

Corporate & Commercial

Listing Rules Changes Relating to Connected Transactions

Background

On 21 March 2014, The Stock Exchange of Hong Kong Limited (the “**Exchange**”) published the amendments to the Main Board Listing Rules and the GEM Listing Rules (collectively, the “**Listing Rules**”) in connection with the connected transaction regime, which will become effective on 1 July 2014. In this newsletter, we will highlight the key changes of the Listing Rules for your attention.

Key amendments of the Listing Rules

Plain language

The Exchange simplified the language of the connected transaction rules by replacing the current Chapter 14A of the Main Board Listing Rules (Chapter 20 of the GEM Listing Rules) with the plain language Guide on Connected Transaction Rules issued by the Exchange in April 2012, with minor modifications on drafting.

Exemptions for connected persons at the subsidiary level

Transactions between the issuer group and persons connected only at the subsidiary level will now be exempted from the circular and independent shareholder approval requirements. The exemptions are subject to the approval by the board and the independent non-executive directors’ confirmation that the terms of the transactions are fair and reasonable, and they are on normal commercial terms and in the interest of the issuer and its shareholders as a whole. It should be noted that the issuer is still required to publish an announcement for such transaction and may still require obtaining the shareholders’ approval under Chapter 14 of the Main Board Listing Rules (Chapter 13 of the GEM Listing Rules).

Further, all the persons connected with the issuer’s insignificant subsidiaries will be excluded from the definition of connected person. An insignificant subsidiary means a subsidiary whose total assets, profits and revenue compared to that of the issuer group are less than (i) 10% under the percentage ratios for each of the latest three financial years (or if less, the period since the incorporation or establishment of the subsidiary); or (ii) 5% under the percentage ratios for the latest financial years.

Refine the scope of associates

The Exchanges refined the scope of associates by excluding the trustees of an employee share scheme or occupational pension scheme from the definition of “associate”, provided that (i) the interests of the connected persons in the scheme are, individually or together, less than 30% and (ii) the scheme is established for a wide scope of participants.

The current definition of “associate” under the Listing Rules includes an entity in which a connected person has 30% or more direct or indirect interest. According to the current note 1 to Rule 14A.11(4) of the Main Board Listing Rules (Rule 20.11 of the GEM Listing Rules), an entity will be exempted from the definition of associate if the connected person holds an interest in the entity only through his/its shareholding in the issuer. Under the amended Listing Rules, the exemption will further apply if the interests of the connected person and his associates in the entity (other than the interests held through the issuer) are together less than 10%.

Refine the scope of connected transactions

The following transactions between the issuer and third parties will be excluded from the definition of connected transactions under the amended Listing Rules:

1. any disposal of interests in the target company to a third party where a controller (i.e. director, chief executive or controlling shareholder of the issuer or any of its subsidiaries) at the issuer level is the target company’s substantial shareholder;
2. any acquisition or disposal of interests in the target company from or to a third party where a controller at the subsidiary level is the target company’s substantial shareholder; and
3. transactions with third parties set out in the current Rule 14A.13(1)(b)(ii) to (iv)) of the Main Board Listing Rules (Rule 20.13(1)(b)(ii) to (iv)) of the GEM Listing Rules).

Exemptions from the connected transaction requirements

The current monetary threshold under the de minimis exemption for fully exempt connected transactions (i.e. exempt from all reporting, announcement and shareholder approval requirements) will be increased from HK\$1 million to HK\$3 million.

For provision or receipt of consumer goods or services to or from a connected person, the 1% cap on transaction value, which is one of the current conditions for exemption, will be removed.

Further, indemnities provided to, or purchase of insurance for, directors against liabilities incurred in the course of performing their duties, which do not contravene any laws in Hong Kong and the place of incorporation of the issuer, will be exempted from connected transaction requirements.

Refinement or clarification of the connected transaction requirements

For connected transactions involving option arrangements, the termination of an option would be classified as if the option is exercised, unless the issuer has no discretion over the termination. Further, the Exchange introduced an alternative classification method for the transfer, non-exercise or termination of an option granted by a connected person.

Regarding the auditors' confirmation on continuing connected transactions, it will be aligned with Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants.

The independent board committee's opinion on a connected transaction must cover whether the transaction is on normal commercial terms and in the issuer's ordinary and usual course of business.

Alignment of the definitions of connected person and associate

The definitions of connected person and associate in Chapter 1 will be renamed as "core connected person" and "close associate" respectively to distinguish them from those governed by Chapter 14A of the Main Board Listing Rules (Chapter 20 of the GEM Listing Rules), which will also be applied in the following parts of the Listing Rules for ensuring consistency:

1. reverse takeovers;
2. significant corporate actions/ spin-offs/ directors' service contracts;
3. grant of share options to connected persons;
4. independence confirmation from a sponsor;
5. independence confirmation from an independent financial adviser; and
6. other parts where the use of the Chapter 14A of the Main Board Listing Rules (Chapter 20 of the GEM Listing Rules) definitions of connected person and associate are corollary to the connected transactions requirements.

Summary

The Exchange adopted most of the proposals with some amendments taking into account the market's comments. The changes aim to refine the scope of connected persons and connected transactions, fine tune the framework for continuing connected transactions and clarify the connected transaction rules. It is expected that the changes to the connected transaction rules will further improve the connected transaction regime in Hong Kong and provide clearer guidance to the market players.

For enquiries, please contact our Corporate & Commercial Department:

E: cc@onc.hk
W: www.onc.hk

T: (852) 2810 1212
F: (852) 2804 6311

19th Floor, Three Exchange Square, 8 Connaught Place, Central, Hong Kong

Important: The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

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