Related Party Transactions
Key implementation Impediments
Case Studies

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OECD Guide on Fighting Abusive RPT

Regulatory framework to monitor RPTS

- Definitions of connected persons and related parties
- Thresholds for Board and Shareholders’ approval
- RPT disclosure policies to investors
- Role of External Auditor
- Role of Independent Directors and Independent Advisors
- Independence of Independent Directors
- Shareholding voting mechanism and process
- Legal Redress for the minority shareholders
Related Party Transactions –

Types of Abusive Related Party Transactions

- Injection of assets
- Cross guarantees and loans to associates
- Privatization and sale of assets
- Transfer of wealth schemes

- Recurring Related party Transactions – Revenue rather than capital/ Asset transactions
Definitions – Who are Related Parties

Family Relationships

- Spouse, brother, sister, mother, father, son and daughter
- Cousin, step sister, mother in-law, auntie, uncle
- Grandparent, grandson, second cousins

Company relationships

- Parent / holding company, subsidiary
- Associates of the holding company
- Associates of the listed entity
I Own You, You Own Him, He Owns Me: The Lee Family’s Samsung Dynasty
Examples of related party transactions under FASB and IASB

<table>
<thead>
<tr>
<th>FASB</th>
<th>IASB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Services received or furnished, such as accounting, management,</td>
<td>Rendering or receiving of services;</td>
</tr>
<tr>
<td>engineering and legal services;</td>
<td>Leases;</td>
</tr>
<tr>
<td>Sales, purchases and transfers of realty and personal property;</td>
<td>Purchases or sales of property and other assets;</td>
</tr>
<tr>
<td>Use of property or equipment by lease or otherwise;</td>
<td>Purchases or sales of goods;</td>
</tr>
<tr>
<td>Borrowings and lendings;</td>
<td>Transfers of research and development;</td>
</tr>
<tr>
<td>Guarantees;</td>
<td>Transfers under license agreements;</td>
</tr>
<tr>
<td>Inter-company billings based on allocations of common costs</td>
<td>Transfers under finance agreements (including loans and equity</td>
</tr>
<tr>
<td></td>
<td>contributions in cash or in kind);</td>
</tr>
<tr>
<td></td>
<td>Provisions of guarantees or collateral;</td>
</tr>
<tr>
<td></td>
<td>Settlement of liabilities on behalf of the entity or by the entity</td>
</tr>
<tr>
<td></td>
<td>on behalf of another party.</td>
</tr>
</tbody>
</table>
RPT Disclosure Policies

Timely and Adequate Information is important to investors/shareholders.

**Malaysia, Singapore and Hong Kong** - Thresholds established for making announcements to shareholders

A circular is tabled at AGM for revenue and recurring items to be approved by shareholders.

**Company Practice**
Some companies disclose their RPT policies and procedures in the annual report; example- Bank of China
Recurring RPT Disclosure – SGX requirement

General Mandate from shareholders at AGM
RPT is revenue or trading in nature -

Circular to Shareholders
- The nature of the transactions
- Methods for determining transaction prices
- Independent financial advisors opinion
- Opinion from audit committee if different from IFA
- “interested persons” will abstain from voting on the resolution
- Aggregate value of the transactions
Recurring RPT in Malaysia—Announcement if deviation is >10 per cent

<table>
<thead>
<tr>
<th>Date</th>
<th>Cumulative Value of Transaction * (RM’000)</th>
<th>% of deviation since prev. ann. Based on mandated amount</th>
<th>Announcement ?</th>
</tr>
</thead>
<tbody>
<tr>
<td>31-Apr-09  (AGM)</td>
<td>1,500</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>31-Aug-09</td>
<td>1,680</td>
<td>12%</td>
<td>Yes</td>
</tr>
<tr>
<td>30-Sep-09</td>
<td>1,800</td>
<td>8%</td>
<td>No</td>
</tr>
<tr>
<td>30-Oct-09</td>
<td>1950</td>
<td>18%</td>
<td>Yes</td>
</tr>
</tbody>
</table>

* period should be from previous AGM to the next AGM
A sampling of related-party transactions disclosed to the Hong Kong Exchange

<table>
<thead>
<tr>
<th>Listed company</th>
<th>Nature of disclosed transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>C Y Foundation Group Ltd</td>
<td>Acquisition of 100% of a company owned by chairman and his spouse</td>
</tr>
<tr>
<td>Wo Kee Hong (Holdings) Ltd</td>
<td>Purchase of a unit of vintage Ferrari from a director and controlling shareholder</td>
</tr>
<tr>
<td>Great Wall Motor Co Ltd</td>
<td>Acquisition of companies in China</td>
</tr>
<tr>
<td>China Resources Logic Ltd</td>
<td>Acquisition of China Resources Gas Ltd</td>
</tr>
<tr>
<td>Sino Union Petroleum &amp; Chemical International Ltd</td>
<td>Acquisition of HK$600 million worth of shares from the Chairman of the Board</td>
</tr>
<tr>
<td>Central China Real Estate Ltd</td>
<td>Acquisition of 100% of CCRE Forest Peninsula from a connected person</td>
</tr>
<tr>
<td>Lippo China Resources Ltd</td>
<td>Joint announcement of continuing connected transactions (tenancy agreement)</td>
</tr>
<tr>
<td>Hong Kong Chinese Ltd</td>
<td></td>
</tr>
<tr>
<td>Honghua Group Ltd</td>
<td>Continuing connected transactions (sales and purchases framework agreements)</td>
</tr>
<tr>
<td>Advanced Semiconductor Manufacturing Corp Ltd</td>
<td>Continuing connected transactions (product sales, technology transfer and software licensing)</td>
</tr>
<tr>
<td>Zhongda International Holdings Ltd</td>
<td>Continuing connected transactions (sales of products and raw materials)</td>
</tr>
</tbody>
</table>
Role of External Auditor

External Auditors complement the role of the Board in monitoring and curbing abusive RPTs.

**ISA 550 – Auditing Standard – guide to auditing RPT**

Are they arms length transactions?
Is the pricing right for both recurring and one – off deals?
What is the best method to identify RPTs?
Are RPTs reported by the company complete?
Are there missing transactions?
Valuation Report Requirements - Malaysia

- Requirement of valuation report on real estate irrespective on the mode of sale/purchase consideration (cash or securities) for RPT:
  - all transaction which are ≥ 5% of the relevant percentage ratio
- Valuation report to be submitted to Bursa not later than 1 month before the submission of circular/draft circular (as the case maybe)
- Valuation must comply with SC’s Valuation Guidelines
- Significant change – issuer/ valuer must update valuation report

Source: bursa Malaysia
Case Study: CNOOC. CNOOC was listed in Hong Kong in 2001. It holds exclusive rights to PRC offshore oil and natural gas exploration rights as stated in prospectus when listed. It also provides technical services to its parent company. CNOOC called for an EGM in 2005.

CNOOC asked for raising of caps for continuing transactions for technical services provided to the parent company. It also asked for reclassifying of technical services into 3 categories; exploration services, oil and gas development and marketing and management.

CNOOC’s parent gave CNOOC a non compete undertaking at time of listing. CNOOC sought minority shareholder approval to give consent to the parent to engage in competing business, both onshore and offshore.

How would you respond to the EGM notice for both the transactions? What information and reports would you want to review in deciding on your vote?
Role of Independent Director

Case study: Satyam – an Indian company – provides computer network and outsourcing services to Coca Cola, Citigroup, Nissan Motors and Quantas. Employs 53,000 staff in Bangalore, Chennai and Hyderabad. Listed on NYSE and won the Golden Peach Ward by World Council of CG in 2007.

Chairman Raju (Major Shareholder) proposed to Board of Directors to buy two related companies Maytas Infrastructure and Maytas Property for USD1.6 billion on 16 Dec 2008. They seek only Board Approval – shareholder approval not required. BOD approved the deals. There are 6 INEDS and some are prominent businessmen and an academic. Nevertheless the Board approved it in the morning.

At Analyst briefing later that day –

- Investors questioned the deal. What questions would you ask?
- What is the role of Independent Non Executive Directors in the approval process of this transaction?
Satyam’s fall from grace

Source: NSE, CFA Institute
Board and Shareholder Approval

Board Approval - Interested Directors must not be allowed to vote.

Shareholder Approval - Interested shareholders must not be allowed to vote.

This practice is followed in Singapore, Malaysia, Hong Kong, China and Indonesia.

Independent Directors to approve RPT where controlling shareholders are usually the related party.
# Threshold for Shareholder Approval

<table>
<thead>
<tr>
<th>China</th>
<th>Singapore</th>
<th>Indonesia</th>
<th>Korea</th>
<th>Malaysia</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value above RMB30 million or 5 per cent of NTA</td>
<td>Single transaction 5 per cent of group latest audited NTA</td>
<td>No specific thresholds, but law requiring RPTs to be approved by independent shareholders.</td>
<td>Shareholder approval not required, only notification after board approval.</td>
<td>5 per cent of relevant ratios Asset ratio Profit ratio Consideration Ratio Revenue Ratio Transaction 0.25 per cent and below exempted from reporting</td>
<td>Shareholder approval not required Only Board Approval.</td>
</tr>
<tr>
<td>Recurring transaction 5 per cent on aggregate basis in one financial year</td>
<td>Transaction S$100k and below is exempted</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Shareholder Voting Mechanism

Case Study: CNOOC. In 2004, shareholder approval was sought to deposit RMB6.6 billion cash to CNOOC Finance for a 3 year period. This amounts to 16.6% of NTA of CNOOC. The EGM will be held on 29 April 2004, right after the Easter holidays in Hong Kong. You just received the notice as an investor with only one week to respond.

As an investor what information would you require to make a decision on your vote?

This case also bring up another practical issue to address. Voting process and voting proxies. What are your views on how this can be improved?
The Way Forward

Investors

Issuers

Advisors

Regulators

Markets