Review of regulatory provisions on Related Party Transactions

1 Objective

1.1 This memorandum seeks to review the regulatory provisions with respect to Related Party Transactions (RPTs) and consequent amendments to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR Regulations").

2 Background

2.1 With an aim to review and strengthen the regulatory norms pertaining to RPTs, undertaken by listed entities in India, SEBI constituted a Working Group in November 2019 comprising members from the Primary Market Advisory Committee (PMAC), including persons from the Industry, Intermediaries, Proxy Advisors, Stock Exchanges, Lawyers, Professional bodies, etc.

2.2 As part of SEBI's consultative approach, the Report of the Working Group (**Annex I**) was placed on the website of SEBI on January 27, 2020 for public comments on, *inter-alia*, the following proposals:

- 2.2.1 Definition of Related Party
- 2.2.2 Definition of RPTs
- 2.2.3 Thresholds for classification of RPTs as material
- 2.2.4 Process followed by Audit Committee for approval of RPTs
- 2.2.5 Disclosure requirements

2.3 Comments (including suggestions) were received from 65 entities/ persons, which included Law Firms, Corporates, Company Secretaries, Consultants, Individuals, etc.

2.4 An analysis of the public comments received on the aforementioned proposals was placed before PMAC for deliberation.

3 Recommendation of the Working Group and PMAC, analysis of comments and the proposal for consideration

Existing provisions in the LODR, recommendation of the Working group, comments/suggestions received along with our views and the proposals are discussed in detail in the following paras:

3.1 **Definition of Related Party**

3.1.1 Existing provisions in the LODR

a) Regulation 2 (zb) of LODR Regulations defines "related party" as related parties defined under section 2(76) of the Companies Act, 2013 or under the applicable accounting standards.

b) LODR Regulation further deems any person or entity belonging to the promoter or promoter group of the listed entity and holding 20% or more of the shareholding of the listed entity, to be a related party.

3.1.2 Recommendation of the Working Group

a) All persons or entities belonging to the 'promoter' or 'promoter group', irrespective of their shareholding in the listed entity, shall be deemed to be related parties.

b) Further, any person or any entity, directly or indirectly (including with their relatives), holding 20 percent or more of the equity shareholding in the listed entity, shall be deemed to be a related party.

3.1.3 Rationale

a) SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 ("ICDR Regulations"), *inter-alia*, defines a "promoter" as a person who has control over the affairs of the issuer, directly or indirectly whether as a shareholder, director or otherwise or in accordance with whose advice, directions or instructions, the board of directors of the issuer is accustomed to act.

b) Further, a significant percentage of Indian businesses are structured as intrinsically linked group entities that operate as a single economic unit, with the promoters exercising influence over the entire group. Thus, promoter or promoter group may exercise control over a company irrespective of the extent of shareholding.

c) There is also a possibility of a shareholder not being classified as a promoter but may be exercising influence over the decisions of the listed entity by virtue of shareholding.

3.1.4 Comments/ suggestions received and our views

<u>Comments/suggestions</u>

a) A majority of the comments received suggest retaining the existing threshold of 20 percent for any person or entity belonging to the promoter or promoter group to be classified as related parties of the listed entity. It is also suggested to consider replacing the words

"belonging to" with "forming part of" and to restrict the definition of related party to promoters only.

b) Further, while commentators are in agreement with the fact that any person having 20 percent or more shareholding can be considered to exercise control, they have highlighted concerns related to lack of clarity regarding manner of calculating indirect shareholding.

c) Some of the suggestions include casting an obligation on shareholders rather than on the listed entity. Suggestions have also been received to consider computation of indirect shareholding on the basis of declaration provided to the Company under the provisions of the Companies Act, 2013. It has also been suggested to restrict the definition to direct holdings only.

Our views

d) It is felt that promoter or promoter group may exercise control and influence the decision making of the listed entity. Accordingly, the proposal to consider every person or entity forming part of the promoter or promoter group, irrespective of their shareholding in the listed entity, as related party may be accepted without any modification.

e) Considering the comments received, citing practical difficulties in computation of indirect shareholding for the purpose of defining related party, it is felt to confine the definition of related party to any person or any entity, either directly or on a beneficial interest basis.

f) PMAC was in agreement with the recommendations of the Working Group with aforesaid modifications.

3.1.5 Proposal

a) Accordingly, the recommendation of the Working Group that promoter/promoter groups shall be deemed to be a related party irrespective of shareholding, may be accepted.

b) Further, the recommendation regarding inclusion of significant shareholder under the ambit of related party may be accepted with a modification that any person or any entity, directly or on a beneficial interest basis (under section 89 of the Companies Act, 2013), holding 20 percent or more of the equity shareholding in the listed entity, at any time during the immediately preceding financial year, shall also be deemed to be a related party.

3.2 **Definition of RPTs**

3.2.1 Existing provisions in the LODR

a) Regulation 2 (zc) of LODR Regulations defines RPT as any transfer of resources, services or obligations between a listed entity and a related party regardless of whether a price is charged or not and a "transaction" with a related party shall be construed to include a single transaction or a group of transactions.

3.2.2 Recommendation of the Working Group

a) "RPT" means a transaction involving a transfer of resources, services or obligations between:

i. the listed entity or any of its subsidiaries on one hand and a related party of the listed entity or any of its subsidiaries on the other hand; or

ii. the listed entity or any of its subsidiaries on one hand, and any other person or entity on the other hand, the purpose and effect of which is to benefit a related party of the listed entity or any of its subsidiaries,

Certain transactions which, by their very nature treat all shareholders equally such as payment of dividend, subdivision or consolidation of securities, bonus or rights issue, buy-back of securities, or corporate actions which are subject to procedures specifically laid down by SEBI in other regulations, such as preferential allotment should fall outside the purview of RPTs.

b) Schematic representation of the existing framework for RPTs and recommendation of the Working Group is placed as **Annex II**.

3.2.3 Rationale

a) The Working Group felt that the current RPT regulatory framework may be insufficient to cover transactions where the listed entity could transfer its assets/value to a subsidiary, whether in India or overseas, and such entity could then transact with the related parties of the listed entity to move the assets out of the consolidated entity.

b) It was also observed that certain innovative structures have been used, in the recent past, to avoid classification of transactions as RPTs, thereby avoiding regulatory compliance and disclosure requirements. In order to address the issues, the definition was proposed to be broadened to include transactions which are

undertaken, whether directly or indirectly, with the intention of benefitting related parties.

c) Further, to ease the compliance burden, it was proposed to exempt corporate actions from the purview of RPTs which are subject to procedures specifically laid down by SEBI in its other regulations and which are uniformly applicable to all shareholders.

3.2.4 Comments/ suggestions received and our views

Comments/suggestions

a) A majority of the comments received are against the proposal citing practical difficulties in ascertaining the transactions with unrelated parties, the purpose and effect of which is, to benefit the related parties of the listed entity or any of its subsidiaries. Some commentators have suggested to provide a guidance on the same.

b) Some of the comments received suggest to expand the list of exclusions from the definition of RPTs viz., routine transactions which are at arm's length and in the ordinary course of business, reimbursement of expenses, acceptance of deposits by banks/NBFCs wherein terms of transactions are same, transactions of subsidiary with its own related party or with the related parties of the listed entity, etc.

Our views

c) Current RPT framework may be insufficient to cover transactions which can be done through subsidiaries or by the listed entity with the related parties of subsidiaries to move the assets out of the consolidated entity without having to follow norms applicable to RPTs. Accordingly, it is proposed to expand the scope of definition of RPTs by including transactions of the listed entity or any of its subsidiaries on one hand and related parties of the listed entity or any of its subsidiaries on the other hand.

d) It is also desirable to include transactions with unrelated parties, the purpose and effect of which is, to benefit the related parties of the listed entity or any of its subsidiaries. It is important to consider substance of the relationship and not merely legal form as a part of good governance practice.

e) PMAC, while agreeing with the proposal, has further recommended to give enough time to the listed entities for implementation.

f) It is also felt desirable to exempt transactions involving acceptance of fixed deposits by Banks/NBFCs from the purview of RPTs subject

to disclosing such transactions along with half-yearly report submitted to stock exchanges. This is because the terms of such transactions are uniform for all public.

3.2.5 Proposal

a) The recommendation of the Working group as mentioned at para 3.2.2 (a) (i) shall be made applicable with effect from April 1, 2022 and at 3.2.2 (a) (ii) shall be made applicable with effect from April 1, 2023, respectively with the following modification:

- The scope of exclusions may be expanded to include any acceptance of fixed deposits by banks/NBFCs at the terms uniformly applicable/ offered to shareholders/public subject to disclosure of the same along with the disclosures of RPTs every six months in the format specified by SEBI.

3.3 **Thresholds for classification of RPTs as material**

3.3.1 Existing provisions in the LODR

a) Regulation 23 (1) of LODR Regulations *inter-alia* specifies that transaction with a related party shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds 10 percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.

3.3.2 Recommendation of the Working Group

a) Any transaction with a related party shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds Rs.1,000 crore or 5 percent of the annual total revenues, total assets or net worth of the listed entity on a consolidated basis as per the last audited financial statements of the listed entity., whichever is lower, provided that the criterion relating to net worth shall not be applicable if the net worth of the listed entity is negative.

3.3.3 Rationale

a) The threshold of 10 percent of the consolidated turnover appeared to be high, which was evident from review of the data for transactions for the top 500 listed entities, which involved shareholder resolutions in the past 5 years.

b) It was also felt that some high value transactions in absolute terms may not get covered under the existing materiality threshold. It was also noted that in international jurisdictions, benchmarks other than turnover such as assets have been used to define the materiality threshold.

c) Accordingly, the Working Group had recommended to reduce the threshold to 5 percent of the annual total revenues, total assets or net worth of the listed entity on a consolidated basis and also to include an absolute threshold of Rs. 1000 crore, whichever is lower.

3.3.4 Comments/ suggestions received and our views

Comments/suggestions

a) Majority of the comments are against the proposal arguing that an absolute threshold of Rs. 1000 crore is arbitrary and it would be inconsistent with the provisions of Companies Act which were amended in November 2019 removing absolute threshold.

b) Some of the comments suggest to exclude net worth criterion for determining the threshold for materiality and continue linking it with the turnover/revenue only. Suggestion has also been received to compute the threshold on a standalone basis and to refer the latest available financials for the purpose of reckoning revenues, assets and net worth rather than last audited financial statements.

c) It is also suggested to prescribe the threshold in percent terms linked to revenue or asset size, depending on nature of transaction, e.g. if transaction relates to purchase or sale of goods or loan/Inter-Corporate Deposits (ICDs), then the limit may be linked to annual consolidated total revenue or consolidated total assets, respectively.

Our views

d) PMAC had recommended considering the modification of materiality thresholds for RPTs to Rs. 5000 Crore or 10% of the consolidated turnover of the listed entity, whichever is lower.

e) Considering the comments, it is felt appropriate to continue with the existing threshold of 10 percent of the annual turnover of the listed entity on a consolidated basis as per the last audited financial statements of the listed entity.

f) It is also felt that it would be appropriate to continue with the recommendation of the Working Group to prescribe an absolute threshold of Rs. 1000 crore. This is on account of the fact that certain

high value transactions may not get covered under the existing threshold for materiality.

3.3.5 Proposal

Accordingly, the recommendation of the Working Group may be accepted with modification by prescribing a threshold for materiality as Rs. 1,000 crore or 10 percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity, whichever is lower.

3.4 **Approval requirements of the Audit Committee**

3.4.1 Existing provisions in the LODR

a) Regulation 23(2) of LODR Regulations mandates that all RPTs shall require prior approval of the audit committee.

3.4.2 Recommendation of the Working Group

a) All RPTs and subsequent material modifications shall require prior approval of the audit committee of the listed entity.

b) RPTs to which the subsidiary of a listed entity is a party but the listed entity is not a party, shall require prior approval of the audit committee of the listed entity. Such approval is mandatory only if the value of RPT (whether entered into individually or taken together with previous transactions during a financial year) exceeds 10 percent of the annual total revenues, total assets or net worth of the subsidiary, on a standalone basis, for the immediately preceding financial year, whichever is lower, provided that the criterion relating to net worth shall not be applicable if the net worth of the subsidiary is negative.

c) Further, prior approval of the audit committee of the listed entity shall not be required for RPTs of listed subsidiaries where the listed entity is not a party.

3.4.3 Rationale

a) It was noted that, under the Companies Act, terms of reference of audit committee, *inter-alia*, include approval or any subsequent modification of transactions of the company with related parties.

b) Transactions undertaken by an unlisted subsidiary with related parties of the listed entity would not require prior approval of the audit committee or shareholders of the listed entity except for sale, disposal or leasing of 20 percent or more of the assets of a material subsidiary which require prior approval of the shareholders of the

listed entity by way of special resolution under regulation 24(6) of the LODR and thus, may be used as a conduit for moving out from the consolidated entity the value/assets which rightfully belong to the shareholders of the listed entity.

c) It was also felt that an exception from taking approval of the audit committee of the parent listed entity (subject to materiality thresholds) should be given for listed subsidiaries, since they are independently subject to the LODR framework on RPTs.

d) Further, taking cognizance of the fact that proposed provision may increase the compliance burden for the listed entity and the members of the audit committee, it was recommended to exempt transactions which are below a specified threshold of the subsidiary on a standalone basis.

3.4.4 Comments/ suggestions received and our views

Comments/suggestions

a) A majority of the comments are in favour of the proposal suggesting to define the term 'material modification', while others have suggested to link it to the materiality policy approved by the board of directors of the listed entity.

b) While some comments suggest to use consolidated financials of the listed entity, to maintain consistency in reporting and to facilitate ease of doing business for small subsidiaries; others have suggested to enhance the threshold of 10 percent or to include only the material subsidiaries under the ambit of audit committee approval for transaction where only subsidiary of the listed entity is a party and the listed entity is not a party.

c) Some of the commentators have highlighted concerns related to taxation on account of 'POEM- place of effective management'. It is also suggested to provide an option of ratification and exempt those unlisted subsidiaries which are required to appoint Independent Directors and constitute audit committees.

Our views

d) Considering the comments, PMAC recommended accepting the proposal with modifications, by authorizing the audit committee to define the term 'material modification' and disclosing it as a part of RPT policy with a view to provide clarity and maintain transparency.

e) Further, with a view to maintain consistency and facilitate ease of compliance, it is felt prudent to link the materiality threshold to the

consolidated financial parameters of the listed entity instead of standalone financial parameters of the subsidiary, for placing RPTs of unlisted subsidiaries to the audit committee of the listed entity where such listed entity is not a party.

3.4.5 Proposal

a) Accordingly, the recommendation of the Working Group may be accepted with modification by authorizing the audit committee to define material modification and disclose it as a part of policy on materiality of RPTs and on dealing with RPTs.

b) Further, w.r.t. recommendation of the Working Group for RPTs involving the subsidiary of a listed entity but not the listed entity, the threshold for placing such transactions before the audit committee of the listed entity, shall be linked to the annual consolidated turnover, as per the last audited financial statements of the listed entity.

3.5 **Approval of shareholders for material RPTs**

3.5.1 Existing provisions in the LODR

a) In terms of regulation 23(4) of LODR Regulations, all material RPTs shall require approval of the shareholders through resolution and no related party shall vote to approve such resolutions whether the entity is a related party to the particular transaction or not.

3.5.2 Recommendation of the Working Group

a) All material RPTs and subsequent material modifications, shall require prior approval of the shareholders through resolution and no related party shall vote to approve such resolutions whether the entity is a related party to the particular transaction or not.

b) Prior approval of the shareholders of a listed entity shall not be required for a RPT to which the listed subsidiary is a party but the listed entity is not a party.

3.5.3 Rationale

a) It was thought prudent to make it mandatory to obtain shareholder approval for material modifications to the RPTs earlier approved by the shareholders.

b) As a general matter, while the LODR specifically requires prior approval of the audit committee, the word “prior” is not used for shareholder approval. In order to maintain consistency, it was

recommended that the word “prior” may be added for shareholder approval as well.

c) It was also felt that an exception from taking approval of the shareholders of the parent listed entity (subject to materiality thresholds) should be given for listed subsidiaries, since they are independently subject to the LODR framework on RPTs.

3.5.4 Comments/ suggestions received and our views

Comments/suggestions

a) Majority of the commentators have suggested to define the term ‘material modification’. While some commentators suggested to exempt transactions which are in the ordinary course of business or at arm’s length, others have suggested to provide an option of ratification within a certain time period.

b) It has been highlighted that modification to the provisions requiring “prior” approval of shareholders is avoidable as it poses practical issues and would be disruptive to business activities. Alternatively, RPTs may be ratified at the ensuing General meeting, along with a disclosure/ explanation, as to why prior approval was not taken.

c) It has also been suggested that the requirement of shareholder approval may be restricted to wholly owned subsidiaries or material subsidiaries (as defined under the LODR), since the existing framework of compliance and scrutiny of RPTs of the subsidiaries under the LODR is extensive and sufficient. It has also been suggested to exempt transactions involving transfer of/ rights of proprietary technology, know-how, brand usage or provision of specialized services, etc.

d) Some suggestions have been received for allowing other related parties not interested in the transaction to vote.

Our views

e) Considering the comments, PMAC recommended accepting the proposal with modifications, by authorizing the audit committee to define the term ‘material modification’ and disclosing it as a part of RPT policy with a view to provide clarity and maintain transparency, respectively.

f) It is also felt prudent to obtain “prior” approval of shareholders for material RPTs; this is on account of the practical difficulties which the listed entity may face in case transaction is rejected by the shareholders at a later stage. Further, this would ensure consistency

with the requirement of obtaining prior approval of the audit committee for all RPTs as specified in the LODR Regulations.

g) With regard to suggestion of allowing related parties to vote, it is felt that determining whether a particular promoter or promoter group is interested or not in a RPT could lead to subjectivity and differing interpretations. Further, even if a particular promoter/promoter group is not interested in a particular RPT, factions of various promoter groups may intentionally collude with each other to influence the vote on a RPT. Accordingly, no change is proposed in respect of provision related to voting by interested parties.

3.5.5 Proposal

Accordingly, the recommendation of the Working Group as mentioned at para 3.5.2 may be accepted additionally specifying that subsequent material modifications shall be as defined by the audit committee.

3.6 **Exemption from the applicability of provisions related to RPTs**

3.6.1 Existing provisions in the LODR

a) In terms of regulation 23(5) of LODR, provisions of regulation 23 (2), (3) and (4) of LODR (dealing with prior approval of audit committee, omnibus approval and shareholder approval, respectively) are not applicable in the following cases:

(a) transactions entered into between two government companies;

(b) transactions entered into between a holding company and its wholly owned subsidiary whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.

3.6.2 Recommendation of the Working Group

a) The Working Group recommended to exempt transactions entered into between two wholly-owned subsidiaries of the listed holding company, whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval from the provisions of regulation 23 (2), (3) and (4) of LODR in addition to the existing exemptions.

3.6.3 Rationale

a) In line with the exemption given to transactions between a holding company and its wholly owned subsidiary from the requirements of

audit committee and shareholder approval, it is felt that transactions between two wholly owned subsidiaries of the listed holding company, whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval, should be similarly exempt from such requirements.

3.6.4 Comments/ suggestions received and our views

Comments/suggestions

a) A majority of the comments received are in favour of the proposal. While majority of the views received concur with the proposed exemption, some suggestions have been received to expand the scope of exemptions by including transactions already requiring approval of the board/shareholders as per the provisions of existing law like mergers and acquisitions, transactions which are in the ordinary course of business and at arm's length, transactions with JVs and associates, etc.

Our views

b) Considering the comments received, it is proposed that transactions entered into between two wholly-owned subsidiaries of the listed holding company, whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval be exempted from the ambit of regulatory framework governing RPTs. Further, certain transactions like preferential allotment, which are subject to procedures specifically laid down by SEBI in other regulations, are already exempted from the purview of RPT framework. PMAC has also recommended the same.

3.6.5 Proposal

Accordingly, the recommendation of the Working Group may be accepted without any modification.

3.7 **Format for reporting of RPTs to the stock exchanges**

3.7.1 Existing provisions in the LODR

a) Regulation 23 (9) of LODR Regulations specifies that the listed entity shall submit within 30 days from the date of publication of its standalone and consolidated financial results for the half year, disclosures of RPTs on a consolidated basis, in the format specified

in the relevant accounting standards for annual results to the stock exchanges and publish the same on its website.

3.7.2 Recommendation of the Working Group

a) The listed entity shall submit, to the stock exchanges disclosures of RPTs, in the format specified by SEBI and publish the same on its website.

b) The format broadly includes disclosure of details of name of the related party, type of transaction, tenure and value of the proposed transaction, etc.

c) The listed entity shall make such disclosures every six months on the date of publication of its standalone and consolidated financial results.

3.7.3 Rationale

a) It was observed that there was no consistency in RPT disclosures, being made to the stock exchanges, across listed entities, more so since there is no specific format prescribed in the Ind AS. Thus, with a view to address issue of asymmetry in information due to varied reporting formats, the need was felt to standardize the same through a prescribed format.

b) It was also observed that Ind AS requires these disclosures only at an aggregate level with a specific category of related party such as parent, subsidiary etc. Disclosure of aggregate level information does not provide substantive information and a breakup of the same should be given such that RPTs with different counter-parties should be separately disclosed. Further, as it is alleged that RPTs are being misused by way of advancement of loans/ICDs to related parties, it was felt that such transactions need more detailed disclosures.

c) Currently, the listed entity is required to make RPT disclosures within 30 days from the date of publication of its standalone and consolidated financial statements. It was felt that the details of all RPTs would already be available with the listed entity when the financial results are announced; accordingly, the listed entity should be able to disclose details of RPTs in the prescribed format on the same day of publication of financial statements.

3.7.4 Comments/ suggestions received and our views

Comments/suggestions

a) A majority of the comments received are against the proposal suggesting to retain the existing format as well as the timelines for submission of RPT disclosures.

Our views

b) Considering that details of all transactions would be available with the listed entity when financial results are being announced, the listed entity should be able to disclose details of RPTs in the prescribed format on the same day of publication of financial statements.

c) However, considering that the majority of the comments received were against the proposal, PMAC recommended making amendments to LODR to the effect that the listed entity shall make such disclosures every six months within 15 days from the date of publication of its standalone and consolidated financial results with effect from April 1, 2022 and on the date of publication of its standalone and consolidated financial results with effect from April 1, 2023.

d) Further, certain modifications are proposed in the disclosure format *inter-alia* including removal of date of approval of audit committee, details of sources of funds, PAN not to be displayed on exchange website, removal of tenure of RPTs as approved by the audit committee, etc.

3.7.5 Proposal

Accordingly, the recommendation of the Working Group may be accepted with modification that the listed entity shall make RPT disclosures every six months within 15 days of, and simultaneously on the date of publication of its standalone and consolidated financial results with effect from April 1, 2022 and April 1, 2023, respectively. Considering the comments received and the recommendations of the Working Group, a suitable format for disclosure of RPTs every six months, may be prescribed by way of a circular.

3.8 **Information to be provided to Shareholders for consideration of RPTs**

3.8.1 Existing provisions in the LODR

a) Presently, there is no provision related to information to be placed before the shareholders for approval of RPTs.

3.8.2 Recommendation of the Working Group

a) The notice being sent to shareholders seeking approval for any proposed RPT shall, in addition to the requirements under the Companies Act, 2013, *inter-alia* include the following information as a part of the explanatory statement:

(1) A summary of the information provided by the management of the listed entity to the audit committee;

(2) Justification for why the transaction is in the interest of the listed entity;

(3) Additional information in case a transaction relates to any loans, ICDs, advances or investments made or given by the listed entity or its subsidiary;

(4) Whether the approval of the RPT by the audit committee was unanimous;

(5) A statement that the valuation or other external report, if any, relied upon by the listed entity in relation to the proposed transaction will be available for inspection at the registered office of the listed entity;

(6) Percentage of the counter-party's annual total revenues, total assets and net worth, that is represented by the value of the proposed RPT: Provided that the information mentioned in this sub-clause may be placed in the notice sent to shareholders on voluntary basis; and

(7) Any other information that may be relevant.

3.8.3 Rationale

a) It is observed that the level of minority individual shareholder voting in India is currently low and due to the requirement of a majority vote of non-related shareholders for RPTs, a need was felt to maximize informed shareholder participation.

b) It was felt that the information required to be disclosed to the audit committee should also be provided to the shareholders in a brief and comprehensible manner. Further, it may be relevant for the shareholders to know whether the approval for the RPT was given unanimously by the audit committee.

c) It was also felt that a copy of the valuation report or any other external report relied upon by the management of the company should be annexed to the notice to the shareholders so as to provide

useful insights on the RPT. However, the Working Group also recognised the fact that such reports may be voluminous and technical. Accordingly, it was proposed that such reports would be available for inspection at the registered office of the listed entity.

3.8.4 Comments/ suggestions received and our views

Comments/suggestions

a) A majority of the comments are against the proposal suggesting to remove the requirement to state whether the approval of the RPT by the audit committee was unanimous, to provide exemption to banks, to remove the criterion of determining RPT as a percent of net worth of the counter party.

b) It has also been suggested that information should be placed only before the audit committee and not before the shareholder to protect confidentiality.

c) While some commentators have suggested to drop the proposal of making available the valuation report, others have suggested to make such reports publicly available.

Our views

d) Considering the comments, it is felt that disclosure of whether the approval of RPT by the members of the audit committee was unanimous or not would lead to speculation; hence, the suggestion to remove the same from information to be placed before shareholders for seeking approval may be accepted.

e) Considering that giving loans/advances is the core activity of banks, it is felt that listed banks may be exempted from making additional disclosures, with respect to details of source of funds and cost of funds, in the notice to shareholders where the transaction relates to any loans, ICDs, advances or investments.

f) Further, considering the importance of valuation report and technological advancements, the listed entity may provide such reports through the registered email address of the shareholders.

3.8.5 Proposal

Accordingly, the recommendation of the Working Group may be accepted with following modification and the same shall be issued by way of a circular:

(1) Disclosure of whether the approval of the RPT by the members of the audit committee was unanimous may not be included;

(2) Exemption to listed banks/NBFCs from the requirement of disclosure of information with respect to details of source of funds and cost of funds relating to loans, ICDs, advances or investments, etc.

(3) Valuation or other external report, if any, relied upon by the listed entity in relation to the proposed transaction may be made available on the registered email address of the shareholder of the listed entity.

3.9 **Information to be reviewed by the Audit Committee for Approval of RPTs**

3.9.1 Existing provisions in the LODR

Para 2 of Part B of Part C of Schedule II of LODR Regulations states that the audit committee shall mandatorily review the statement of significant RPTs (as defined by the audit committee), submitted by management.

3.9.2 Recommendation of the Working Group

a) The audit committee shall, *inter-alia*, mandatorily review the following information in addition to reviewing status of long term (more than one year) or recurring RPTs on an annual basis:

(1) Type, material terms and particulars of the proposed transaction;

(2) Name of the related party and its relationship with the listed entity or its subsidiary, including nature of its concern or interest (financial or otherwise);

(3) Tenure of the proposed transaction;

Explanation. - The transaction should have a particular tenure or term and should not be indefinite or open ended;

(4) Value of the proposed transaction;

Explanation. - An upper limit should be provided and in case of a recurring or continuous transaction, the aggregate value and the time period within which such limit will be exhausted;

(5) The percentage of the listed entity's annual total revenues, total assets and net worth, on a consolidated basis, for the immediately preceding financial year, that is represented by the value of the proposed transaction, provided that, for a RPT involving a subsidiary, the value of the proposed transaction as a percentage of the subsidiary's annual total revenues on a standalone basis should be additionally provided;

(6) If the transaction related to any loans, ICDs, advances or investments made or given by listed entity or its subsidiaries: details of sources of funds, nature of indebtness, cost of funds, tenure, applicable terms (including covenants, tenure, interest rate and payment schedule, etc.)

(7) Justification as to why the RPT is in the interest of the listed entity;

(8) Percentage of the counter party's annual total revenues, total assets, and net worth, that is represented by the value of the proposed RPT provided that the information mentioned in this sub-clause may be placed before the audit committee on a voluntary basis;

3.9.3 Rationale

a) It was felt that while the company's management is expected to provide all relevant information regarding an RPT to the audit committee to evaluate the same, it would be prudent to specify in the LODR, the minimum information to be provided to the audit committee in relation to any RPT for which approval is sought.

b) It was also felt that that since considerable information is being provided to the audit committee for approval of a RPT and it is also proposed to prescribe an extensive format for public disclosure of RPTs, the need to place, before the audit committee, a separate statement of significant RPTs may not be required.

3.9.4 Comments/ suggestions received and our views

Comments/suggestions

Majority of the comments are in favour of the proposal with some modifications. It is suggested that information relating to tenure of proposed transactions shall not be mandatory.

Our views

The suggestion regarding not specifying a particular tenure of RPT, in the information placed for review by the audit committee, may not be accepted. The listed entity shall specify the tenure of the transaction in the information placed before the audit committee and in case there is any subsequent modification, the same shall be approved by the audit committee.

3.9.5 Proposal

Accordingly, the recommendation of the Working Group may be accepted and the same shall be issued by way of a circular.

3.10 **Disclosure requirements related to RPTs in the Annual Report**

3.10.1 `Existing provisions in the LODR

a) The listed entity is required to disclose RPTs in its annual report in the format specified under Schedule V of the LODR. The annual report is also required to contain disclosure of all transactions with persons/entities belonging to the promoter/promoter group holding 10% or more of the shareholding in the listed entity. These disclosure requirements are not applicable to listed banks.

b) It is required to include "disclosures on materially significant RPTs that may have potential conflict with the interest of the listed entity at large, in the corporate governance report forming part of the annual report of the listed entity".

3.10.2 Recommendation of the Working Group

a) The disclosure requirements currently specified under Schedule V in the Annual Report should be applicable only to companies with listed debt securities.

b) Further, disclosures with respect to 'loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount', which are currently specified under Schedule V, shall be included as part of the corporate governance disclosures to be made in the Annual Report of the listed entity as per the LODR.

3.10.3 Rationale

a) Currently, LODR mandates certain disclosures relating to loans and advances as specified under Schedule V in the Annual Report of the listed entity except for listed banks. The format recommended by the Working Group covers such disclosures except with respect to "loans and advances which are in the nature of loans to firms/companies in which directors are interested by name and amount".

b) Accordingly, in order to avoid duplication in disclosures and for ease of compliance burden, it was recommended that the disclosure requirements under Schedule V in the Annual Report should be made applicable only to entities which have listed debt securities and

not to entities which have listed specified securities (equity shares and convertible securities).

c) Further, disclosures with respect to 'loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount' may be included as part of the corporate governance disclosures to be made in the Annual Report of the listed entity as per the LODR.

3.10.4 Comments/ suggestions received and our views

Comments/suggestions

a) A majority of the comments are in favour of the proposal. Some of the commentators have suggested certain modifications like defining director's interest, including information on loans and advances in which directors are interested under the financial information section instead of Corporate Governance section and to grant exemption to banks for disclosure of 'Loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount' for a listed entity and its subsidiaries, etc.

Our views

b) 'Loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount' is an existing requirement. It is also specified under the LODR that for the purpose of this disclosure, directors' interest shall have the same meaning as given in section 184 of the Companies Act, 2013. Accordingly, the suggestion may not be accepted

c) It is also felt appropriate to continue with the recommendation of the Working Group to disclose the information on loans and advances in which directors are interested in the Corporate Governance section of the Annual Report.

3.10.5 Proposal

Accordingly, the recommendation of the Working Group may be accepted without any modification.

3.11 **Proposal that was not part of the consultation paper but has been proposed for amendment, in this memorandum**

3.11.1 Existing provisions in the LODR:

- In terms of regulation 23(4) of the LODR Regulations all material related party transactions shall require approval of the shareholders through resolution and no related party shall vote to approve such resolutions whether the entity is a related party to the particular transaction or not.
- Further, regulation 23(7) of the LODR Regulations specifies that all entities falling under the definition of related parties shall not vote to approve the relevant transaction irrespective of whether the entity is a party to the particular transaction or not.

3.11.2 Proposal

Accordingly, it is proposed to delete regulation 23(7) of the LODR in order to remove redundancy,

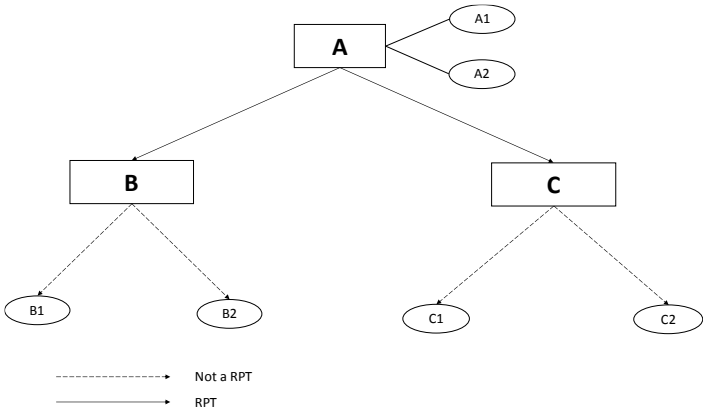
4 Proposal for the consideration of the Board

4.1 The Board is requested to consider the proposals at para 3.1 to 3.11 and approve the amendments to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 placed at **Annex III**. These amendments are proposed to be made applicable at a later date as specified in the specific regulations.

4.2 The Board is also requested to authorize the Chairman to take consequential and incidental steps to give effect to the decision of the Board.

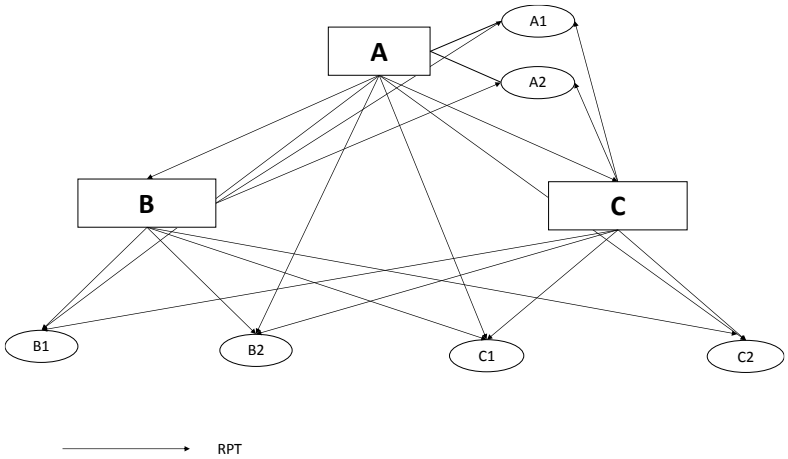
The Consultation paper is available on www.sebi.gov.in

Figure 1 RPTs as per existing provisions



A is a listed entity; B and C are its subsidiaries. A1/A2, B1/B2 and C1/C2 are related parties of A, B and C, respectively.

Figure 2 RPTs as per recommendation of the WG



Note: Representation excludes second part of the recommendations which refers to transactions with unrelated parties, the purpose and effect of which is, to benefit related parties of the listed entity.

This shall be notified at a later date.