

**CONSULTATION PAPER ON PROPOSED CHANGES TO
THE CONNECTED TRANSACTION RULES
Response to the Questionnaire**

Consultation Questions

A. Transactions with persons connected with an issuer only by virtue of their relationship with the issuer's subsidiaries

1. Do you think that the definition of connected person should exclude persons connected by virtue of their relationship with an issuer's subsidiaries?

Yes

No

Please provide reasons for your views.

We agree with the analysis in the Consultation Paper and agree to take the alternative approach of excluding only those subsidiaries that are insignificant.

2. If your answer to question 1 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

N/A

3. On the basis that the definition of connected person will continue to include person connected at the subsidiary level, do you agree with the proposal to introduce an “insignificant subsidiary exemption” for connected transactions?

Yes

No

Please provide reasons for your views.

We agree with the view that if the definition of connected person will continue to include a person that is connected at a subsidiary level, such subsidiary must be significant to the listed issuer in term of assets, revenues, and profits and that insignificant subsidiary should be excluded or exempted.

4. Based on your experience, do you think that the “insignificant subsidiary exemption” would be used by you (or for market practitioners, your clients)?

Yes

No

Please describe the circumstances and refer to Option 1 or 2.

There are many circumstances where insignificant subsidiaries are ‘used’ by clients, for example, in joint ventures with different partners, each individual joint venture subsidiary will be an insignificant subsidiary and will not be a major subsidiary as defined in Rule 13.25(2) under Option 1.

5. If your answer to question 3 is “Yes”, do you agree with

- (a) the proposed materiality threshold under (i) Option 1 or (ii) Option 2?

Yes (*please choose one of the following options*)

Option 1

Option 2

No

Please provide reasons for your views.

We prefer Option 1 as this is more stringent and is consistent with the concept of ‘major subsidiary’ as used or defined in Rule 13.25 the concept of which is known and is familiar to the market and all issuers.

(b) the proposed bases for assessing the significance of a subsidiary, i.e. the asset ratio, revenue ratio and the profits ratio?

Yes

No. The significance of a subsidiary should be determined by (*please specify*): _____

Please provide reasons for your views.

It is sensible to follow the tests of significance by reference to and *pari passu* with the tests for the definition of ‘major subsidiary’ under Rule 13.25(2).

(c) the proposed additional safeguard to require the consideration ratio be less than 10% if an “insignificant” subsidiary concerned is itself a party to the transaction or its securities/assets are the subject of the transaction?

Yes

No

Please provide reasons for your views.

We do not think it necessary to introduce the additional consideration test of 10% as an additional safeguard even if the ‘insignificant’ subsidiary per se is a party to the transaction or its securities/assets are the subject of the transaction. If such subsidiary is a party to the transaction, such transaction will per se be governed by the rules and requirements under Chapters 14 & 14A, if applicable.

(d) the proposed mechanism for applying the exemption to continuing connected transactions described in paragraph 27 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

If the issuer enters into any continuing connected transactions falling within the proposed exemption, we agree that:

- (a) the issuer must reassess the situation annually based on the latest published audited financial information of the issuer group;**
- (b) if the connected person no longer qualifies for the exemption, the issuer must disclose the facts in its annual report and from that date onwards, the issuer must comply with all reporting requirements for continuing connected transactions as the proposed exemption no longer applies; and**
- (c) the issuer must maintain a record of its insignificant subsidiaries.**

Given that such continuing connected transaction is exempted, we do not agree to limit the duration of the agreement or to follow the requirements in Rule 14A.35 which governs non-exempt continuing connected transactions.

We also take the view that if during the year, a subsidiary ceases to be an insignificant subsidiary and a transaction has been entered into prior thereto, which is exempted on the basis that such subsidiary was then an insignificant subsidiary, such transaction will still be exempted during its terms provided that such facts and circumstances will have to be disclosed to the Stock Exchange and the market by way of an announcement.

6. If your answers to question 5 are “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If you answer is “No”, please provide reasons and alternative views.

If our comments as above are accepted, consequential amendments will have to be made to the proposed draft Rule amendments.

7. If you agree with Option 2, do you think that the definition of “major subsidiary” under Rule 13.25 should be amended to align with that in the “insignificant subsidiary exemption” if adopted?

Yes

No

Please provide reasons for your views.

N/A

B. De minimis thresholds that trigger disclosure or shareholders' approval requirement for connected transactions

8. (a) For the exemption from independent shareholders' approval requirement, do you support the proposal to revise the percentage threshold to 5%? If your answer is "No", please specify the percentage threshold that you consider appropriate.

Yes

No. The percentage threshold should be (*please specify*): _____

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

- (b) For the exemption from all reporting, announcement and independent shareholders' requirements, do you support the proposal to revise the percentage threshold to 1%? If your answer is "No", please specify the percentage threshold that you consider appropriate.

Yes

No. The percentage threshold should be (*please specify*): _____

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

9. If your answer to question 8 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

10. Do you agree that a percentage threshold is sufficient to assess whether a connected transaction is eligible for the de minimis exemptions?

Yes

No

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

11. Do you believe that an absolute monetary cap should also be imposed, irrespective of the percentage threshold test for de minimis exemptions? If your answer is yes, please specify the monetary cap that you consider appropriate for fully exempt connected transactions (the monetary cap for connected transactions exempt from independent shareholders' approval would be adjusted proportionately).

Yes. The monetary cap for fully exempt connected transactions should be:

- HK\$100 million
- HK\$200 million
- HK\$500 million**
- HK\$1,000 million
- Other monetary cap (*please specify*): HK\$_____

No

C. Transactions that are revenue in nature and in the ordinary and usual course of business

12. Do you agree that the connected transaction Rules should govern revenue transactions with connected persons?

Yes

No

Please provide reasons for your views.

We have diverse views as to whether and to what extent the connected transaction Rules should govern revenue transactions entered into with connected persons in the ordinary and usual course of business of the issuer as similar transactions are excluded from the definition of “transaction” (under Rule 14.04(g) for the purpose of Chapter 14, subject to the necessary safeguards therein).

As many issuers are majority-controlled or state-controlled, we are inclined to agree with the Stock Exchange not to introduce a general exemption for revenue transactions with connected persons for the time being but to relax certain connected transaction requirements in relation thereto so as to strike a regulatory balance between the costs to the issuers and the benefits to the market.

We also suggest the Stock Exchange should review this issue regularly so as to reflect the views of the market.

Proposed exemption for revenue transactions with associates of a passive investor

13. Do you agree with the proposed exemption for revenue transactions with associates of a substantial shareholder who is a passive investor in the issuer group?

Yes

No

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

14. Do you think that the proposed exemption should also require the substantial shareholder be a passive investor in the relevant associate, for example, it is not involved in the management of the relevant associate?

Yes

No

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

15. If your answer to question 13 is “Yes”,
- (a) do you agree that the passive investor must be a sovereign fund or an authorised unit trust or mutual fund?

Yes

No

Please provide reasons for your views.

Please see our views and comments on question 15(b).

(b) do you think that the exemption should be made available to other passive investors? If so, which?

Yes. The exemption should be made available to *(please specify)*:

No

Please provide reasons for your views.

We are inclined to exempt all associates of any substantial shareholder (of an issuer) if such substantial shareholder is a passive investor of the issuer meeting the criteria set out in paragraph 59 of the Consultation Paper, and is not just limited to a sovereign fund, unit trust or mutual fund.

(c) do you agree that the passive investor must not have representative on the board of directors of the issuer and its subsidiaries?

Yes

No

Please provide reasons for your views.

We think that in order to qualify for the status of a passive investor, it must not have a representative on the Board of Directors of the issuer and its subsidiaries, otherwise such passive investor will have an influence on the Board that is or may be in conflict with its status and position as a passive investor.

(d) do you agree with other proposed conditions set out in paragraph 59 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

We agree with the conditions set out in paragraph 59 of the Consultation Paper except that the passive investor should not only be limited to a sovereign fund, unit trust or mutual fund but should be expanded to include all entities that meet the conditions under paragraph 59.

We also take the view that a substantial shareholder ceases to be a passive investor and hence its associates will cease to be exempted; any transaction entered into prior thereto, on the basis of such exemption, will still be exempted during its term, provided that such facts and circumstances will have to be disclosed to the Stock Exchange and the market by way of an announcement, and any future transactions will be subject to the normal connected transaction rules.

16. If your answer to question 13 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

If our comments are accepted, consequential amendments may be required.

Proposed modification of the exemption for provision of consumer goods or consumer services

17. Do you agree with the proposed changes to expand the exemption for acquisition of consumer goods or services described in paragraph 66 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

We agree with the views outlined in the Consultation Paper.

18. If your answer to question 17 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

19. Can you think of any other suggestions to improve the regulation of revenue transactions with connected persons?

Yes

No

If your answer is “Yes”, please elaborate your views.

HKEx may consider adopting the mechanism under Rule 14A.35 and annual review procedures under Rules 14A.37 & 14A.38 to exempt all connected transactions that are of a revenue nature and are entered into in the ordinary and usual course of business of the issuer on terms that are no more favourable than those offered to independent third party consumers.

D. Definition of associate

(1) Definition of associate in Rule 1.01 (for non-PRC issuer) and Rule 19A.04 (for PRC issuer)

20. Do you support the proposal to carve out from the definition of associate the following entities?

(i) The holding company of the investee company or a fellow subsidiary of this holding company described in paragraph 68(e) of the Consultation Paper.

Yes

No

(ii) A company controlled by the investee company (not being a subsidiary of the investee company) described in paragraph 68(f) of the Consultation Paper and this company’s subsidiary, holding company and fellow subsidiary.

Yes

No

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

21. If your answer to question 20 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

(2) Extended definition of associate in Rule 14A.11(4)

22. Do you agree with the proposed extension of the definition of associate to a company in which a connected person’s relative has a majority control as described in paragraph 74 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

23. If your answer to question 22 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

E. Definition of connected person

(1) Non wholly-owned subsidiary

24. Do you agree with the proposed exemption for (i) transactions between a connected subsidiary and any of its own subsidiaries; and (ii) transactions between any subsidiaries of the connected subsidiary?

Yes

No

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

25. If your answer to question 24 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

26. Do you agree that a non wholly-owned subsidiary should not be regarded as a connected person in the circumstances described in paragraphs 81(a) and (b) of the Consultation Paper?

Yes

No

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

27. If your answer to question 26 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

(2) Promoter of a PRC issuer

28. Do you support the proposal to delete “promoter” of a PRC issuer from the definition of connected person?

Yes

No

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

29. If your answer to question 28 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

(3) PRC Governmental Body

30. Do you support the proposal to apply those provisions for PRC Governmental Body in Chapter 19A to connected persons of non-PRC issuers?

Yes

No

Please provide reasons for your views.

31. If your answer to question 30 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

Yes

No

If your answer is “No”, please provide reasons and alternative views.

(4) Management shareholder of a GEM issuer

32. Do you support the proposal to delete “management shareholder” from the definition of connected person in the GEM Rules?

Yes

No

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

33. If your answer to question 32 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

F. Other changes to the connected transaction Rules

(1) Exemption for small transaction involving issue of new securities by subsidiary

34. Do you agree with the proposal to remove the restriction on applying the de minimis exemptions to an issue of securities by the issuer's subsidiary?

Yes

No

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

35. If your answer to question 34 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

(2) Exemption for financial assistance provided on a pro-rata basis

36. Do you agree with the proposal to clarify that the exemption under Rule 14A.65(3)(b)(i) will apply where the commonly held entity is also a connected person?

Yes

No

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

37. If your answer to question 36 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

(3) Transactions with third parties involving joint investments with connected persons

38. Do you agree with the proposal to extend the exemption under Note 3 to Rule 14A.13(1)(b)(i) to disposal transactions mentioned in paragraph 108 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

We agree with the views and analysis of the Stock Exchange as outlined in the Consultation Paper.

39. If your answer to question 38 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

(4) Annual review of continuing connected transactions

40. Do you agree with the proposed Rule amendments to clarify that the annual review requirements apply to continuing connected transactions that are subject to reporting and disclosure requirements in Chapter 14A?

Yes

No

Please provide reasons for your views.

If our comments on question 19 are accepted, we think the annual review procedures should cover such connected transactions, even if they are exempted, as their exemptions are premised on the safeguards imposed under the annual review procedures.

41. If your answer to question 40 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

42. Are there any other comments you would like to make?

Yes

No

If your answer is “Yes”, please elaborate your views.

**The Law Society of Hong Kong
Securities Law Committee
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