

Guide on Related Party Transactions in the MENA Region



UNION OF ARAB SECURITIES AUTHORITIES



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ABOUT THE UNION OF ARAB SECURITIES AUTHORITIES (UASA)

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ABOUT THIS PUBLICATION

The regulatory treatment of related party transactions has so far not been subject to research and hence regulations bearing on RPTs are still evolving in most jurisdictions in the MENA region. In order to address this gap, the UASA and the OECD agreed to collaborate on a project aimed to shed light on regulations bearing on approval and disclosure of RPTs in the MENA region. This publication is an outcome of a year-long study of RPT frameworks in the region, based on a survey of securities regulators in the MENA region. It concludes with recommendations to policymakers designed to ensure adequate oversight of RPTs in order to promote market integrity in the region.

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Foreword

The regulatory treatment of related party transactions (RPTs), while often perceived as a technical subject, is at the same time key to improving corporate governance frameworks and practices, including in the Middle East and North Africa (MENA) region. Globally, RPT frameworks and practices have been subject to growing attention due to the risks associated with RPTs and the negative consequences of illegitimate RPTs already witnessed in a number of markets.

Recognising the importance of creating adequate frameworks for regulation of RPTs, the Organisation for Economic Co-operation and Development (OECD) in 2012 published a peer review of its member countries entitled *Related Party Transactions and Minority Shareholder Rights*. The OECD has also conducted work on RPT treatment in other regions such as Asia, where concentrated ownership and the presence of business groups, much like in the MENA region, has highlighted the risk of inappropriate RPTs. *The Guide on Fighting Abusive Related Party Transactions in Asia* was published by the OECD in 2009.

In the MENA region, while the prevalence of RPTs is also significant, their regulatory treatment has so far not been adequately addressed. In order to bridge this gap, the Union of Arab Securities Authorities (UASA) and the Organisation for Economic Co-operation and Development (OECD) agreed to collaborate on a project aimed to shed light on this complex policy issue in the context of the MENA region. This project, approved by the Board of the UASA in Kuwait in February 2013, commenced in June 2013 with a survey of Arab capital market authorities (contained in Annex I to this report, originally carried out in Arabic).

The survey was disseminated to securities regulators in the MENA region and 15 responses were received.¹ The results of the questionnaire were compiled and published by the UASA in May 2014, under the supervision of its Secretary General Jalil Tarif, providing the basis of the analysis and recommendations contained in this report. The focus of the questionnaire and this report is on RPTs in listed companies, which are most likely to impact market confidence and the level of portfolio investment.

Overall, the results of the survey highlight the evolving nature of RPT frameworks in the region and the important role played by the Arab securities authorities in setting standards for review and disclosure of RPTs and to a lesser extent, for their enforcement. Responses also illustrate important differences in regulatory approaches and practices related to approval of RPTs, as well as their disclosure and enforcement.

¹ Responding institutions include: the Algerian Capital Market Authority (COSOB), the Egyptian Financial Supervisory Authority, the Iraqi Securities Commission, the Jordan Securities Commission, the Saudi Arabian Capital Market Authority, the Kuwaiti Capital Markets Authority, the Capital Markets Authority of Lebanon, the Libyan Stock Market, the Moroccan Capital Market Authority (CDVM), the Omani Capital Markets Authority, the Palestine Capital Market Authority, the Qatar Financial Markets Authority, the Tunisian Capital Market Authority (CMF), the Syrian Commission on Financial Markets and Securities and the United Arab Emirates' Securities and Commodities Authority.

Based on the results of the regional survey undertaken by the UASA, this report, authored by Alissa Amico, provides a number of recommendations aimed to reinforce regulatory frameworks for monitoring of RPTs. It is hoped that the adoption of these recommendations by policymakers will contribute to enhancing the oversight of RPTs, thereby improving the efficiency and transparency of Arab capital markets and their attractiveness to local and foreign investors. These recommendations were discussed by Arab securities regulators in May 2014 at the UASA annual meeting held in Marrakech, Morocco and further developed to take into account comments received.

The OECD and the UASA would like to thank Arab securities authorities which completed the questionnaire and provided insights in discussions of this report. While the information presented herein was validated by the respective Secretariats of the UASA and the OECD, its accuracy rests on the responses provided by participating institutions. It is hoped that this work will contribute to sharing of experience among Arab Securities Authorities and will help promote dialogue and co-operation on issues of common interest to members of the UASA who also actively participate in OECD's work in the region.

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Part I. Definitions and Context

Introduction

Related party transactions may take a variety of forms and may include: transactions involving the sale or purchase of goods, property or assets, provision or receipt of services or leases, transfer of intangible items, provision, receipt or guarantee of financial services, assumption of financial or operating obligations, purchase of equity or debt or establishment of joint ventures (OECD, 2009a). Considering the prevalence of business groups and the generally informal nature of commercial relations in the MENA region, these types of transactions are quite common. In particular, transactions between the company and its controlling shareholder are quite frequent and raise concerns that these shareholders might be in a position to extract private benefits of control. The prevalence of company groups and holding companies in the region and the existence of business relations among their subsidiaries raise similar considerations.

Not all related party transactions negatively affect the company as they might be in the legitimate interest of both parties and be subject to appropriate approvals from the shareholders and/or the board. However, in non-arm's length transactions involving the sale or purchase of goods, transfer of intangible items and even the establishment of joint ventures, the risk of shareholder abuse is present. As a result, the knowledge of existing relationships and transactions between related parties is essential for regulators, boards, management, shareholders, and possibly the wider value chain. Regulators worldwide have indeed moved to tighten requirements concerning the approval and disclosure of RPTs and even prohibit certain types of transactions.

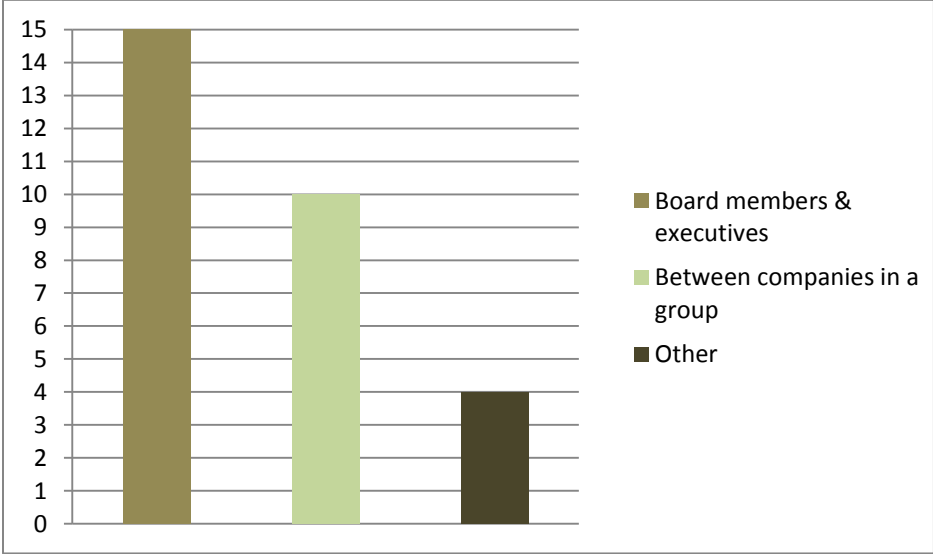
Dealing with equity and non-equity RPTs emerged as an important issue on the global corporate governance agenda due to some high profile cases which have damaged market confidence. While the legal and regulatory frameworks governing RPTs have not been subject to rigorous review and discussion until relatively recently, regulators are now aware of the risks that RPTs carry for market integrity. In the MENA region, the risk of an illegitimate RPT is exacerbated by the presence of companies controlled by private or governmental shareholders who are often active in both management and key board functions, as well as by the existence of holding and conglomerate structures across the region.

Regulators in the region recognise that on the one hand, RPTs can be economically beneficial, especially in the context of company groups where they can act as a substitute to markets. On the other hand, it is also understood that in the MENA ownership context in particular, they present a serious risk of abuse by company insiders, including controlling shareholders, board members and even management. Creating a regulatory framework for dealing with all types of RPTs requires considering the concentrated ownership landscape and governance practices more generally. It also requires considering policy trade-offs in order to ensure that the regime is, on the one hand, robust in safeguarding the rights of shareholders, and on the other, does not create unnecessary burdens for listed companies or those wishing to access capital markets.

Generally speaking, the regulatory approach in most jurisdictions in the region has been to allow RPTs, but to impose review and approval mechanisms designed to minimise the risk of shareholder abuse through tunnelling of corporate assets. MENA jurisdictions have adopted a blend of shareholder, board and - in some instances - even regulator approvals of RPTs. However, and unlike the common practice globally, specific types of RPTs such as loans to board members and executives are generally not prohibited. In addition, and somewhat contrary to the global trends, RPTs in the region are generally subject to shareholder, not board, review and approval.

As will be discussed further in this report, regulators appear to have left a number of policy options relevant to RPT approvals to company boards which are often responsible for defining a corporate conflict of interest policy. This is an important point considering that, as demonstrated in the Figure 1 below, the most common RPTs in the region are with board members or among companies in the same group. The second most common source of RPTs in the region as reported by regulators are transactions between companies in the same group, which is consistent with the presence of holding companies and company groups, both in the private and the public sector (see Figure 1 below).

Figure 1. Common RPTs in the MENA region (by jurisdiction)



Source: Compilation of questionnaire responses, UASA.

Defining a “related party”

The starting point for identifying and monitoring related party transactions is the identification of entities or persons who can be considered as a “related party”. The OECD Methodology for the application of the OECD Principles of Corporate Governance suggests that the definition of a “related party” should be sufficiently broad to capture the kinds of transactions in the jurisdiction that present a real risk of potential abuse, that could not be easily avoided and that could be effectively enforced. The

definition of a “related party” must take into account all parties who may exercise direct and indirect control in a given transactional context.

The International Accounting Standards, and notably IAS 24, establish a broadly accepted definition of related parties and how transactions with such parties should be disclosed. IAS 24, last re-issued in 2009, provides a definition of related parties which has been widely accepted globally and one that is substantially similar to other standards such as US GAAP. The IAS 24 definition of related parties, summarised in Box 1 below, is important since the IAS is the reporting standard for listed companies in most MENA jurisdictions (with the exception of a few such as Saudi Arabia).

Box 1. IAS related party definition

IAS 24 defines the related party of a reporting entity as:

- a) the party that, directly or indirectly, through one or more intermediaries:
 - controls, is controlled by, or is under the joint control of the reporting entity (including a holding entity, parent, subsidiaries, sister and associate entities);
 - has an interest in the reporting entity that gives it significant influence over it; or
 - has joint control over the reporting entity;
- b) the party is an associate (as defined in IAS 28 “Investments in Associates and Joint Ventures”) of the reporting entity;
- c) the party is a joint venture in which the reporting entity is a venture partner;
- d) the party is a member of the key management personnel of the reporting entity or the parent;
- e) the party is a close family member of a person identified in (a) or (d) above;
- f) the party is an entity that is controlled, jointly controlled or significantly influenced by persons identified in (d) or (e) above through the significant voting power they directly or indirectly have in such entity; or the party is a post-employment defined benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity.

Pursuant to the Standard, the following parties are not identified as related parties:

- a) two entities simply because they have a director or key manager in common, notwithstanding the definition of the ‘related party’ above;
- b) two ventures simply because they share joint control over a joint venture;
- c) providers of finance, trade unions, public utilities, and government departments and agencies,
- d) parties that do not control, jointly control or significantly influence the reporting entity, simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process).
- e) a single customer, supplier, franchiser, distributor, or general agent with whom an entity transacts a significant volume of business merely by virtue of the resulting economic dependence.

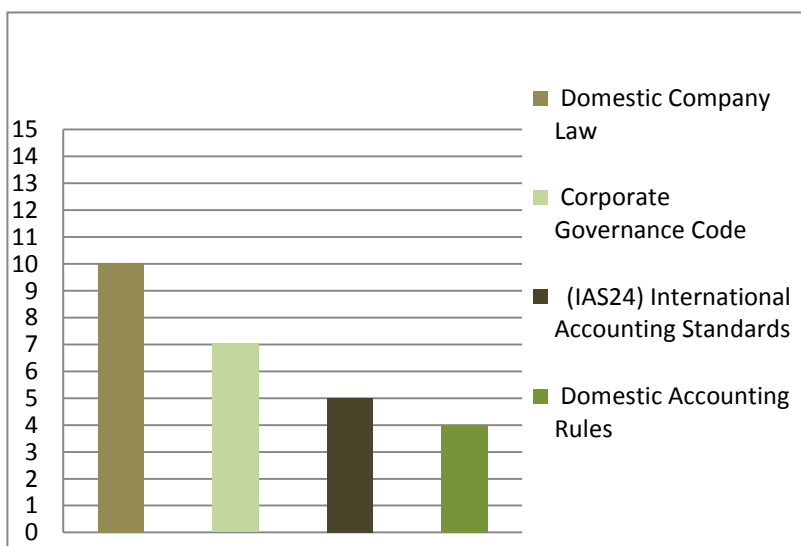
Source: IAS 24 (<http://www.iasplus.com/en/standards/ias/ias24>), accessed 1 July 2014.

National guidelines on related party transactions in the MENA region build on this definition, recognising the complexities posed by concentrated ownership, family ownership and government ownership of MENA listed and unlisted companies. While the definitions of related parties contained in national laws and regulations of MENA countries differ from this definition, their underlying intent is to account for

national ownership and regulatory context with a view to tailor the definition to the tight-knit corporate landscape of the region.

To define and regulate RPTs, MENA policymakers adopted a mixture of legislation, local and international accounting standards, and regulations related to corporate governance. The results of the survey conducted for the purposes of this report demonstrate that 10 out of 15 jurisdictions are principally using the companies law, 7 the corporate governance code and 4 the accounting standards to define RPTs. For example, Algeria, Lebanon, and Libya rely exclusively on the companies law to define related party transactions, while Iraq and Tunisia use the companies law in addition to local accounting standards. In addition to the international accounting standards, countries such as Jordan and Kuwait refer to the national corporate governance codes. Oman and Qatar use both the national corporate governance code and the companies law. Figure 2 below provides a further breakdown by jurisdiction.

Figure 2. Sources of national definitions of RPTs (by jurisdiction)



Source: Compilation of questionnaire responses, UASA.

The above Figure highlights the multiple sources of law and regulations that influence how related parties are identified and hence how the regulator, shareholders and other parties are informed of their existence and terms of transactions between them. This observation underscores the need to ensure that national RPT definitions are consistent, considering that in some MENA jurisdictions differences between requirements of the companies law and national corporate governance codes can be observed. Consistency is especially important considering that a number of jurisdictions in the region have recently amended their listing requirements, companies law or the corporate governance code. The revision of the Companies Law in Kuwait has for example, introduced a number of new provisions on approval and disclosure of RPTs, as will be further explored below.

The role of corporate governance codes

The nature of corporate governance codes in the region varies in that some have been introduced by regulators on a “comply-or-explain” basis while others remain voluntary. In countries such as Saudi Arabia and Qatar, where national corporate governance codes were introduced by securities regulators², they are the principal source of rules concerning RPTs, including the definition of related parties, approval processes and disclosure. For example, Qatar’s Corporate Governance Code provides a detailed definition of who is considered to be a related party. According to the Code, a person is considered to be a related party if he or she is: “a) a member of the board of directors of the company or an affiliated company, b) is a member of the senior executive management of the company, c) owns or controls 10% or more of the voting shares in the company or any of its affiliated companies, d) is a relative of any of the natural persons, mentioned in a, b, and c above, e) is a company in which the natural persons mentioned in paragraphs (a) to (d) above, f) own jointly or individually 20% or more of its voting shares; g) or is a director, CEO or a key officer of such Company, is an Affiliated Company or a Parent company of the company” (QFMA, 2009). Similar provisions exist in other countries’ corporate governance codes.

The region’s oldest and perhaps still most comprehensive regime for addressing RPTs is offered by the Omani Corporate Governance Code. It defines related parties as following: “directors in the past 12 months in the company or parent company or subsidiary or fellow company; chief executive officer or general manager or any employee of the company; any person who holds or controls 10% or more of the voting rights of the company or parent company or subsidiary or fellow company; any person who is an associate of any natural person as mentioned under Clauses (1,2,3) and shall include parents, sons, daughters, spouses and business entities wherein at least 25% of the voting power is controlled collectively or individually; any person who is an associate of any juristic person as mentioned under 1,2,3, above. This shall include parent company, subsidiaries, fellow companies and directors and employees of such companies and business entities wherein they hold individually at least 25% of the voting power” (Oman CMA, 2002).

² Unlike for example, Tunisia and Lebanon where they were developed by private sector and NGO stakeholders.

Part II. Protection of shareholder rights

Progress in protecting minority shareholder rights

Over the past decade, countries of the Arab world have made amendments to their governance codes, companies and securities laws in order to protect the rights of minority shareholders. A number of key shareholder protections are now covered in governance codes, about half of which apply on a comply-or-explain basis, hence requiring companies to explain what measures they took to protect minority shareholder rights. Shareholder protections contained in the companies law are also being reinforced. A revision of the companies law is currently also contemplated in Saudi Arabia, the UAE and other countries in the region.

While most jurisdictions now allow for minority shareholders to call for AGMs and to table resolutions for discussion and participate in the decision making process in a number of other ways, these measures are often observed as being insufficient in light of the concentrated ownership structures prevalent in the region, especially when resolutions are adopted by a simple majority vote. Failure to use cumulative voting systems in some countries such as Libya and some companies in Saudi Arabia (where cumulative voting is recommended but not required by the CMA), may adversely impact minority shareholder rights. A recent OECD review of the legal frameworks for shareholder rights protections highlighted a number of remaining challenges, summarised in Box 2 below.³

³ Some of these provisions have been revised in the past three years since the survey was executed, but the majority remain valid.

Box 2. Provisions bearing on shareholder rights protections

- Regardless of the size of their holdings, in most countries in the region shareholders have the right to participate and vote in general meetings (AGMs). However, in Tunisia companies are allowed to determine the threshold to participate in annual general meetings and in Saudi Arabia shareholders are required to have at least 20 shares to participate and vote in general meetings.
- Notice of shareholder meetings varies between 14 and 30 days. Large shareholders can also request to convene an extraordinary general assembly. The ownership bloc required to do so varies quite significantly from Tunisia, Saudi Arabia and Morocco where 3%, 5%, 10% of capital respectively is sufficient, to the UAE and Syria, where 30% and 25% of outstanding equity is required.
- One-share one-vote rule is the commonly accepted system in the region. In several jurisdictions such as Egypt, Morocco and Tunisia multiple share classes exist, as do non-voting shares.
- In all MENA countries, shareholders can in principle vote by proxy, but electronic voting remains relatively rare. In Morocco, electronic voting and voting by mail is accepted and in Tunisia, companies are required to allow shareholder voting by mail. Electronic voting is also a voluntary option for companies in Saudi Arabia.
- Generally speaking, shareholders have the right to vote on all matters discussed in general assembly meetings. Key decisions on, for instance, appointment and removal of directors, issuance of additional capital and amendments to the articles of association are usually subject to shareholders' approval. Only in Algeria can shareholders vote on the appointment and removal of internal auditors.
- Depending on the size of their holdings, shareholders are allowed to place items on the agenda of general meetings. In Algeria, this is not mandatory but recommended by the corporate governance code. Generally speaking, the threshold to place items on the AGM agenda ranges from 5-10% of capital (e.g. Morocco, UAE, Egypt, Saudi Arabia).
- Shareholders' right to vote on the distribution of profits appears to be accepted in the region. Nevertheless, only in a few countries such as Egypt and UAE, does legislation provide for timely payment of dividends (in a period of maximum 30 days).

Source: OECD, 2011.

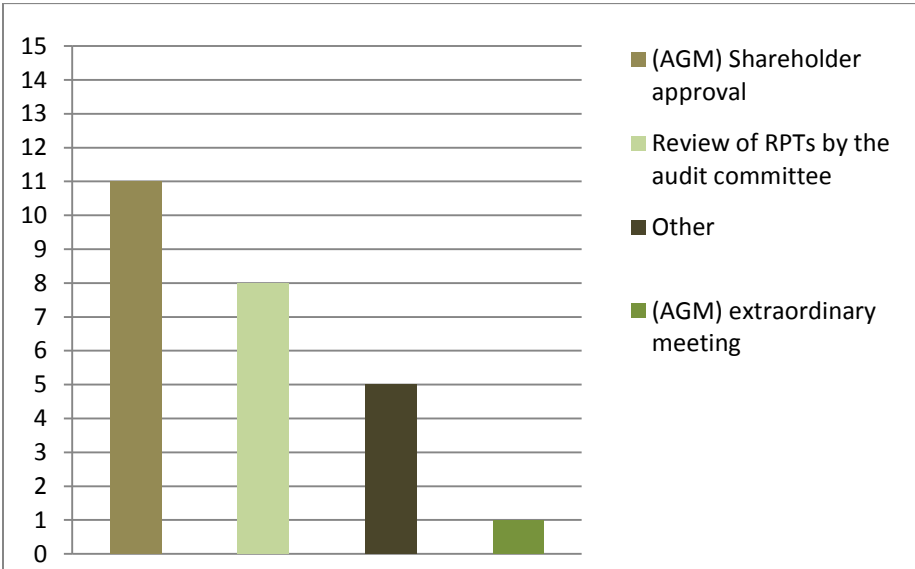
In addition, shareholder rights, notably with respect to approving executive and board remuneration are only now starting to be considered in the region. At the time of the publication of this report, no jurisdiction in the region has approved either a consultative or a mandatory shareholder "say on pay" policy as is now common in a number of countries globally. A few countries such as Saudi Arabia limit board compensation to 10% of company income; however this is still a quite general limit. A number of other regulators in the region have sought to limit executive and board compensation and have met with resistance from the private sector. Although compensation could be considered a relevant topic for overview of practices on RPTs, it is not explicitly treated in this report due to lack of standards and data on company practices in this area.

Approaches to approval procedures

Review and approval of RPTs remains a key shareholder protection issue and regulatory approaches to RPT approvals vary quite widely globally. In most OECD jurisdictions, the board is responsible for taking decisions regarding RPTs with a view to protect the best interests of the company (OECD, 2014). In the MENA region, the practice appears to be different insofar as shareholder review and approval remains most predominant (refer to Figure 3 below). This approach reflects the fact that the majority of RPTs in the region are undertaken with board members and rendering board approvals ineffective for a number of reasons, including principally the lack of a requirement to involve independent board members in approval of RPTs and challenges related to board independence in the region more generally.

In principle, regulators could require concerned board members to abstain from participating in discussions on a given transaction (as it is already the case in a number of jurisdictions) and/or require this discussion to be led by an independent board member. In practice, this might be challenging given that controlling shareholders often sit on the boards and that director duties (i.e. fiduciary duty and duty of loyalty) are not well defined in the region. The survey revealed that in Algeria, Iraq, Syria and Libya in particular, the functions of the board are not defined in a manner to facilitate the monitoring of and control over RPTs.

Figure 3. Primary method of RPT approval (by jurisdiction)



Source: Compilation of questionnaire responses, UASA.

Another feature of RPT approval regimes in the Arab world is the involvement of government entities, most often securities regulators, in the approval process. For instance, in Iraq, RPTs are reviewed directly by the Iraq Securities Commission. In Jordan, RPTs in listed companies are reviewed by the

Jordan Securities Commission, in SOEs by the Companies Controller Department in the Ministry of Industry and Trade, in banks by the Central Bank, and insurance companies by the Insurance Authority.

Finally, questionnaire responses highlight that RPT approval procedures in the region do not take into account materiality criteria. Instead, the prevalent approach appears to be to place all RPTs through the same review and approval procedure, regardless of their materiality or other characteristics. While this approach subjects all RPTs to a presumably thorough shareholder or board scrutiny, it risks not focusing the attention of the approving organs on high risk transactions. The lack of differentiation between recurring and non-recurring transactions also results in an approach that does not target the most economically significant dealings. An interesting approach to differentiating recurrent and non-recurrent transactions was taken by Singapore where listed companies are able to seek a mandate from the shareholders for recurrent transactions of revenue or trading nature or those necessary for its day-to-day operations (OECD, 2009a).

The actual mechanisms of RPT approval in the region often combine AGM, board or audit committee review and oversight, depending on the size of the transaction, the nature of the related party and other parameters. In order to illustrate the complexity of approval procedures, Box 3 presents an excerpt of the Omani corporate governance code which provides for a number of different oversight mechanisms and options for companies wishing to enter in RPTs. These mechanisms, including board and shareholder approvals, the involvement of independent board members and auditors are further explored in the following sections.

Box 3. The Omani regime for approval of RPTs

The Omani corporate governance code is quite exhaustive in prescribing rules on approval, disclosure and enforcement of illegitimate RPTs. The Code specifies that the related party shall not have any direct or indirect interest in the transactions with the company except as under:

- The normal contracts and transactions in ordinary course of business without any differential advantage accruing to the related party. The AGM shall be notified of these transactions on ex post-facto basis every year. The normal transaction shall mean routine transactions carried out on regular basis in order to achieve the company's objectives (absence of such transactions may lead to non-attainment of the company's objective).
- Contracts entered through a transparent mode of open tendering or limited tendering after obtaining and evaluating at least 3 independent bids in accordance with the guidelines prescribed by the audit committee. The best tender shall be chosen. The AGM shall be notified of these transactions on ex post basis every year.
- Through the procedure approved by the audit committee in case of small value transactions within the monetary limits prescribed in the procurement manual of the company.
- Through prior approval of the general meeting of the company after due recommendation by the audit committee. The following shall apply:

The notice to the shareholders for the purpose of obtaining prior approval of the shareholders shall contain the following details: the name of the related party; nature and extent of the interest of such party in the transaction; value of the transaction; validity period of the proposed arrangement; any other relevant information. In case of acquisition or disposal of assets, an independent valuation and a statement by the audit committee and the board about the suitability of the terms of the transactions is required.

The approval shall be obtained prior to start of the execution of the transaction. The approval shall not be of general nature. The approval shall be explicit for each transaction with full specific details. The concerned related party is not allowed to participate in the voting.

The full details of the terms of the transaction shall be sent to all the shareholders as part of the notice for general meeting with the statement from the board (other than related party) that the transaction is fair and reasonable so far as the interests of the shareholders of the company are concerned. During the subsequent year, the auditors shall report about the proper discharge of the responsibilities of the related party under the contract.

The above rules and guidelines are not meant to be exhaustive. Additional stipulations as mentioned under IAS shall also apply. In addition, the Code stipulates that any transaction, in violation of these guidelines, shall be considered void and will not affect shareholders adversely. The damages shall be borne by the concerned related party (ies).

Source: Oman CMA, 2002, Articles 19-25.

An interesting example of RPT approval procedures is provided by the Italian regime which provides two avenues for approving an RPT, depending on a transaction's materiality. A general procedure applies to any RPT other than small transactions, with further procedures that apply to those transactions considered material. The Italian example was selected for the purposes of this discussion due to similarities in the ownership context of Italian listed companies (including concentrated ownership, use of company groups, etc.) but also due to the involvement of directors, shareholders and auditors in the approval process. Box 4 below summarises the procedures for RPT approvals in Italy.

Box 4. Approving RPTs in Italy

In Italy, one of two procedures has to be followed to approve RPTs, depending on the transaction's materiality. A general procedure applies to any RPT other than small transactions, while further requirements are to be followed when a RPT is material (special procedure).

The general procedure for transactions below the materiality threshold requires that a committee of unrelated directors comprising a majority of independent ones gives its advice on the company's interest in entering into the transaction and on its substantial fairness. The opinion of the committee is not binding for the body responsible to approve the RPT – whether it is the CEO or the board of directors. However, if this opinion is negative, the transaction must be disclosed in the quarterly report.

The involvement of independent directors is stronger when the RPT is material. A committee of unrelated independent directors must be involved in the negotiations: they have to receive adequate information from the executives and may give them their views. The committee has a veto power over a given transaction. Material RPTs must be approved by the whole board upon the favorable advice of a committee of independent directors.

Companies may still enter into a given transaction despite the negative advice of independent directors, provided that a general meeting is convened where a majority of unrelated shareholders approve it. In other words, companies may enter into a RPT on which independent directors have given a negative opinion and a majority of unrelated shareholders have voted against, so long as the unrelated shareholders represented at the meeting together hold less than 10 percent of the shares (or less, if identified in the company's charter).

Under both procedures, the committee in charge of giving its advice may obtain the advice of independent experts (such as an investment bank or a law firm) of its own choice at the company's expense. For non-material RPTs the internal code may set an annual budget for such external advice.

Source: Bianchi et al, 2014.

Shareholder approval

Shareholder approval remains the most prevalent approval method of RPTs in the MENA region, with 11 jurisdictions surveyed requiring it. Interestingly, shareholder approvals in the region are not used as a complement to board approvals or for specific transactions only. The arrangements for how shareholder approvals are solicited and what governance organs are involved vary. In Tunisia for instance, the board and the audit function are required to submit special reports to the AGM which can decide whether a given RPT should be approved. In Kuwait, Morocco and Lebanon, RPTs are subject to shareholders' approval and must also be reviewed by the audit committee or equivalent.

The heavy reliance on shareholders' approval across the region is somewhat different from global trends, where it is employed by a few countries as an alternative or as a complement to the board approval procedure. Shareholder approvals are commonly employed for reviewing transactions proposed not on market terms and/or large or unusual transactions. Shareholder approvals are for example commonly required for the issue of securities, the acquisition or transfer of large assets and more generally large transactions. In other jurisdictions, shareholder approval of RPTs is required only in exceptional situations. For instance, in Italy and Turkey, shareholder approval is required only for transactions which were not approved by a committee of independent directors.

OECD analysis has found that shareholder approval tends to be most effective when applied on an ex-ante basis, when shareholders are given access to the relevant information and when they can access independent evaluations or reports. Questionnaire responses suggest that shareholder approvals in the region are provided ex-post through the AGM. In addition, shareholders do not generally request independent valuations or further information allowing them to judge the fairness of a given transaction. On the other hand, auditors appear quite involved in the process of review of RPTs alongside shareholders, which to some extent compensates for the lack of shareholder access to outside expertise.

Board approval procedures

Globally, review and approval of RPTs by the board or one of its committees remains the most prevalent method for controlling RPTs. In the Arab countries, while shareholder approval of RPTs is most common, boards are often required to develop a conflict of interest policy, including on related party transactions. 9 jurisdictions in the region require the board to develop and put in place a policy for the review and disclosure of related party transactions. In addition, in most countries, members of the board and the executive are required to make disclosures relating to cross-directorships and other potential conflicts of interest in order to provide shareholders and regulators the necessary information to assess the risk of inappropriate RPTs.⁴

In Saudi Arabia for instance, the Corporate Governance Regulations state that boards must develop a written policy to address potential conflicts of interest in relation to its board members, executives and shareholders. Likewise, the Palestinian Authority Corporate Governance Code stipulates that boards must develop a written policy on conflict of interest situations and include specific details on the type of situations for the board to consider. It requires that the policy include an assertion that the chairman or any member of the board does not have direct or indirect interest in contracts, projects and arrangements contracted by the company or for its account.⁵

Likewise, the Jordanian Code of Corporate Governance specifies that the board should set clear policies and procedures that identify conflicts of interest and the respective measures taken to avoid or prevent actual, potential, or perceived conflict of interest that could affect the integrity, fairness, and accountability of the organisation. Such policies should include but are not limited to covering the following aspects: what constitutes a conflict of interest, how and under what circumstances RPTs should be considered, as well as the misuse of company assets and privileged information for personal advantage.

Other countries in the region have adopted alternative mechanisms for managing potential conflicts of interest. In Qatar for instance, the company, not the board, must develop a specific policy to address

⁴ However, the legislations of the United Arab Emirates, Morocco and Syria do not include any provisions in this regard.

⁵ In case where such transactions are approved, the board member must have offered the best bid and the board's approval on such bid should not be by a vote of less than two-thirds excluding the concerned member.

transactions between the company and related parties such as board members, large shareholders and management. In Tunisia, companies are not required to develop an RPT specific policy. Instead, board members must inform the legal representative of the company if he/she has assumed the position of an agent, board member, chairman, general manager, or member of a management board or supervisory council of any other company.

In Lebanon, where governance rules for financial institutions are more sophisticated than for listed companies due to the small size of the capital market and the important economic role played by the banking sector in the Lebanese economy, the Central Bank mandates that bank boards must establish specialised committees, including one which would be responsible for overseeing the audit and disclosure of RPTs (commonly the Audit Committee). Furthermore, all decisions relating to advances, including those granted to board members, heads of departments and major shareholders, are subject to prior approval by a specialised committee.

As can be seen from the above, the requirement for boards to establish a conflict of interest policy is now quite common in the region and in principle, the introduction of such policies should act to further improve the integrity of MENA boards and introduce further clarity in their responsibility and potential liability towards the company and its shareholders. While the concept of director liability is used as a mechanism to ensure directors' diligence, OECD's work globally demonstrates that actual director liability is quite limited and enforcement challenging (OECD, 2012). In part reacting to this observation, some countries such as Turkey have recently required interested directors to reveal their profits from RPTs.

Box 5, focusing on Kuwait's legal regime, highlights how the revision of its Companies Law affects the liability for board members of both listed and unlisted companies. This new legislation is relatively unique in the region, giving the Ministry of Industry and Commerce as well as the Capital Market Authority important powers in oversight of RPTs, in addition to those available to the board and the general assembly.

Box 5. New Kuwait Companies Law: Implications for liability of board members

Kuwait's new Companies Law, introduced in 2012, contains the following provisions concerning the approval of RPTs and conflicts of interest of the board:

- Board members may enter into related transactions only with the approval of the Capital Market Authority
- Restriction on disclosure of inside information by board members to: (i) shareholders unless at a general assembly and (ii) complete prohibition of disclosure to third parties
- Restriction on related transactions, unless general assembly approves them
- Right of company to file a lawsuit against board members due to the "errors causing damages to the company"
- Shareholders may file a personal or derivative action against board members
- In addition, any interested party can review and obtain a copy of the company's memorandum of association, minutes of its general assembly meetings and other information & documents kept with the MOCI
- Supervision and inspection of companies and their accounts by the MOCI to ensure compliance with the new Companies Law
- The Ministry of Industry and Commerce may appoint company's external auditor or another auditor
- Right of shareholders/partners holding minimum 5% capital to request for appointment of inspector by the MOCI.

Source: Tamimi and Company, 2013.

The role of independent directors

A number of well governed jurisdictions globally display a preference for involving independent board members and/or the audit committee in particular in approval of RPTs.⁶ For instance, Belgium established a specific duty for its independent directors to evaluate RPTs and to designate an independent financial expert to assist them with valuation matters. In the MENA region, the majority of surveyed institutions (11 respondents) do not ascribe any particular role to independent directors in review of RPTs (as it is the case in a number of jurisdictions such as Chile and Singapore), despite the fact that the requirements for the independence of MENA boards have been substantially tightened in recent years.

In fact, there is a certain level of convergence in the region, where around at least 30% of the board is required to be independent (e.g. Saudi Arabia, UAE, etc.). As the requirements for board independence in the region are tightened, a greater role for independent and/or minority directors in reviewing RPTs would have a positive impact on minority shareholder protection. The condition for the effectiveness of such arrangements however is the real independence of these directors, not only from management but

⁶ There are indeed some exceptions to this such as in France where the independent directors do not legally have a more important role than others in review and approval of RPTs, and where this responsibility generally lies with the external auditor (OECD 2012).

also from controlling shareholders. In practice, there is still a lack of clarity in the region between the terms non-executive, disinterested and independent directors, and as a result, boards may be comprised of significantly or even majority of non-executive directors who are not necessarily independent by virtue of their ties to controlling shareholders.

Independence of board members from controlling shareholders is important to ensure in the region; this is also a priority in other emerging markets. The appointment of directors by minority shareholders might be a policy option to consider in order to address this challenge. An alternative solution would be to better define independence requirements. In Saudi Arabia for instance, Corporate Governance Regulations stipulate conditions which in the view of the regulator would constitute an infringement on independence. In other countries such as Morocco, independence requirements are described qualitatively and no limitations such as those contained in the codes of Oman or Qatar are in place. This effectively leaves companies more flexibility to decide which directors they consider as being independent. Refer to Box 6 for examples of how some MENA jurisdictions have set out the requirements for independence on company boards.

Box 6. Examples of independence definitions in the MENA region

In Saudi Arabia, the Corporate Governance Regulators specify that a director is not considered independent if:

- he/she holds a controlling interest in the company or in any other company within that company's group or if he/she, during the preceding two years, has been a senior executive of the company or of any other company within that company's group
- he/she is a first-degree relative of any board member of the company or of any other company within that company's group
- he/she is first-degree relative of any of senior executives of the company or of any other company within that company's group
- he/she is a board member of any company within the group of the company which he is nominated to be a member of its board.
- If he/she, during the preceding two years, has been an employee with an affiliate of the company or an affiliate of any company of its group, such as external auditors or main suppliers; or if he/she, during the preceding two years, had a controlling interest in any such party.

The Omani Corporate Governance code defines an independent director as one who either himself or his spouse or relative, during the last two years, was neither a member of the executive management of the Company nor had any relationship that resulted in any significant financial transactions with the Company or its parent, affiliated or related company. Independence rules are considered to be breached if the director:

- was an employee of any of the Associated Company during the last two years;
- is attached to a consultancy company providing consultancy services to the Company or any of its Associated Companies;
- is related to any of the Company's major stakeholders;
- has any personal service contracts with the Company or any of its stakeholders or executive management members;
- is associated with any non-commercial organisation obtaining large finances from the Company or any of its Associated Companies;
- is working as an executive in any other company, where executives are members of the board of directors; or
- is associated with, or an employee with any of the current or the past External Auditors of the Company or any of its Associated Companies.

Source: Saudi CMA, 2006; Oman CMA, 2009.

That said, the requirement – present in a number of MENA countries – that audit committees be composed at least of half of independent directors – to some extent mitigates for lack of requirements to specifically involve independent directors in the approval of RPTs since in a number of MENA countries the audit committee is charged with reviewing RPTs at one stage or another. Indeed, the results of the survey highlight that in the region (see Table 1) a key method to protect shareholders from abusive RPTs is through a review of such transactions by the audit committee or equivalent.⁷ 8 jurisdictions report to require the approval of the audit committee or equivalent before any RPT is executed. For further information about specific aspects of board approvals of RPTs in various MENA jurisdictions, refer to Table 1.

⁷ These jurisdictions include the United Arab Emirates, Algeria, Saudi Arabia, Syria, Oman, Palestinian Authority, Kuwait, Egypt, Morocco, Lebanon, and Tunisia.

Prevailing regulations provide that boards should be well informed of RPTs and have access to the relevant details regarding the terms on which such transactions are considered. This should include the ability of the board or the audit committee – when it is the governance organ charged with reviewing and approving RPTs - to seek independent appraisal for material RPTs. In approximately half of the jurisdictions surveyed, independent appraisal of RPTs is not required and is hence not sought. In other jurisdictions, board recourse to independent advisors for assessment of RPTs remains rare although there are no specific provisions preventing boards from seeking external assistance.

Very few jurisdictions encourage independent assessment of related party transactions. In Oman, the Companies Law contains a requirement for an independent assessment to be conducted in the case of acquisition or disposal of assets only. In Egypt, management is required to submit a report prepared by an independent expert to the board on any RPT, including an assessment on whether there are any damages to the company and shareholders.

As recommended in OECD's analysis following the financial crisis, the board should have access to the expertise that would allow it to assess the overall risk profile of the company considering its defined risk appetite. In this regard, in addition to the board having access to outside expertise when considering a given RPT, the introduction of the role of the Chief Risk Officer reporting to the board was recommended in earlier reports, as well as the introduction of whistleblowing channels directly to the board. In the MENA region, the presence of Chief Risk Officers with a direct access to the board is relatively limited.

Likewise, whistleblowing mechanisms which might provide valuable information to the risk function and to the board are relatively new to the region. 7 jurisdictions reported the absence of regulatory provisions requiring the introduction of whistleblowing procedures. In some countries such as the UAE, corporate governance rules require audit committees to develop a whistleblowing policy and for this policy to be approved by the board. That said, in Oman, Egypt and many other jurisdictions, where there are no legal provisions regarding whistleblowing, securities regulators commonly investigate complaints or reports from company insiders and also from the general public.

Table 1. Board oversight of RPTs

Jurisdiction	Board level policy covering review and disclosure of RPTs	Role of independent board members in review of RPTs	Independent appraisals for material RPT
Algerian Capital Market Authority (COSOB)	Not required	None	Not required
Egyptian Financial Supervisory Authority	Required	Committee composed of some independent board members approves RPTs	Required
Iraqi Securities Commission	Not required	None	Required
Jordan Securities Commission	Required	Committee composed of some independent board members approves RPTs	Not required
Kuwaiti Capital Market Authority	Required	None	Not required
Capital Market Authority of Lebanon	Not required	None	Required
Libyan Stock Market	Required	None	Not required
Moroccan Capital Market Authority (CVDM)	Not required	None	Not required
Omani Capital Market Authority	Required	Committee composed of some independent board members approves RPTs	Required
Palestine Capital Market Authority	Required	None	Not required
Qatar Financial Markets Authority	Required	None	Required
Capital Market Authority of Saudi Arabia	Required	Assign a sufficient number of non-executive directors in relevant committees	Not required
Syrian Commission on Financial Markets and Securities	Required	None	Not required
Tunisian Capital Market Authority (CMF)	Not required	None	Required
United Arab Emirates' Securities and Commodities Authority	Not required	None	Required

Source: Compilation of questionnaire responses, UASA, 2014.

The role of internal and external auditors

Internal and external auditors play a significant role in the control over related party transactions, especially in some countries such as Canada and France. For instance, in Canada, management is required to notify the auditor of any RPTs, the auditor is in turn responsible for assessing the proposed transactions and reporting them to the board. In some jurisdictions, external and internal auditors also play a key role in determining who is an interested party, effectively shaping the approval process for RPTs. For instance, in Italy, internal auditors play a key role in eliminating the influence of interested members (OECD, 2012).

External auditors, perhaps more so than internal auditors, also play a role in the review of RPTs in the MENA region, although they serve as an input to boards' and shareholders' review (refer to Table 2). In 12 jurisdictions surveyed, the external auditor of a company is responsible for reviewing RPTs before they are presented to the AGM. For instance, Egypt introduced a requirement in 2009 requiring auditors to review transactions between interested parties as a step before their approval by the AGM. In Saudi Arabia, domestic accounting standards require the auditor to oblige the company to disclose RPTs in the notes to the financial statements. External auditors in the UAE must include details of the conflict of interest situations in the financial report to be presented to the AGM. In Tunisia, in addition to informing the AGM, auditors are required to report any breaches of law to the state prosecutor and shall inform the Association of Public Accountants in Tunisia.

These and similar provisions present in law and regulations of MENA countries are related to auditor liability which is a relatively new concept to the region. Few auditors have so far been found in breach of their duties and fewer even have had disciplinary action taken against them. This situation prevails despite the fact that legal provisions have been introduced in a number of jurisdictions such as Oman and Iraq to hold auditors liable for any breach in the exercise of their duties. In practice, in a number of countries in the region such as for instance Egypt, auditor qualification and licencing remains a challenge. In order to address deficiencies in the auditor licencing system, a distinction between auditors of listed and unlisted companies was introduced in Egypt (OECD, 2009b).

The rigor of the auditor licencing process is especially important in some jurisdictions where auditors play an important role in the oversight of RPTs. For example, in Tunisia, the chairman or an authorised board member is required to inform the auditor of any RPTs, who in turn prepares a special report to the general assembly. The concerned related party, who has a direct or indirect interest in the transaction being considered, may not participate in the vote and their shares shall not be counted for the purposes of calculating the quorum and majority vote.

Table 2. Internal and external audit involvement in review of RPTs

Jurisdiction	Obligation of internal auditor to Review RPTs	External auditor review of RPTs (Before presented to the AGM/board)
Algerian Capital Market Authority (COSOB)	Obligated	Not responsible
Egyptian Financial Supervisory Authority	Obligated	Responsible
Iraqi Securities Commission	Not obliged	Not responsible
Jordan Securities Commission	Obligated	Responsible
Kuwaiti Capital Market Authority	Obligated	Responsible
Capital Market Authority of Lebanon	Not obliged	Responsible
Libyan Stock Market	Not obliged	Not responsible
Moroccan Capital Market Authority (CVDM)	Not obliged	Responsible
Omani Capital Market Authority	Obligated	Responsible
Palestine Capital Market Authority	Obligated	Responsible
Qatar Financial Markets Authority	Obligated	Responsible
Capital Market Authority of Saudi Arabia	Not obliged	Responsible
Syrian Commission on Financial Markets and Securities	Obligated	Responsible
Tunisian Capital Market Authority (CMF)	Not obliged	Responsible
United Arab Emirates' Securities and Commodities Authority	Not obliged	Responsible

Source: Compilation of questionnaire responses, UASA, 2014.

The relationship of the internal auditor, on the other hand, is less directly with the board or shareholders and much more in liaison with the audit committee. In Jordan, Oman and the Palestinian Authority, the internal auditor shall communicate with the audit committee who in turn reports findings to the board as a whole. As per the above Table, approximately half of the jurisdictions surveyed report the involvement of internal auditors in the review of RPTs, however their responsibilities are less stringent than those of external auditors. Refer to Box 7 which outlines the nature of the reform of auditor responsibilities vis-à-vis RPTs in the United States.

Box 7. Role of auditors in review and disclosure of RPTs in the United States

In June 2014, the US Public Company Accounting Oversight Board adopted new and amended audit standards (to be submitted to SEC for approval) that expand audit procedures for related party transactions, significant unusual transactions, and a company's financial relationships and transactions with its executive officers. The new standards require auditors to perform specific procedures to understand the nature of the relationship and of the terms and business purposes of RPTs.

Auditors are now also required to perform additional procedures to evaluate whether the company has properly identified all of its related parties and transactions with them. The amended standards go further than their previous version in requiring the auditor to perform procedures to obtain the understanding of the company's transactions with its executive officers, although auditors are not expected to make assessment as to whether compensation arrangements are reasonable.

New requirements encapsulated in the Audit Standard 18 require auditors to communicate to the audit committee their evaluation of the company's identification of, accounting for, and disclosure of its relationships and transactions with related parties. The management is also required to confirm in writing that it has made available to auditors names of all related parties and confirm that they are no agreements other than those declared in the management representation letter.

Source: Harvard Law School, 2014.

Transactions with controlling shareholders

An increasingly common feature of corporate governance regimes worldwide is the duty of controlling shareholders not to infringe on minority rights. This duty is especially important in the context of RPT oversight as it provides for another avenue of managing RPTs in situations where, for instance, controlling shareholders attempt to dilute minority shareholders by issuing equity to themselves at below market price. As a result, in a number of jurisdictions, controlling shareholders have special responsibilities towards the company, allowing any breaches in their duties to be used as a basis of enforcement.

When a controlling shareholder acts via a group company, the issue of director duties – and in particular, whether they owe the duty to the holding company or one of its subsidiaries is extremely complex. The issue of company groups and director responsibilities needs to be better addressed by the legislation and regulations in the region with a view to introduce greater clarity in the existing regulatory framework. Corporate governance codes and corporate law in the region have not yet addressed the issue of director duties, especially in the context of company groups.

The survey results revealed differences in the way MENA securities regulators treat transactions by controlling shareholders (other than the board members). Notably, 6 regulators (e.g. Algeria, Egypt, etc.) require approval of such transactions by the AGM, which may not be most effective in the context of controlled companies. Other jurisdictions such as UAE, Morocco and Tunisia require AGM and board approval of RPTs. In Qatar, the Qatar Financial Market Authority (onshore regulator in Qatar) and the Qatar Exchange must also be notified about such transactions.

In Jordan, the corporate governance code recommends that transactions with controlling shareholders other than the board members need to be presented to the audit committee. In addition, any transactions with shareholders representing over 10% of the company's total shareholders must be disclosed to the Jordan Securities Commission and the Amman Stock Exchange simultaneously. In Lebanon, both AGM and the board approval are required for transactions with controlling shareholders of financial institutions by virtue of the Banque du Liban (Central Bank) circular.

Part III. Disclosure and Enforcement

International disclosure standards

Disclosure is a key mechanism of informing market participants of company dealings with related parties and assuring them that they were subject to necessary approvals. The OECD Principles of Corporate Governance recommend that “disclosure should include, but not be limited to material information on related party transactions.” The accompanying Methodology further notes that transactions should be disclosed to the market either individually or on a grouped basis, including whether they have been executed on normal or market terms. In reality, regulatory approaches to RPT disclosure vary in terms of how (individually or cumulatively) and when (immediately, on a quarterly or annual basis) RPTs should be disclosed, depending on the size of a given transaction and its materiality, its terms and with whom it was concluded.

The IAS 24 standard on related party transactions (described further in Box 8) was re-issued in November 2009 and applies to annual periods beginning on or after 1 January 2011. All OECD member countries have adopted either IFRS (i.e. IAS 24) or a local standard equivalent to IAS, which requires all listed companies to disclose annually transactions with directors, executives and controlling shareholders in their annual reports. In the European Union, listed companies also have to disclose annually any transactions with directors, senior executives and controlling shareholders in accordance with IAS 24. Other EU requirements in place (i.e. Company Law Directives) stipulate that all EU member states must require even smaller, unlisted companies to reveal any material RPTs concluded on non-market terms.

Disclosure of RPTs might be provided as part of the annual report or – especially in the case of material transactions – it may be required in the form of immediate reporting to the market. Some countries such as Argentina and the UK require immediate disclosure of any significant RPT (OECD, 2014). While immediate reporting of RPTs is less common in Arab markets, the technical functionality of electronic disclosure platforms can now enable it in a number of countries such as Saudi Arabia, Turkey and others. Box 8 provides further details on the type of transactions on which disclosures are typically made and contains the disclosure elements that are commonly revealed. These disclosures should indicate that related party transactions were made on terms equivalent to those prevailing in arm's length transactions.

Box 8. IAS 24 approach to disclosure of RPTs

Transactions that require disclosure if made with related parties include:

- purchases or sales of goods
- purchases or sales of property and other assets
- rendering or receiving of services
- leases
- transfers of research and development
- transfers under license agreements
- transfers under finance arrangements (including loans and equity contributions in cash or in kind)
- provision of guarantees or collateral
- commitments to do something if a particular event occurs or does not occur in the future, including executory contracts (recognized and unrecognized)
- settlement of liabilities on behalf of the entity or by the entity on behalf of another party

The information that should be disclosed to the market when a RPT is entered to includes:

- the amount of the transactions
- the amount of outstanding balances, including terms and conditions and guarantees
- provisions for doubtful debts related to the amount of outstanding balances
- expense recognized during the period in respect of bad or doubtful debts due from related parties

Also, separate disclosures are frequently required for the following:

- the parent;
- parties with joint control or significant influence over the entity;
- subsidiaries;
- associates;
- joint ventures in which the entity is a party;
- key management personnel of the entity or its parent; and
- other related parties.

Source: IAS 24 (<http://www.iasplus.com/en/standards/ias/ias24>), accessed 1 July 2014.

Disclosure practices in Arab capital markets

Evidence from regulators globally demonstrates that the percentage of companies which report significant RPTs varies significantly from 7% in the United States and Malaysia to over 40% in Mexico and over 50% in China⁸ (OECD, 2012). Similar statistics, allowing to judge the prevalence and size of RPTs, are not available for participating Arab jurisdictions. Although in most jurisdictions, ex-post disclosure of RPTs is required, it is unclear whether companies' disclosure practices in this regard are indeed satisfactory. Information on the incidence of RPTs in the Arab world is generally not publicly available and was not reported by regulators participating in the survey. Going forward, it would be important to better understand the size and impact of RPTs in Arab capital markets in order to allow regulators to

⁸ These figures refer to specifically to the percentage of companies reporting RPTs larger than 1% of their revenues within the past 3 years.

deal with them appropriately and decide, for example, whether further regulatory capacity should be dedicated to their oversight.

The specific nature and source of provisions governing the disclosure of individual RPTs in the region appears to vary significantly. Only one jurisdiction in the region (i.e. Libya) does not have legal or regulatory provisions specifying what disclosures shall be made with regard to RPTs. In most jurisdictions, the source of these regulations are the securities authorities, however in a few instances, specific disclosure provisions may apply as a result of listing requirements or other rules of the stock exchange. Likewise, the authority to which disclosures shall be made varies, although in most jurisdictions (10 out of 15), disclosures are to be made to the securities regulator. In some jurisdictions, disclosures are also made to other parties such as auditors and stock exchange.

In the MENA region, related party transactions are generally not subject to materiality requirements for the disclosure obligations to be applicable. In the region, 12 out of 15 jurisdictions surveyed (except Jordan, Iraq and the Palestinian Authority⁹), no materiality conditions for approval and disclosure have been introduced. For instance, in Saudi Arabia, companies are required to disclose in the board reports contained in annual financial statements, all information relating to any business transactions or contracts to which the company is a party, and whether there any board members, members of the management team or those with relation to either have any interest in them. In addition, the report must include names of companies where a member of its board holds a board position.

An interesting point highlighted by the survey is that some countries do not differentiate in the approval and disclosure of related party transactions for listed or unlisted companies. There are large differences in this regard across the region, in part arising from the fact that the international accounting standards are only applicable to listed companies in most jurisdictions. In Oman, where unlisted companies are also required to apply IAS, they are required to report their RPTs according to IAS 24. Listed companies are required to comply with the requirements of the code and the more rigorous oversight of the Omani Capital Markets Authority.¹⁰

As mentioned above, intra-group RPTs are a common corporate reality. On this basis, transactions with group companies, especially when they are recurrent and conducted on market terms, are often exempt from ongoing disclosure and are subject to special, less onerous, approval and disclosure procedures (OECD, 2012). For instance, in some countries such as Italy and Belgium, the RPT disclosure regime is waved for company groups. Disclosure of intra-company RPTs does not appear particularly well addressed in the region's regulatory frameworks and warrants further attention.

The following Table presents a summary of RPT disclosure regimes in the region.

⁹ In Jordan, the Securities Commission requires transactions of JD 50,000 (US \$70,500) or more to be reported. In the Palestinian Authority, transactions must be disclosed only in situations where key assets of the company are disposed of.

¹⁰ For all Omani companies, RPTs should be disclosed in the interim financial statements. Furthermore, companies are required to inform the Annual General Assembly of all details of transactions made during the year. The external auditor is obligated to ensure that the related party has adhered to all its obligations.

Table 3. Rules governing the disclosure of RPTs in the MENA Region

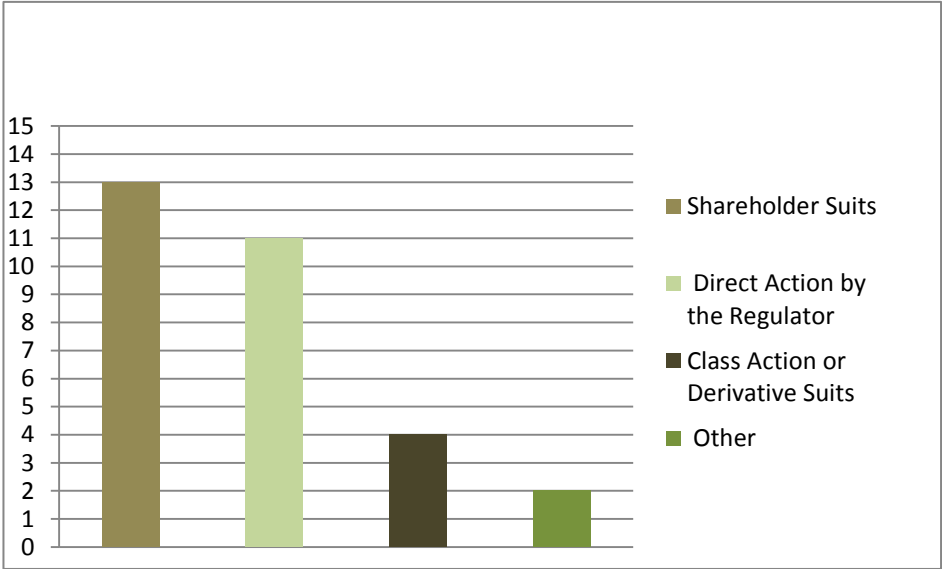
Jurisdiction	Source of law/regulations defining RPTs	Nature of RPT addressed	Regulatory treatment of RPTs in non-listed companies
Algerian Capital Market Authority (COSOB)	Domestic Company Law	Self-dealing by board members and executives	Same
Egyptian Financial Supervisory Authority	Domestic Accounting Rules and Company Law and Corporate Governance Code	Transactions between companies in a group and self-dealing by board members and executives	Different
Iraqi Securities Commission	Domestic Accounting Rules and Company Law	Self-dealing by board members and executives	Same
Jordan Securities Commission	International Accounting Standards and Corporate Governance Code	Self-dealing by board members and executives	Different
Kuwaiti Capital Market Authority	International Accounting Standards and Corporate Governance Code	Transactions between companies in a group and self-dealing by board members and executives	Different
Capital Market Authority of Lebanon	Company Law	Transactions between companies in a group and self-dealing by board members and executives	Different
Libyan Stock Market	Company Law	Self-dealing by board members and executives	Same
Moroccan Capital Market Authority (CVDM)	Company Law	Self-dealing by board members and executives	Same
Omani Capital Market Authority	International Accounting Standards and Company Law and Corporate Governance Code	Transactions between companies in a group and self-dealing by board members and executives	Different
Palestine Capital Market Authority	International Accounting Standards	Transactions between companies in a group and self-dealing by board members and executives	Same
Qatar Financial Markets Authority	International Accounting Standards and Company Law and Corporate Governance Code	Transactions between companies in a group and self-dealing by board members and executives	Same
Capital Market Authority of Saudi Arabia	Domestic Accounting Rules and Company Law and Corporate Governance Code	Transactions between companies in a group and self-dealing by board members and executives	Different
Syrian Commission on Financial Markets and Securities	N/A	Transactions between companies in a group and self-dealing by board members and executives	Different
Tunisian Capital Market Authority (CMF)	Domestic Accounting Rules and Company Law	Transactions between companies in a group and self-dealing by board members and executives	Same
United Arab Emirates' Securities and Commodities Authority	Corporate Governance Code	Transactions between companies in a group and self-dealing by board members and executives	Different

Source: Compilation of questionnaire responses, UASA, 2014.

Enforcement mechanisms

Enforcement against illegitimate RPTs appears challenging worldwide, as observed in OECD’s recent review on related party transactions and minority shareholder rights. The report noted that formal enforcement appears to be weak globally and that most jurisdictions display a reliance on market mechanisms underpinned by extensive disclosure obligations, allowing shareholders to act in instances where they perceive certain transactions as being detrimental to their interests (OECD, 2012). Indeed, in all OECD member countries, securities regulators can scrutinise disclosures on material RPTs and request improvements in disclosure. In addition, regulators in some countries have the right to reverse transactions or to support derivative and class action suits.

Figure 4. Methods of enforcement against illegitimate RPTs (by jurisdiction)



Source: Compilation of questionnaire responses, UASA, 2014.

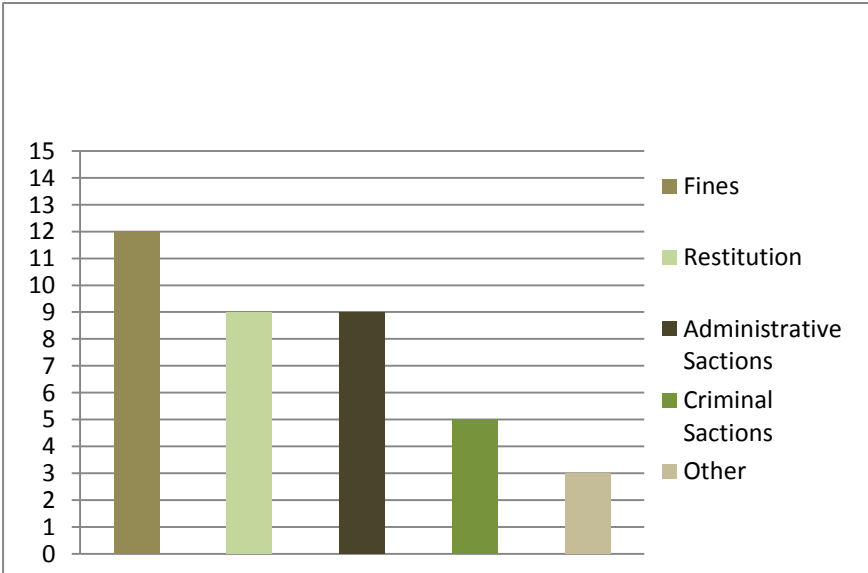
Enforcement against illegitimate RPTs is nascent in the MENA region, owing to the developing capacity of regulators to enforce corporate governance breaches more generally and to their emerging expertise with applying existing regulations on RPTs. In few jurisdictions surveyed, (e.g. in the UAE, Algeria, Iraq, and the Palestinian Authority) authorities report to have taken no enforcement actions. Generally speaking, the securities regulators surveyed did not provide examples or details of transactions they might have reviewed or sought to enforce. Survey responses indicated that forced disclosure and cancellation of illegitimate RPTs¹¹ are common enforcement mechanisms.

¹¹ Indeed, in 8 of the surveyed jurisdictions, the cancellation of RPTs in instances where such transactions are in conflict with the interests of the company is possible.

In almost all jurisdictions surveyed (13 out of 15), securities authorities have a role to play in enforcement, in particular in cases against board members with whom most RPTs are indeed concluded in the region. Executives, auditors and brokers were also mentioned as possible targets of enforcement action by survey respondents. Shareholders appear less targeted by RPT enforcement cases, although most jurisdictions explicitly or implicitly allow for such actions to be taken.

Most jurisdictions in the region resort to administrative as opposed to criminal sanctions, generally in the form of fines or cancellation of transactions. For instance, Tunisia had changed its legal regime in 2009 allowing minority investors to request the cancellation of illegitimate RPTs by courts. Few Arab jurisdictions (e.g. Morocco, Oman, Kuwait, Egypt and Iraq) impose criminal actions. Figure 5 below demonstrates the types of penalties imposed by Arab securities regulators for breach of RPT approval or disclosure requirements.

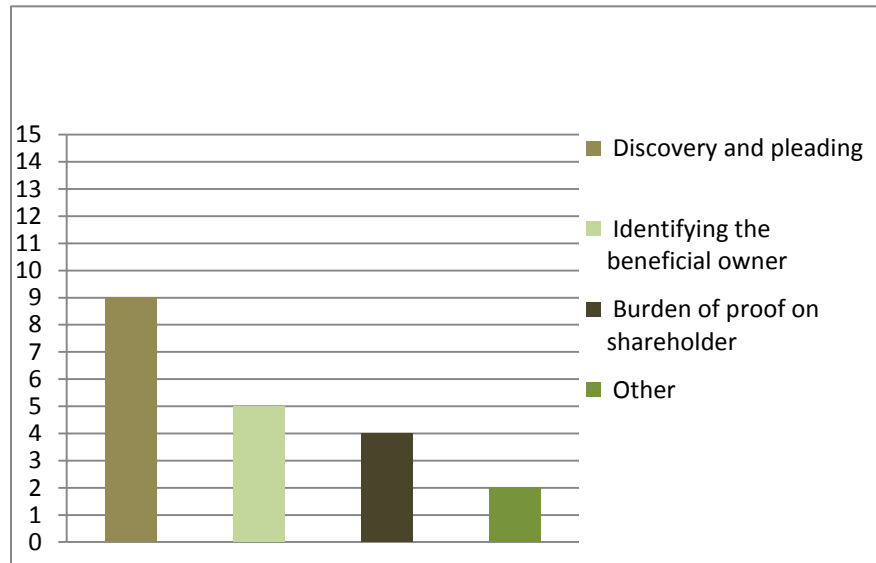
Figure 5. Penalties imposed on illegitimate RPTs (by jurisdiction)



Source: Compilation of questionnaire responses, UASA, 2014.

According to the securities regulators surveyed, practical obstacles to taking enforcement actions against illegitimate RPTs are linked primarily to limitations in their ability to detect such transactions and understand on what terms they were made. 9 out of 15 regulators consider this issue to be the overriding practical obstacle facing them. The second type of obstacle frequently cited by regulators is the difficulty of identifying ultimate shareholders. The identification of beneficial owners remains indeed a significant challenge and an important one for securities exchanges and also for stock exchanges to address in their regulatory capacity (e.g. for example, in cases of insider trading).

Figure 6. Obstacles to enforcement of illegitimate RPTs (by jurisdiction)



Source: Compilation of questionnaire responses, UASA, 2014.

Although private enforcement is in principle as feasible as public enforcement, in practice it rarely takes place, although class action and derivative suits are allowed in some jurisdictions. The United Arab Emirates, Algeria, Saudi Arabia, Qatar, Kuwait and Egypt do not use derivative suits. The burden of proof appears to be a key deterrent to private enforcement. The efficiency of the legal system more generally, in terms of expediency of courts or their overall capacity to effectively deal with commercial cases is a general precondition to effective enforcement of RPTs when they go to courts. Indeed, it is doubtful whether reliance on private enforcement of RPTs would be effective in the MENA region, considering the general passivity of institutional shareholders and the dominance of retail investors in almost all MENA markets.

This implies that going forward, the burden in terms of identifying, investigating and prosecuting illegitimate RPTs lies primarily with securities regulators which, as alluded to above, face a number of limitations in terms of enforcing RPTs, as summarised in Table 4 below.

Table 4. Enforcement mechanisms against illegitimate RPTs

Jurisdiction	Most effective mechanisms for enforcing the legal/regulatory regime concerning RPT	Main types of enforcement actions taken	Remedies and penalties imposed
Algerian Capital Market Authority (COSOB)	Shareholder suits, action by the regulator	N/A	Restitution, administrative sanctions
Egyptian Financial Supervisory Authority	Shareholder suits, action by the regulator	Administrative and legal actions	Administrative and criminal sanctions
Iraqi Securities Commission	Action by the regulator	Administrative penalties and pursuit in courts	Fines, restitution, criminal sanctions
Jordan Securities Commission	Shareholder suits , class action or derivative suits, action by the regulator	Administrative and legal actions	Fines and administrative sanctions
Kuwaiti Capital Market Authority	Shareholder suits, action by the regulator	Administrative and legal actions and judicial actions	Fines, restitution, administrative and criminal sanctions
Capital Market Authority of Lebanon	Shareholder suits, derivative suits or direct action by the regulator	Judicial actions	Fines, restitution
Libyan Stock Market	Shareholder suits	Administrative and legal actions	Restitution
Moroccan Capital Market Authority (CVDM)	Shareholder suits	Administrative and legal actions, judicial actions, and alternative dispute resolution mechanisms	Fines, restitution, administrative and criminal sanctions
Omani Capital Market Authority	Shareholder suits, class action or derivative suits, action by the regulator	Administrative penalties and pursuit in courts	Fines, restitution, administrative and criminal sanctions
Palestine Capital Market Authority	Direct action by the regulator	N/A	Fines and administrative sanctions
Qatar Financial Markets Authority	Shareholder suits, action by the regulator	Administrative penalties and pursuit in courts	Fines, restitution, administrative sanctions
Capital Market Authority of Saudi Arabia	Shareholder suits, action by the regulator	Administrative penalties and pursuit in courts	Fines
Syrian Commission on Financial Markets and Securities	Shareholder suits	Administrative penalties and pursuit in courts	Fines
Tunisian Capital Market Authority (CMF)	Shareholder suits, class action or derivative suits, action by the regulator	Administrative and legal actions	Fines, restitution, administrative sanctions
United Arab Emirates' Securities and Commodities Authority	Shareholder suits, action by the regulator	No action taken up to date for the lack of cases that require	Fines

Source: Compilation of questionnaire responses, UASA, 2014.

Part IV. Policy Recommendations¹²

1. Regulators should consider broadening the legal definition of “related parties” to capture relevant transactions that present a risk of potential abuse. The definition should be sufficiently harmonised in different bodies of law and regulations such as company and securities law, listing rules and accounting standards. Consistency in the national definition of a “related party”, including that contained in the corporate governance code, should be sought.
2. The use of IAS 24 or an equivalent national standard to regulate the identification and disclosure of dealings with related parties represents progress which should be coupled with other measures for ongoing reporting of RPTs to the regulator, shareholders and other relevant parties. Where domestic accounting standards are used, the definition of related parties should be substantially similar to international good practices summarised in IAS and OECD recommendations.
3. Regulators should urge companies and their boards to develop and make public a policy to monitor related party transactions (either standalone or as part of a broader policy on conflicts of interest) that should be subject to an effective system of checks and balances. This policy should be disclosed to shareholders and should make clear which RPTs are prohibited and accepted, as well as the circumstances in which they can be considered as acceptable.
4. Regulators might wish to consider prohibiting certain types of transactions that do not generate value for companies and tend to create situations of abuse of company assets such as loans to executives and board members. The legal and regulatory framework should clearly specify which, if any, related party transactions are prohibited and which transactions require explicit approval of the relevant oversight entity such as the securities regulator.
5. Regulators should review existing shareholder and board approval processes to ensure that they take into consideration the ownership context of MENA listed companies, notably the presence of concentrated ownership and company groups. Special consideration should be given to whether RPT approval processes involving controlling shareholders can be effective and what mechanisms need to be introduced to limit the risk of tunnelling.
6. Regulators may wish to introduce additional mechanisms to ensure controlling shareholders may not approve illegitimate RPTs detrimental to the interests of minority shareholders. Regulators may consider giving special rights to disinterested minority shareholders to review and approve RPTs (i.e. majority of the minority) in order to further limit the risk of minority shareholder expropriation. If this regulatory option is adopted, the regulator must be able to clearly identify interested and disinterested shareholders.

¹² The following recommendations are the result of a regional consultation process with MENA securities regulators. They do not necessarily reflect the OECD’s official position or the OECD Corporate Governance Committee’s evaluation of frameworks and practices in the region.

7. The timing of shareholder approvals of RPTs should be reviewed since experience demonstrates that ex-ante, as opposed to ex-post, approvals are most effective. Where shareholders are responsible for approving RPTs, they should have the right to request independent valuations or further information on proposed transactions allowing them to judge their fairness and potential impact on company affairs.

8. In jurisdictions that rely on board approvals of RPTs, the role of independent directors should be enhanced and they should have the ability to request advice from independent experts. An important precondition for this recommendation to be practically useful is the introduction of adequate criteria for appointment of independent directors, including limits on board terms and the number of consecutive board memberships a director may have.

9. The definition of director duties should be clear and should facilitate both private and public enforcement action where warranted. The legal and regulatory framework should explicitly define director duties in the context of company groups. Directors should owe a duty of care and loyalty to all shareholders.

10. The regulatory framework should be reviewed with a view to include provisions addressing the materiality of RPTs, including the adoption of thresholds for disclosure and approval by shareholders or boards. In addition to materiality thresholds, regulators might wish to consider differentiating between recurrent and non-recurrent transactions in order to focus on those that might represent the highest economic impact and hence risk to companies.

11. Enforcement entities should have access to relevant and timely information on related parties. Policymakers should facilitate enforcement efforts, giving relevant entities the necessary legal powers and capacity to effectively enforce rules against illegitimate RPTs or assist shareholders wishing to engage in private enforcement. Further consideration might also be given to the type of penalties that can be issued by the relevant enforcement entities and their ability to support private enforcement efforts where appropriate.

12. In jurisdictions where the external auditor plays an important role in the oversight and disclosure on RPTs, it is especially important to assure that the auditors are sufficiently independent and qualified to deliver an opinion to the board or shareholders. The legal responsibilities of auditors should be clearly outlined in the regulatory framework. Limitations on consulting services that auditors may provide to firms to which they also provide assurance services and limits of audit terms, as adopted worldwide, are useful in this regard.

13. The legal and regulatory framework should ensure that legal action, including through courts and alternative dispute resolution, does not prevent minority shareholders from seeking legal redress quickly and cost-effectively. Considering the minimal level of RPT related investigations and prosecutions reported in the region, it is recommended that the capacity of securities regulators and courts to identify, analyse and prosecute illegitimate RPTs should be further enhanced.

14. Related party transactions should be disclosed to the market in a way that facilitates informed decision making by shareholders and stakeholders. Material related party transactions

should in particular be disclosed in the quarterly or annual reports of companies, including the terms on which they were concluded as well as the approval processes which they were subject to. Existing electronic disclosure platforms developed by MENA stock exchanges and securities authorities could be a useful mechanism for facilitating continuous disclosure.

15. Finally, regulators may decide that a simplified regime should apply to smaller capitalised or non-listed companies. Some flexibility in the RPT regime may be maintained by setting minimum approval and disclosure requirements by law and allowing companies to define the specific modalities which suit their individual situation over and above such minimum requirements. Public disclosure of these modalities is crucial to ensure that all shareholders and potential investors are aware of company policies for dealing with conflicts of interest generally and RPTs specifically.

Annex I. Questionnaire to Arab Securities Authorities

I. Definition and disclosure of related party transactions

How does your jurisdiction define a related party transaction? You can choose multiple responses if necessary.

- Use of International Accounting Standards (IAS 24)
- Use of US GAAP (equivalent to IAS 24)
- Use of domestic accounting rules
- Use domestic Company Law
- Use of Corporate Governance Code

If domestic rules are used, please provide references to relevant laws and regulations and cite them.

Are there any special rules governing the disclosure of related party transactions?

- Yes
- No

Please elaborate.

To whom are reports on RPTs disclosed? Multiple answers are possible.

- To the external auditor
- To the general assembly meeting
- To the securities regulator
- To the stock exchange
- Other

Please elaborate.

What is the predominant nature of related party transactions in your jurisdiction?

- Between companies in a group
- Self-dealing by board members and executives
- Other, please describe.

Are there thresholds for materiality of RPTs defined by law or regulations for which additional review/reporting is required? Does it apply for all transactions or only for transactions outside of the normal business of the company?

- Yes
- No

Please elaborate.

Is there a difference in regulatory treatment of RPTs for listed and non-listed companies?

- Yes
- No

Please elaborate.

Have there been any developments in the regulatory framework in relation to related party transactions? If so, please describe? What might be the remaining priorities in this regard?

- Yes
- No

Please elaborate.

What concerns have RPTs raised for abuse of minority shareholder rights? Please cite any recent types of related party transactions that might be illustrative (company and individual names can be left out if necessary).

II. Main channels for oversight of RPTs

What is the primary method of shareholder protection from inappropriate RPTs? Multiple answers are possible.

- Review of RPTs by the audit committee (or another committee of the board)
- Shareholder approval through AGM
- Possibility to convene extraordinary shareholder meeting
- Other methods, please specify.

Can completed transactions be cancelled if later discovered to be not in the best interest of the company?

- Yes
- No

Please elaborate.

How are RPTs involving controlling shareholders (not on the board) addressed?

- Transactions approved by the AGM
- Transactions approved by the board
- Other, please specify

Is the internal auditor, general counsel or other official responsible for reviewing RPTs, required to report directly to the board?

- Yes
- No

Please elaborate.

Is the external auditor responsible for reviewing RPTs before they are presented to the AGM/board? Is he required to report his findings to the board?

- Yes
- No

Please elaborate.

III. Board monitoring of related party transactions

Are boards required to set a policy covering review and disclosure of related party transactions?

- Yes
- No

Please elaborate.

What role do independent board members have in relation to review of RPTs (either on a designated committee or on the board as a whole)?

- None
- Committee of independent board members approves RPTs
- Committee composed of some independent board members approves RPTs
- Other, please specify

How are board duties enforced? Multiple answers are possible.

- By the regulator
- By private enforcement
- By market mechanisms and shareholder activism
- By other methods, please specify.

Have board duties, especially those of care and loyalty, evolved through jurisprudence? Are board duties defined in such a way as to facilitate control of RPTs?

- Yes
- No

Please elaborate.

Are there provisions in place to ensure disclosure by board members and key executives of shareholdings, business interests, cross directorships, and conflicts of interest that may help in ensuring appropriate review (and abstention when conflicted) of related party transactions?

- Yes
- No

Please elaborate.

Does the regulatory framework encourage reporting of unethical/unlawful behaviour through whistle blowing or other mechanisms?

- Yes
- No

Please elaborate.

Is the board or its designated committee encouraged, required or allowed to seek independent appraisals for material related party transactions?

- Yes
- No

Please elaborate.

IV. Enforcement of illegitimate RPTs

What mechanisms exist in your jurisdiction for enforcing the legal/regulatory regime concerning related party transactions? Which mechanisms are regarded as most effective?

- Shareholder suits
- Class action or derivative suits
- Direct action by the regulator
- Other

Please elaborate.

How are shareholder decisions enforced?

- Via the board
- Via action by the regulator
- Other

Please elaborate.

Has there been jurisprudence clarifying the distinction between inappropriate and legitimate related party transactions?

- Yes

No

Please elaborate, citing cases where possible.

What are the main types of enforcement actions taken?

- Administrative and legal actions at the request of the supervisory authority or upon complaint.
- Judicial actions at the request of the state or upon complaint
- Alternative dispute resolution mechanisms/arbitration
- Other actions, please specify

What are the practical limitations related to different enforcement options?

- Difficulties in identifying beneficial owner or related parties
- Limits on powers of discovery and pleading
- The burden of proof rests with minority shareholder
- Other, please describe

Against whom may enforcement actions be taken in connection with an inappropriate related party transaction? Multiple answers may be possible.

- Company controller
- Board member(s)
- Manager(s)
- Market intermediaries
- Experts (investment bankers, appraisers and auditors)
- Others, please specify.

What remedies can be awarded and penalties imposed for actions related to illegitimate related-party transactions? Multiple answers may be possible.

- Fines
- Restitution
- Administrative sanctions
- Criminal sanctions
- Other actions, please specify

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UNION OF ARAB SECURITIES AUTHORITIES



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