

## Extract of HKSA responses to the HKEx Consultation Paper on Proposed Amendments to the Listing Rules relating to Corporate Governance Issues

### Introduction of “total assets test” and “turnover test”

Consultation Proposal B.18.4 [Paragraphs 55 to 63 - Consultation Conclusion Report]

*We will amend the Rules to adopt a new basis for the "assets test". The new "assets test" will be the total assets being the subject of the transaction divided by the total assets of the issuer. The total assets of the issuer mean the total fixed assets, including intangible assets, plus the total current and non-current assets of the issuer. We will also make similar changes to certain provisions under the Rules which have made references to "net tangible assets" or "net assets", where appropriate. We will use "total assets" as the new basis for the relevant tests.*

Q47 Do you agree with our proposal?

HKSA : DISAGREE

While we do not disagree entirely with the principle of the proposal, we have reservations about the way in which it would work in practice. There is a perception that this proposed change is to facilitate certain issuers with large total assets as well as large total liabilities to make acquisitions and disposals without being burdened by the disclosure and shareholders' approval requirements that would have applied had the size of the transactions been determined by reference to the existing “assets test”.

Corporate governance should be about greater transparency, not less. We are of the view that if the proposed changes will result in fewer transactions being notifiable transactions, they will tend to result in a decrease in transparency – i.e. transactions that would under the current rules be required to be announced and be the subject of a circular, and possibly shareholders' consent, no longer being subject to such disclosure and shareholders' consent requirements. If this is the case, the changes would not promote better corporate governance. We note that the Consultation Paper does not provide any analysis (based upon a representative cross-section of notifiable transactions over a certain historical period) to show whether the proposed changes would, had they been in force then, have resulted in some of those transactions ceasing to be notifiable (and hence not being disclosed) or ceasing to be subject to shareholders' consent.

An alternative approach might be to stipulate a threshold of minimum total assets or market capitalisation, such that where an issuer exceeded this it would be permitted to use total assets as the basis for computing the assets test.

Conclusion B.18.5 [Paragraph 195 - Consultation Conclusion Report]

*We will amend the Rules so that if issuers can satisfy us that the anomalous results of profits test are due to exceptional circumstances, we may allow the adoption of a "turnover test" to substitute for the "profits test". The "turnover test" will only apply if the "profits test" is not applicable. The "turnover test" is the turnover attributable to the assets being the subject of the transaction divided by the turnover of the issuer.*

Q48 Do you agree with our proposal?

HKSA : DISAGREE

See reasons above for Q47. The proposed change may result in less transparency and disclosure by issuers engaging in transactions. The rationale behind the four tests is surely to provide an approximate comparison of the value of the issuer compared to the value of the assets being acquired or disposed of. Profits are surely a better typical approximation of value than revenue. If there are anomalies in applying the profits test to loss-making/ minimal profit making companies, this could be dealt with by providing for certain relaxations of the profits test in the Listing Rules.

Consultation Proposal B.18.6 [Paragraph 63 - Consultation Conclusion Report]

*We will amend the Rules to use total assets as the denominator for the "consideration test". The total assets of the issuer mean the total fixed assets, including intangible assets, plus the total current and non-current assets of the issuer.*

Q49 Do you agree with our proposal?

HKSA : DISAGREE. See our reply to Q47 above.

## New thresholds for notifiable transactions

### Consultation Proposal B.19.6(a) [Paragraphs 64 to 73 - Consultation Conclusion Report]

*We will adjust the threshold levels of relevant tests under the Rules, which have made references to "net tangible assets" or "net assets", where appropriate. For categorisation of notifiable transactions, the threshold levels of all size tests will be adjusted as follows:*

- (a) *Share transaction – a transaction where all percentage ratios is less than 5% but the transaction involves issue of securities for which listing will be sought as consideration.*

Q50 Do you agree with our proposal?

HKSA : DISAGREE

Based on the reasons set out in our comments on Q47 to Q49 above, we intend to retain the existing “assets test” and “profits test”. As such, the threshold for the classification of a share transaction should be retained at 15%.

### Consultation Proposal B.19.6(b)

- (b) *Discloseable transaction – a transaction where any of the percentage ratios is 5% or more but each is less than 25%.*

Q51 Do you agree with our proposal?

HKSA : DISAGREE

The existing threshold should be retained based on the reasons set out in our replies to Q47 to Q49 above.

### Consultation Proposal B.19.6(c)

- (c) *Major transaction – a transaction where any of the percentage ratios is 25% or more, but each is less than 100% for an acquisition transaction or less than 75% for a disposal transaction.*

Q52 Do you agree with our proposal?

HKSA : DISAGREE

The existing threshold should be retained based on the reasons set out in our replies to Q47 to Q49 above.

Consultation Proposal B.19.6(d)

*(d) Very substantial acquisition – an acquisition where any of the percentage ratios is 100% or more.*

Q53 Do you agree with our proposal?

HKSA : AGREE

Consultation Proposal B.19.6(e)

*(e) Very substantial disposal – a disposal where any of the percentage ratios is 75% or more.*

Q54 Do you agree with our proposal?

HKSA : DISAGREE. See our reply to Q40.

Q40 is in relation to the following proposal:

Consultation Proposal B.16.4 [Paragraph 189 - Consultation Conclusion Report]

*We will introduce in the Rules a new type of transaction, namely "very substantial disposals". This type of transaction will cover disposal of assets, business or company, where any of the percentage ratios under the various tests for classification of the transaction is 75% or more.*

Q40 Do you agree with our proposal?

HKSA : DISAGREE.

We are concerned about the practical problems faced by loss-making companies.

The proposal seems to imply (amongst other things) that a company must be able to comply with the requirements of Chapter 8 post disposal (see Rule 14.07(3)). This could be a commercial disaster for listed companies. A company may be loss-making and wish to dispose of a loss-making business which comprises 75% of its assets. However, to do so would result in the company being treated as a new listing applicant in circumstances where it cannot fulfil the Chapter 8 requirements. Presumably, the Company would remain suspended until it could satisfy the Chapter 8 requirements – perhaps indefinitely, possibly resulting eventually in de-listing. This would not seem to be in the interests of minority shareholders.

## CONNECTED TRANSACTIONS

### De minimis thresholds for connected transactions

**Consultation Proposal B.28.2(a) [Paragraphs 64 to 73 - Consultation Conclusion Report]**

*We will amend the Rules so that the basis for the de minimis thresholds for connected transactions will refer to the total assets instead of the net tangible assets of issuers. Consequently, we will also adjust the relevant percentage level of the de minimis thresholds. The revised Rules will provide the following de minimis thresholds:*

- (a) *a connected transaction will normally be exempt from all the relevant reporting, announcement and shareholders' approval requirements if it is on normal commercial terms where the total consideration or value is less than the higher of:*
- (i) *HK\$1,000,000; or*
  - (ii) *0.01% of the total assets of the issuer.*

Q67 Do you agree with our proposal?

HKSA : DISAGREE. See our comments on Q47 above.

**Consultation Proposal B.28.2(b)**

(b) *a connected transaction will normally be subject to the reporting and announcement requirements if it is on normal commercial terms where the total consideration or value is less than the higher of:*

- (i) *HK\$10,000,000; or*
- (ii) *1% of the total assets of the issuer.*

Q68 Do you agree with our proposal?

HKSA : DISAGREE. See our comments on Q47 above.