

6 July 2023

Exemptions and waivers from requirements of connected transactions

LC Lawyers
林朱律師事務所
Law firm member of the
EY global network



To reduce listed issuers' compliance burden, exemptions and waivers from all or some of the connected transaction requirements are available for specific categories of connected transactions.

Introduction

The rules on connected transactions are set out in Chapter 14A of the Listing Rules. The objective of the connected transactions rules is to ensure that a listed issuer takes into account the interests of shareholders as a whole when it or one of its subsidiaries enters into connected transactions. Connected transactions include both capital and revenue nature transactions. They may be one-off transactions or continuing transactions. The general requirements for connected transactions include disclosures in announcements, circulars and annual reports, and shareholders' approval. Persons with material interests cannot vote on the resolution approving the transaction.

Continuing connected transactions also require annual reviews by independent non-executive directors and the auditors.

To reduce listed issuers' compliance burden, exemptions and waivers from all or some of the connected transaction requirements are available for specific categories of connected transactions. These apply to connected transactions that are immaterial to the listed issuer's group, or specific circumstances where the risk of abuse by connected persons is low. This article summarizes the exemptions and waivers with respect to the connected transactions requirements under the Listing Rules.

Connected persons and connected transactions

Generally speaking, a connected transaction is any transaction between a listed issuer or any of its subsidiaries and a "connected person". "Connected persons" are defined to include:

1. a director, chief executive or substantial shareholder (holding 10% or more of the voting rights) of the listed issuer or any of its subsidiaries, or an associate of any such persons;
2. a person who was a director of the listed issuer or any of its subsidiaries in the past 12 months, or an associate of such a person; or

3. a connected subsidiary, namely: (a) a non-wholly owned subsidiary of the listed issuer where any connected person(s) at the issuer level are entitled to exercise, or control the exercise of, 10% of more of the voting power at general meetings of

the non-wholly owned subsidiary. This excludes an indirect interest in the subsidiary which is held by the connected person(s) through the listed issuer; or (b) a subsidiary of such a non-wholly owned subsidiary.

Requirements for connected transactions

Written agreement

- ▶ The listed issuer must enter into a written agreement with all relevant parties in respect of the connected transaction (LR14A.34)

Reporting

- ▶ The listed issuer's next published annual report must include the details of the connected transaction specified in LR14A.71, among others, the transaction date; the transaction parties and a description of their connected relationship; a brief description of the transaction and its purpose; total consideration and terms; and the nature and extent of the connected person's interest

Notification and announcement

- ▶ The listed issuer must notify the Stock Exchange as soon as possible after the terms of the connected transaction have been agreed upon and publish an announcement as soon as possible (LR14A.35 and 14A.68)

Independent shareholders' approval

- ▶ Connected transactions must be approved by the issuer's independent shareholders. Voting on the resolution approving the connected transaction must be by way of poll. Any shareholder with a material interest in the transaction(s) must abstain from voting (LR14A.36 and 14A.70(12)). The Stock Exchange may waive the general meeting requirement and accept a written independent shareholders' approval if: (a) no shareholder of the issuer would be required to abstain from voting if a general meeting were held; and (b) the written independent shareholders' approval is obtained from a shareholder or closely allied group of shareholders who (together) hold more than 50% of the voting rights in general meeting (LR14A.37)

Independent board committee and financial adviser

- ▶ An independent board committee (consisting only of independent non-executive directors) must be established to advise shareholders on the connected transactions (LR13.39(6)(a)). An independent financial adviser must be appointed to advise the independent board committee and independent shareholders on the matters set out above (LR13.39(6)(b))

Shareholders' circular

- ▶ The listed issuer must send a circular to shareholders at the same time as it gives notice of the general meeting to approve the transaction; or if the transaction is to be approved by way of written shareholders' approval from a shareholder or closely allied group of shareholders, within 15 business days of publication of the announcement (LR14A.46 and 14A.48). The shareholders' circular must comply with the contents requirements of LR14A.69(1) to (4), 14A.42, 14A.43, 14A.45 and 14A.70 and must include the letter from the independent board committee and the independent financial adviser's opinion

Additional requirements for continuing connected transactions

Fixed period of not exceeding three years

► In the case of continuing connected transactions, the agreement governing the transaction must be on normal commercial terms and must be for a fixed period. It must not exceed three years except in special circumstances where the nature of the transaction requires a longer period. In this case, the issuer must appoint an independent financial adviser to explain why the agreement requires a longer period and that it is normal business practice for agreements of this type to be of a longer duration (LR14A.52). The reporting requirements must be followed for each subsequent financial year during which the listed issuer undertakes the continuing connected transaction.

Annual cap requirement for continuing connected transactions

► The listed issuer must set a maximum aggregate annual cap expressed in monetary terms, the basis of which must be disclosed. The annual cap must be determined by reference to previous transactions and figures in the group's published information or be based on reasonable assumptions if no previous transaction exists. The annual cap must be approved by shareholders if the continuing connected transaction requires shareholder approval (LR14A.53). If the annual cap is exceeded, or if the relevant agreement is renewed or its terms are changed materially, the listed issuer must re-comply with the announcement and independent shareholders' approval requirements (LR14A.54).

Annual review requirements for continuing connected transactions

► Each year, the listed issuer's independent non-executive directors must review the continuing connected transactions and confirm in the annual report and accounts that the transactions have been entered into: (a) in the ordinary and usual course of business of the group; and (b) either on normal commercial terms or terms no less favorable to the listed issuer than those available to/from independent third parties; and (c) in accordance with the governing agreement on terms that are fair, reasonable and in the interests of the shareholders as a whole (LR14A.55). Each year, the auditors must provide a letter to the board of directors confirming whether anything has come to their attention that causes them to believe that the continuing connected transactions: (a) have not been approved by the issuer's board of directors; (b) were not, in all material respects, in accordance with the group's pricing policies if the transactions involve provision of goods or services by the group; (c) were not entered into, in all material respects, in accordance with the relevant agreement governing the transactions; and (d) have exceeded the annual cap (LR14A.56).



Exemptions from connected transactions requirements

The exemptions from connected transactions requirements are broadly divided into two categories: fully exempt from shareholders' approval, annual review and all disclosure requirements (**fully exempt connected transactions**); and exempt from shareholders' approval requirement (**partially exempt connected transactions**).

Fully exempt connected transactions include, but are limited to the following:

1. intra-group transactions
2. transactions with persons connected with insignificant subsidiaries
3. de minimis transactions
4. financial assistance
5. certain issues of new securities
6. purchases of own securities
7. directors' service contracts and insurance
8. buying or selling of consumer goods or services
9. sharing of administrative services
10. transactions with associates of passive investors

Fully exempt connected transactions	
1. Intra-group transactions	<p>Transactions between a listed issuer and a non wholly-owned subsidiary or between its non wholly-owned subsidiaries will not constitute connected transactions where:</p> <ol style="list-style-type: none"> a. listed issuer's subsidiaries are connected persons only because they are the subsidiaries of a connected subsidiary, transactions between these subsidiaries will not be treated as connected transactions. (LR14A.17); or b. a listed issuer's subsidiary falls under the definition of connected person only because it is: (i) a substantial shareholder of another subsidiary of the listed issuer; or (ii) an associate of a director (or a person who was in the past 12 months a director), a chief executive, a substantial shareholder or a supervisor of any subsidiary of the listed issuer. (LR14A.18).
2. Transactions with persons connected with insignificant subsidiaries	<p>Persons connected with the listed issuer's "insignificant subsidiaries" are not connected persons, and therefore the transactions with such persons are not connected transactions. An "insignificant subsidiary" is a subsidiary of the listed issuer whose total assets, profits and revenues are less than: (a) 10% under the percentage ratios for each of the three preceding financial years; or (b) 5% under the percentage ratios for the latest financial year (LR14A.09).</p>

<p>3. <i>De minimis</i> transactions</p>	<p>Transactions on normal commercial terms where each or all of the percentage ratios except the profits ratio is/are:</p> <ol style="list-style-type: none"> a. less than 0.1%; b. less than 1% and the transaction is a connected transaction only because the connected person is connected by virtue of its relationship(s) with one or more of the listed issuer's subsidiaries; or c. less than 5% and the total consideration is less than HK\$3 million (LR14A.76(1)). <p>This exemption does not apply to the issue of new securities by an issuer to a connected person.</p>
<p>4. Financial assistance</p>	<p>The following financial assistances are wholly exempt from connected transactions rules:</p> <ol style="list-style-type: none"> (a) Financial assistance provided by a banking company in its ordinary and usual course of business to a connected person or Commonly Held Entity¹ is fully exempt if it is conducted on normal commercial terms or better. (b) Financial assistance provided by a listed issuer group (which is not a banking company) to a connected person or Commonly Held Entity is fully exempt if it is: <ol style="list-style-type: none"> a. provided on normal commercial terms (or better to the group); and b. the assistance provided is proportional to the equity interest directly held by the listed issuer or its subsidiary in the connected person/ Commonly Held Entity and any guarantee is given on a several basis (LR14A.89). (c) Financial assistance received by a listed issuer's group from a connected person or Commonly Held Entity is fully exempt if: <ol style="list-style-type: none"> a. it is conducted on normal commercial terms or better; and b. it is not secured by the assets of the listed issuer group (LR14A.90). (d) Provision of an indemnity for a director of the listed issuer or its subsidiaries is fully exempt if: <ol style="list-style-type: none"> a. the indemnity is for liabilities that may be incurred in the course of the director performing his duties; and b. the indemnity is in a form permitted under the laws of Hong Kong and where the company providing the

¹ The term "Commonly Held Entity" refers to a company whose shareholders include:

- a. a member of the listed issuer's group; and
- b. a connected person(s) at the issuer level who (individually or together) can exercise or control the exercise of 10% or more of the voting power at the company's general meeting. This 10% excludes any indirect interest held by the person(s) through the listed issuer. (LR14A.27) ("**Commonly Held Entity**").

	indemnity is incorporated outside Hong Kong, the laws of the company's place of incorporation (LR14A.91).
5. Certain issues of new securities	<p>Issues of new securities by a listed issuer or its subsidiaries to a connected person are fully exempt where:</p> <ol style="list-style-type: none"> a. the connected person receives a <i>pro rata</i> entitlement to securities in its capacity as shareholder; b. securities are issued under a Chapter 17 share option scheme or under a share option scheme in existence before the issuer was listed for which approval for listing was granted at the time of listing; c. the connected person subscribes for securities in a rights issue or open offer through excess application (under LR 7.21(1) or 7.26A(1)); d. securities are issued under a "top-up placing and subscription" that meets the following conditions: <ol style="list-style-type: none"> i. the new securities are issued to the connected person: <ul style="list-style-type: none"> • after such connected person has reduced its holding in the same class of securities by placing them to third parties who are not its associates under a placing agreement; and • within 14 days after the date of the placing agreement; ii. the number of new securities issued to the connected person does not exceed the number of securities placed by it; and iii. the new securities are issued at a price not less than the placing price. The placing price may be adjusted for the expenses of the placing. (LR14A.92(4)).
6. Purchase of own securities	Share repurchases by a listed issuer or its subsidiary from a connected person on a recognized stock exchange are wholly exempt from the connected transaction requirements (unless the connected person knowingly sells shares to the listed issuer)(LR14A.94(1). Share repurchases under a general offer made under the Code on Share Buy-backs are also fully exempt (LR14A.94(2)).
7. Directors' service contracts and insurance	A director entering into of a service contract with the listed issuer or one of its subsidiaries is fully exempt (LR14A.95). Purchase and maintenance of insurance for a director of the listed issuer or its subsidiaries against liabilities to third parties that may be incurred in the course of performing his duties are fully exempt if it is in the form permitted under the laws of Hong Kong and where the company purchasing the insurance is incorporated outside Hong Kong, the laws of the company's place of incorporation (LR14A.96).

8. Sharing of administrative services	<p>The sharing of administrative services between a group and a connected person on a cost basis is fully exempt, provided that the costs are identifiable and are allocated to the parties involved on a fair and equitable basis.</p>
9. Buying or selling consumer goods or services	<p>A group buying consumer goods or services as a customer from, or selling consumer goods or services to, a connected person on normal commercial terms in the ordinary and usual course of business is wholly exempt if:</p> <ol style="list-style-type: none"> a. the goods or services are of a type ordinarily supplied for private use or consumption; b. the goods or services are for the buyer's own consumption or use and not be: <ol style="list-style-type: none"> i. processed into buyer's products or for resale; or ii. used by the buyer for any of its businesses or contemplated businesses. This condition does not apply if the buyer is the group and there is an open market and transparency in the pricing of the goods or services; c. they are used/consumed by the buyer in the same state as bought; and d. the transaction is on no more favourable terms to the connected person, or no less favourable terms to the group, than those available to or from independent third parties (LR14A.97).
10. Transactions with associates of a passive investor	<p>A connected transaction conducted between the listed issuer's group and an associate of a passive investor² is fully exempt if it meets the following conditions:</p> <ol style="list-style-type: none"> a. the passive investor is a connected person only because it is a substantial shareholder of the listed issuer and/or any of its subsidiaries; b. the passive investor <ol style="list-style-type: none"> i. is not a controlling shareholder of the listed issuer or its subsidiaries; ii. does not have any representative on the board of directors of the listed issuer or its subsidiaries, and is not involved in the management of the listed issuer's group (including having any influence over the management of the listed issuer's group through negative control (e.g., its veto rights) on material matters of the listed issuer's group);

² A "passive investor" is a substantial shareholder of the listed issuer and/or any of its subsidiaries that:

- a. is a sovereign fund, or a unit trust or mutual fund authorized by the Securities and Futures Commission or an appropriate overseas authority; and
- b. has a wide spread of investments other than the securities of the listed issuer's group and the associate that enters into the transaction with the listed issuer's group.

	<p>iii. is independent of the directors, chief executive, controlling shareholder(s) and any other substantial shareholder(s) of the listed issuer or its subsidiaries; and</p> <p>c. the transaction is of a revenue nature in the ordinary and usual course of business of the listed issuer's group, and conducted on normal commercial terms or better.</p>
--	---

Partially exempt connected transactions

De minimis transactions	<p>Connected transactions are exempt from the independent shareholders' approval requirement (but subject to the reporting and announcement requirements) where:</p> <p>a. the connected transaction is on normal commercial terms or better; and</p> <p>b. all of the percentage ratios except the profits ratio is/are on an annual basis:</p> <p style="margin-left: 20px;">i. less than 5%; or</p> <p style="margin-left: 20px;">ii. less than 25% and the total consideration is less than HK\$10 million. (LR14A.76(2))</p>
Exemption for connected persons at the subsidiary level	<p>Transactions with persons connected only at the subsidiary level are exempt from the shareholders' approval requirement if:</p> <p>a. the transactions are on normal commercial terms or better;</p> <p>b. the transactions are approved by the issuer's board of directors; and</p> <p>c. the listed issuer's independent non-executive directors confirm that the terms of the transactions are fair and reasonable, and they are on normal commercial terms and in the interests of the issuer and its shareholders as a whole (LR14A.101).</p>



Waivers from the Stock Exchange for connected transactions requirements

The Stock Exchange may waive any requirements under Chapter 14A in individual cases, subject to any conditions that it may impose. Listed issuers (or listing applicants (as the case may be)) need to apply to the Stock Exchange for the relevant waivers.

Transactions relating to non-executive directors

The Stock Exchange may waive all or some of the connected transaction requirements for a connected transaction with a non-executive director of the listed issuer or its subsidiaries if:

- a. the transaction is connected only because of the interest of a non-executive director; and
- b. the director does not control the listed issuer's group, and his principal business interest is not the listed issuer's group.

Where a waiver is granted from the shareholders' approval requirement, the Stock Exchange may require the listed issuer's auditor or an acceptable financial adviser to give the opinion that the transaction is fair and reasonable to the shareholders as a whole (LR14A.103).

Provision of guarantees to connected subsidiaries or Commonly Held Entities for public sector contracts awarded by tender

The Stock Exchange may waive all or some of the connected transaction requirements for a joint and several guarantee or indemnity provided by the listed issuer's group to a third party creditor for the obligations of a connected subsidiary or a Commonly Held Entity if:

- a. the guarantee or indemnity is required for a government or public sector contract awarded by tender;
- b. each of the other shareholders of the connected subsidiary or Commonly Held Entity has given a similar joint and several guarantee or indemnity to the third party creditor; and
- c. each of the other shareholders of the connected subsidiary or Commonly Held Entity has agreed to indemnify the listed issuer's group for the liability guaranteed, or indemnified at least in proportion to its equity interest in the subsidiary or entity. The listed issuer must demonstrate that such shareholder indemnity is sufficient (LR14A.104).

Continuing connected transactions of new applicants

The Stock Exchange may waive the announcement, circular and shareholders' approval requirements for continuing connected transactions entered into by a new applicant or its subsidiaries. The new applicant must disclose in the listing document its sponsor's opinion on whether the transactions are in the ordinary and usual course of business of the listed issuer's group, on normal commercial terms or better, are fair and reasonable and in the interests of the shareholders as a whole (LR14A.105).

Stock Exchange's discretion

In any event, the Stock Exchange has the power to deem any person to be a connected person (LR14A.19) and also reserves the right to specify that an exemption will not apply to a particular transaction (LR14A.75). In addition, the Stock Exchange may impose conditions on any waiver from strict compliance with the connected transactions requirements (LR14A102).

The Report covers thematic reviews on specific areas based on the results of previous years as well as emerging trends or matter to be of higher risks. This article summarizes HKEX's findings, focusing on (i) financial reporting and related controls, (ii) material asset impairments, and (iii) issuers' compliance with annual report disclosure requirements.

KEY CONTACT



LI Fai

Partner

Fai.Li@eylaw.com.hk

+852 2629 1722

Contact us

LC Lawyers LLP

Suite 3106,

31/F One Taikoo Place,

979 King's Road,

Quarry Bay, Hong Kong

Tel: (852) 2629 3200

Fax: (852) 2956 1980

https://www.eylaw.com.hk/en_hk

Follow us on WeChat



© 2023 LC Lawyers LLP.

All Rights Reserved.

APAC no. 03017701

This material has been prepared for general informational purposes only and is not intended to be relied upon as professional advice. Please contact us for specific advice.