5.3.5

RELATED PARTY TRANSACTIONS

Related party transactions (RPTs) are one of the situations in which a COI is inherent. RPTs are usually legitimate transactions between the company and a related party. A problem arises where such a transaction allows the related party to extract more value from the company than it would otherwise be entitled to (for example, a majority shareholder being paid above the market price for goods it sells to the company).

The Board should approve the related party transaction policy, regularly revise it and oversee its implementation.

Related party

Although the definitions in national regulations differ in detail, for the purposes of RPT governance the concept of a related party usually includes at least the following persons:

1. a direct or indirect controlling shareholder of the company, or any other person that, through shareholding or otherwise, has sole or joint control or significant influence over the company;
2. a member of the Board or of the key management personnel of the company or its affiliated entities;
3. close relatives of the persons listed in (1) and (2);
4. the holding, subsidiary and other affiliated entities of the company and of the persons listed in (1) to (3).

Related party transaction

A related party transaction is any arrangement involving a transfer of value (resources, services, rights or obligations) between the company and a related party, irrespective of whether a price is charged.

RPT governance

RPT governance aims to distinguish, and prevent, RPTs that are unfair to the company, to its shareholders generally or to minority shareholders from transactions that benefit the company and enhance its value. Although national regulations differ,

good corporate governance requires at least the following standards in respect of RPTs:

1. **Sufficient information.** Management provides the approving body with sufficient information on the terms and conditions of the proposed transaction.
2. **Audit committee opinion.** The opinion of the Board's audit committee (if the company has one) on the proposed RPT is obtained before the Board approves it. Committee members with a potential COI in respect of the RPT recuse themselves from its consideration and the vote, and follow the other principles of COI management.
3. **Board approval.** The RPT is approved by the Board in accordance with the RPT policy. Board members with a potential COI in respect of the RPT recuse themselves in the same way.
4. **Approval conditions.** When considering and approving an RPT, the audit committee and the Board must ensure that:
    i. the transaction is at *arm's length*; if it is not, the approving body must evaluate and justify that the RPT is *in the best interests* of the company and is *not unfair* to the shareholders unrelated to it. Before approving the RPT, the audit committee or the Board may obtain an independent qualified third-party opinion on the fairness of the transaction (a *"fairness opinion"*);
    ii. **the same internal procedures** have been followed for the evaluation, approval and monitoring of the RPT as for any other third-party transaction;
    iii. continuing RPTs (for example, the provision of services over a period of time, as opposed to one-off purchases) are regularly revisited, including:

    – regular reporting on and monitoring of the performance of the RPT;

    – regular re-evaluation and re-approval of the transaction, to ensure that it continues to be at arm's length, fair and in the best interests of the company; and

    – a change of its terms, or its termination, where it can no longer be justified as fair or as serving the interests of the company.

5. **Disclosure.** RPTs are disclosed in the company's financial statements and annual report.

Transactions with related parties entered into in the ordinary course of business and on market terms, and non-material transactions, are usually excluded from prior evaluation and approval. The permitted exclusions should be defined in the RPT policy and comply with national regulatory requirements, and summary information

on such transactions should be reported regularly to the Board (for example, in the regular compliance reports).

KEY TAKEAWAYS

A. Related party transactions are transfers of value between the company and a related party: a controlling shareholder, a member of the Board or key management, their close relatives, or affiliated entities. They are usually legitimate but carry an inherent conflict of interest.

B. The Board approves an RPT policy, revises it regularly and oversees its implementation. Its purpose is to prevent transactions that are unfair to the company, its shareholders generally or minority shareholders.

C. Before approval, management provides sufficient information, the audit committee gives its opinion, conflicted members recuse themselves, and the Board satisfies itself that the transaction is at arm's length or otherwise justified as being in the company's best interests, if necessary, with an independent fairness opinion.

D. RPTs follow the same procedures as any third-party transaction, continuing RPTs are re-evaluated and re-approved regularly, and RPTs are disclosed in the financial statements and annual report.

E. Ordinary-course, market-terms and non-material transactions may be excluded from prior approval if the policy so provides and the law allows, but summary information on them is still reported to the Board.

QUESTIONS FOR THE BOARD

1. *Do we have a Board-approved related party transaction policy that defines related parties, approval thresholds and permitted exclusions in line with national law?*
2. *Which related party transactions did the Board approve in the last year, and for each, how did it satisfy itself that the terms were at arm's length or otherwise in the company's best interests?*
3. *Did the audit committee give its opinion before approval, and did all conflicted members recuse themselves from the materials, discussion and vote?*
4. *Which continuing related party arrangements exist, when were they last re-evaluated, and are they still fair to the company?*
5. *Are related party transactions fully disclosed in the financial statements and annual report, and does the Board receive summary reporting on the transactions excluded from prior approval?*