

7 January 2022

**Financial Supervisory Commission R.O.C. (Taiwan)
Securities and Futures Bureau**

85, Sec. 1, Xinshen S. Rd., Da'an District,
Taipei City, Taiwan (R.O.C.)

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

Dear Sir/Madam,

On 9 November 2021, the Financial Supervisory Commission (FSC) released draft amendments to the “Regulations Governing the Acquisition and Disposal of Assets by Public Companies” (“Amendments”, “Regulations”) and welcomed public feedback. A significant proposed change is to require shareholder approval on Related-Party Transactions (RPT) for asset acquisitions and disposals that exceeds 10% of a company’s total assets. Given RPTs potentially pose more risk to minority shareholders, we welcome the FSC’s initiative to strengthen minority shareholder protections.

BlackRock¹ is one of the world’s leading asset management firms, providing quality investment management, risk management and advisory services for institutional investors, intermediaries and individual investors worldwide. BlackRock supports a regulatory regime that protects investors, especially minority shareholders rights, and facilitates responsible growth of capital markets.

From our experience as an investor in the Taiwan and global markets, we have some suggestions to consider on the proposed amendment and would like to provide the FSC with an international investor’s perspective on relevant issues that may assist in enhancing the RPT regulatory regime. Our views cover six main areas: definition of related-party, types of RPTs, exemption criteria, voting rights, voting threshold, and disclosure.

Definition of Related-Party

In discussing RPTs, it would be useful to first define what constitutes a “related-party”, which can refer to a wide range of relationships between entities and individuals. In the current draft of the Regulations, this definition is not readily available, which presents an initial hurdle for stakeholders wishing to establish whether the rules apply.

The second challenge arises due to a lack of clarity in the International Accounting Standards (IAS 24) definition of “related-party” in a few different scenarios. For example, the definition of “close family members” as a related party is limited to only

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first-degree relatives; however, the broader nexus of the family tree could potentially exert control over various listed entities in many Asian markets including Taiwan. Another grey area is determining whether an entity is controlled by a person or an entity when there are multiple layers of crossholding. Furthermore, how related entities are defined under the “Legal Entity Director” system, with representatives that could be replaced at any time, is unclear.

Within the region, both the Hong Kong Stock Exchange (HKEX) and Singapore Stock Exchange (SGX) provide extensive guidance on the circumstances in which parties would be considered “related” under listing regulations.² We strongly recommend introducing a clear and comprehensive definition of “related-parties” to ensure all stakeholders are aware of their rights, responsibilities and obligations.

Types of RPTs

RPTs can come in various forms, such as asset acquisition or disposal, rental agreements, privatization, mergers, loans, guarantees, endorsements, sales of goods and services, among the more common of such transactions.

We welcome the Amendments placing rental agreements, one-off acquisitions and disposal RPTs under shareholders’ voting authority. However, we believe all types of RPTs should also fall under scope, given that all RPTs could potentially be subject to abuse, transferring value to the related party at the expense of shareholders generally. The Hong Kong Stock Exchange (HKEX), for example, requires continuing RPTs be subject to shareholder approval at least once every three years.³

To facilitate this, we recommend having a consolidated RPT regulatory regime. Currently, regulations governing disclosure and internal control for different types of RPT are dispersed among different regulations. For example, the regulations governing annual report reporting requires RPT disclosures for sales of goods and services and loans and endorsement. However, compared to the Amendments, the Regulations Governing Loaning of Funds and Making of Endorsements by Public Companies do not have an RPT section that specifies internal control. RPT rules around the sales of goods and services are also unclear.

We believe it would be helpful to have a consolidated approach to all types of RPTs in Taiwan with regulations that govern the definition, disclosure, and internal control requirement such as having board, audit committee, and/or shareholder approval. Ideally, all different types of material RPTs should require shareholder vote by unaffiliated shareholders.

Exemption criteria

Conglomerates with controlling-shareholders are a common corporate structure in Asia, including Taiwan. It is not uncommon to see intergroup RPTs whereby the interests of a controlling shareholder take precedence over minority shareholders. To mitigate this risk, some regulators have set up mechanisms such as ensuring independent oversight at the board level and approval by minority shareholders of relevant RPTs.

² Chapter 14A.06-31 Connected Transactions, Equity Securities, Hong Kong Main Board Listing Rules (HKEX); Chapter 9 Interested Person Transactions - 904, Singapore Exchange Rulebooks (SGX).

³ Chapter 14A.52, HKEX

The current Amendments exempt intergroup RPTs from shareholder vote; instead, these are only subject to board approval. Despite regulations on board independence being strengthened with the guidance of the Corporate Governance 3.0 Roadmap, most of Taiwan's listed company boards are insufficiently independent – only one-third or less of the board being independent directors – to provide the necessary independent oversight to protect against conflict of interest. As such, we recommend that intergroup RPTs should not enjoy any exemptions from independent shareholder approval and that regulations be further enhanced to require independent shareholders' approval for all such transactions.

Voting rights

Board directors are required to not participate in discussions and vote on board agenda items where there may be a conflict of interest according to Article 16 of the Regulations Governing Procedure for Board of Directors Meetings of Public Companies. Similarly, related parties should be required to abstain from voting on RPT resolutions at general shareholder meetings to protect independent shareholders from the inherent potential conflict of interest that such transactions pose. Such requirements exist in the HKEX and Singapore Stock Exchange (SGX) listing rules.⁴

Ensuring that outcomes are determined through votes exercised by independent shareholders is particularly important when the controlling-shareholder is the related-party. If the controlling shareholder is allowed to vote, our experience has been that the outcome can often be a foregone conclusion, regardless of the impact on independent shareholders.

Voting threshold

Compared to other jurisdictions, the threshold for asset value that triggers shareholder approval under the proposed Amendments appears to be high, at 10% of total assets. In contrast, the SGX requires shareholder votes for RPT transactions over 5% of net tangible assets.⁵ We suggest having multiple criteria to adequately capture all material RPTs given companies' capital structures vary widely. For example, the HKEX considers ratios relative to asset and consideration value, profits, revenue and equity capital to determine voting and disclosure requirements.⁶ We note that currently provisions in the same Regulation also reference additional criteria such as 20% of paid-in capital and NT\$300m which would require audit committee approval.

Disclosure

For shareholders to comprehensively assess RPTs subject to their vote, robust disclosure is essential. In addition to the information listed in Article 15-1 of the Regulations, we suggest further disclosure on the background and rationale of the transaction, the identity of the related party, and the audit committee's recommendation on the transaction.

⁴ Chapter 14A.03 HKEX; Chapter 9 – 919 SGX.

⁵ Chapter 9 – 906 SGX.

⁶ Chapter 14A.33 HKEX.

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To make an informed decision, shareholders need more than generic descriptions commonly observed under the current disclosure regime. Disclosure should include other alternatives considered, the cost or strategic advantages the transaction presents, and detailed terms of the agreement. In addition, companies should be required to provide detailed information of the related party, including the significance of the transaction relative to the related party's financial position, a brief description of the related party's business, and its shareholding structure if it is a business entity. Finally, we recommend best practice disclosures to include the assessment process and advice of the audit committee, and where relevant, the board. We also recommend providing the above information for all types of RPT disclosures in the annual report regardless of the need for a shareholder vote.

Other recommendations & conclusion

The Amendments mark an important step by the FSC to introduce additional measures to protect minority shareholder rights and enhance good corporate governance practices in the market. We believe it is timely for the FSC to review a long-standing concern of investors, and our recommendations above represent our views and experience on the full breadth of issues surrounding the risks associated with RPTs.

The complexity of RPTs entails that progress will likely be achieved through a phased approach; thus, we believe it would be helpful if the FSC could make public the timeline on how the RPT regime will be systematically strengthened over time. Lastly, we recommend that over time, all material transactions that alter a company's risk profile, in addition to RPTs, be clearly defined and subject to shareholder approval as is the case in relevant regional exchanges, for instance HKEX and SGX.⁷

We welcome further discussion on any of the points raised and hope the consultation serves as a broader, long-term conversation on the RPT regime. Thank you once again for the opportunity to provide our views.

Yours faithfully,

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⁷ Chapter 14 HKEX; Chapter 10 SGX.