

The OECD report on related party transactions

Global issues but local solutions

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Dealing with RPT is a major problem around the world

- The OECD has regional corporate governance Roundtables in Asia, Mena, Latin America and Russia. Participants have identified RPT as a major policy and political issue.
- China has also identified the management of RPT as a special issue.
- In all areas companies are usually parts of a company group, sometimes pyramidal, and with concentrated control.

Do not to ban RPTs but manage them

- Economic efficiency in company groups often justified by underdeveloped capital markets etc
- The economic argument is that controlling shareholders need some private benefits of control to compensate them for oversight and for holding concentrated ownership and therefore risk .

The role of the OECD Principles

- One of the Financial Stability Board's core standards that all FSB members accept
- Consequently, OECD Corporate Governance Committee has been expanded to cover non-OECD G20 countries together with Hong Kong China and Singapore.
- Peer reviews then to advise committee members and also to test the Principles

transactions and minority shareholder rights

- Covers Belgium, France, Italy, Israel (a new OECD country) and India (G20 country) in detail
- More general coverage of many other G20/FSB countries and jurisdictions

Issues in managing RPT

- How to balance efficiency against possibility to abuse minority shareholders
- Definition, Disclosure and transparency
- Approvals mechanism
- Enforcement
- Responsibilities of controlling shareholders
- Dealing with company groups
- Dealing with State owned companies (SOE)

Definition and disclosure

- Nearly all on IFRS 24 or domestic equivalent for consolidated accounts: are the auditors up to speed?
- But with RPT, the question of continuous disclosure set by the regulator
- And to keep it manageable, a materiality/threshold definition and often define a subset of IFRS 24 transactions transactions and intragroup transactions
- Definitions: what is a transaction on normal or market terms . Recurrent transactions often excluded eernt
- Disclosing of substantial and procedural fairness.

Comparative arrangements in Europe

- Italy: has a quantitative criteria for defining major RPT, 5 per cent of various bases, Lower for company pyramids given stronger incentives, minor transaction reported and also to regulator, also monitor normal transactions.provision for intragroup disclosure
- Belgium: intra group disclosure; materiality criteria for disclosure and whether on market terms.
- France: special treatment for convention reglementee, wide definition but no materiality criteria: recurrent transactions under normal conditions exempted from reporting since May 2011; major disclosure by auditors report annually

Approvals mechanisms

- France: board authorisation with no special role for the audit committee; no special legal role of independent directors but supported by Code; ex post shareholder approval by disinterested sh based on report by auditor. Investor criticism.
- Belgium: Special role of independent directors on the board. Also cover large large intra group transactions; >1 per cent of consol assets; few ex ante or ex post sh rights but other legal protection of abuse of majority powers
- Italy: Ind directors in a committee and inde experts. For major transactions can refuse. If board proceeds then sh vote. For small transactions non binding but if board proceeds then disclosure
- Boards and audit committees often have major role

Are directors independent if elected by control SH ?

- Italy: Special slate for at least one director to be elected by minority
- Also provision for minority appointing at least one director in Israel
- Belgium: loss of reputation important. Also might have been important in India
- The exchanges in China can denounce a board member director which has significant consequences
- In all need for directors to declare interest

Enforcement and redress

- Few derivative actions around the world. Israel and India now moving to financially support litigation
- Redress limited
- Italy: jurisprudence support for compensation principle
- Violation of minority rights: few cases
- Abuse of corporate property in Europe but few cases concerning listed companies
- Important role of regulator in covering market transactions and important for controlling whether interests declared by directors and shareholders

Responsibility of Controlling shareholders?

- Covered by abuse of minority rights in Europe but is it enough?
- In some such as Germany and Israel there is also a fiduciary duty of the controlling shareholder to other shareholders

Dealing with company groups

- Already some provision including also for disclosing intra group transactions (eg India, Belgium, Italy)
- Rosenblum doctrine accepted in Belgium and France. Does it confuse the duty of loyalty of board members?
- Special provisions; eg in Italy lower threshold for pyramids given the incentive structure and for some transactions with companies where controlling shareholders do not have incentives for shifting
- Compensation principle and director liability

Dealing with SOEs

- Major issue in for example China, Brazil, Russia, India. Partial listings add to problem
- In Europe strong rules on state aid, competition and level playing field

Issues going forward

- Supporting derivative actions
- Special courts. India and Israel
- With limited regulatory and judicial resources, a role for disinterested shareholders
- Company group law: getting directors duties right
- Tightening materiality thresholds
- Better disclosure and avoid aggregation problems
- Independent directors: special voting systems as in Italy and Israel

Thank you

- The report and others are available at www.oecd-library.org