

Consultation on defining Material Related Party Transactions and Disclosure Requirements as required in terms of the Shareholders Rights Directive II

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NOTE: The documents circulated by the MFSa for the purpose of consultation and in draft form and consist of proposals. Accordingly, these proposals are not binding and are subject to changes and revisions following representations received from Licence Holders and other involved parties. It is important that persons in the consultation bear these considerations in mind.

1. Purpose

On 20 May 2017, Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 (“the new EU Shareholders Rights Directive”, or “SRD II”), which amends Directive 2007/36/EC regarding the encouragement of long-term shareholder engagement, was published in the Official Journal of the European Union. The new EU Shareholders Rights Directive came into force on the 10th June 2017 and EU Member States are required to transpose SRD II into national law by 10 June 2019.

Following the 2008 financial crisis, certain deficiencies in the corporate governance of listed companies came to the forefront. In this regard, the European Commission¹ highlights specific shortcomings: the challenges of good-decision making and the corresponding control by shareholders, mistrust stemming from excessive directors' remuneration not comparable to performance, and bureaucratic procedures in exercising shareholders rights.

The new EU Shareholders Rights Directive aims to tackle the above-mentioned challenges through an approach that focuses on increased transparency, enhanced efficiency of the chain of intermediaries and improved long-term shareholder engagement. SRD II strives to further solidify the shareholders' position and contribute to the long-term sustainability of EU companies.

One of the provisions introduced by SRD II is to enhance transparency is the disclosure and approval of related party transactions. The new Article 9c of the SRD II aims to increase transparency and to protect the listed company and its shareholders, especially minority shareholders against the risk of the Related Party taking advantage from its position to the detriment of the listed company and its shareholders.

The SRD II requires Member States to define material related party transactions and to ensure that companies publicly announce material transactions with related parties. Also, Member States need to ensure that material related party transactions are approved according to procedures which prevent the Related Party from taking advantage of its position and provide adequate protection for the interests of the company and of the shareholders who are not a Related Party, including minority shareholders.

The existing Listing Rules already deal extensively with related party transactions and the Authority believes that robust procedures, where the Audit Committee has a very important role, are already catered for in the Listing Rules. However, the existing Listing Rules do not define what is “material” in the context of related party transactions and leaves it up to the discretion of the Audit Committee to decide what constitutes a material transaction.

In view of the new requirements of the SRD II in defining materiality in the context of a related party transaction and to ensure that companies publicly announce material transactions with related parties, the Authority has decided to issue this Consultation Document.

¹ European Commission Fact Sheet – Shareholders' rights directive Q&A, Dated 14 March 2017.

2. Related Party Transactions

2.1 Present Requirements

The present Listing Rules, specifically Listing Rules 5.135 to 5.144 in Chapter 5, set out safeguards that apply to transactions and arrangements between an Issuer and a Related Party. Such safeguards are intended to prevent a Related Party from taking advantage of its position and also to prevent any perception that it may have done so.

The present rules require the Audit Committee of the Issuer (or any other committee established by the Issuer that satisfies the composition requirements applicable to an Audit Committee) to vet and approve related party transactions. Where the proposed transaction is deemed to have a material effect on the Issuer's business, the Issuer has to make a Company Announcement which contains: i) the nature and details of the transaction; ii) the name of the Related Party concerned; and iii) details of the nature and extent of the interest of the Related Party in the transaction.

Furthermore and in terms of Listing Rule 5.142, where the proposed related party transaction is not approved by the Audit Committee but the Issuer still wants to proceed with the transaction, the Issuer is required, amongst others, to issue a Company Announcement which contains: i) the nature and details of the transaction; ii) the name of the Related Party concerned; and iii) details of the nature and extent of the interest of the Related Party in the transaction. Listing Rule 5.142.3, further requires the Issuer to obtain the approval of its shareholders.

In vetting and approving related party transactions, an Audit Committee is required to give consideration, amongst others, to the materiality of the transaction in the context of the Issuer's business.

2.2 Proposed Definition

In transposing the requirements of the SRD II, the Authority is proposing to define the term Related Party in line with International Financial Reporting Standards, which standards are applicable to listed companies in Malta. The Authority is of the opinion that this approach will help to align as much as possible the reporting of related party transactions as required by SRD II with the reporting of such transactions in the annual financial statements.

The Listing Authority is proposing to amend the definition of Related Party to read as follows:

“Related party shall have the same meaning as in the international accounting standards adopted in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council.”

In view of the requirements being imposed by SRD II to determine whether a related party transaction is material or not, the Listing Authority is proposing to introduce tests, which should be used by Issuers to determine the size of the related party transaction relative to that of the Issuer, as follows; (1) the gross assets test; (2) the profits test; and (3) the consideration test.

The *gross assets test* shall have the same meaning as defined under Listing Rule 5.151 to Listing Rule 5.155 of Chapter 5 of the Listing Rules.

The *profits test* shall have the same meaning as defined under Listing Rule 5.156 of Chapter 5 of the Listing Rules.

The *consideration test* shall have the same meaning as defined under Listing Rule 5.157 to Listing Rule 5.160 of Chapter 5 of the Listing Rules.

It is being proposed that Material Related Party transactions are defined as those transactions which would result in 5% or more of any one of gross assets, profits and consideration tests.

In this regard, a new definition under the Glossary section to the Listing Rules is being proposed to be included in order to define Material Related Party transactions as follows:

“Transactions entered into by the Issuer with a Related Party, where any of the tests mentioned in Listing Rule 5.151 to Listing Rule 5.155 (the gross assets test), Listing Rule 5.156 (the profits test) and Listing Rules 5.157 to 5.160 (the consideration test) result in 5% or more. In determining the materiality of the related party transactions, the audit committee shall take into account and ensure that those transactions with the same related party that have been concluded in any twelve month period or in the same financial year, and have not been subject to the requirements listed in Listing Rule 5.141, are aggregated.”

The aggregation provision set out in Article 9c(8) of the SRD II implies that even transactions that are not material, individually, need to be aggregated and, effectively, announced and approved by the Board of the Directors if the materiality threshold as defined above, is reached. Consequently, Listing Rule 5.143.7 which provides *“where the aggregate consideration or value of the related party transaction does not exceed fifty thousand (€50,000) in any twelve (12) month period.”* Under the Exemptions section will be deleted.

2.3 The Role of the Audit Committee

In addition to defining Material Related Party transactions, the following Listing Rules are being amended (as indicated in bold) to reflect the requirements of SRD II.

Listing Rule 5.140 – Audit Committee Considerations

5.140 *The audit committee shall give due consideration to:*

5.140.1 ***whether the transaction is a Material Related Party transaction***

5.140.2 *whether the transaction is in the ordinary course of the Issuer's business or the business of any its Subsidiary Undertakings as applicable;*

5.140.3 *whether the transaction gives rise to preferential treatment to the Related Party;*

5.140.4 *the nature of the transaction;*

5.140.5 *the position of the related party;*

5.140.6 *the influence that the information about the transaction may have on the economic decisions of shareholders of the issuer; and*

5.140.7 *the risk that the transaction creates for the issuer and its shareholders who are not a related party, including minority shareholders;*

SRD II recognises that the nature of transactions with related parties, in addition to the position of the related party, may affect shareholders' evaluation and assessment of valuation. The SRD II requirements build on the accounting framework set under the International Financial Reporting Standards (IFRS) and requires companies having shares admitted to trading on regulated markets to have safeguards in place with respect to material related party transactions.

Listing Rule 5.141 – Approval by Audit Committee

5.141 *Should the audit committee, after considering the proposed related party transaction as laid down in Listing Rule 5.140, deem the proposed transaction **to be material and approves such a transaction, such Material Related Party transaction shall be approved by the board of directors of the Issuer and a Company Announcement containing the below information shall be published:***

5.141.1 *the nature and details of the transaction;*

5.141.2 *the name of the Related Party concerned; and*

5.141.3 *details of the nature and extent of the interest of the Related Party in the transaction, **including the date and value of the transaction and other information necessary to assess whether or not the transaction is fair and reasonable from the perspective of the Issuer and of the shareholders who are not a related party, including minority shareholders.***

In view of the requirements of the SRD II, when issuing a Company Announcement, Issuers with shares admitted on a regulated market need to ensure that the information contained in the Company Announcement contains at least the information prescribed in Listing Rule 5.141.1 to Listing Rule 5.141.3. Prior to issuing the Company Announcement, approval by the Board of Directors needs to be obtained.

Listing Rule 5.142 – No Approval obtained from Audit Committee

5.142 *Where the proposed **Material Related Party** transaction is not approved by the audit committee but the **board of directors of the Issuer** still wants to proceed with the transaction, the Issuer shall:*

- 5.142.1 *make a Company Announcement which shall contain:*
- 5.142.1.1 *the nature and details of the transaction;*
 - 5.142.1.2 *the name of the Related Party concerned;*
 - 5.142.1.3 *details of the nature and extent of the interest of the Related Party in the transaction, **including the date and value of the transaction and other information necessary to assess whether or not the transaction is fair and reasonable from the perspective of the Issuer and of the shareholders who are not a related party, including minority shareholders; and***
 - 5.142.1.4 ***the fact that the Material Related Party transaction has not been approved by the Audit Committee, including the reasons for not approving such a transaction.***
- 5.142.2 *send a Circular to its shareholders containing the information required by Listing Rule 6.17; and;*
- 5.142.3 *obtain the approval of its shareholders either prior to the transaction being entered into or, if it is expressed to be conditional on such approval, prior to completion of the transaction and, where applicable, ensure that the Related Party itself abstains from voting on the relevant resolution. The board of directors of the Issuer shall disclose the fact that the audit committee has not approved the related party transaction in question at the general meeting convened for the purpose of this Listing Rule.*

In order to ensure transparency, it is proposed that in the circumstances, where the Audit Committee does not approve the material related party transaction, this should be included in the Company Announcement including the reasons for not approving the transaction.

New Listing Rule 5.142A - Additional Disclosure Requirements

- 5.142A** ***An Issuer shall ensure that the same procedure indicated in Listing Rule 5.141 and Listing Rule 5.142 apply to material transactions concluded between the related party of the Issuer and the Issuer's subsidiary.***

The SRD II imposes the requirement on Issuers to publicly disclose material related party transactions between the related party of the Issuer and the Issuer's subsidiary. Material transactions concluded between the related party of the Issuer and the Issuer's subsidiary should be subject to the same procedure applicable to material related party transactions entered into directly with the Issuer.

New Listing Rule 5.142B – Public disclosure of inside information

5.142B *The disclosure requirements under Listing Rule 5.141, Listing Rule 5.142 and Listing Rule 5.142A are without prejudice to the rules on public disclosure of inside information as referred to in Article 17 of Regulation (EU) No 596/2014 on Market Abuse.*

Article 17 of Regulation (EU) no 596/2014 on Market Abuse, requires issuers to ensure that inside information which directly concerns them, is made public in a manner which enables fast access and complete, correct and timely assessment of the information by the public. Accordingly, disclosure requirements, through a Company Announcement, of material related party transactions, are without prejudice to the requirements of Article 17 of Regulation (EU) no 596/2014 on Market Abuse.

3. Feedback

Any comments and feedback are to be addressed to Capital Markets by email on CapitalMarkets@mfsa.com.mt. Interested parties are kindly asked to submit any comments in writing by not later than **Monday 27th May 2019**.

The protection of individuals with regard to the processing of personal data by the Authority is based on Data Protection Act (CAP. 586).