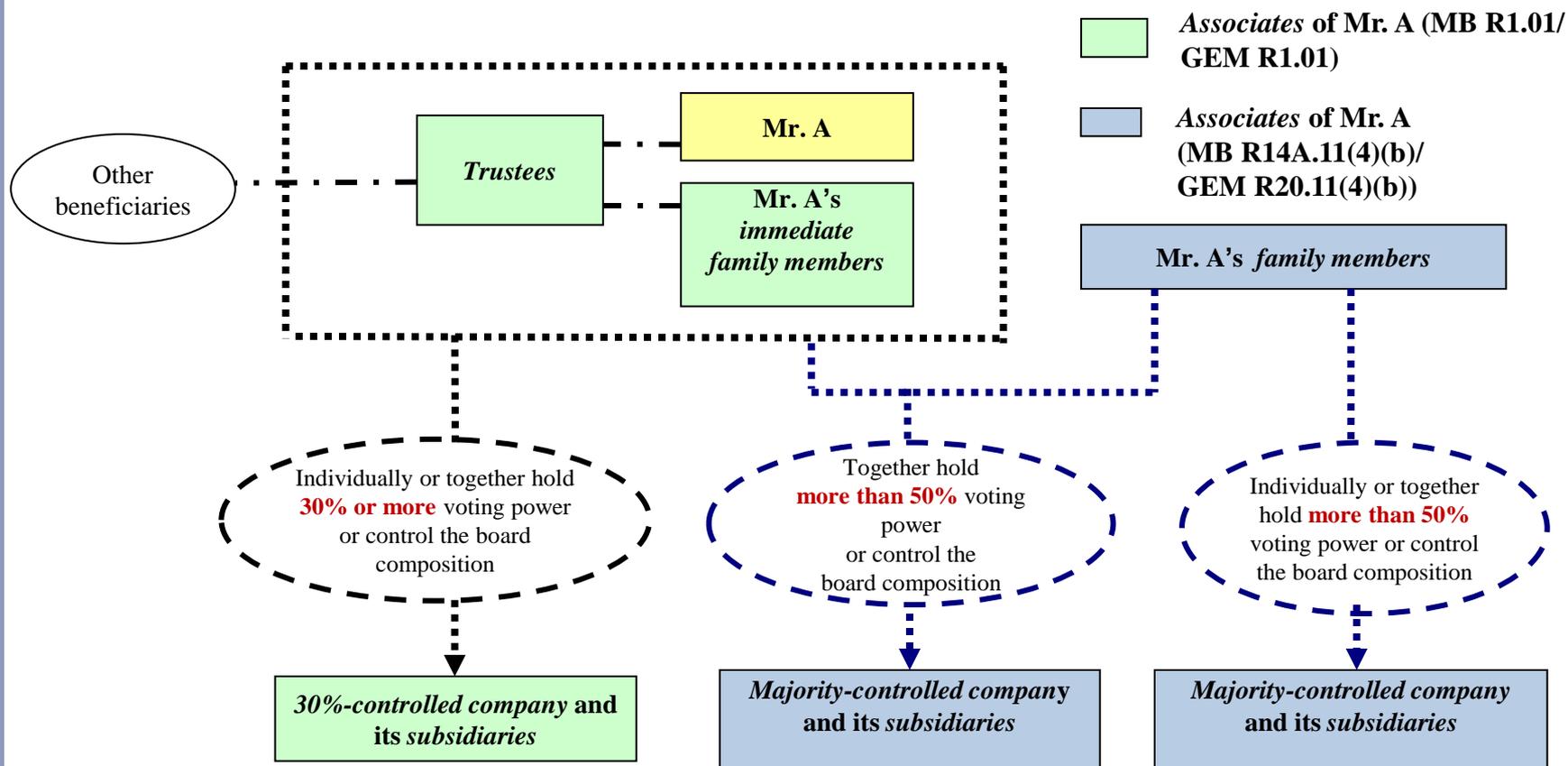


## Scope of connected persons



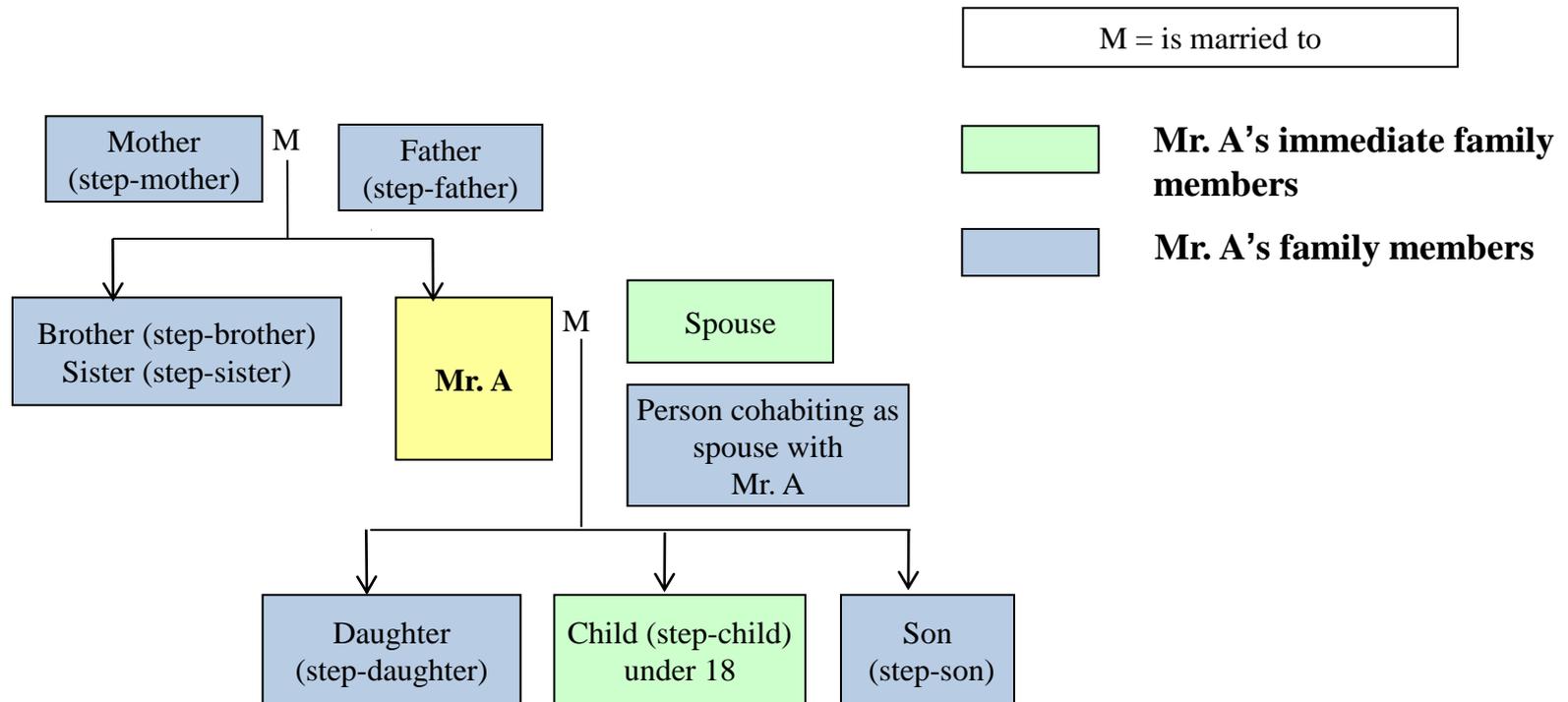
# (1) Associates of a connected person (individual)

- Mr. A is a director and substantial shareholder of Listco



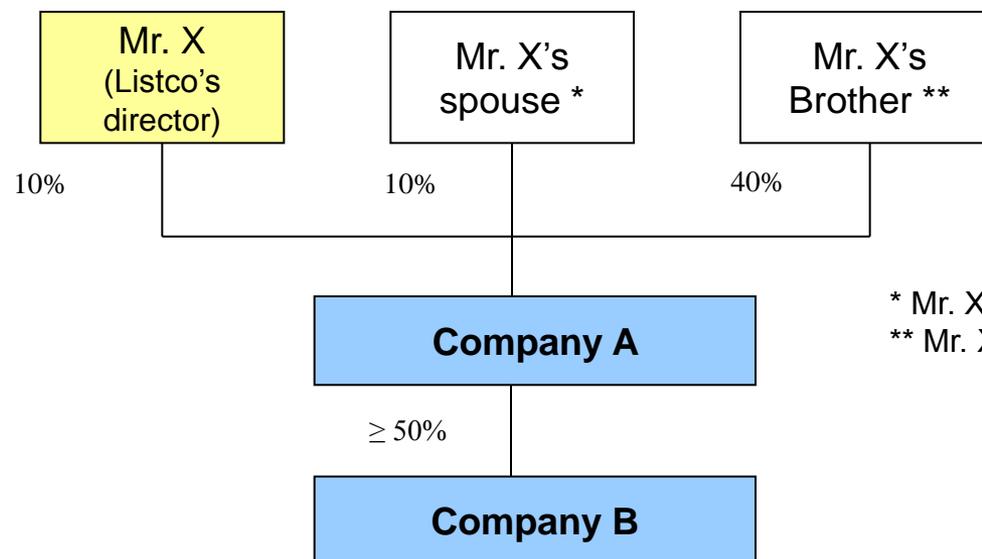
# (1) Associates of a connected person (individual)

- Mr. A's immediate family members and family members



## (1) Associates of a connected person (individual)

### Example A



\* Mr. X's immediate family member  
\*\* Mr. X's family member

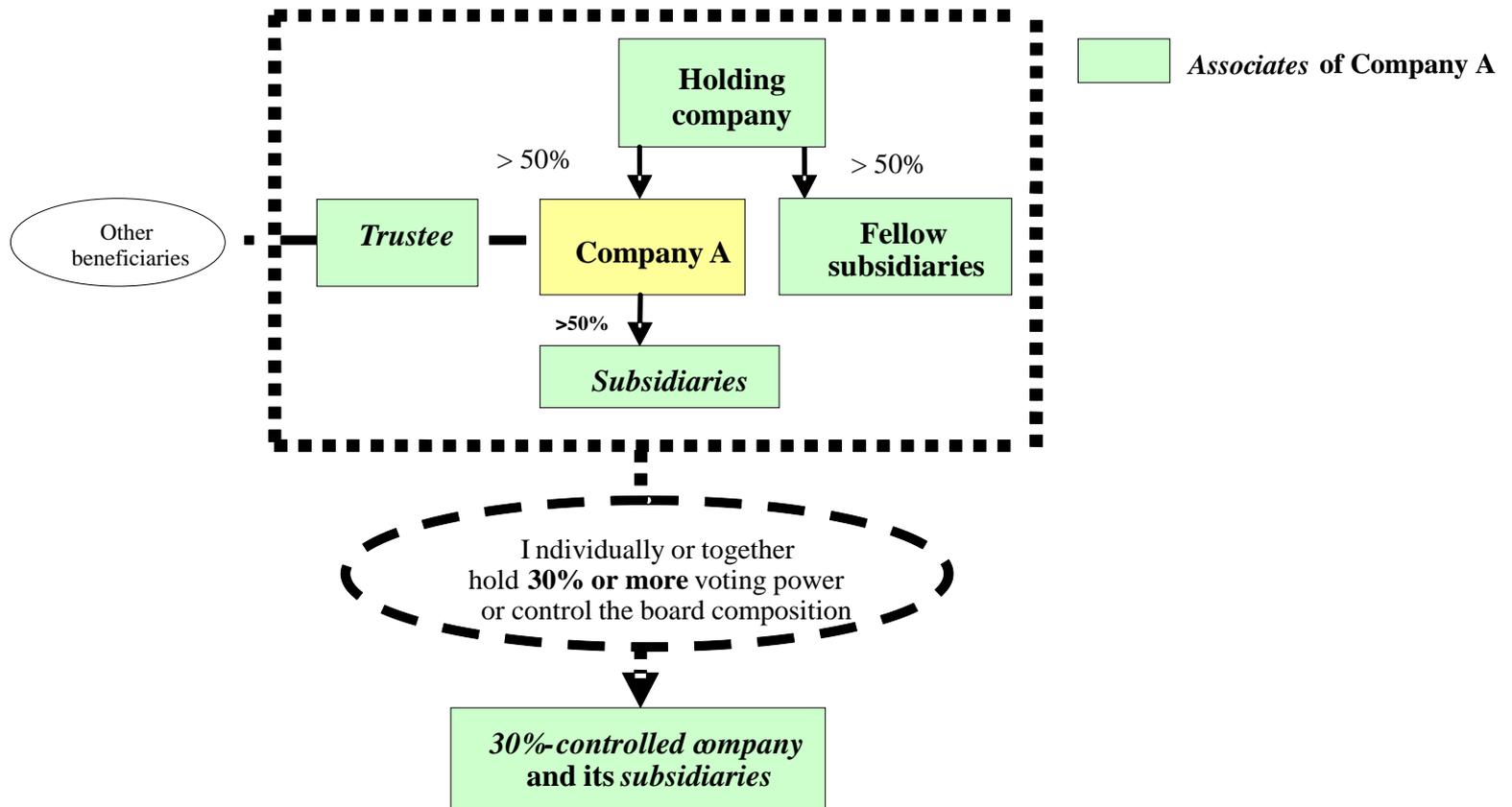


Are Companies A and B regarded as Mr. X's associates?

→ Yes, because Mr. X, his spouse and brother together have a “majority control” (>50%) over Company A

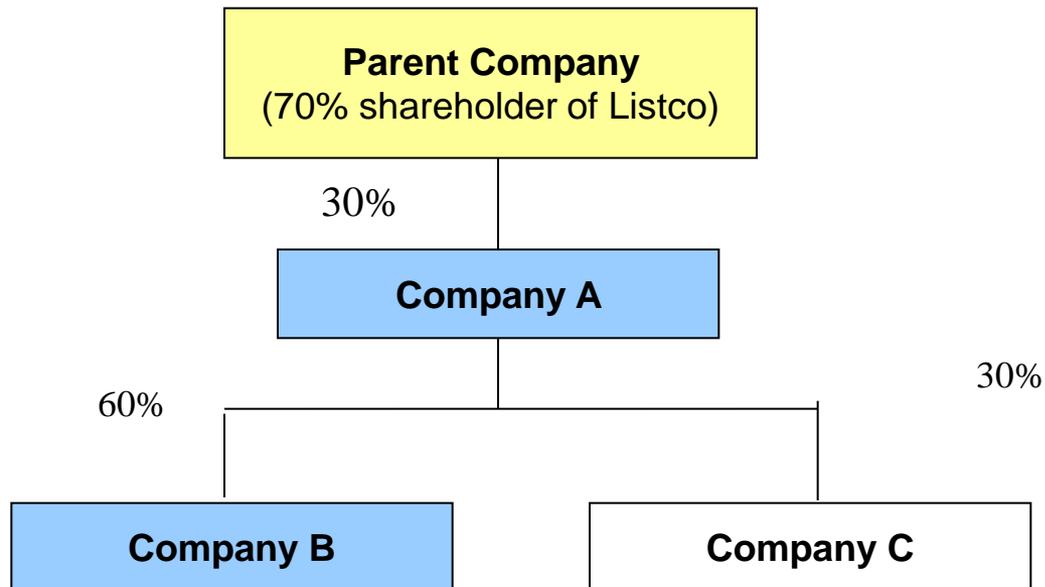
## (2) Associates of a connected person (company)

- Company A is a substantial shareholder of Listco



## (2) Associates of a connected person (company)

### Example B



Are Companies A, B and C regarded as Parent Company's associates?

- Companies A and B are associates of Parent Company
- Company C is not an associate of Parent Company

### (3) Connected subsidiary

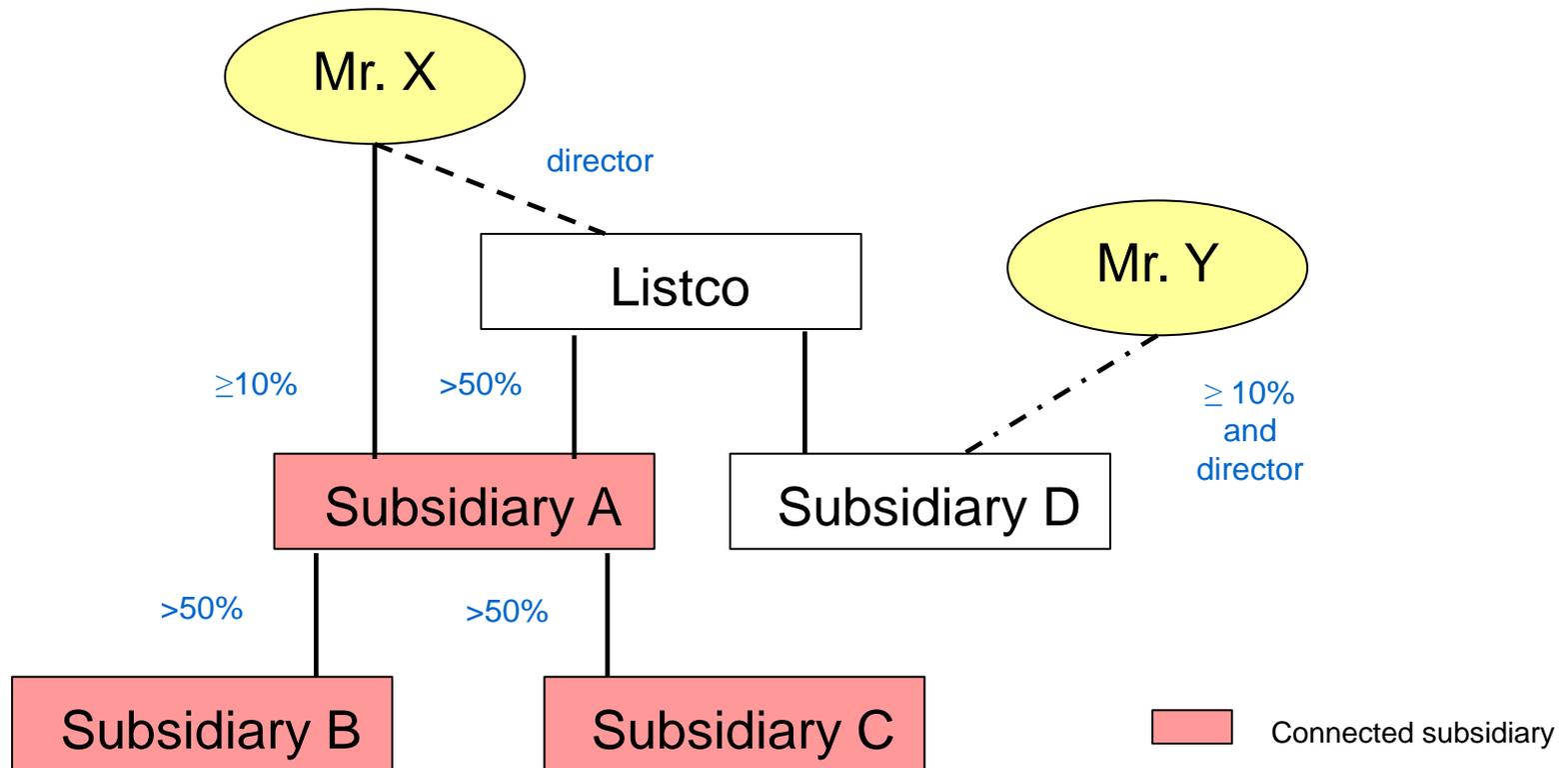
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Connected subsidiary includes:

- 1) an issuer's non wholly-owned subsidiary which is substantially held by a person connected at the issuer level; and
- 2) any subsidiary of the non wholly-owned subsidiary referred to in (1).

## (3) Connected subsidiary

### Example C

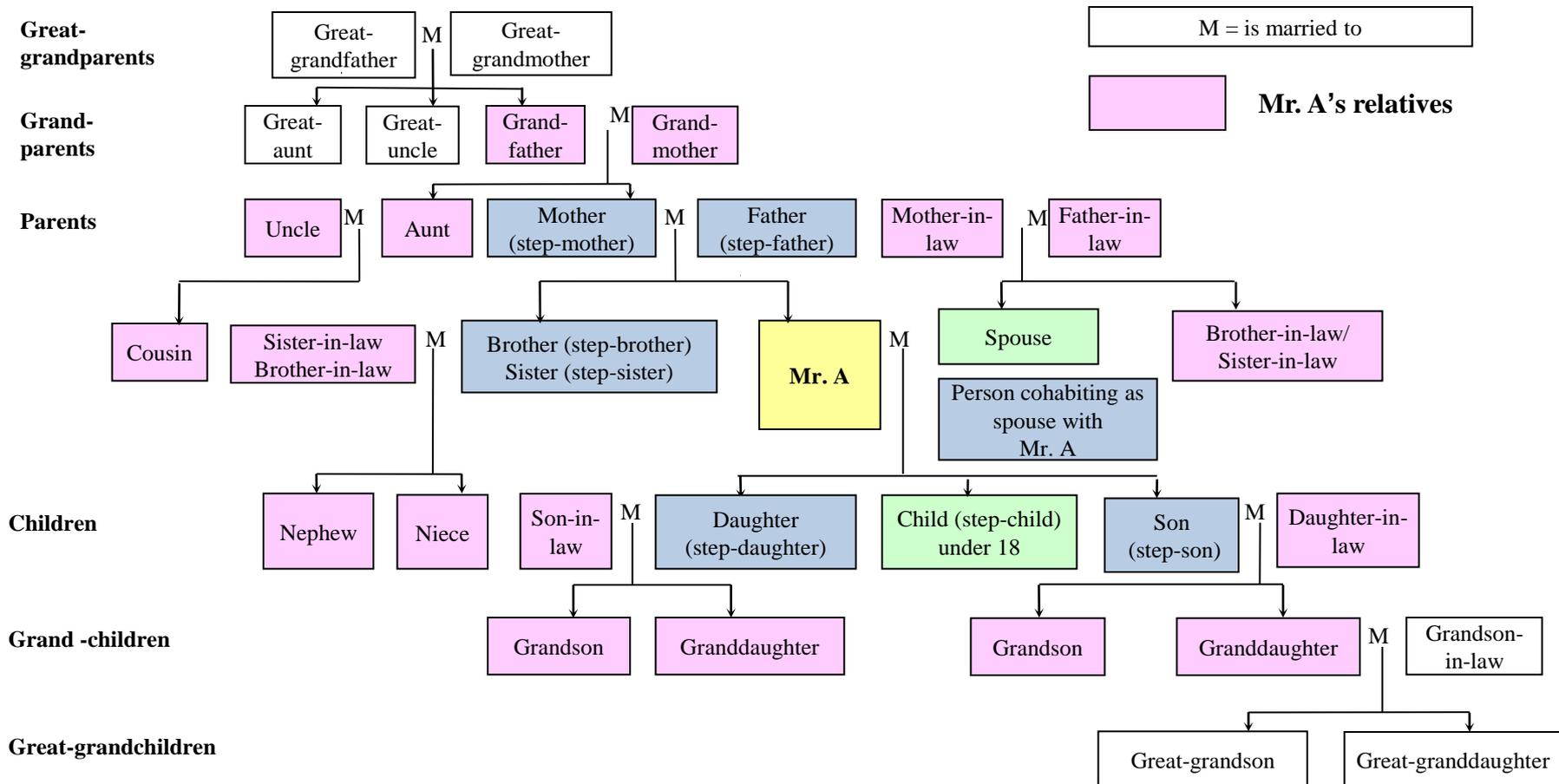


## (4) Deemed connected persons

- The Exchange may deem a person to be connected, including:
  - a) relatives of a connected person with close association with the connected person;
  - b) the person has entered into an agreement or arrangement with the connected person,who, in the Exchange's opinion, should be considered as a connected person.
- Issuers must seek prior consultation with Exchange on transactions with these persons
  - demonstrate whether the transactions should be subject to connected transaction Rules

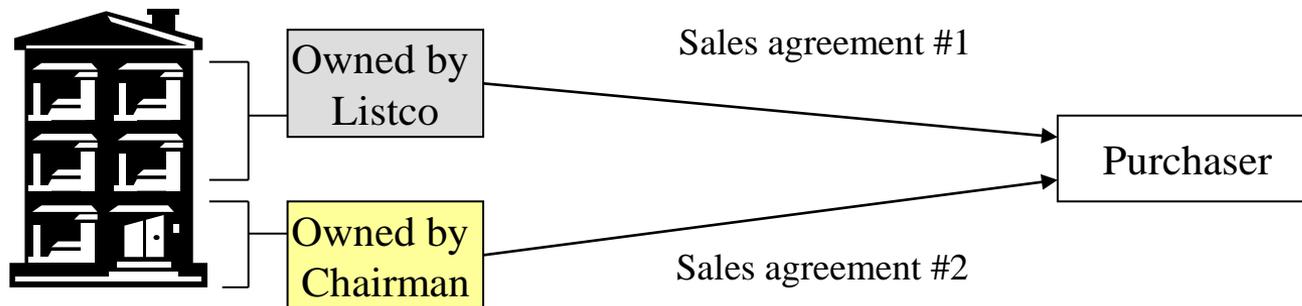
# (a) Relatives of connected persons

- Mr. A is a director and substantial shareholder of Listco



## (b) Persons entering into agreement with connected person

### Example D:

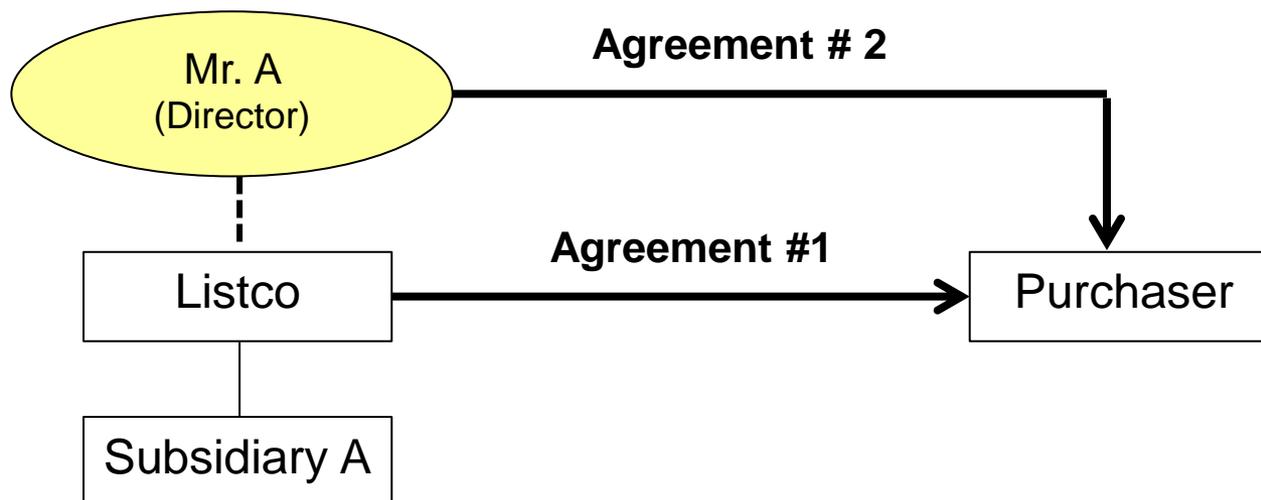


### **Facts:**

- Purchaser acquired the building for redevelopment purpose.
  - Sales agreements # 1 and 2 were signed on the same day and were inter-conditional.
  - Chairman did not negotiate for Listco's sales agreement, but took part in decision making process.
- The Purchaser has been deemed as a connected person for transaction under Sales agreement #1.

## (b) Persons entering into agreement with connected person

### Example E:



### **Facts:**

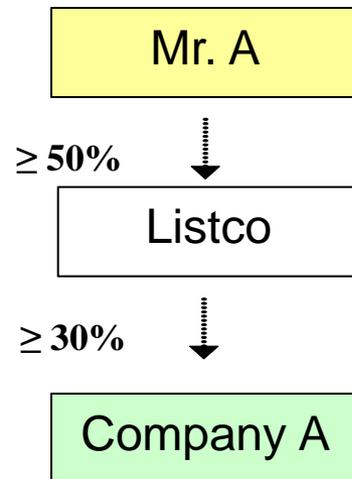
- Under Agreement #1, Listco sells Subsidiary A to Purchaser
  - Under Agreement # 2, Mr. A will assist Subsidiary A to obtain a mining license.
- The disposal under Agreement #1 would be deemed as a connected transaction in light of Mr. A's interest in Agreement #2.

## (5) Exempt connected persons

Examples:

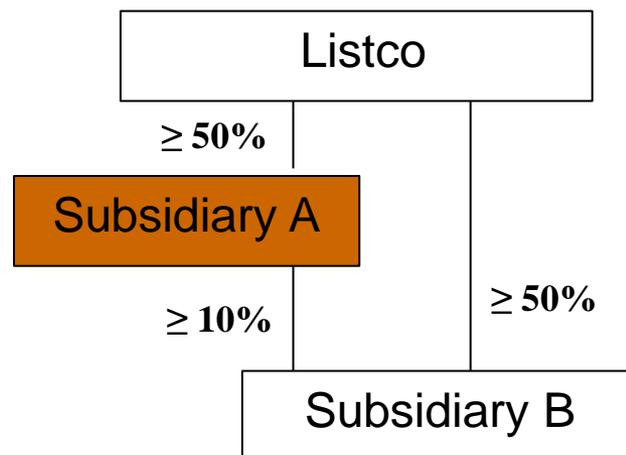
- a) PRC Governmental Body
- b) An entity which is an associate of a connected person only because of the connected person's interest in the entity via the issuer

[Note 1 to MB R14A.11(4)/ GEM R20.11(4)]



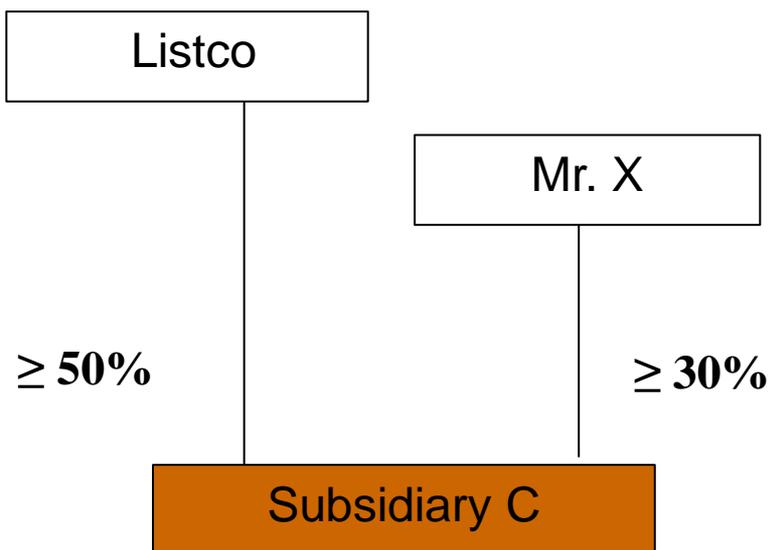
## (5) Exempt connected persons

- c) A subsidiary (Subsidiary A) becomes connected only because of its substantial shareholding in another subsidiary (Subsidiary B)



## (5) Exempt connected persons

- d) A subsidiary (Subsidiary C) is an associate of a person only connected at the subsidiary level (e.g. Mr. X)



### III. What are connected transactions

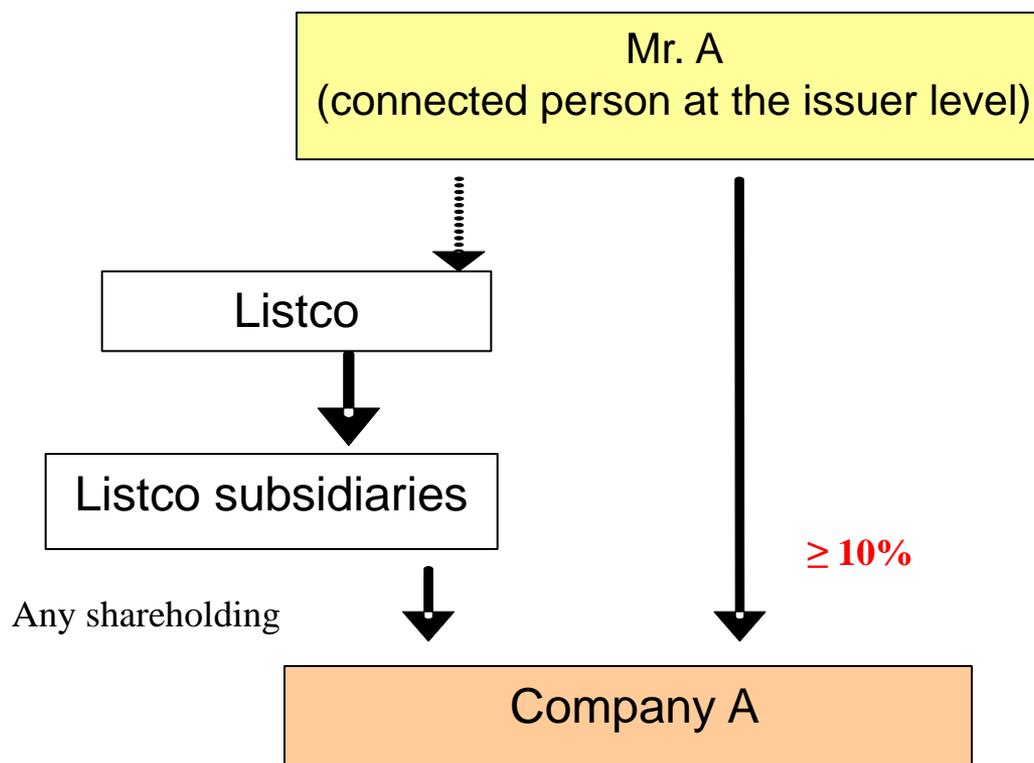
- CT Rules apply to connected transactions conducted by issuers and their subsidiaries
- Connected transactions include:
  - Transactions with connected persons
  - Transactions with independent third parties which may confer benefits to connected persons

## Connected transactions involving independent third parties

- Rationale: Avoid conferring benefits to a connected person through his interest in the target company
  
- Two specific circumstances:
  - 1) Financial assistance to/ from commonly held entity  
[MB R14A.13(2)(b)(ii)/ GEM R20.13(2)(b)(ii)]
  
  - 2) Buy/ sell shareholding interest from/ to third party  
[MB R14A.13(1)(b)/ GEM R20.13(1)(b)]

## (1) Financial assistance to/ from commonly held entity

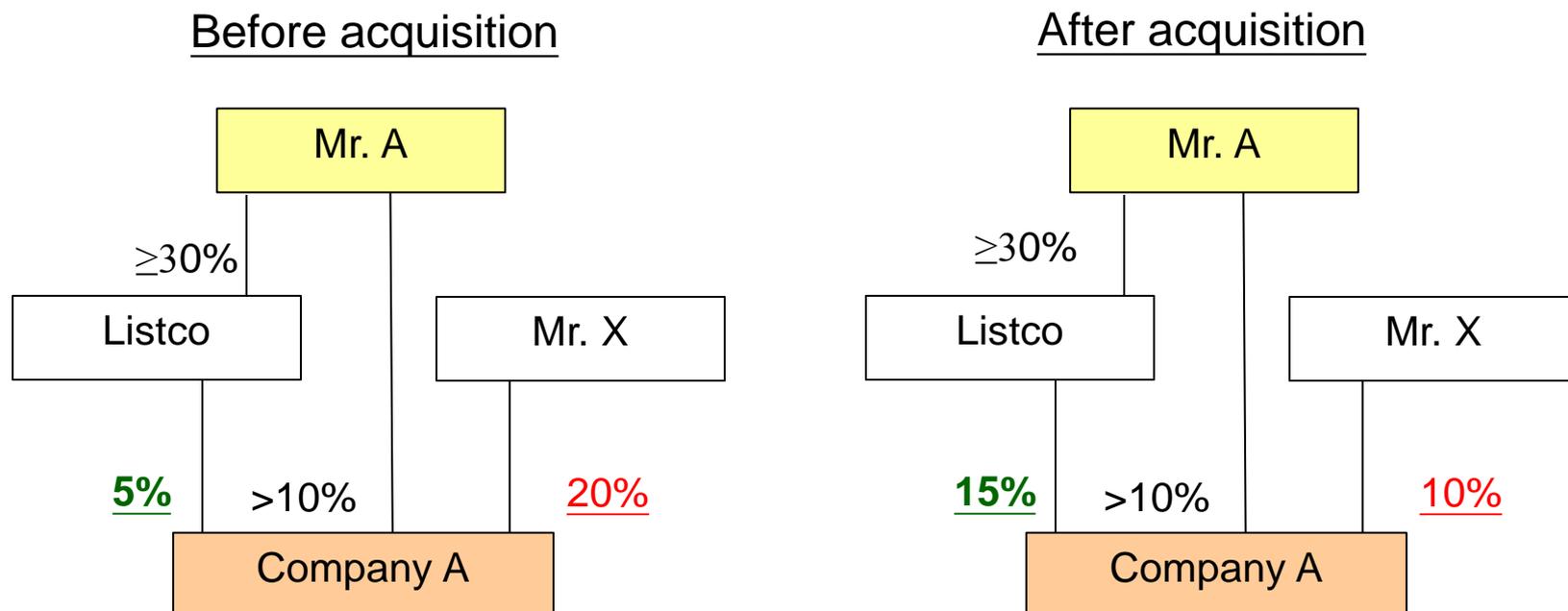
### Example F:



→ Provision of financial assistance to/ from Company A is a connected transaction

## (2) Buy/ sell shareholding interest from/ to third party

### Example G:



→ Acquisition of 10% of Company A from Mr. X is a connected transaction

## Nature of connected transactions

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- Connected transactions include both capital and revenue nature transactions
  - whether or not conducted in the group's ordinary and usual course of business
- They can be one-off or continuing transactions

## Contrast with Chapter 14

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### (1) Definition of “transaction” in MB Chapter 14/ GEM Chapter 19

- excludes revenue transaction in the group’s ordinary and usual course of business
- excludes financial assistance to subsidiaries

## Contrast with Chapter 14

### (2) Treatment with options

- MB Chapter 14/ GEM Chapter 19 - Issuer may seek shareholder approval of exercise of an option in future at the time of acquiring the option
- MB Chapter 14A/ GEM Chapter 20 - Transfer of option by issuer is treated as if the option is exercised
- MB Chapter 14A/ GEM Chapter 20 - Non-exercise of option is a transaction classified as if the option has been exercised

## IV. Connected transaction requirements

## Requirements for connected transactions

	Written agreement	Announcement	Annual reporting	Independent shareholder approval	Additional reporting for CCTs *
Fully exempt	Yes	No	No	No	No
Subject to announcement only	Yes	Yes	Yes	No	Yes
Subject to announcement and independent shareholder approval	Yes	Yes	Yes	Yes	Yes

\* Include agreement  $\leq 3$  years, setting annual monetary cap, annual review by independent directors and auditors

## Points to note

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- (1) For CCTs, issuers must re-comply with the connected transaction requirements before:
- the annual cap is exceeded
  - the agreement is renewed
  - material change to terms of agreement

## Points to note

(2) Annual confirmation of CCTs by auditors according to HKICPA Practice Note 740 is acceptable

[http://app1.hkicpa.org.hk/ebook/HKSA\\_Members\\_Handbook\\_Master/volumeIII/pn740.pdf](http://app1.hkicpa.org.hk/ebook/HKSA_Members_Handbook_Master/volumeIII/pn740.pdf)

“ ...

Based on the foregoing, in respect of the disclosed continuing connected transactions:

- a. nothing has come to our attention that causes us to believe that the disclosed continuing connected transactions have not been approved by the Company's board of directors.
- b. for transactions involving the provision of goods or services by the Group, nothing has come to our attention that causes us to believe that the transactions were not, in all material respects, in accordance with the pricing policies of the Company.
- c. nothing has come to our attention that causes us to believe that the transactions were not entered into, in all material respects, in accordance with the relevant agreements governing such transactions.
- d. with respect to the aggregate amount of [each of] the continuing connected transactions set out in the attached list of continuing connected transactions, nothing has come to our attention that causes us to believe that the disclosed continuing connected transactions have exceeded the maximum aggregate annual value disclosed in the previous announcement(s) dated [*relevant date(s)*] made by the Company in respect of [each of] the disclosed continuing connected transactions.”

## Points to note

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- (3) Issuers must disclose in their annual reports whether their related party transactions constituted connected transactions (MB App 16 – para 8(3)/ GEM R 18.09(3))

## V. Exemptions for connected transactions

- The Rules exempt specific categories of connected transactions
  - immaterial to issuers
  - low risk of potential abuse
  
- Examples:
  - 1) De minimis exemption
  - 2) Transactions with persons connected with insignificant subsidiaries
  - 3) Financial assistance provided by banking issuers
  - 4) Pro rata financial assistance provided by issuers to connected persons/ commonly held entities
  - 5) Financial assistance provided by connected persons/ commonly held entities to issuers
  - 6) Issue of securities under specific circumstances

## (1) De minimis exemptions

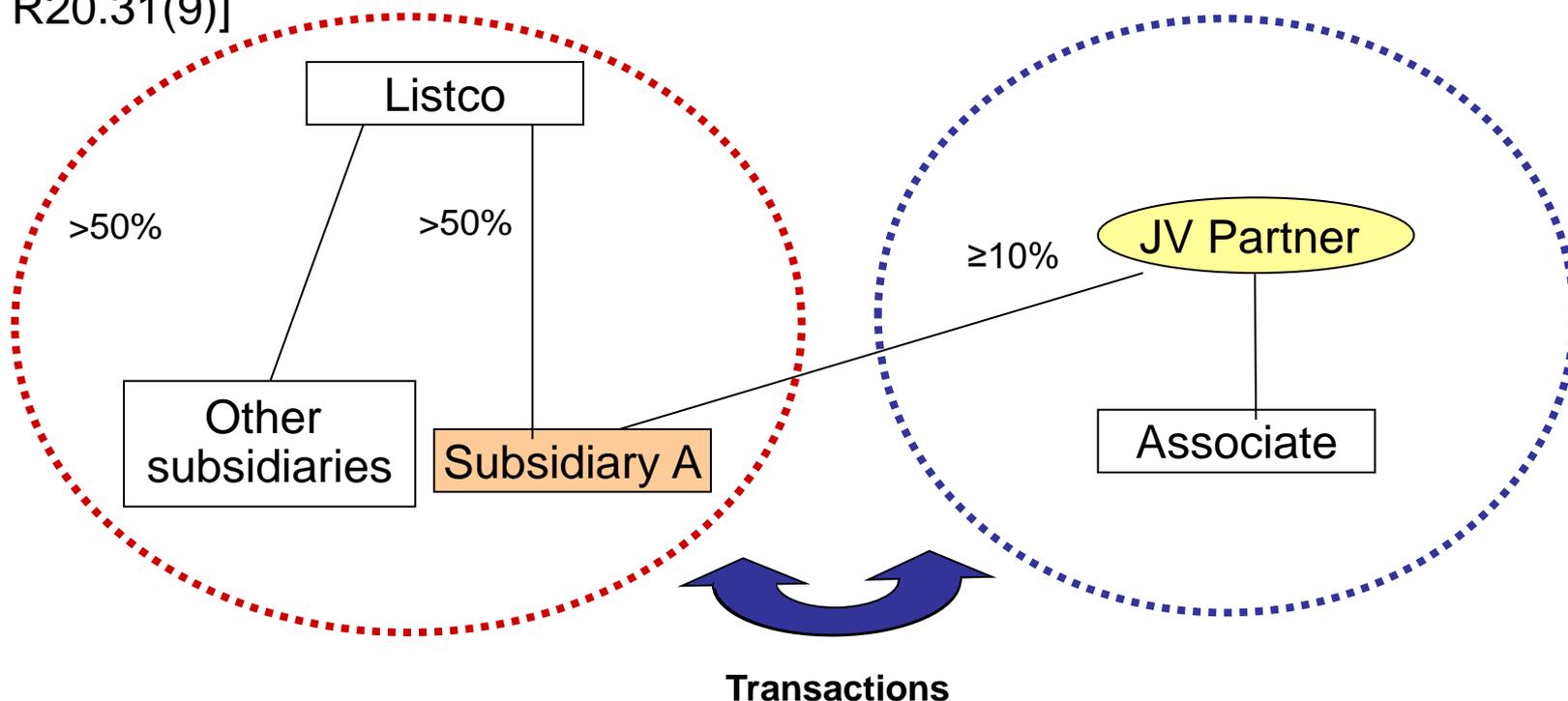
- Exempt immaterial transactions if
  - are on normal commercial terms
  - do not involve issue of new securities by issuers to connected persons
- Size test computation
  - Compute all size tests in MB Chapter 14/ GEM Chapter 19 (except profits test)
  - Use the annual cap to calculate the assets test, revenue test and consideration test for CCTs
  - For placing of deposits to connected finance company, compute size tests using the “maximum daily outstanding balance (including accrued interest)” as the annual cap
  - If size test produces an anomalous result, issuers should seek our prior approval for use of alternative size test(s)

## (1) De minimis exemptions

Fully exempt transactions	<p>Size test</p> <ul style="list-style-type: none"><li>– &lt; 0.1%; or</li><li>– &lt; 1% (for transaction involves persons only connected at the subsidiary level); or</li><li>– &lt; 5% and the consideration &lt; HK\$1 million.</li></ul>
Transactions subject to announcement only	<p>Size test</p> <ul style="list-style-type: none"><li>– &lt; 5%; or</li><li>– &lt; 25% and the consideration &lt; HK\$10 million.</li></ul>

## (2) Transactions with persons connected with insignificant subsidiaries

- Exempt transactions with connected persons related to “insignificant subsidiary” only (e.g. JV Partner and its Associate) [MB R14A.31(9)/ GEM R20.31(9)]



- \* Subsidiary A's assets, profits and revenue ratios:
  - < 5% for the latest financial year
  - < 10% for each of the latest 3 financial years

## (2) Transactions with persons connected with insignificant subsidiaries

### Example H:

March 2012: Listco published its accounts for year ended 31/12/2011  
June 2012: Transaction between Listco and JV Partner (substantial shareholder of Subsidiary A)

	<b>Percentage ratios for Subsidiary A</b>
2009	6% to 8%
2010	All <5%
2011	5% to 9%

Subsidiary A is “insignificant” at the time of the transaction based on the three-year test (<10% for latest 3 financial years)

→ Transaction with JV Partner exempt

### (3) Financial assistance provided by banking issuers

- Exempt financial assistance provided by an issuer (a banking company) to its connected persons or commonly held entities [MB R14A.65(1)/ GEM R20.65(1)]
- “Banking company” means a bank, a restricted licence bank or a deposit taking company defined in the Banking Ordinance or an overseas banks



Does the exemption apply to provision of financial assistance by an issuer holding a money lending licence?

→ No

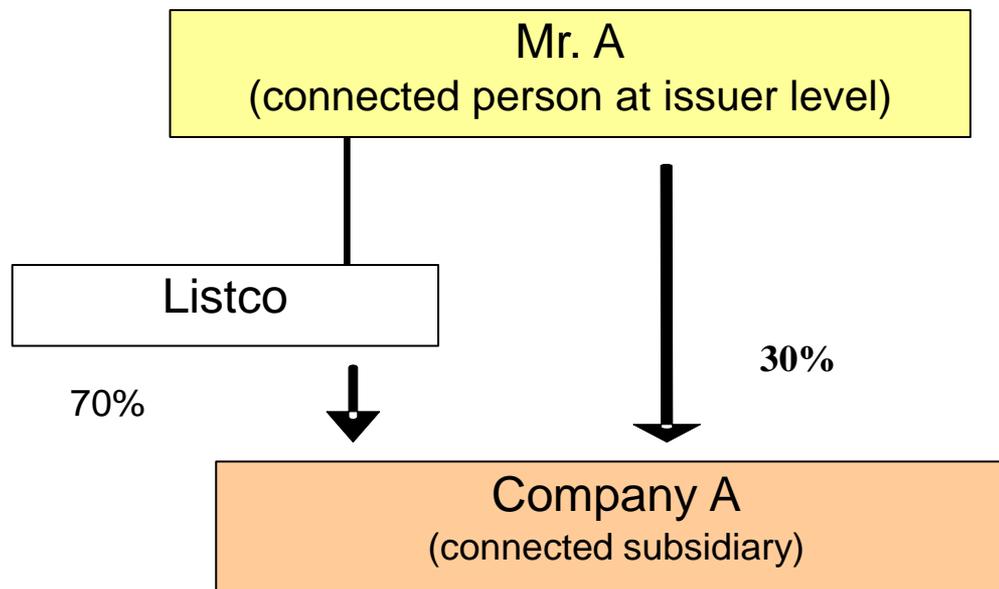
## (4) Pro rata financial assistance provided by issuers

- Exempt financial assistance provided by an issuer to its connected person/  
commonly held entity if:
  - provided on a pro rata basis;
  - normal commercial terms; and
  - any guarantee given is on a several basis (but not a joint and several basis).

[MB R14A.65(3)/ GEM R20.65(3)]

## (4) Pro rata financial assistance provided by issuers

### Example I :

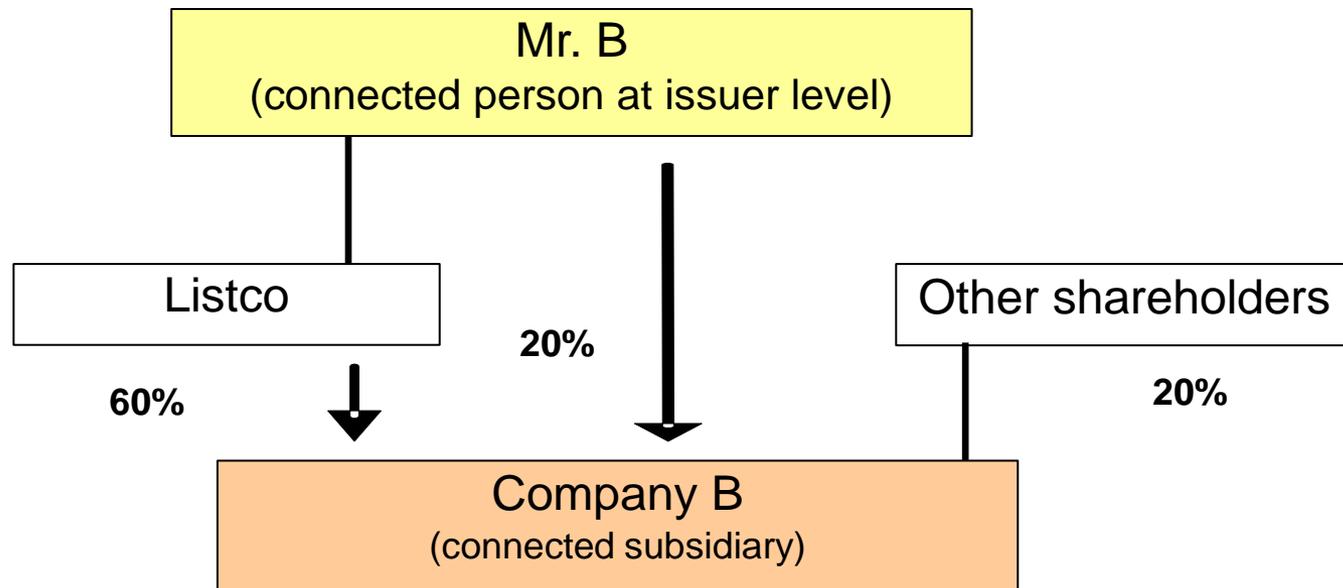


Each of Listco and Mr. A provides guarantee to Company A in proportion to their interests in Company A and on a several basis

→ Exempt connected transaction

## (4) Pro rata financial assistance provided by issuers

### Example J :



Listco and Mr. B provide loan to Company B in the amount of HK\$60 million and HK\$20 million respectively (>5%).

→ Not exempt

## (5) Financial assistance provided to issuers

- Exempt financial assistance received by an issuer from its connected person/ commonly held entity if:
  - normal commercial terms; and
  - no security over issuer's assets[MB R14A.65(4)/ GEM R20.65(4)]



If an issuer provides its assets as security for a loan from a connected person/ common held entity, is it subject to shareholder approval requirements?

→ Yes, unless the de minimis exemption applies

## (6) Issue of securities

- Exempt the following issue of securities by an issuer or its subsidiary to connected persons:
  1. pro rata issue to shareholders (e.g. rights issue, bonus issue)
  2. For rights issue/ open offer
    - excess application
    - taking up shares as underwriter/ sub-underwriter
  3. Share option scheme
    - comply with MB Chapter 17/ GEM Chapter 23
    - pre-IPO share option scheme with prior listing approval
  4. Top-up placing and subscription

## Recap

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- Who are connected persons
- What are connected transactions
- Connection transaction requirements
- Exemptions for connected transactions

Thank you