

7 January 2022

Securities and Futures Bureau
No. 85, Section 1, Xincheng South Road,
Da'an District
Taipei City
Taiwan

To Whom it May Concern,

Proposed Draft Amendments to Regulations Governing the Acquisition and Disposal of Assets by Public Companies

We are writing in response to the call for public comment on the Proposed Draft Amendments to Regulations Governing the Acquisition and Disposal of Assets by Public Companies issued by the Financial Supervisory Commission on 08 November 2021.

General comments

We welcome this proposed revision to regulations related to related-party transactions (RPTs), which has long been a topic of discussion between ACGA and regulators in Taiwan. We particularly welcome the decision to propose adding a shareholder vote for some transactions, a significant shift from the previous requirements. We also note with appreciation the direct mention of our *CG Watch 2020* report in the announcement of the draft.

While the draft makes strides in addressing the risks to minority shareholders associated with these transactions, it is unclear how some remaining concerns will be addressed and we also reiterate our suggestion of taking a holistic approach to the issue. We elaborate further on these points below.

1. Structure of the related-party transaction regime

A long-standing concern of ACGA has been the fragmented nature of Taiwan's RPT regulations, which makes the system extremely difficult to navigate. We are pleased to learn that regulators are addressing this by preparing to publish a Guide to the regulations, which we believe will go a long way toward resolving the issue. We write this submission letter with the understanding that further clarification will be available in that Guide and we look forward to reviewing and commenting further once it is available.

Next, we would bring attention to the conceptualisation of how regulations and thresholds are triggered in the RPT system. The Taiwan rules seem to operate via what we would call an "opt-in" approach, while other markets such as Hong Kong use an "opt-out" approach. By this we mean that in Hong Kong, all RPTs are covered by the rules until they are opted out or

exempted, for example via *de minimus* rules. In Taiwan, it would appear that RPTs are not covered by the rules until they are opted in, ie particular thresholds such as 10% of total assets are met. We remain concerned that this approach may leave out far too many material transactions that in other markets would be subject to disclosure or shareholder approval. We would appreciate further clarification from the regulator on this point.

2. Types of transactions

Related to this concern about fragmentation, we observe that the proposed amendments apply to only one type of transaction – acquisition and disposal of assets. However, this is only one piece of the RPT puzzle and we suggest that the RPT system as a whole would benefit from a review and the addition of shareholder approval requirements for other types of transactions, in particular:

- Sales of goods and services
- Loans and loan guarantees
- Transactions involving financial institutions

We also would appreciate further clarification on what types of cumulative transactions are covered by the shareholder approval requirement and how such cumulations are calculated.

3. Definition of “related party”

We understand that the primary definition for “related party” in the rules rests on that provided in IAS24. While we recognise the value of referring to an internationally agreed-upon definition, we note that this definition was developed for accounting purposes and may not be strong enough for corporate governance purposes. We are concerned that it does not cover all the relevant material relationships and leaves too much room for interpretation, particularly in reference to “substantive” relationships with “influence” and “control”.

Furthermore, it is not clear how the rules are applied. Since the definition is in accounting rules, where does responsibility reside for identifying and disclosing related parties and RPTs for corporate governance purposes – with accountants or elsewhere?

We also note some apparent inconsistency in the rules, for example, IAS24 refers to family members including a person’s spouse, domestic partner, children and dependents, but not siblings or second-degree relatives, ie, uncles and aunts, nieces or nephews or grandparents and grandchildren. However, Article 18 of Regulations Governing the Preparation of Financial Reports by Securities Issuers does make reference to second-degree relatives of the president or chair of an issuer. It is not clear which definition takes precedence in which circumstances nor how such inconsistencies are reconciled in practice. We also note that it would appear first cousins are not included anywhere in the rules.

We also note that, unlike in Hong Kong, the definition of related party does not extend to the beneficiary level.

Beyond these are more serious concerns having to do with some of the unique characteristics of the Taiwan market. First, is the prevalence of minority controlling structures whereby it is possible to control or influence a listed company with very small shareholdings. Second, substantial shareholders may not hold directorships or exercise influence in their own name. Finally, the legal entity director system allows for the natural persons holding board positions to be changed at will. How are the complications of managing related parties in these circumstances addressed in the rules?

4. Exemptions

We were surprised to see that intra-group transactions are subject to a blanket exemption to shareholder approval in the proposed rules. We are concerned about this because in our view much of the risk for minority shareholder expropriation comes precisely from these intra-group transactions. We note that in Hong Kong related parties include “connected subsidiaries” defined as non wholly-owned subsidiaries of the listed issuer where any connected person(s) at the issuer level, individually or together, can exercise or control the exercise of 10% or more of the voting power at the subsidiary’s general meeting. In Hong Kong transactions with such entities are not exempt. In this case, we believe a blanket exemption for intra-group transactions puts Taiwan quite far behind international best practice.

5. Threshold

Our initial impression was that the threshold of 10% of total assets to trigger shareholder approval for an RPT would be quite high. However, we appreciate the regulator’s clarification that this figure is based on the parent company only financial statement so the actual number is likely to be considerably lower and could be lower than that used in other markets which base their thresholds on consolidated figures. That said, it is still unclear how this will work in practice and exactly how many transactions and of what scale and type will actually be subject to the requirement. We would appreciate further information on this from the regulator in the future.

6. Voting

The rules in this proposed amendment do not specify that interested parties are barred from voting in the shareholder approval process. Regulators have said that such interested parties will not be allowed to vote, but is not clear where in the rules this is specified. We would appreciate further clarification on who is barred from voting, how that is determined and what rules apply.

7. Disclosure

There are several places where RPTs are disclosed in Taiwan, for example on the stock exchange website under operating statements and under material disclosures, as well as in annual reports. However, there does not appear to be a centralised location to find information on such transactions. Might we suggest creating one, or, at least including information in the Guide on where to find all the RPT information available in English and Chinese.

Secondly, we find disclosure on RPTs in Taiwan to be very boilerplate and formulaic. It appears that for material disclosures, firms need only provide one-word or one-sentence answers to a 29-question template that in some cases does not even require firms to provide details on the nature of the relationship that triggered the requirement for disclosure in the first place. For more complete and informative disclosure, we suggest referring to the circular requirements in Hong Kong and requiring narrative disclosure on substantial RPTs.

On a related point, it will be important for shareholders to have access to full information on RPTs when they are exercising their approval rights. As we understand it, they are to have access to the same information as is available to the audit committee. We ask that this point be clarified in the rules. We also encourage regulators to ensure that the legal, internal audit and internal control units tasked with identifying related parties and providing information on RPTs to the audit committee and shareholders are functioning independently and are themselves free of undue influence from interested parties.

8. Enforcement

We would ask for greater transparency from the regulator on enforcement of RPT rules. There is no separate entry specific to RPTs in regulator enforcement disclosures and it is not clear what the scale is of RPT infractions nor how regulators approach enforcement. We would be particularly interested to know where in the system infractions and enforcement tend to occur. We would also be keen to know whether enforcement focuses on the “responsible person” of firms, who may often be rank-and-file employees simply following orders, or on interested individuals who exercise substantial influence. We would also be interested to know how the regulator handles instances of RPTs involving those who were not correctly identified as related parties and what mechanisms regulators have in place for identifying such relationships.

9. Appraisal

Finally, we appreciate that the proposed amendments, and related guidance on appraisals, offer further structure to the appraisal industry and expands the pool of candidates that can offer appraisal services. While this will hopefully serve to satisfy demand for appraisal services, we are concerned that by expanding the pool beyond accountants, there is the risk of the addition of unethical elements. Furthermore, we are quite concerned about devolving much of the responsibility for monitoring to professional associations. How will a high ethical standard be assured? We note that without a fair appraisal industry, legally requiring independent appraisal will not be effective. We hope that enforcement of the new appraisal rules will be strict, swift and fully disclosed. We also hope that regulators will keep a keen eye on this point and not hesitate to strengthen the rules or intervene if needed.

In conclusion, although concerns remain, we support the proposed amendments as a first step in strengthening Taiwan's RPT regime and we appreciate the addition of a shareholder approval requirement. We trust that further clarification will be included in the upcoming RPT Guide and we would be pleased to discuss any of the points in our letter further with you.

Yours sincerely,

A handwritten signature in black ink that reads 'NEESHA WOLF' with a stylized flourish underneath.

Neesha Wolf
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