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An Approach to the New Rules of Shanghai Stock Exchange on Related Party Transactions of Listed Company

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The Shanghai Stock Exchange (SSE) issued the "SSE Implementation Guidelines to Related Party Transactions of Listed Companies" ("Guide") on 4 March 2011 for further standardization of the administration of listed companies. Based on a collection of provisions on related party transactions in existing rules like in "SSE Stock Listing Rules", the Guide details current regulating requirements with a view in new market and in new situation of administration. This article briefly explains some significant issues in the Guide.

Clarifies the Inner Functional Organs in Charge of the Management of Related Party Transactions of Listed Companies

It is said explicitly in the Guide that the responsibilities of control and daily management of a listed company's related party transactions shall be assumed by the audit committee or the related party transaction control committee under the board of directors. In accordance with the Guide, the audit committee (or the related party transaction control committee) shall confirm the list of the related parties and report it to the board of directors and the board of supervisors in a timely manner, thus endowing it with the duty of daily management of information about related parties. It is also regulated in the Guide that the audit committee of a listed company (or the related party transaction control committee) shall be entitled to review and comment on significant related party transactions in writing.

Elaborates the Scope of Related Parties and the Types of Related Party Transactions

Based on a series of existing rules, the Guide elaborates on the scope of related parties and types of related party transactions. In terms of the

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scope of related parties, the Guide stipulates that any natural persons, legal persons, or other entities as the shareholders holding over 10% equity of the holding subsidiary which has an important influence on a listed company should be regarded as the related parties. As for the types of related party transactions, some listed companies provide financial assistance or guarantee, in a proportion higher than their shareholdings or investments, to the company which jointly invested by them and their related parties, or declare abjuration of the right of capital increase according to shareholdings or investments or the preemptive right in the company which jointly invested by them and their related parties. The Guide explicitly lists the above transactions as related party transactions.

Indicates a Tougher Supervision on Purchase of Assets of Related Party at a High Premium

The Guide stipulates specific rules for the related party transactions of a listed company's assets purchase from related parties with a high premium. Concerning the significant related party transactions of a listed company's assets purchase at a high premium of over 100% from related parties, the Guide spells out stricter requirements for disclosure and decision-making processes, including provisions of disclosure of the motivation of its assets purchase at a high premium; provisions of online voting and other conveniences for shareholders participating in the shareholders meeting; provisions of profit prediction report on target assets in related party transaction issued by accountants with relevant qualifications in securities or future exchange; disclosure of all related data in the valuation, if the price of target assets would be determined by method based on the expectancy of future revenue, such as discounted cash flow technique (DCF), hypothetical development method of valuation (HDMV), etc; disclosure of the discrepancy between actual profit and predicted one as well as the special audit opinion, since the purchase of assets, for three (3) consecutive years in annual report; and provisions of explicit comment by connected transaction control committee or audit committee.

Clarifies the Conditions for Exemption in Related Party Transactions

The Guide specifies the conditions under which companies can apply to SSE for exempting from discussion and disclosure of the transactions in a way that the related party transactions are required. First, related party transactions based on public bidding or auction. Second, the pricing in the daily related party transaction is pursuant to the state regulations. Third, the interest rate of the financial assistance provided by a related party for a listed company is not higher than the benchmark interest rate of loan stipulated by the People's Bank of China and the listed company provides no mortgage or guarantee for the assistance. Fourth, a listed company with guarantee from related parties provides no counter-guarantee. Fifth, related party transactions between a listed company and other legal entities without connected relationship except sharing the common natural person as independent director. Sixth, the transaction involves a state secret, or a business secret or other situations which are recognized by SSE and whose disclosure would be a violation of laws and regulations concerning confidentiality, or would severely jeopardize the listed company's interest. Besides, a listed company may submit the application for exemption to the shareholder meeting for review if a company is established solely by the listed company and its related parties' monetary payment, and the ratio of equity shares in the company is decided by shares of contribution.

China Securities Regulatory Commission (CSRC) and stock exchanges have issued specific regulations and rules successively for standardization of related party transactions of listed companies. The Guide published by SSE details the requirements for decision-making and disclosure processes of listed companies' related party transactions. The promulgation and implementation of the Guide may help to further curb and prevent the improper related party transactions, thus is beneficial for the interest of listed companies and their shareholders.

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