

Recent Amendment to Listing Rules

March – April 2014



Agenda

- I. Background
- II. Rule changes relating to connected transactions
- III. Rule changes relating to definitions of connected person and associate

I. Background

- 26 April 2013 – published Consultation Papers on (1) Review of Connected Transaction Rules and (2) Alignment of Definitions of Connected Persons and Associates
- 26 June 2013 – Consultation period ended
- March 2014 – published Consultation Conclusions and Rule amendments
- 1 July 2014 – Rule amendments become effective

Part II: Rule changes relating to connected transactions

- Purpose
- Rule amendments
 - Scope of connected persons
 - Scope of connected transactions
 - Exemptions for connected transactions
 - Requirements for connected transactions
- Transitional arrangements
- Guidance letter on continuing connected transactions

Purpose

- Simplify and improve clarity of the Rules to ease issuers' compliance burden, while maintaining the same level of investor protection
 - Rewrite Chapter 14A* in plain language
 - Refine areas where the risk of abuses is remote

* The equivalent GEM Rules are in Chapter 20.

Rule amendments - Scope of connected persons

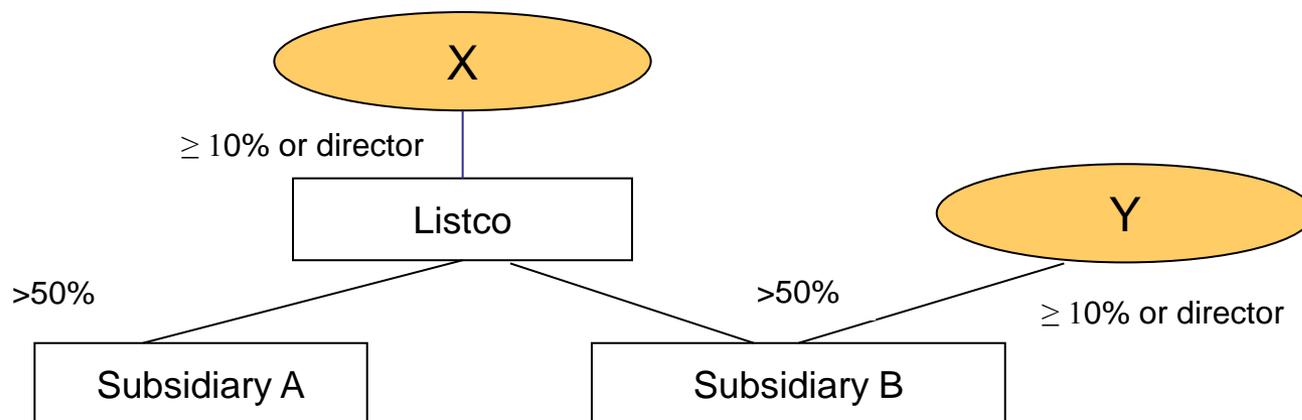
- A. Exemptions for persons connected at the subsidiary level
- B. Exemption for trustee interest
- C. Exemption for interest in an associate held via issuer
- D. Retaining the current deeming provision

A. Exemptions for persons connected at subsidiary level

(1) Shareholder approval exemption

Current Rule

- Connected persons include directors and substantial shareholders
 - at the issuer level
 - at the subsidiary level

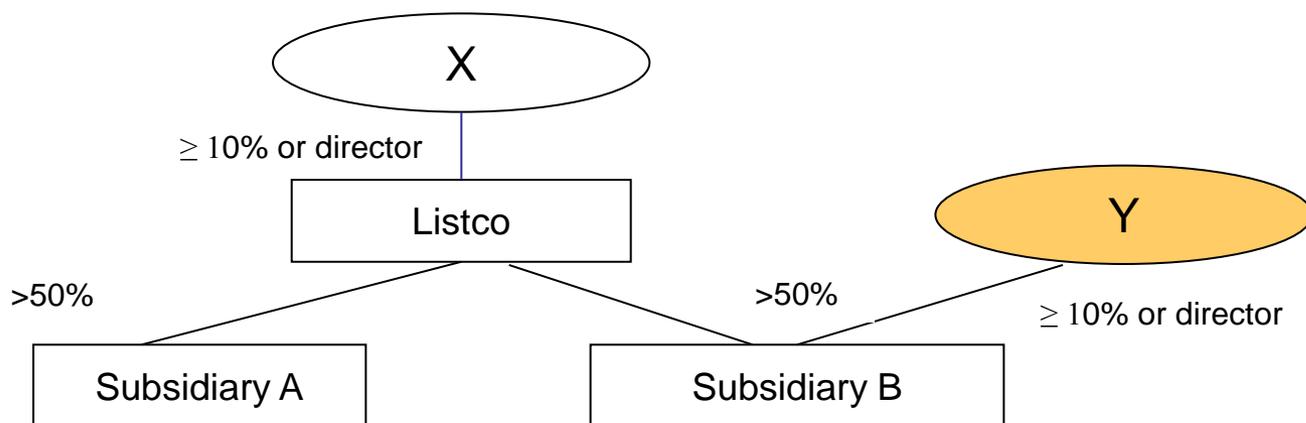


A. Exemptions for persons connected at subsidiary level

(1) Shareholder approval exemption

New Rule

- Exempt transactions with person connected at the subsidiary level from shareholder approval if:
 - Normal commercial terms
 - Approved by board
 - INEDs' view: fair and reasonable



Transactions between Y and Listco or Subsidiary A/B are exempt from shareholder approval

A. Exemptions for persons connected at subsidiary level

(1) Shareholder approval exemption

Current Rule

- Exempt Qualified Property Acquisition involving persons connected at the subsidiary level from shareholder approval subject to certain conditions.

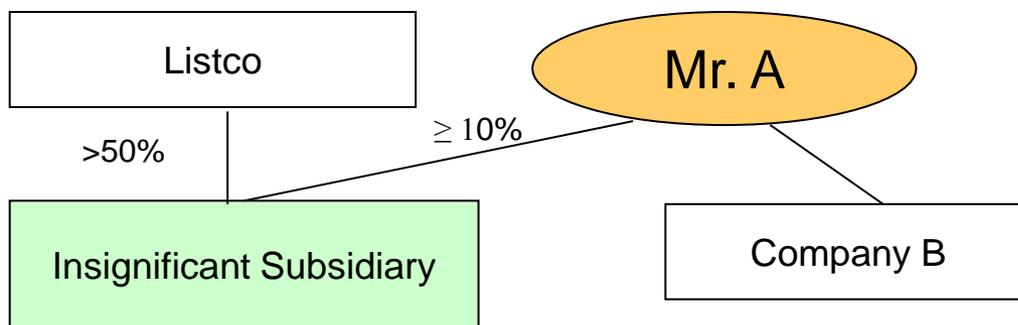
New Rule

- Remove this exemption because the shareholder approval exemption will apply to all transactions with persons connected at the subsidiary level.

A. Exemptions for persons connected at subsidiary level

(2) Persons connected with insignificant subsidiary

Current Rule



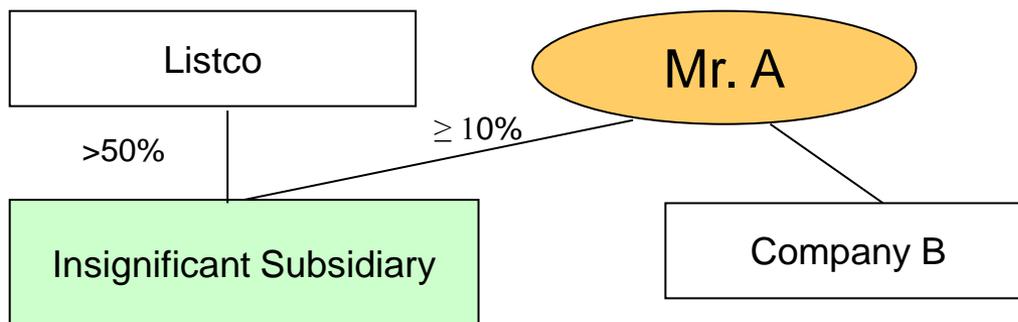
- Transaction with Mr. A is exempt if
 - Normal commercial terms; and
 - If the transaction involves Insignificant Subsidiary \rightarrow Consideration ratio $<10\%$
- Mr. A is a connected person

A. Exemptions for persons connected at subsidiary level

(2) Persons connected with insignificant subsidiary

New Rule

- Exempt persons connected with “insignificant subsidiary” from definition of connected person, *rather than* exempt transactions with these persons

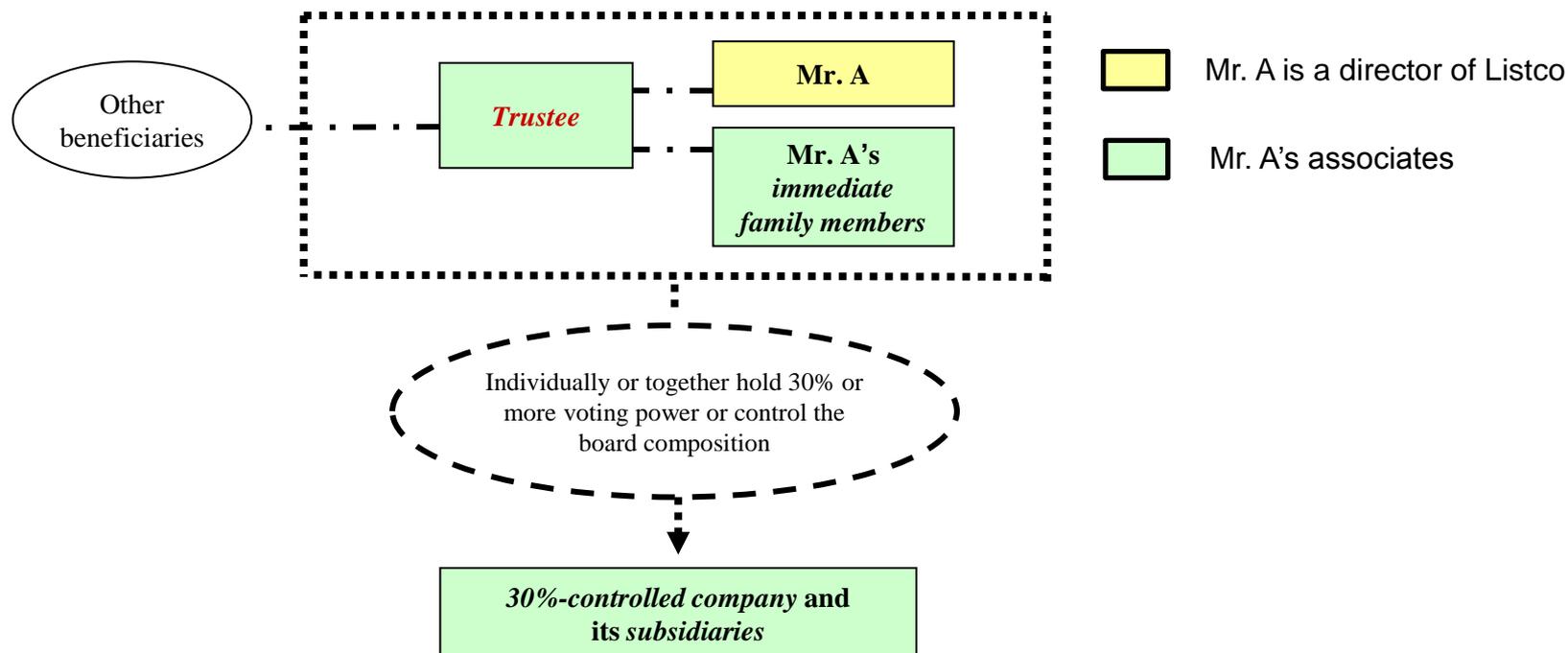


→ Mr. A is not a connected person

B. Exemption for trustee interest

Current Rule

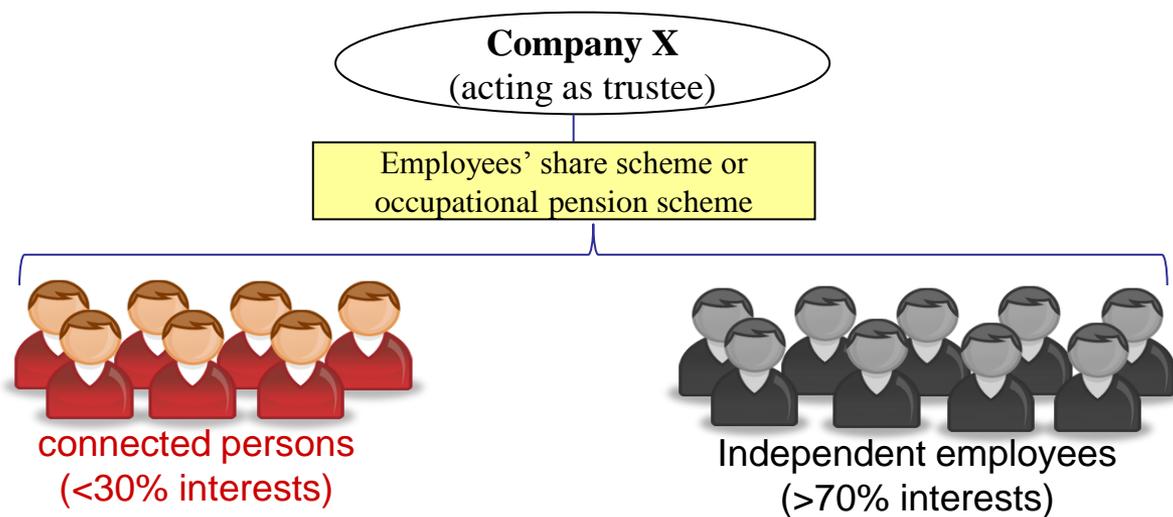
- “Associate” includes trustee of a trust where the connected person is a beneficiary / discretionary object.



B. Exemption for trustee interest

New Rule

- Exempt trustee of an employees' share scheme or pension scheme if
 - the scheme is established for a wide scope of participants
 - connected persons' total scheme interests < 30%

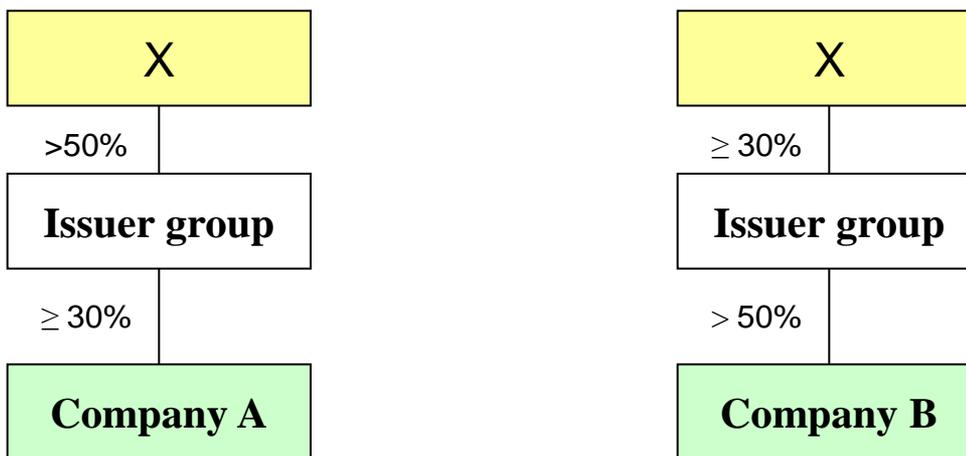


Company X is excluded from the definition of associate.

C. Exemption for interest in an associate held via issuer

Current Rule

- “Associate” excludes a 30%-controlled company if the connected person’s interest in the company is only held via the issuer group

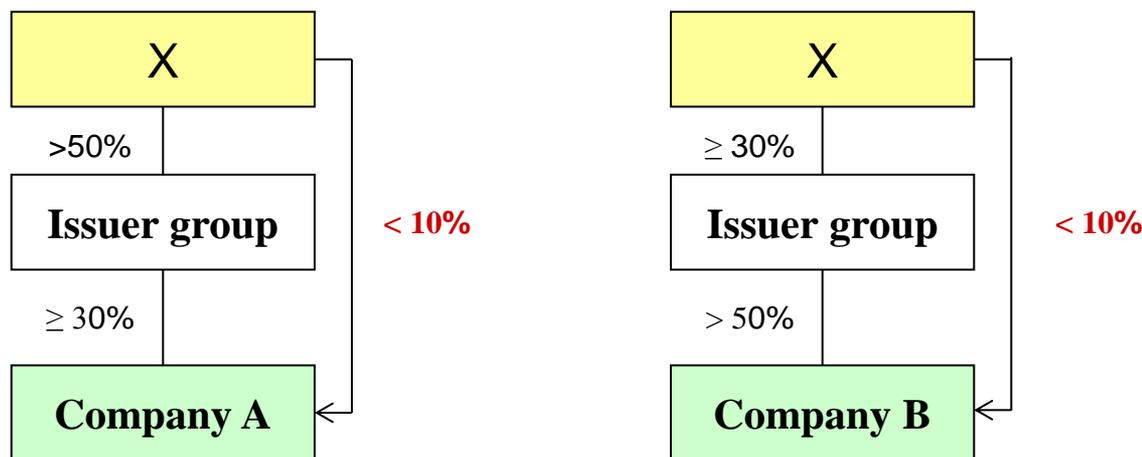


Company A/B is not an associate of X.

C. Exemption for interest in an associate held via issuer

New Rule

- In defining “30%-controlled company”, exclude company in which connected person and his associates together hold <10%, other than those held via the issuer group



Company A/B is not an associate of X.

D. Deeming provision

Current Rule

- Exchange has the general power to deem a person as connected

Our proposal

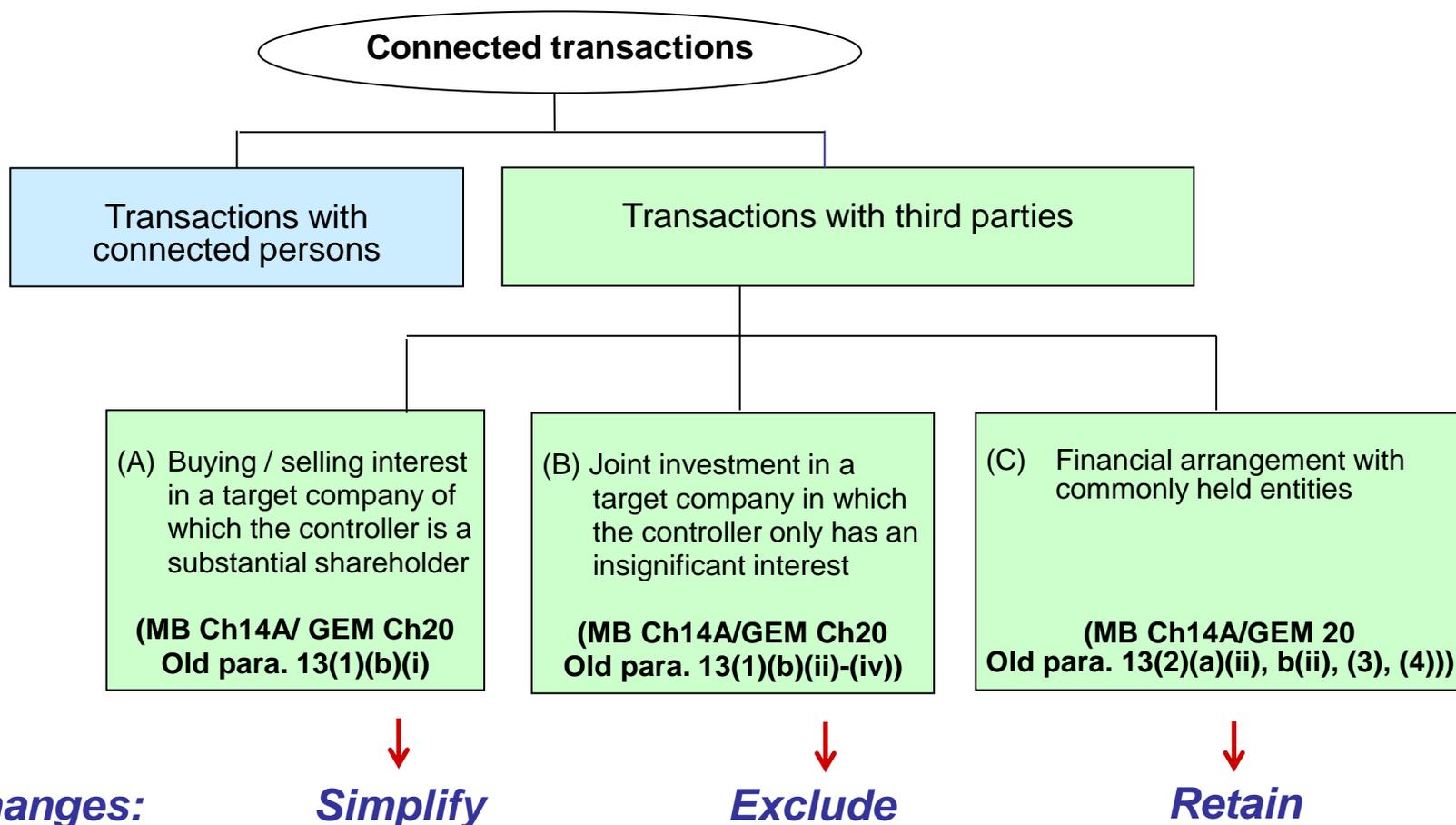
- Specify in the Rules that the deeming provision will cover:
 - Shadow director
 - De facto controlling shareholder
 - Person accustomed to acting according to connected persons' directions or instructions

Conclusion

- Not adopted, Exchange continues to apply the deeming provision to:
 - Persons exercising significant influence over the issuer and standing to benefit from the transaction

Rule amendments

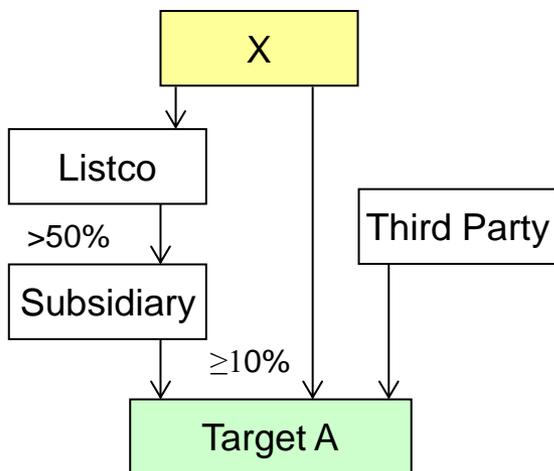
- Scope of connected transactions



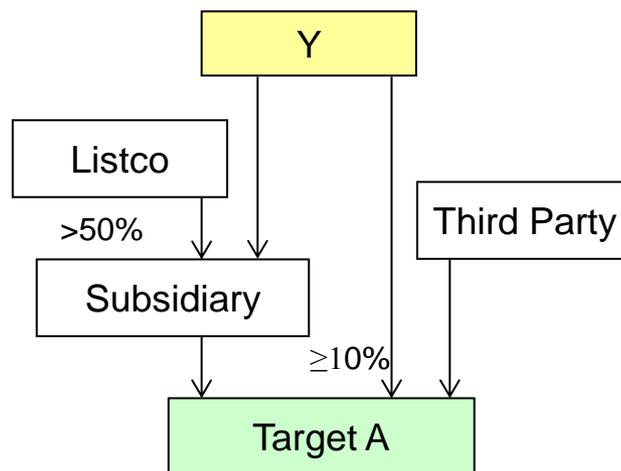
E. Buying/ selling interests in a target company

Current MB Ch14A/ GEM 20 – para. 13(1)(b)(i)

Scenario 1: X is a controller* of Issuer



Scenario 2: Y is a controller* of Subsidiary



- Acquisition/ disposal of interest in Target A from / to Third Party constitute a connected transaction.

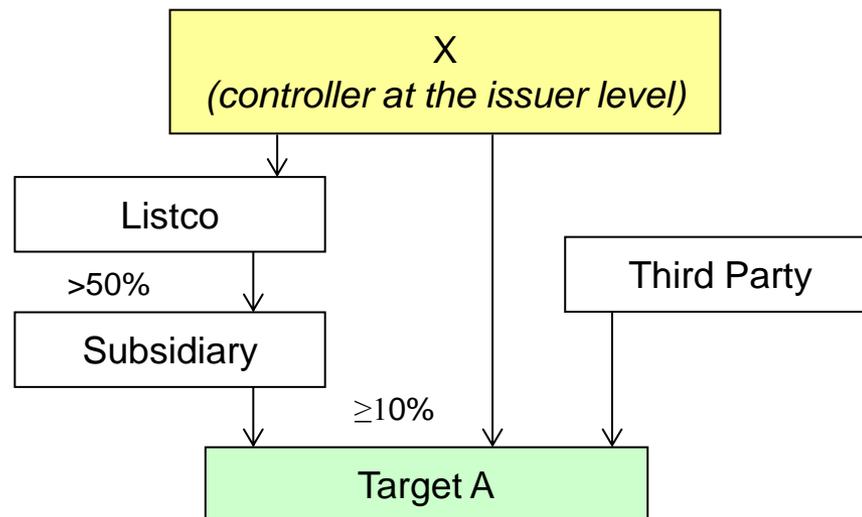
* "Controller" means a director, controlling shareholder or chief executive .

E. Buying/ selling interests in a target company

New Rule

- Exclude disposal of target company to third party

Example

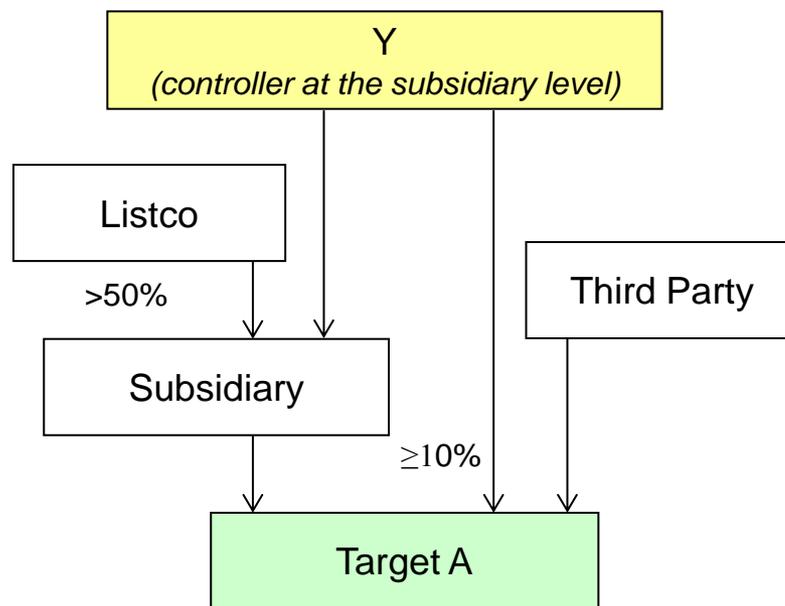


Disposal of interest in Target A to Third Party will not be a connected transaction.

E. Buying/ selling interests in a target company

New Rule

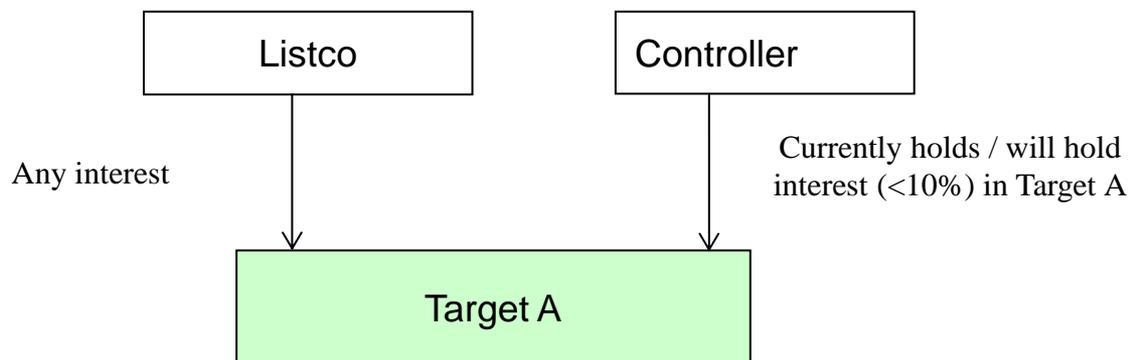
- Exclude controller at the subsidiary level



Acquisition/ disposal of interest in Target A from/to Third Party will not be a connected transaction.

F. Joint investment with controller

Current MB Ch14A/ GEM 20 – para. 14A.13(1)(b)(ii) to (iv)



- Connected transactions include transactions between Issuer and a third party, where both the Issuer and Controller will invest in Target A:
 - Interests acquired by Issuer are of fixed income nature;
 - Interests held by the Issuer are on less favourable terms than Controller; or
 - Different class of shares to be held by the Issuer and Controller.

New Rule

- Exclude these transactions from the definition of connected transaction

Rule amendments - Exemptions for connected transactions

- G. Monetary limits for de minimis exemption
- H. Consumer goods/ services exemption
- I. Directors' indemnity/ insurance

G. Monetary limits for de minimis exemption

Current Rule

- Connected transactions are full exempt if
 - $<0.1\%$; OR
 - $<\text{HK\$}1$ million and $<5\%$

New Rule

- Increase monetary limit from $\text{HK\$}1\text{m}$ \rightarrow $\text{HK\$}3\text{m}$

H. Consumer goods/services exemption

New Rule

- Relax condition on exempting transactions involving consumer goods/ services
 - Remove 1% restriction on total consideration or purchase

I. Directors' indemnity/ insurance

New Rules

- Exempt (i) indemnity for directors and (ii) directors' liabilities insurance, if
 - the liabilities are incurred in the course of performing their duties, and
 - the insurance/indemnity is allowable under the laws of
 - (a) Hong Kong and
 - (b) the place of incorporation of the company providing the indemnity/
purchasing the insurance

Example

- Under Mr. A's director service contract, Listco will provide indemnity for Mr. A's liabilities arising from
 - proper discharge of duties by Mr. A and
 - negligence, default and breach of duty by Mr. A

(a) Can Listco apply the new directors' indemnity exemption?

No. HK Companies Ordinance does not allow directors' indemnity to cover negligence, default and breach of duty by directors.

(b) Can Listco apply the current directors' service contract exemption?

No.

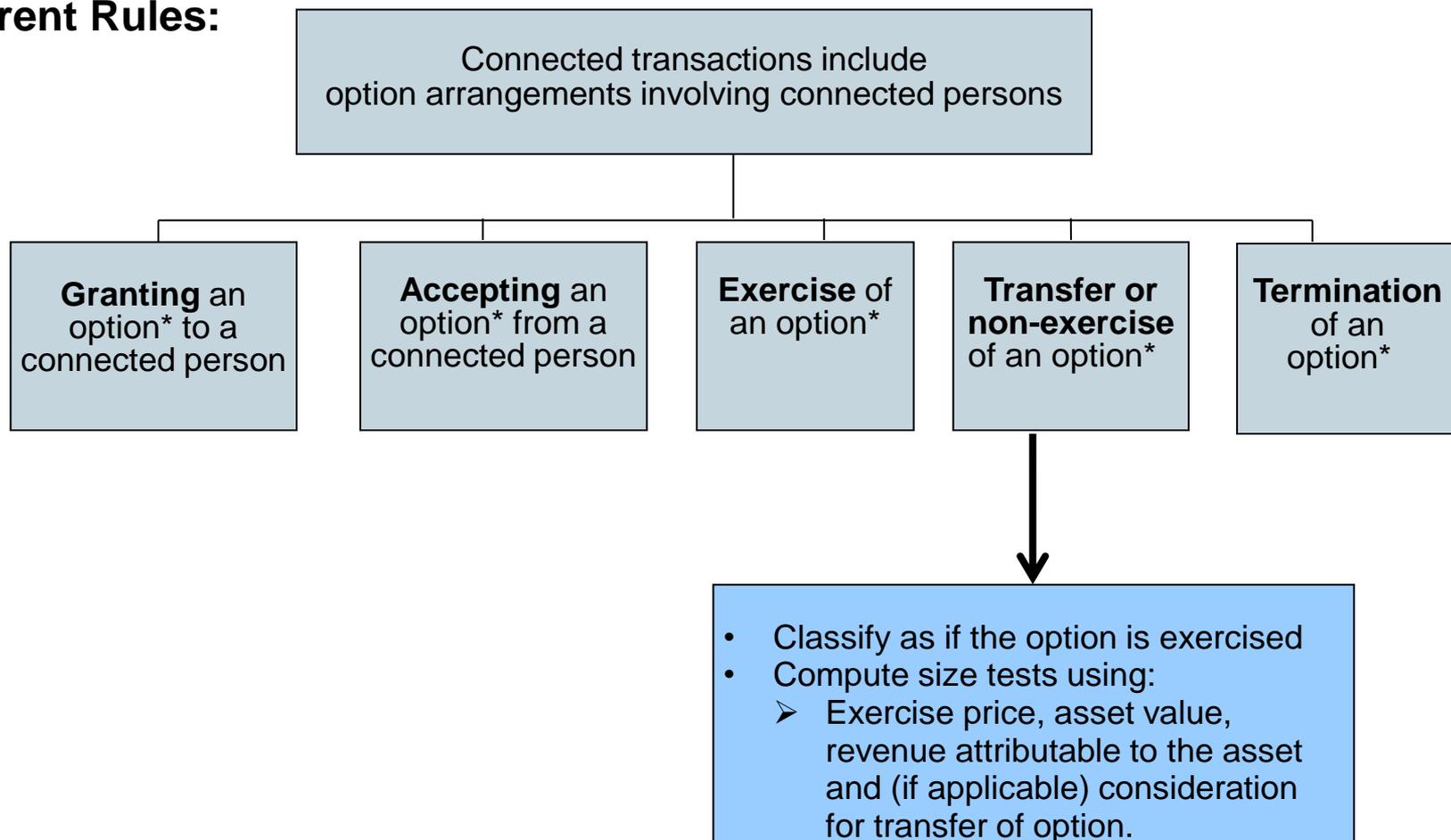
Rule amendments

- Requirements for connected transactions

- J. Option arrangements
- K. Independent directors' view on transactions
- L. Auditors' annual confirmation on CCTs

J. Option arrangements

Current Rules:



* Option to buy or sell assets or subscribe securities

J. Option arrangements

(1) Termination of option

Current Rule:

- Termination of option is a transaction.
- Not specify how to calculate size tests.

New Rule:

- Termination of option will be classified as if the option is exercised.
→ Consistent with non-exercise or transfer of option

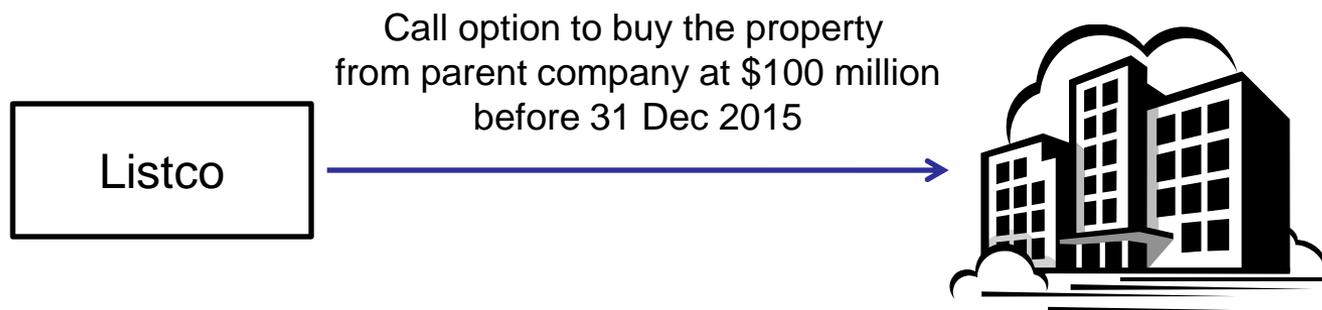
J. Option arrangements

(2) Classification of option arrangements

New Rules:

- Allow alternative test to classify transfer/non-exercise/termination of option:
 - 1) Assets and consideration ratios calculated based on the higher of
 - (a)(i) *Put option*: Exercise price less asset value
 - (ii) *Call option*: Asset value less exercise price
 - (b) Consideration or amount payable/receivable by the issuer
- 2) Require Exchange's prior consent
- 3) Asset valuation by independent expert using generally acceptable methodologies
- 4) INEDs' and IFA's view: fair and reasonable, in the interest of issuer and shareholders as a whole
- 5) Announce the transaction including INEDs' and IFA's view

Example



- On 30 Jun 2015, Listco obtains a property valuation at \$150 million, but decides not to exercise the option before its expiry.
- Current Rule: Asset ratio: \$150 million; Consideration ratio: \$100 million

If Listco proposes to apply the alternative classification test, how should it compute the size tests?

Compute the asset and consideration ratios based on \$50 million (i.e. asset value less exercise price).

K. Independent directors' view on transactions

Current Rule:

- Independent board committee must opine on:
 - whether the connected transaction is fair and reasonable and in the interest of issuer and shareholders as a whole

New Rule:

- Require independent board committee' opinion to also cover:
 - whether the connected transaction is on normal commercial terms and in the issuer's ordinary and usual course of business

L. Auditors' annual confirmation for CCTs

New Rule:

- Align auditors' annual confirmation for CCTs with HKICPA Practice Note 740
 - Codify current practice to accept negative confirmation

Transitional arrangements

For agreements entered into before Rule changes:

- One-off connected transactions
 - Issuers should comply with the connected transaction requirements applicable at the time of entering into the agreement.
- Continuing connected transactions
 - Issuers may apply the exemption for the reporting or annual review requirements in the next annual reports → need to announce

Guidance letter on continuing connected transactions (CCTs)

- Purpose
- Regulatory framework for CCTs
- Fixed term agreements
- Framework agreements

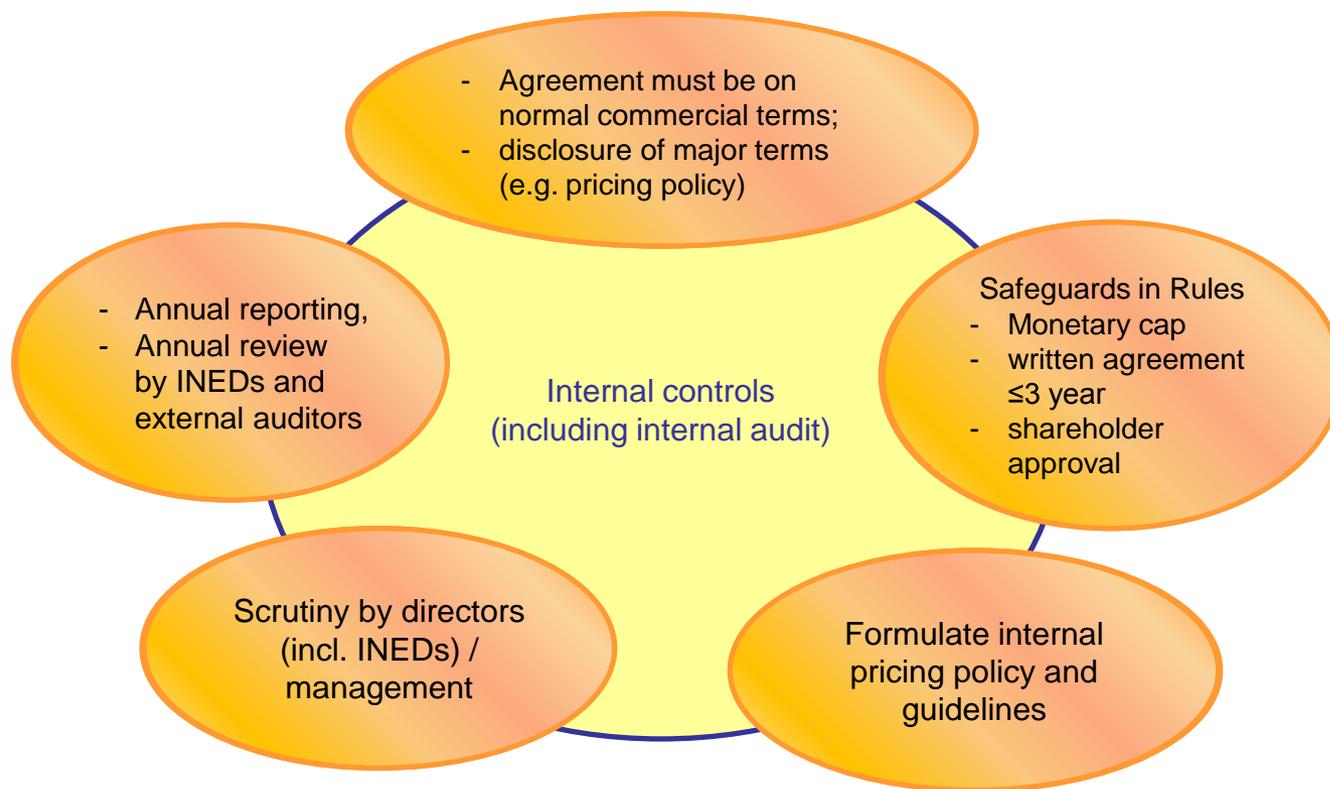
Guidance letter on continuing connected transactions (CCTs)

Purpose

- Improve disclosure about terms of CCT agreements
- Provide sufficient safeguards to ensure terms of CCTs are normal commercial terms

Regulatory framework for CCTs

Current Rules and market practice for CCTs



Fixed term agreements

- Contain specific pricing terms and fixed transaction volume

- Example:
 - fixed total or per unit consideration
 - based on a pre-determined formula (e.g. cost plus 2%)
 - based on published reference price (e.g. government rates, quoted commodity prices)

Fixed term agreements

Our guidance

- Issuers must disclose the specific pricing terms *[MB R14A.35(1)/ GEM R20.35(1)]*
 - Should not merely describe the parameters used for determining the consideration or formula

Framework agreements

- Specify pricing policy for the CCTs
- Ensure normal commercial terms – on par with terms available to independent third parties
- Facilitate INEDs/auditors to perform their annual review

Framework agreements

Our guidance

- Issuers should disclose pricing policy/guidelines in their announcements and circulars.
- Separate pricing policy for each type of transactions under the agreement.

Unclear disclosure of pricing policies

Example 1:

“The transactions will be conducted on normal commercial terms. The consideration will be based on arms’ length negotiation with reference to the prevailing market prices.”

Example 2:

“The transactions will be agreed between the issuer and the connected person on a “cost plus” mechanism.”

Example 3:

*“The transaction shall be priced in accordance with the following terms:
(i) government-prescribed price; (ii) where there is no government-prescribed price, the government-guidance price; (iii) where there is neither a government-prescribed price nor a government-guidance price, the relevant market price; (iv) where none of the above is available or applicable, the price to be agreed between the parties which shall be determined on the basis of reasonable cost plus reasonable profit margin and by reference to the historical price”*

Part III: Rule changes relating to definitions of connected person and associate

New Rules

- Apply the Chapter 14A definitions of connected person/associate in other parts of the Rules

What are the implications?

- Extend the application of those affected Rules to the following persons:
 - **Extended connected persons:** issuer group's former directors in the last 12 months, and their associates
 - **Extended associates:** connected person's extended family members (person cohabiting with him as a spouse, his child aged 18 or above, his parents, siblings, and companies controlled by them)
- Deemed connected person is not extended.
- No change to the definition of "associate" if the connected person is a company.

Highlight of major changes

(A) Transactions

- **Reverse takeover rules:** Apply to assets injection from incoming controlling shareholder and his/its *associates*.
- **Notifiable transaction announcement:** Confirm counterparty (or its beneficial owner) is also independent of *connected persons*.

Highlight of major changes

(B) Voting at general meeting

- **Significant corporate actions** (e.g. withdrawal of listing, refreshment of general mandate, etc.) / **Spin-off** : Require controlling shareholders and his/its *associates* to abstain from voting at general meeting*.
- **Director's service contract (>3yrs)**: Require the director and his *associates* to abstain from voting at the general meeting.

** For significant corporate actions, if there is no controlling shareholder, directors and chief executive and their associates are required to abstain from voting in favour. For spin-off proposals, the controlling shareholder who has a material interest in the proposal and his associates is required to abstain from voting.*

Highlight of major changes

(C) Share options

- **Grant of options to connected persons:**
 - Require INEDs to approve grant of options to the issuer's director, chief executive or substantial shareholder and their *associates*.
 - Apply the announcement/disclosure requirement to grant of options to the issuer's director, chief executive or substantial shareholders and their *associates*.
 - Require shareholder approval for grant of options to the issuer's substantial shareholder or INED and their *associates*, exceeding the prescribed limit.

Highlight of major changes

(D) Sponsor/ IFA

■ Independence of sponsor:

- Require sponsor to confirm that it is not a **connected person** of the new applicant

■ Independence of IFA:

- Require IFA to confirm that it is not, and does not hold more than 5% of, an **associate** of the counterparty

→ Not extended to other members of the sponsor group/ IFA group

New Rules

- Rename the definitions of connected person and associate in Chapter 1
 - “Connected person” → “Core connected person”
 - “Associate” → “Close associate”

Guidance materials on Rule changes

- Summary of proposals in HKEx press release of 21 March 2014:
<http://www.hkex.com.hk/eng/newsconsul/hkexnews/2014/140321news.htm>
- FAQ Series 28: Requirements on connected transaction Rules
http://www.hkex.com.hk/eng/rulesreg/listrules/listrulesfaq/Documents/FAQ_28.pdf
- Guidance letter on CCTs:
<http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/iporq/Documents/gl73-14.pdf>
- Reference tables:
http://www.hkex.com.hk/eng/rulesreg/listrules/mbrulesup/mb_contxn_index.htm
http://www.hkex.com.hk/eng/rulesreg/listrules/gemrulesup/gem_contxn_index.htm

Thank you