

# **PROXY *Governance*, Inc.**

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Roundtable on Abusive Related Party  
Transactions in Asia: Shareholder's Perspective

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**Presentation to**



**[October 2010]**



**PROXY** Governance

# Outline

- Kinds of related-party transactions requiring shareholder votes.
- Framework for evaluating related-party transactions.
- How Asia compares.
- Consequences of poor disclosure.
- Suggestions for improvement.



# Most Related Party Transactions not Subject to Shareholder Approval

- **Most transactions classified as day-to-day business transactions**
  - Transfer Pricing
  - Intercompany Loans and Guarantees
  - Leasing or Licensing Agreements between related companies
  - Loans to directors and officers (if allowed)
- **No reporting due to materiality disclosure threshold**
  - Often does not apply to consolidated financial statements as the consolidated statements present information about the holding and its subsidiaries as a single reporting enterprise.
- **Director approval adequate for most transactions from regulatory perspective**

# Related Transactions that Require Shareholder Approval

- **Sale of Company/ Asset**
  - Requirement in most jurisdiction
- **Purchase of Asset with stock**
  - No shareholder approval required if all cash transaction in most jurisdictions
- **Capital Raising or Restructuring of Capital**

# Not all Related-Party Transactions are Bad

- Very common in Asia; Results from ownership structure – family and state control.
- Red flag when economic interest not aligned to controlling interest.
- Should be an arm-length transaction: deal terms favorable to minority shareholders?
- The process of approval and transparency regarding deal terms is also key for gaining shareholder approval and trust.

# Evaluating the Overall Framework

- Regulatory framework for disclosure of related-party transactions.
- Quality of oversight provided by regulator.
- Legal liabilities of directors and quality of judiciary system – class action lawsuits.
- Internal controls and audit quality.
- Disclosure of company policy on related-party transactions.
- Financial press coverage and analysis.

# PGI Framework for Evaluating the Review Process

- Quality of directors and overall independence of company board.
- Disclosure document should address:
  - Deal Terms - nature of transaction, amounts involved, financing methods;
  - Process of oversight provided by independent directors;
    - Appointment of independent special committee,
    - Advice sought from independent financial advisors,
    - Related-parties abstain from discussion and voting.
- Market reaction to deal.
- Company history with regard to related-party transactions.



# Related-Party Transactions Framework in Asian Countries

Criteria	China	HK	India	Indon.	Malay	SK	Taipei
% of publicly traded company with controlling shareholder	69%	56%	45%	80%	26%	10%	5%
% of companies that report RPTs (1% of revenue or more) in last 3 yrs	53%	38%	17%	0%*	7.4%	53%	16%
Are class-action suits common?	No	No	No	No	No	No	No
Are derivative suits common?	No	Yes	No	No	No	No	No
Supermajority vote for mergers?	Yes^	No	Yes	Yes	Often	Yes	Yes^

Source: *Shareholder Rights Across Markets: A Manual for Investors*, CFA Institute, 2009

\* Disclosure threshold high- 10% of revenues or 20% of equity; ^ requires two-thirds of votes casts

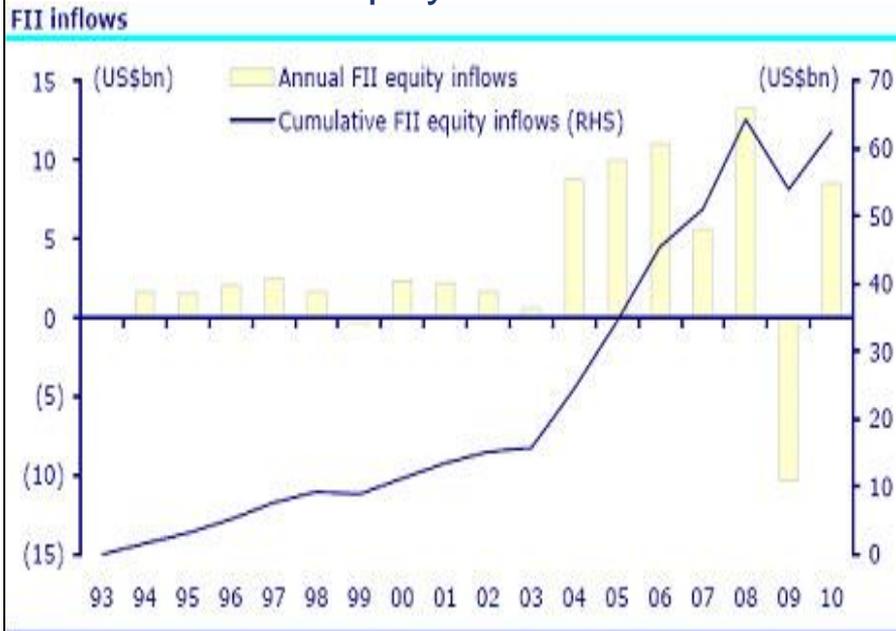
# How Asia Compares

- Insufficient information provided to shareholders to make informed decisions, though some better than others, such as Hong Kong, Singapore and Malaysia.
- Shareholder proxy reforms needed in some markets such as India and Hong Kong.
  - Voting in AGM's is by show of hands, unless poll demanded – one person vote, instead of one share, one vote.
  - In Hong Kong, since March '04 voting by poll mandatory for related-party transactions.
- Class action lawsuits should be encouraged.

# Consequences of Poor Disclosure

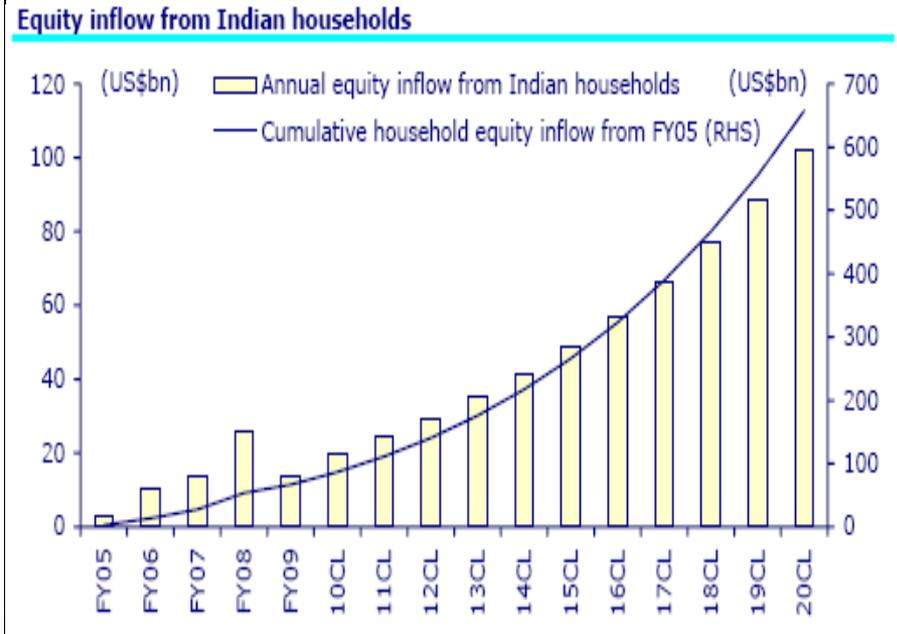
- Changing face of minority shareholders in EM countries: Foreign and domestic institutional investor participation in equity markets increasing.

- FII own about 16% of Indian equities (worth US\$147bn) and account for 10-15% of the equity



Source: Sebi, CLSA Asia-Pacific Markets

- Growth of MFs, domestic investments in equity mrkt to grow to about US\$ 100 billion in 2020



Note: Priced on 27 October 2009. Source: CLSA Asia-Pacific Markets

# Consequences of Poor Disclosure cont'd

- These shareholders (esp. foreign investors) expect comparable disclosure in English, have developed voting policies on related-party transactions, maybe required by law to vote shares.
- Often, lack of information results in withhold or abstain vote recommendations by proxy advisory firms, which could increase votes against management proposals.
- Increased transparency about related-party transactions and the review process employed by company is beneficial to shareholders and the company.

# Suggestions for Regional Improvement

- Enhance and streamline materiality limits and disclosure requirements for related-party transaction across Asian countries.
- Develop best practice guide for controlled companies with significant related-party transactions that would require, for example:
  - Independent board level committee to review related-party transactions for companies with multiple transactions.
  - Appointment of independent financial advisors to review fairness of terms and valuations used.
  - Enhance disclosure formats that provide relevant information to shareholders in a timely manner.



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