The OECD report on related party transactions

Global issues but local solutions
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Grant Kirkpatrick, Consultant, ex OECD
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 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