Guide on Fighting Abusive Related Party Transactions in Asia – An Introduction

Fianna Jesover, Senior Policy Manager, Corporate Affairs Division

25 October 2010
INTRODUCTION & BACKGROUND TO THE GUIDE

CHARACTERISTICS OF THE ASIAN ECONOMY

1. Controlling ownership by family or state
2. Informal ways of doing business raises the risk of abusive RPTs
3. Legal & regulatory framework varies in effectiveness

The Guide was developed on a consensus basis by the Asian Roundtable Taskforce on RPTs in 2008 and 2009.

It was adopted by the Asian Roundtable in Manila on 9 September 2009.
Focus: Publicly traded companies
Goal: To be used as a benchmark to monitor and curb abusive RPTs
Subject: 2 main concerns of investors (monitor abusive RPTs and pre/post options if transactions are perceived to be abusive)

- 9 key recommendations
- Discussions/analysis of issues, challenges, examples of practices
- Addresses role of board of directors, independent directors, external auditors, shareholders & regulators
- Need for a balanced regulatory approach: Regulatory Impact Assessment (RIA)
List of the 9 key recommendations

1. Harmonised legal definition of ‘related party transactions’
2. Provide thresholds for disclosure and shareholder approval
3. Approval of RPTs by a majority of disinterested shareholders
4. Objectivity in the decision making process of the board
5. Independent directors should play a central role
6. Give non controlling shareholders sufficient influence over the nomination and election of independent directors
7. Company should develop and make public a policy to monitor RPTs
8. External auditors should be independent, competent and qualified
9. The legal and regulatory framework should ensure that legal action does not prohibit minority shareholders from seeking legal redress
Definition of related parties & RPTs

1- Given ownership structure, need clear definition
2- A legal definition that refers to control and broad enough to capture transactions that present a risk of abuse
3- Need to harmonise the definition among bodies of law, listing rules and accounting standards

The key to monitoring & curbing abusive RPTs is the **identification of related parties**

**Continuing or non-recurring RPTs?** Approach may differ

=> => => => => =>

Need for aggregation clause to address breaking up of transactions to avoid obligations
Ex-ante Actions
Disclosure & shareholder approval

- Strike a balance in threshold levels
- Thresholds based on materiality

1. Exemption from disclosure and approval
2. Threshold for disclosure
3. Threshold for shareholder approval

- Must be by a majority of disinterested shareholders

1. Single threshold
2. Different ratios
3. Hybrid threshold
Board oversight & approval

1 – Objective judgement

- Crucial in decision making
  =>=> => Independent directors play a key role
- Policy framework: board approval procedures, power to conduct investigations and right to obtain independent advice

2 – Challenges to independence

- Non-controlling shareholders must have sufficient influence over the nomination & election of independent directors
- Develop relevant expertise & competence - on-going training
- Excessive compensation may impair independence
Monitoring & role of auditors

Company should develop & make public a **policy to monitor RPTs**

**Role of auditors**
External auditors *complement* the role of the board – don’t replace it - in monitoring/curbing abusive RPTs

**Challenge** : Independence, competence & qualifications to provide the board and shareholders with assurance
Ex-post Actions
Effectiveways for shareholders to obtain legal redress

**CHALLENGES:**

- Class action suits not permitted in some jurisdictions
- Derivative suits unattractive
- Cost
- Lack of knowledge & experience within the judiciary
- Insufficient resource for regulators

The legal and regulatory framework should ensure that legal action does not prohibit minority shareholders from seeking legal redress (including specialised courts and alternative dispute resolution)

- Judiciary should be trained, independent, competent & experienced
- Regulators should be sufficiently resourced with the capacity to set priorities effectively
Implementation & Enforcement efforts

1. Coherent legal framework dealing with RPTs should be established in each jurisdiction

2. A balanced regulatory approach: Regulatory Impact Assessment (RIA) can be a useful tool
The way forward...

- The Guide as a **benchmark** for regulators, policymakers, practitioners and shareholders

- Spotlight on investor’s main concerns, hope it will prompt decision-makers to enhance **legal & regulatory framework**

- Ultimately, followed by **effective implementation** efforts, including **harmonisation of investor protection safeguards** and overall higher standards of corporate governance
The HK Exchange has a consultation paper out on refining some of the rules for connected transactions. The HK SEC will test these against the Guide, to see if they diverging from the Guide recommendations.

Malaysia and Philippines are including references to Guide recommendations in reform efforts.

RiskMetrics is sharing it with its clients and planning to include it as a pan-group framework for assessing related party transactions globally.

- CFA Institute
- Asian Corporate Governance Association
- IOSCO, APEC, IFC
- Latin American Roundtable
Thank you !