भारतीय प्रतिभूति और विनिमय बोर्ड
Securities and Exchange Board of India

Report of the Working Group on Related Party Transactions

Background

SEBI constituted a Working Group in November 2019 to review the policy space pertaining to related party transactions under the Chairmanship of Mr. Ramesh Srinivasan, Managing Director & CEO, Kotak Mahindra Capital Company Limited. The Working Group comprised of members from PMAC including persons from the Industry, Intermediaries, Proxy Advisors, Stock Exchanges, Lawyers, Professional bodies etc.

The terms of reference of the Working Group were to make recommendations to SEBI on the following issues:

1. Review the policy space relating to related party transactions, including the following:
   (a) Definition of *"related party"* and *"related party transactions";*
   (b) Thresholds for classification of *"related party transactions"* as material; and
   (c) Process followed by Audit Committee for approval of related party transactions.

2. Review the provisions relating to related party transactions in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 vis-à-vis the Indian Accounting Standards and the Companies Act, 2013.

3. Specify a format for periodic disclosure of related party transactions by listed entities.

4. Recommendations for strengthening the monitoring and enforcement of regulatory norms related to related party transactions.

5. Any other matter, as the Working Group deems fit pertaining to related party transactions.

The Working group has submitted its report on January 22, 2020.

Public Comments:

In order to take into consideration the views of various stakeholders, comments are sought from the public on the aforesaid report placed alongside in the following format:

Name of the person/entity				
Sr. No.	**Recommendation in the report to which the comment pertains**	**Comment**	**Rationale for the comment**	**Revisions to the recommendations, if any (Please provide revisions to amendments as well, if possible)**

Comments may be sent by email to Shri Pradeep Ramakrishnan, GM at pradeepr@sebi.gov.in, Ms.Ishita Sharma, Manager at ishitas@sebi.gov.in and Ms. Sonal Pednekar, Manager at sonalp@sebi.gov.in no later than February 26, 2020.

Issued on: January 27, 2020

REPORT OF THE WORKING GROUP

ON

RELATED PARTY TRANSACTIONS

JANUARY 22, 2020

भारतीय प्रतिभूति और विनिमय बोर्ड
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Preface

I am grateful to the SEBI Chairman, Mr. Ajay Tyagi, for entrusting the Working Group with this responsibility and to the SEBI team led by Mr. Amarjeet Singh, Executive Director, for his valuable direction and input. The completion of this Working Group's deliberations and this report in a short span of approximately six weeks was possible due to the active participation and wholehearted support of all the members of the Working Group. I also take this opportunity to express my gratitude to my fellow Working Group members for their valuable time, input and contribution to many deliberations over the past few weeks.

I would like to thank representatives from corporates and institutional investors who have shared their experience, perspective and suggestions with respect to related party transactions.

India has a strong capital market with high standards of governance. Over the last few years, India has enjoyed increasing comfort with global investors both from a growth perspective as well as from a governance perspective.

The corporate governance standards have continuously been strengthened and there is increasing focus on the quality of disclosures being made by listed entities. While it is recognised that related party transactions can *per se* have sound economic rationale and can be value enhancing, there have been concerns about some such transactions being questionable or against the interest of minority shareholders or even bordering on fraud or ill-intent, particularly in the recent past. There have also been cases observed where an entity has complied with the letter of the law, while ignoring its spirit. The prevalent use of complex group structures and subsidiaries for related party transactions, particularly with unlisted entities, has increased concerns such as siphoning of funds, money laundering and round tripping.

It is with this background that SEBI set up a Working Group on Related Party Transactions. The Working Group has taken a comprehensive look at the current requirements pertaining to related parties and related party transactions by listed entities and made its recommendations *inter-alia* taking into account the following:

- enhancing transparency;
- improving quality of information that investors have access to;
- better approval processes by listed entities; and
- more robust enforcement mechanism.

Ramesh Srinivasan
Chairman, Working Group on Related Party Transactions
January 22, 2020

Acknowledgements

The Working Group expresses its gratitude to Mr. G. Mahalingam, Mr. Amarjeet Singh, Ms. Barnali Mukherjee, Mr. Pradeep Ramakrishnan, Ms. Ishita Sharma and Ms. Sonal Pednekar from SEBI.

Special thanks are due to the S&R Associates team including Ms. Tanya Aggarwal, Ms. Aditi Agarwal and Ms. Raveena Dhawan for their assistance with the report.

Special thanks are also due to Ms. Gesu Kaushal and Mr. Lohit Sharma from Kotak Mahindra Capital Company Limited, Mr. Avishkar Naik, Mr. Lokesh Bhandari and Mr. Ketul Jain from the National Stock Exchange of India Limited, Ms. Aditi Chandani and Mr. Varun Krishnan from Stakeholders Empowerment Services and Mr. Sivananth Ramachandran from the CFA Institute, for providing their valuable input.

Chapter 1: Introduction

A. The Working Group on Related Party Transactions

I. Composition of the Working Group

The Working Group to discuss related party transactions ("**Working Group**") was constituted on November 4, 2019, with the following members:

S. No.	Member Name	Organisation and designation	Capacity
1.	Mr. Ramesh Srinivasan	Managing Director & CEO, Kotak Mahindra Capital Company Limited	Chairman
2.	Mr. Amarjeet Singh	Executive Director, Securities and Exchange Board of India	Member
3.	Mr. Dolphy D'Souza	Partner, SRBC & Co. LLP	Member
4.	Mr. J. N. Gupta	Co- Founder & Managing Director, Stakeholders Empowerment Services	Member
5.	Dr. Sridhar Jayaraman*	Confederation of Indian Industry	Member
6.	Mr. Sandip Bhagat	Partner, S&R Associates	Member
7.	Mr. Khushro Bulsara*	BSE Limited	Member
8.	Ms. Priya Subbaraman*	National Stock Exchange of India Limited	Member
9.	Mr. Vidhu Shekhar	Country Head (India), CFA Institute	Member

** As nominated by the respective organisation / industry body*.

II. Terms of Reference of the Working Group

With the aim of strengthening regulatory norms in relation to related party transactions undertaken by listed entities in India, the Working Group was requested to make recommendations on the following issues:

6. Review the policy space relating to related party transactions, including the following:

   (d) Definition of *"related party*" and *"related party transactions";*

   (e) Thresholds for classification of *"related party transactions"* as material; and

   (f) Process followed by Audit Committee for approval of related party transactions.

7. Review the provisions relating to related party transactions in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 vis-à-vis the Indian Accounting Standards and the Companies Act, 2013.

8. Specify a format for periodic disclosure of related party transactions by listed entities.

9. Recommendations for strengthening the monitoring and enforcement of regulatory norms related to related party transactions.

10. Any other matter, as the Working Group deems fit pertaining to related party transactions.

The Working Group was requested to provide its recommendations in the context of equity listed entities.

III. Approach

The Working Group had five meetings over a period of one month with the first meeting held on November 14, 2019 and the last on December 11, 2019. The Working Group deliberated on each of the terms of reference in detail.

The Working Group reviewed case studies and empirical evidence wherever possible, including international practices and feedback from stakeholders to reach a conclusion on the various issues considered by it. The Working Group also conducted two meetings with company secretaries and institutional investors to solicit views and different perspectives from persons and organisations who deal with issues pertaining to related party transactions. The Report of the Working Group was placed before the Primary Market Advisory Committee ("**PMAC**") of SEBI in its meeting held on January 17, 2020 and the suggestions made by the PMAC have been incorporated in this Report.

This report ("**Report**") sets out recommendations of the Working Group which include, *inter alia*, amendments to certain provisions of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**LODR**"). The Working Group kept in mind the objectives of investor protection as well as ease of doing business while setting out these recommendations. The consolidated draft of the proposed amendments to the LODR recommended by the Working Group is set out in Appendix-I to this Report.

B. Related Party Transactions- Regulatory Framework

A related party transaction ("**RPT**") is a transfer of resources, services or obligations between two parties, irrespective of whether a price is charged or not. With respect to a corporate entity, related parties would broadly consist of its executives, directors or promoters, who are responsible for making decisions for the corporate entity. RPTs are prone to abuse by persons in control of the decision making of the corporate entity for personal gains and are therefore, strictly regulated under most regimes. RPTs, if misused, will cause significant loss of value of the corporate entity entering into the RPT. In India, where the existence of promoter driven and closely held companies is prevalent, the risk of abuse by way of RPTs is relatively high.

RPTs have always been prevalent and have also contributed to the growth of business for entities around the world. Hence, in spite of the possibility of misuse, most jurisdictions have permitted RPTs, *albeit* with certain safeguards. Therefore, the Working Group also recognised that there is no need to prohibit RPTs, although the regulatory framework should be fortified to mitigate the possibility of abuse.

An ideal regulatory framework for RPTs should encourage value enhancing RPTs while penalizing undesirable RPTs. In his article on '*RPTs and Intragroup Transactions*', Jens Damman discusses[1] three strategies that legal systems may adopt to deal with RPTs within corporate groups. First, legal systems may use tax and other incentives to induce ownership structures which reduce the costs of intragroup self-dealing. Secondly, legal systems may provide various protective rights to minority shareholders in order to ensure that they avoid being subject to an exploitative controlling shareholder or promoter in the first place. And thirdly, "*once a corporate group has emerged, individual transactions can be policed to ensure that they do not enrich controlling shareholders at the expense of the minority*." The last two suggestions are within this Working Group's scope and therefore the discussions of the Working Group and this Report are focused around the same.

RPTs can be regulated either by way of a substantive review or a procedural review[2]. Substantive review of RPTs would involve examining the terms of the transaction and evaluating the fairness of the transaction. Procedural review of RPTs would involve judging the fairness of the transaction on the basis of the procedure through which the RPT was executed. For this purpose, the regulator would have to specify the procedure for obtaining approvals of persons considered to be best placed to objectively judge the RPT. The Working Group recognised that ideally, review of RPTs would need to be a combination of both, substantive and procedural review.

I. Legislative History

The legal regime in India relating to RPTs has evolved over the years after taking into consideration recommendations made by a number of committees such as the Narayana Murthy Committee on Corporate Governance (2003), J.J. Irani Committee on Company Law (2005), the Company Law Committee (2016) and the Kotak Committee on Corporate Governance (2017).

Requirements in relation to RPTs under the erstwhile listing agreement:

Several disclosure requirements with respect to RPTs were mandated under Clause 49 of the erstwhile listing agreement. This listing agreement referred to Accounting Standard 18 for the definition of the term 'related party transactions'.

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1 Jens Dammann, '*Related Party Transaction and Intragroup Transactions*', The Law and Finance of Related Party Transactions edited by Luca Enriques and Tobias H. Troger (Cambridge University Press 2019)

2 Alessio M. Pacces, '*Procedural and Substantive Review of Related Party Transactions*', The Law and Finance of Related Party Transactions edited by Luca Enriques and Tobias H. Troger (Cambridge University Press 2019) where the author compares the efficacy of a procedural review based regime with a substantive review based regime and ultimately makes a case for appointment of 'non-controlling shareholder dependent directors' to better regulate related party transactions.

Under the erstwhile listing agreement, the audit committee of a listed entity was required to review the disclosure of related party transactions in the annual financial statements with the management of the entity before submission to the board of directors for their approval. The audit committee was also required to review a statement of significant RPTs submitted to it by the management. The erstwhile listing agreement required a disclosure of materially significant RPTs that may have potential conflict with the interest of the company in the annual report. Pursuant to the recommendations of the Narayana Murthy Committee on Corporate Governance, the following disclosures in the quarterly compliance reports on corporate governance in relation to RPTs were mandated in clause 49 of the erstwhile listing agreement:

"*(A) Basis of related party transactions*

(i) A statement in summary form of transactions with related parties in the ordinary course of business shall be placed periodically before the audit committee.

(ii) Details of material individual transactions with related parties which are not in the normal course of business shall be placed before the audit committee.

(iii) *Details of material individual transactions with related parties or others, which are not on an arm's length basis should be placed before the audit committee, together with Management's justification for the same*."

Regulation of RPTs under the Companies Act, 1956:

The concept of related party transactions was not explicitly defined in the Companies Act, 1956 ("**1956 Act**"). However, restrictions were imposed on certain kinds of transactions with certain related parties by way of Sections 294, 294A, 294AA, 297 and 314 of the 1956 Act.

(i) Under the 1956 Act, directors of companies and certain other persons were prohibited, without the consent of the board of directors, from entering into a contract or arrangement for:
   (a) sale, purchase or supply of any goods, materials or services; or
   (b) underwriting the subscription of any shares in, or debentures of, the company.

(ii) The prohibition in (i) above applied to a contract entered by the director, his relatives, a firm in which such director or the director's relative is a partner, any partner of such firm, or a private company of which the director is a member or a director.

(iii) If the paid-up share capital of the company exceeded Rs.1 crore, the prior approval of the Central Government was also required in addition to board approval, prior to entering into such transactions.

(iv) An exemption from the requirement of such prior approvals was granted for cash transactions at prevailing market prices, transactions undertaken regularly by the company and in case of a banking or insurance company for any transaction in the ordinary course of business with any director, relative, firm, partner or private company as described above.

(v) Further, Section 314 of the 1956 Act prohibited the director of a company from holding any office or place of profit under the company or any subsidiary of the company (unless the remuneration received from such subsidiary in respect of such office or place of profit was paid over to the company or its holding company), without the consent of the shareholders of the company by way of a special resolution.

(vi) Additionally, no partner or relative of such director, no firm in which such director, or a relative of such director, is a partner, no private company of which such director is a director or member, and no director or manager of such a private company was allowed to hold any office or place of profit carrying a total monthly remuneration above a prescribed limit.

(vii) A monetary threshold was prescribed for the monthly remuneration of the office or place of profit in the company, above which, prior approval of the Central Government was also required.

(viii) Sections 294, 294A, 294AA of the 1956 Act dealt with appointment of sole selling agents and prohibition of payment of compensation to sole selling agents for loss of office in certain cases.

Suggestions of the J.J. Irani Committee:

In 2005, the report of the J.J. Irani Committee on Company Law stated that it would be appropriate to have a 'shareholder approval and disclosure-based regime' in India for regulating transactions in which directors or their relatives are interested as opposed to the 'government approval based regime' as existing in 1956 Act. The J.J. Irani Committee further suggested that transactions between a company and director or persons connected with the director with regard to the sale or purchase of goods, materials or services above a certain materiality threshold should require mandatory shareholders' approval by way of a special resolution. These recommendations were later reflected in the Companies Act, 2013 ("**Companies Act**").

Suggestions of the Kotak committee on corporate governance:

More recently, the committee on corporate governance chaired by Mr. Uday Kotak also dealt with the approval mechanisms and disclosure requirements in relation to RPTs. Some of the suggestions of the committee that were accepted and incorporated into the LODR are mentioned below:

(i) Expanding the scope of the definition of 'related party' to include any person or entity belonging to the promoter or promoter group of listed entity and holding 20% or more of the shareholding in the listed entity.

(ii) Requiring the policy on RPTs of the listed entity to include clear threshold limits, as approved by the board of directors and for such policy to be reviewed and updated every three years.

(iii) Introduction of a lower materiality threshold for transactions involving payments made to related parties with respect to brand usage or royalty.

(iv) Permitting related parties of the listed entity to cast a negative vote on resolutions seeking approval for RPTs.

(v) Requiring the listed entity to disclose its RPTs on a consolidated basis, for each half-year, in accordance with the formats prescribed under the relevant accounting standards for annual results.

(vi) Requiring disclosure of transactions of the listed entity with any person or entity belonging to its promoter/promoter group and holding 10% or more shareholding in the listed entity.

II. Need for Review of RPT Regulatory Framework

Based on the above recommendations and inputs, the current framework of RPTs has evolved. However, as the corporate eco-system evolves, the area of corporate governance including that of Related Party Transactions requires periodic review.

While taking note of some of the recent issues in relation to RPTs, the Working Group observed that one commonality in major corporate wrongdoings was that they were allegedly carried out by persons with the ability to influence the decisions of the company. Shell or apparently unrelated companies, controlled directly or indirectly, by such persons were purportedly used to siphon off large sums of money through the use of certain innovative structures, thereby circumventing the regulatory framework of RPT.

Apart from use of circular transactions, companies appear to have diluted or circumvented the requirements under their policy on RPTs by procuring approvals for continuous lending to group companies.

The Working Group reviewed the approval mechanisms for RPTs and revisited disclosure requirements relating to information relevant for the persons (including shareholders, where required) involved in the approval mechanism. The recommendations of the Working Group aim to strengthen the approval and disclosure processes to assist the audit committee and shareholders in informed decision making with respect to RPTs.

C. <u>Recommendations of the Working Group</u>

The Working Group, based on its deliberations and the terms of reference, has made recommendations as set out in the following chapters:

Chapter 2: Definitions

Chapter 3: Approval Requirements and Materiality Thresholds

Chapter 4: Disclosure Requirements (including information to be provided to shareholders while seeking approval and periodic disclosure to the stock exchanges)

Chapter 5: Strengthening the Monitoring and Enforcement of Regulatory Norms relating to Related Party Transactions

Chapter 2: Definitions

This chapter of the Report examines the present regulatory framework for identification of related parties, related party transactions and associated terms and sets out the recommendations of the Working Group.

I. 'Related Party'

The definition of "related party" as per the LODR[3] includes related parties defined under both the Companies Act and the applicable accounting standards[4]. The LODR 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.

Working Group deliberations and recommendations

The Working Group deliberated and was of the view that all persons or entities belonging to the '*promoter*' or '*promoter group*'[5], irrespective of their shareholding in the listed entity, should be deemed to be related parties for the following reasons:

(i) The Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 ("**ICDR**") *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. Thus, a promoter may exercise control over a company irrespective of the extent of shareholding.

(ii) The Working Group observed that the definition of "*related party*" as per the accounting standards includes, *inter-alia*, any person who has control or significant influence over an entity; however, the accounting standards define these terms in a subjective manner. Hence, there is a possibility that owing to the subjectivity of the definition, certain promoters/promoter group entities with less than 20% shareholding in the listed entity may not get categorised as related parties. Therefore, transactions with such persons may not get categorised as RPTs under the LODR.

(iii) The Working Group noted that control over a listed entity does not depend only on shareholding. 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. The Working Group observed that it is thus not uncommon for group entities to regularly engage in related party transactions such as inter corporate loans, cross collateralization and significant influence arrangements; such inter-linkages in

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[3] Refer **Annexure A** for definitions of 'related party' under the Companies Act and Ind AS 24.

[4] The applicable accounting standard for Indian companies complying with Indian Accounting Standards (Ind AS) under Section 133 of the Companies Act is Ind AS 24.

[5] Refer **Annexure A** for definitions of 'promoter' and 'promoter group' under the ICDR.

business, operations and management can raise concerns relating to RPTs. Considering that promoters may exercise control on promoter group entities and consequently, influence decision making on the group as a whole, the Working Group recommended that promoter group members may also be included under the definition of a related party, irrespective of their shareholding.

The Working Group also deliberated on the compliance burden of subjecting transactions with persons or entities belonging to the promoter or promoter group to the regulations governing RPTs. In this respect, the Working Group was of the view that the benefits of this measure would outweigh the additional compliance burden and that legitimate RPTs would still be approved if they are in the interest of the company.

Further, the Working Group discussed whether certain significant shareholders in a listed entity who do not form part of the '*promoter*' or '*promoter group'* should also be included within the purview of '*related parties*'. The Working Group noted that in several jurisdictions such as the United Kingdom ("**U.K.**"), Italy and Korea, shareholders with a holding above certain thresholds are deemed to be related parties of such company. In such jurisdictions, the rationale for such inclusion is that a person with significant shareholding could influence the decisions of a company. The Working Group deliberated that in the Indian context also, there may be a shareholder who is not classified as a promoter, but may exercise influence over the decisions of the listed entity by virtue of shareholding. The Working Group was therefore of the view that shareholders above a certain threshold of holding in a company should be classified as a related party.

The Working Group deliberated on the threshold for determining shareholding above which a person not forming part of the promoter/promoter group would get classified as a related party and determined that a 20% threshold would be appropriate for the following reasons:

(i) The Working Group noted that the term '*significant influence*' is defined in the Companies Act under the definition of '*associate company*' to mean "control of at least 20% of the total voting power, or control or participation in business decisions under an agreement".

(ii) The Indian Accounting Standard on 'Investments in Associates and Joint Ventures' (Ind AS 28) also states that: *"If an entity holds, directly or indirectly (e.g. through subsidiaries), 20% or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case".*

Thus, a shareholding of 20% is considered sufficient to confer a shareholder with significant influence over the company.

The Working Group further determined that a deeming provision may be created for aggregation of direct and indirect shareholding of individual shareholders and their relatives as defined under the Companies Act, for the purposes of calculating the 20% threshold.

Lastly, the Working Group also discussed if the concept of reciprocity in recognition of related parties should be made mandatory by including such a condition in the definition of related parties. Certain instances were discussed by the Working Group where Company 'A' identified Company 'B' in its financial statements as a related party but Company 'B' did not identify Company 'A' as a related party. The Working Group debated if this could be changed by making reciprocal recognition of related parties mandatory.

The Working Group considered such cases and concluded that specific circumstances could arise when Company 'A' recognises Company 'B' as a related party, but the converse may not be true. This is because related parties for Company 'A' would be identified in relation to Company 'A' itself. For instance, there could be a situation where, say a director in Company 'A' is a director in Company 'B' and holds more than 2% of paid-up share capital of Company 'B'; thus making Company 'B' a related party of Company 'A'; however if such director does not have any shareholding in Company 'A', Company 'A' would not be classified as related party of Company 'B'. Accordingly, the Working Group did not recommend making such reciprocal recognition mandatory by law.

The Working Group therefore recommended the following changes to the LODR:

Current Provision in the LODR	**Proposed Changes**
2(zb) "related party" means a related party as defined under sub-section (76) of section 2 of the Companies Act, 2013 or under the applicable accounting standards: Provided that any person or entity belonging to the promoter or promoter group of the listed entity and holding 20% or more of shareholding in the listed entity shall be deemed to be a related party. Provided further that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s);	2(zb) "related party" means a related party as defined under sub-section (76) of section 2 of the Companies Act, 2013 or under the applicable accounting standards: Provided that: (i) any person or entity belonging to the promoter or promoter group of the listed entity ~~and holding 20% or more of shareholding in the listed entity shall be deemed to be a related party~~; or (ii) any person or any entity, directly or indirectly (including with their relatives), holding 20% or more of the equity shareholding in the listed entity, shall be deemed to be a related party. Provided further that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s);

II. 'Relative'

The LODR currently draws reference from Section 2(77) of the Companies Act for the term 'relative' which, with reference to a person, includes members of his/her Hindu undivided family, husband or wife (as applicable), father (including step-father), mother (including step-mother), son (including step-son), son's wife, daughter, daughter's husband, brother (including step-brother) and sister (including step-sister).

Working Group deliberations and recommendations

One concern raised in the discussions of the Working Group was that directors, key management personnel and promoters may execute RPTs through relatives not covered within the definition under the Companies Act. The Working Group reviewed the definition of 'relative' under the 1956 Act and the Companies Act, and noted that the scope of this definition was narrowed under the Companies Act. After deliberations, the Working Group concluded that no change needs to be made to the definition of 'relative' under the LODR since persons intending to carry out fraudulent transactions may anyway do so through a relative not covered within the definition. Further, other SEBI Regulations such as SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 also define "*relative*" to mean relatives under the Companies Act; hence there is a need to maintain consistency. The Working Group thought it prudent to regulate RPTs by implementing other checks and balances instead.

III. 'Related Party Transaction'

The LODR currently defines '*related party transaction*' 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.

Under Section 188[6] of the Companies Act, '*related party transaction*' has been defined to include certain types of transactions such as the sale, purchase or supply of goods or materials, or selling or otherwise disposing of, or buying property of any kind.

Working Group deliberations and recommendations

The Working Group observed that recently, certain innovative structures have been used to avoid classification of transactions as RPTs and thus avoid the associated

[6] Refer to **Annexure A** for section 188 of the Companies Act.

regulatory compliance and disclosure requirements. Some such instances are mentioned below:

- use of complex structures;
- transactions undertaken by a listed entity with seemingly unrelated parties, however intended to benefit related parties; and
- instances of loans being given to an unrelated party which in turn gives such loan to a related party.

Accordingly, the Working Group examined the definition of RPTs from the perspective of strengthening it and recommended broadening the definition of RPTs to include transactions which are undertaken, whether directly or indirectly, with the intention of benefitting related parties. This concept is also captured in the legislation of other jurisdictions, such as the U.K.

Separately, the Working Group also considered excluding certain corporate actions which, by their very nature treat all shareholders equally, such as payment of dividend, sub-division or consolidation of securities, buy-back, rights and bonus issue of securities. Further, corporate actions which are subject to procedures specifically laid down by SEBI in its other regulations, such as preferential allotment, should also fall outside the purview of RPTs.

The Working Group therefore recommended changes to this definition which, together with proposed changes to this regulation to include transactions involving subsidiaries, are set out in Chapter 3 below.

Chapter 3: Approval Requirements and Materiality Thresholds

This chapter examines the present regulatory framework and sets out recommendations of the Working Group in the following areas:

(1) the approval mechanism for RPTs under the LODR and the Companies Act;
(2) the materiality thresholds adopted under the approval process; and
(3) the process followed by the audit committee while considering an RPT.

I. Approval Mechanism for Related Party Transactions under the LODR and Companies Act

The existing provisions of the LODR and the Companies Act provide the following approval mechanism for RPTs:

(i) Approval of the audit committee of the entity is required for all RPTs under Regulation 23(2) of the LODR (for exemptions under the LODR see paragraph (iii) below). There is no exception for transactions in the ordinary course of business or at arm's length, as per the LODR. Under Section 188(1) of the Companies Act, approval of the board of directors of the company is required for a transaction between the company and its related parties if the transaction is one of the types mentioned therein, with an exemption for transactions in the ordinary course of business and on arm's length basis.

(ii) Approval of the shareholders is required:

(a) under Regulation 23(4) of the LODR, for material RPTs as defined under Regulation 23(1) and 23(1A) of the LODR; and

(b) for transactions listed in Section 188(1) of the Companies Act which exceed a prescribed threshold linked to certain parameters, with an exemption for transactions in the ordinary course of business and on arm's length basis.

(iii) Under Regulation 23(5) of the LODR, transactions between the following entities are exempt from the requirement of audit committee and shareholder approval:

(a) between a listed entity and its wholly-owned subsidiary whose accounts are consolidated with such listed entity and placed before the shareholders at a general meeting for approval; and

(b) between two government companies.

The Companies Act also specifies that the aforementioned transactions are exempt from the requirement of shareholder approval.

RPTs covered by the Companies Act:

The types of transactions specified in Section 188 of the Companies Act are described below. The threshold (to be taken individually or together with the previous transactions during a financial year for points (i) to (iv) below) above which the requirement for shareholder approval is triggered under the Companies Act is also described below:

(i) *sale, purchase or supply of any goods or materials amounting to 10% or more of the turnover of the company, whether such sale, purchase or supply is carried out directly or through appointment of agent;*

(ii) *selling or otherwise disposing of, or buying, property of any kind amounting to 10% or more of the net worth of the company, whether such sale or disposal is carried out directly or through appointment of agent;*

(iii) *leasing of property of any kind amounting to 10% or more of the turnover of the company;*

(iv) *availing or rendering of any services amounting to 10% or more of the turnover of the company, whether such service is availed or rendered directly or through appointment of agent;*

(v) *such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company where the monthly remuneration exceeds Rs.2,50,000; and*

(vi) *underwriting the subscription of any securities or derivatives thereof, of the company exceeding 1% of the net worth of the company.*

Regulation of RPTs by the listed entity at the subsidiary level:

At present, the approval requirements in respect of RPTs under the Companies Act apply to each company in respect of transactions entered into by the relevant company with its own related parties. The Companies Act also covers a transaction at the holding company level relating to the appointment of a related party to any office or place of profit in the subsidiary. The LODR contains certain provisions relating to transactions indirectly undertaken by the listed entity through unlisted subsidiaries, as specified below. However, neither the LODR (except for sale, disposal or leasing of 20% or more of the assets of a material subsidiary) nor the Companies Act specifically requires approvals at the listed entity level in respect of transactions undertaken by an unlisted subsidiary with any related party of the consolidated entity (i.e., the listed entity and/or its subsidiaries).

Currently under Regulation 23(5) of the LODR, audit committee or shareholder approval is not required for transactions between a listed entity and its wholly-owned subsidiary whose accounts are consolidated with such listed entity and placed before the shareholders at a general meeting for approval.

A summary of the obligations of the listed entity with respect to the other entities forming part of the consolidated entity under the LODR and the Companies Act is set out below:

(i) With respect to material subsidiaries (material subsidiaries are defined as subsidiaries of the listed entity whose income or net worth exceeds 10% of the consolidated income or net worth respectively, of the listed entity and its subsidiaries in the immediately preceding accounting year), the following requirements apply:

(a) Pursuant to Regulation 24(1) of the LODR, at least one (1) independent director of the listed entity is required to be a director on the board of an unlisted material subsidiary (with respect to this provision, material subsidiary has been defined with a threshold of 20% of the consolidated income or net worth).

(b) Pursuant to Regulation 24(6) of the LODR, the sale or disposal or leasing of assets amounting to more than 20% of the assets of a material subsidiary (on an aggregate basis during a financial year), subject to certain exceptions, requires prior approval of the shareholders of the listed holding company by way of a special resolution.

(c) Pursuant to Regulation 24A of the LODR, all listed entities and their Indian unlisted material subsidiaries are required to undertake a secretarial audit and annex such reports to the annual report of the listed entity.

(ii) With respect to unlisted subsidiaries of the listed entity, the following requirements apply:

(a) Pursuant to Regulation 24(2) of the LODR, the audit committee of a listed holding company is required to review the financial statements, in particular the investments made by all its unlisted subsidiaries.

(b) Pursuant to Regulation 24(3) of the LODR, the board of the listed entity is required to review the minutes of the boards of such unlisted subsidiaries.

(c) Pursuant to Regulation 24(4) of the LODR, the management of an unlisted subsidiary of a listed entity is required to periodically bring to the notice of the board of the listed entity a statement of all ‘significant transactions and arrangements’ undertaken by the unlisted subsidiary. ‘Significant transaction or arrangement’ has been defined as any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities of the unlisted subsidiary for the immediately preceding accounting year.

(d) Pursuant to Regulation 18(3) read with Part C of Schedule II of the LODR, the role of the audit committee includes reviewing at periodic

intervals the statement of significant related party transactions submitted by the management. The audit committee has been given the discretion to define the term 'significant related party transactions' under the regulations.

(iii) Pursuant to Regulation 18(3) read with Part C of Schedule II of the LODR, the audit committee of the listed entity is also required to:

(a) scrutinise all inter-corporate loans and investments of the listed entity; and

(b) review the utilisation of loans and/or advances from/investment by the holding company in the subsidiary exceeding Rs.100 crore or 10% of the asset size of the subsidiary, whichever is lower, including existing loans/advances/investments as on April 1, 2019.

(iv) Listed entities are also required to disclose to the stock exchanges any agreements, including loan agreements (as a borrower), which are binding on the listed entity and not in the normal course of business. Subsequent amendments made to such agreements or termination of such agreements are also required to be disclosed. The above-mentioned disclosures shall however, be subject to the materiality guidelines under Regulation 30(4) of the LODR.

(v) Under Regulation 33(8) of the LODR, the statutory auditor of the listed entity is required to undertake a limited review of the audit of all entities/companies whose accounts are consolidated with the listed entity.

(vi) Pursuant to Regulation 4 of the LODR, one of the key functions of the board of listed entities is "*monitoring and managing potential conflicts of interest of management, members of the board of directors and shareholders, including misuse of corporate assets and abuse in related party transactions*".

(vii) The code for independent directors under the Companies Act requires independent directors to "*pay sufficient attention and ensure that adequate deliberations are held before approving related party transactions and assure themselves that the same are in the interest of the company*."

Separately, the following disclosures are also required to be made by the listed entity which relates to the consolidated entity:

(i) Pursuant to Regulation 23(9) of the LODR, the listed entity is required to disclose related party transactions on a consolidated basis in a prescribed format within 30 days from the date of publication of its standalone and consolidated financial results for the half year.

(ii) The listed entity is required to make related party disclosures in its annual report in accordance with the format provided in Schedule V of the LODR. Such format states that the disclosure requirements for the listed holding company would also apply to each of the subsidiaries. This disclosure requirement is not applicable to listed banks.

(iii) All transactions of the listed entity with any person or entity belonging to its promoter/promoter group and holding 10% or more shareholding in the listed entity are required to be disclosed in the annual report of the listed entity. This disclosure requirement is not applicable to listed banks.

(iv) Schedule V of the LODR also requires the corporate governance report forming part of the annual report of the listed entity to include "*disclosures on materially significant related party transactions that may have potential conflict with the interest of the listed entity at large*".

Working Group deliberations and recommendations

The Working Group noted 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.

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% 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 belongs to the shareholders of the listed entity.

In light of the above, the Working Group felt the need to strengthen the laws for regulation and oversight of RPTs undertaken by a subsidiary with the related parties of the listed entity or its subsidiaries. It is of significance that the need to regulate the consolidated entity as a whole was also recognised specifically in the report of the Kotak committee on corporate governance dated October 5, 2017 in the following terms– "*The Committee notes that several listed entities in India operate through a network of entities– where some companies have over 200 subsidiaries, step-down subsidiaries, associates, and joint ventures. While investors hold direct equity only in the listed holding company, they have valued the entire business structure at the time of investment. Therefore, it is important for boards to ensure that good governance trickles down to the entire structure*."

The Working Group deliberated on the present regulatory framework governing transactions of subsidiaries of a listed entity and recommended that prior approval of the audit committee of the listed entity should be mandatory for transactions carried out between:

(i) the listed entity or any of its subsidiaries on the 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 the 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.

The Working Group also deliberated that an exception from taking approval of the audit committee and 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. In addition, 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 recommended that transactions between two wholly owned subsidiaries of the listed holding company should be similarly exempt from such requirements. Further, the Working Group determined that an explanation be added to clarify that for RPTs of unlisted subsidiaries of a listed subsidiary, the prior approval of the audit committee or shareholders, as applicable, of the listed subsidiary would suffice.

Further, the Working Group was cognisant that this provision may increase the compliance burden for the listed entity and the members of the audit committee. Accordingly, the Working Group discussed the possibility of exempting transactions which are below a specified monetary threshold of the subsidiary.

After deliberations, the Working Group determined that the related party transactions relating to subsidiaries of the listed entity should require prior approval of the audit committee subject to their value exceeding 10% of the 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 . Further, it was also decided that at this stage, associate companies and joint ventures need not be included under such additional prior approval requirements.

The Working Group was of the view that the RPT provisions of the LODR relating to disclosure requirements in the notice to the shareholders and requirement of prior shareholder approval should also apply to subsidiaries of the listed entity, subject to materiality thresholds of the listed entity on a consolidated basis.

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

The Working Group also sought to clarify that subsequent material modifications of RPTs require prior audit committee approval and, if applicable, shareholder approval. It was noted that, under the Companies Act, approval of the audit committee is required for subsequent modifications for transactions with related parties.

The Working Group therefore recommended the following changes to the LODR:

Current Provision in the LODR	**Proposed Changes**
2(zc) “related party transaction” means a transfer of resources, services or obligations between a listed entity and a related party,	2(zc) “related party transaction” means a transaction involving a transfer of resources, services or obligations between ~~a listed entity and a related party~~:

Current Provision in the LODR	Proposed Changes
regardless of whether a price is charged and a "transaction" with a related party shall be construed to include a single transaction or a group of transactions in a contract: Provided that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s);	(i) the listed entity or any of its subsidiaries on the 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 the 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, regardless of whether a price is charged or not ~~and a~~. Such "transaction" ~~with a related party~~ shall be construed to include a single transaction or a group of transactions~~.in a contract~~: Provided that the following shall not be treated as related party transactions: (a) the issue of specified securities on a preferential basis, subject to requirements under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 being complied with; and (b) the following corporate actions by the listed entity which are uniformly applicable/offered to all shareholders in proportion to their shareholding: i. payment of dividend; ii. subdivision or consolidation of securities; iii. issuance of securities by way of a rights issue or a bonus issue; and iv. buy-back of securities.

Current Provision in the LODR	Proposed Changes
	Provided further that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s);
23(2) All related party transactions shall require prior approval of the audit committee.	23(2) All related party transactions and subsequent material modifications shall require prior approval of the audit committee of the listed entity. Provided that a related party transaction 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 only if the value of such transaction (whether entered into individually or taken together with previous transactions during a financial year) exceeds 10% 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. Provided further that prior approval of the audit committee of the listed entity shall not be required for a related party transaction to which the listed subsidiary is a party but the listed entity is not a party, if such listed subsidiary is not exempt from regulation 23 and the other corporate governance provisions of these regulations specified in regulation 15(2). Explanation: for related party transactions of unlisted subsidiaries of a listed subsidiary specified above, the prior approval of the audit committee of the listed subsidiary would suffice.
23(4) 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	23(4) All material related party transactions and subsequent material modifications, shall require prior approval of the shareholders through resolution and no related party shall vote to approve such

Current Provision in the LODR	Proposed Changes
entity is a related party to the particular transaction or not: Provided that the requirements specified under this sub-regulation shall not apply in respect of a resolution plan approved under section 31 of the Insolvency Code, subject to the event being disclosed to the recognized stock exchanges within one day of the resolution plan being approved;	resolutions whether the entity is a related party to the particular transaction or not: Provided that prior approval of the shareholders of a listed entity shall not be required for a related party transaction to which the listed subsidiary is a party but the listed entity is not a party, if such listed subsidiary is not exempt from regulation 23 and the other corporate governance provisions of these regulations specified in regulation 15(2). Explanation: for related party transactions of unlisted subsidiaries of a listed subsidiary specified above, the prior approval of the shareholders of the listed subsidiary would suffice. Provided further that the requirements specified under this sub-regulation shall not apply in respect of a resolution plan approved under section 31 of the Insolvency Code, subject to the event being disclosed to the recognized stock exchanges within one day of the resolution plan being approved;
23(5) The provisions of sub-regulations (2), (3) and (4) shall not be 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; Explanation. - For the purpose of clause (a), "government company(ies)" means Government	23(5) The provisions of sub-regulations (2), (3) and (4) shall not be 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; (c) transactions entered into between two wholly-owned subsidiaries of the listed holding company, whose accounts are consolidated with such holding

Current Provision in the LODR	Proposed Changes
company as defined in sub-section (45) of section 2 of the Companies Act, 2013.	company and placed before the shareholders at the general meeting for approval. Explanation. - For the purpose of clause (a), "government company(ies)" means Government company as defined in sub-section (45) of section 2 of the Companies Act, 2013.

Voting by interested shareholders under the Companies Act and the LODR:

Pursuant to Section 188(1) of the Companies Act, shareholders of the company that are related parties in the context of the transaction for which shareholder approval is sought, cannot vote to approve such RPT. However, such restriction on voting by shareholders does not apply under the Companies Act in the case of a company where 90% or more of the shareholders are relatives of promoters or related parties. Regulation 23(7) of the LODR adopts a stricter approach and states that no related party of the listed entity, irrespective of whether the related party is interested in that particular RPT, can vote to approve an RPT.

Working Group deliberations and recommendations

The Working Group discussed whether the LODR should be amended to make it consistent with the Companies Act and allow shareholders who are related parties of the listed entity but not concerned with a particular RPT to vote in respect of that particular RPT. Members of the Working Group discussed that due to the existing provisions of the LODR, even parties that are neither interested nor connected with the RPT cannot vote on such transactions, except negatively. However, after detailed discussions, the Working Group decided not to change the current position under the LODR for the following reasons:

(i) Determining whether a particular promoter or promoter group is interested or not in an RPT could lead to subjectivity and differing interpretations.

(ii) 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 an RPT.

II. Materiality Thresholds with respect to Prior Approvals for RPTs

Materiality threshold with respect to prior shareholder approval for RPTs:

Under Regulation 23(1) of the LODR, RPTs undertaken by a listed entity taken individually or together with the previous transactions during that financial year, which

exceed 10% of the annual consolidated turnover of the listed entity in accordance with the last audited financial statements of the listed entity, are considered to be material RPTs. Such material RPTs require approval of the shareholders of the listed entity under Regulation 23(4) of the LODR.

Regulation 23(1) of the LODR requires each listed entity to formulate a policy on materiality of RPTs which should be approved by the board of directors. Such policy should also be reviewed by the board of directors of the company every three years and updated accordingly.

Regulation 23(1A) of the LODR states that, transaction(s) of a listed entity (entered into individually or taken together with previous transactions during a financial year) involving payments to related parties with respect to brand usage or royalty are considered to be material RPTs if their value exceeds 5% of the annual consolidated turnover of the listed entity in accordance with the last audited financial statements of the listed entity.

Working Group deliberations and recommendations

The Working Group noted that although under the Companies Act, RPTs carried out in the ordinary course of business and which are on arm's length, do not require prior shareholder approval, the LODR does not provide such distinction for an RPT. Further, under the current provisions of the LODR, those RPTs which are above a threshold of 10% of annual consolidated turnover require approval from shareholders.

The Working Group reviewed the data for transactions for the top 500 listed entities which involved shareholder resolutions in the past five years, the details of which are given below:

Time period	Number of listed entities	Total number of shareholders' resolutions
January 2019 through September 2019	53	71
January 2018 through December 2018	58	70
January 2017 through December 2017	58	72
January 2016 through December 2016	59	74
January 2015 through December 2015	73	91

Source: Stakeholders Empowerment Services

As may be seen from the above, the number of resolutions seeking shareholder approval for the top 500 listed entities is not high. No absolute numerical threshold is prescribed at present. Accordingly, the Working Group deliberated on the need to revisit the current threshold.

Members of the Working Group were of the view that considering the data, the threshold of 10% of the consolidated turnover appears to be high. Further, particularly in case of listed entities with a high turnover, several RPTs may not be placed before the shareholders for approval. To illustrate, an RPT of Rs.1,000 crore by a listed entity with a turnover of above Rs.10,000 crore does not need to be brought to the shareholders for approval, even though in absolute terms such transaction of Rs.1,000

crore is a high value transaction. In order to address this issue, the Working Group felt the need to reduce the percentage threshold for materiality and also introduce a numerical threshold for seeking shareholder approval for RPTs.

The Working Group noted that in the U.K., transactions above a 5% threshold (based on gross assets, profits, consideration and gross capital) require shareholder approval, with transactions in the ordinary course of business being exempt. Other jurisdictions such as Singapore and Malaysia also have a 5% threshold.

It was also noted that in international jurisdictions, benchmarks other than turnover such as assets have been used to define the materiality threshold. Further, the Working Group discussed that in case of entities with a high revenue and low net-worth; an RPT may be a significant proportion of the net-worth, however may form a low proportion of revenue and thus, may not need to be subject to shareholder approval. Accordingly, the Working Group recommended that the benchmarks for determining materiality may be expanded to include net worth and total assets.

In light of the above, the Working Group concluded that the materiality threshold in Regulation 23(1) may be amended to 5% of the annual total revenues, total assets or net worth of the listed entity on a consolidated basis or Rs.1,000 crore, whichever is lower. The Working Group also concluded that the net worth criterion would not apply to companies with negative net worth. Further, companies can specify a lower materiality threshold as per their RPT policies.

The Working Group therefore recommended the following changes to the LODR:

Current Provision in the LODR	**Proposed Changes**
23(1) The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions including clear threshold limits duly approved by the board of directors and such policy shall be reviewed by the board of directors at least once every three years and updated accordingly: Explanation.- A 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 ten percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.	23(1) The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions including clear threshold limits duly approved by the board of directors and such policy shall be reviewed by the board of directors at least once every three years and updated accordingly: Explanation.- A ~~transaction with a~~ related party transaction shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds ~~ten~~ Rs.1,000 crore or five percent of the annual ~~consolidated turnover~~ 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

Current Provision in the LODR	Proposed Changes
	is lower, provided that the criterion relating to net worth shall not be applicable if the net worth of the listed entity is negative.

III. Process followed by the Audit Committee for Approval of RPTs

Regulation 18 of the LODR requires all listed entities to constitute an audit committee. The audit committee is required to consist of a minimum of three directors. Two-thirds of the audit committee of a listed entity is required to comprise independent directors, unless the listed entity has outstanding equity shares with superior voting rights, in which case the audit committee is required to comprise only independent directors. The chairperson of the audit committee is required to be an independent director. All members of the audit committee must be able to read and understand basic financial statements.

Section 177(1) of the Companies Act mandates constituting an audit committee for:

(i) listed companies; and

(ii) unlisted public companies having:
  (a) paid-up share capital of Rs.10 crore or more;
  (b) turnover of Rs.100 crore or more; or
  (c) outstanding loans, debentures and deposits aggregating to Rs.50 crore or more.

The terms of reference of the Working Group included examining the approval process followed by the audit committee for RPTs. Accordingly, the Working Group reviewed matters such as the composition of the audit committee, right of audit committee to seek outside legal or other professional advice, frequency of meetings and the information to be provided to the audit committee for review.

Under the LODR, minutes of meetings of the audit committee are required to be placed before the board of directors of the listed entity. The board of directors is also required to evaluate the independent directors on the basis of their performance, fulfilment of the prescribed criteria of independence and their independence from the management. Separately, the board of directors of listed entity is required to disclose a confirmation regarding independence of the independent directors, in the corporate governance report. In the event that an independent director resigns before the expiry of his tenure, detailed reasons for such resignation along with a confirmation that there are no other material reasons, is also required to be provided in the corporate governance report. Therefore, the LODR emphasizes on the independence of the members of the audit committee.

While the responsibility of approving RPTs is placed on the audit committee which has a majority of independent directors, at present, however, there is no specific

requirement on the minimum information that should be provided to the audit committee while seeking approval for a proposed related party transaction.

Working Group deliberations and recommendations

The Working Group was of the view that, while company management would be 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.

After deliberations, the Working Group determined that the management of the listed entity should mandatorily provide the following information to the audit committee for approval of a proposed RPT:

(i) Type, material terms and particulars of the related party transaction;

(ii) 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);

(iii) Tenure of the transaction;

(iv) Value of the transaction;

(v) The percentage of the listed entity's annual total revenues, total assets and net worth, on a consolidated basis, that is represented by the value of the proposed RPT (and for a related party transaction involving a subsidiary, such percentage calculated on the basis of the subsidiary's annual total revenues on a standalone basis);

(vi) Where the transaction relates to any loans, inter-corporate deposits, advances or investments made or given by the listed entity or its subsidiary:

  (a) details of the source of funds in connection with the proposed RPT;

  (b) where any financial indebtedness is incurred to make or give loans, inter-corporate deposits, advances or investments, (i) nature of indebtedness; (ii) cost of funds; and (iii) tenure;

  (c) applicable terms, including covenants, tenure, interest rate and repayment schedule, whether secured or unsecured and if secured, the nature of security; and

  (d) the purpose for which the funds will be utilised by the ultimate beneficiary of such funds pursuant to the RPT.

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

(viii) A copy of the valuation or other external party report, if any such report has been relied upon; and

(ix) Any other information that may be relevant.

With respect to the type, material terms and particulars of the related party transaction, the Working Group was of the view that brief details, such as whether the proposed RPT is a sale or purchase of goods or services or whether it involves a loan, inter-corporate deposit, advance or investment should be mentioned. Further, each type of RPT with a single party should be disclosed separately and there should be no clubbing or netting of transactions of the same type. However, RPTs with the same counterparty and of the same type may be aggregated. Details of sale and purchase transactions or loans advanced to and received from the same counterparty should be provided separately, without any netting off.

The Working Group was of the view that the tenure of the RPT should be a finite period and not open-ended. Further, if the proposed RPT is a recurring transaction, the time period within which such multiple transactions are expected to be completed should be clearly specified. The Working Group also determined that the audit committee should undertake an annual review of the status of long-term (more than one year) or recurring RPTs.

In respect of the value of the transaction, the Working Group was of the view that an upper limit should be provided. Further, if the proposed RPT is a recurring transaction, then the aggregate value and the time period within which such limit will be exhausted should be mentioned.

The Working Group felt that it would be necessary for the audit committee to be aware of the value of a proposed RPT as a proportion of the annual total revenues, total assets and net worth of the consolidated entity. Further, for a related party transaction involving a subsidiary of the listed entity such percentage calculated on the basis of the subsidiary's annual total revenues on a standalone basis should also be provided.

Further, justification for each individual transaction must be provided, unless there are a series of transactions interdependent on each other, in which case the justification for the entire series of transactions may be given. As justification, the management could for instance, provide the prices at which transactions of a similar nature as the proposed RPT have been undertaken with unrelated parties; or comparative quotes and if the entity is not able to source comparative quotes externally, the reasons thereof should be provided to the audit committee. The audit committee may also request management for an analysis of the RPT specifying, for example, the deviation from market prices and standard commercial terms.

The Working Group was of the view that since considerable information is being provided to the audit committee for approval of a RPT and it has also prescribed an extensive format for public disclosure of RPTs, the need to place, before the audit committee, a separate statement of significant related party transactions may not be required.

The Working Group also deliberated that there have been cases in the past, where the listed entity gives a large contract to a related party which does not otherwise have much business (apart from that given by the listed entity). The Working Group thus felt

that it would be desirable for the audit committee, before taking a decision on a RPT, to know the percentage of the counter-party's annual total revenues, total assets and net worth, that is represented by the value of the proposed RPT. It was further deliberated whether making such disclosure mandatory will make it onerous for listed entities; hence, to start with, the Working Group felt that such disclosure can be on a voluntary basis.

The Working Group therefore recommended the following changes to the LODR:

Current Provision in the LODR	**Proposed Changes**
Part C of Schedule II of the LODR B. The audit committee shall mandatorily review the following information: ….	Modification of paragraph (2) and insertion of new paragraph (7) in Part B of Schedule II of the LODR B. The audit committee shall mandatorily review the following information: …. (2) ~~statement of significant related party transactions (as defined by the audit committee), submitted by management;~~ with respect to approval of a related party transaction, the following information as provided by the management of the listed entity: (a) Type, material terms and particulars of the proposed transaction; (b) 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); (c) Tenure of the proposed transaction; Explanation.- The transaction should have a particular tenure or term and should not be indefinite or open-ended. (d) Value of the proposed transaction; Explanation.- An upper limit should be provided and in case of a recurring or

Current Provision in the LODR	Proposed Changes
	continuous transaction, the aggregate value and the time period within which such limit will be exhausted. (e) 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 related party transaction 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; (f) If the transaction relates to any loans, inter-corporate deposits, advances or investments made or given by the listed entity or its subsidiary: i. details of the source of funds in connection with the proposed related party transaction; ii. where any financial indebtedness is incurred to make or give loans, inter-corporate deposits, advances or investments, • nature of indebtedness; • cost of funds; and • tenure; iii. applicable terms, including covenants, tenure, interest rate and repayment schedule, whether secured or unsecured and if secured, the nature of security; and iv. the purpose for which the funds will be utilised by the ultimate beneficiary of such funds pursuant to the related party transaction;

Current Provision in the LODR	Proposed Changes
	(g) Justification as to why the related party transaction is in the interest of the listed entity; (h) A copy of the valuation or other external report, if any such report has been relied upon; (i) Percentage of the counter-party's annual total revenues, total assets and net worth, that is represented by the value of the proposed related party transaction: Provided that the information mentioned in this sub-clause may be placed before the audit committee on a voluntary basis; and (j) Any other information that may be relevant. ……. 7. status of long-term (more than one year) or recurring related party transactions on an annual basis.

Chapter 4: Disclosure Requirements

This chapter of the Report discusses the existing legal provisions relating to disclosure obligations of listed entities in relation to RPTs and the Working Group's recommendations in respect thereof. The Working Group's aim was to strike a balance between the additional disclosure requirements recommended on the one hand and the compliance burden on the other.

This chapter of the Report has been divided into two parts:

(1) minimum information to be provided to the shareholders for consideration of RPTs; and

(2) formats for disclosures to be made by the listed entity to the stock exchanges in respect of RPTs.

The disclosure requirements to the audit committee of the listed entity have been covered in Chapter 3.

I. Information to be provided to Shareholders for consideration of RPTs

Pursuant to existing requirements under the Companies Act, the notice issued to the shareholders in respect of a general meeting is required to contain a statement of the business proposed to be transacted at such meeting. Additionally, an explanatory statement is required to be annexed to such notice setting out certain prescribed information in respect of any proposed RPT. The explanatory statement is required to contain the following details:

(i) Name of the related party;

(ii) Name of the director or key managerial personnel who is related, if any;

(iii) Nature of the relationship;

(iv) Type, material terms, monetary value and particulars of the contract or arrangement;

(v) Nature of concern or interest (financial or otherwise) of every director, manager (if any) and key managerial personnel and their relatives in the RPT;

(vi) Where the related party is a corporate entity, the extent of shareholding interest of every promoter, director, manager, if any, and of every other key managerial personnel of the entity in such related party, if the extent of such shareholding exceeds 2% of the paid-up share capital of the related party;

(vii) If any document has been referred to in the proposed resolution and it is to be considered at the meeting, then a statement specifying the place and time where such document can be inspected;[7]

[7] The secretarial standard on general meetings states that such documents should be made available for inspection in physical or in electronic form during specified business hours at the registered office of the

(viii) Any other information or facts that may enable shareholders to understand the meaning, scope and implications of the RPT and to take a decision on the proposed resolution.

Further, under Regulation 17(11) of the LODR, the recommendation of the board of directors of the listed entity on each item of special business is required to be disclosed in the statement to be annexed to the notice to the shareholders.

Working Group deliberations and recommendations

The Working Group noted that the level of minority shareholder voting in India is currently low and due to the requirement of a majority vote of non-related shareholders for RPTs, there is a need to maximize informed shareholder participation.

The Working Group was of the view that the information required to be disclosed to the audit committee in Chapter 3 above should also be provided to the shareholders in a brief and comprehensible manner. In addition, the Working Group after deliberations determined that it may be relevant for the shareholders to know whether the approval for the RPT was given unanimously by the audit committee.

Further, the Working Group also discussed whether 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. Members of the Working Group acknowledged that such reports could provide useful insights on the RPT. However, the Working Group also recognised the fact that such reports may be voluminous and technical. Accordingly, the Working Group concluded that such reports would be available for inspection at the registered office of the listed entity.

The Working Group therefore recommended the following changes to the LODR:

Current Provision in the LODR	**Proposed Changes**
36. Documents & Information to shareholders ….	<u>Insertion of new sub-regulation 36(6)</u> 36(6). The notice being sent to shareholders seeking approval for any proposed related party transaction shall, in addition to the requirements under the Companies Act, 2013, include the following information as a part of the explanatory statement: (1) A summary of the information provided by the management of the

company and copies thereof shall also be made available for inspection in physical or electronic form at the head office and corporate offices of the company. Further, copies of such documents should also be made available at the meeting itself.

Current Provision in the LODR	Proposed Changes
	listed entity to the audit committee pursuant to paragraph B(2) of Part C of Schedule II; (2) The recommendation of the audit committee in respect of the proposed transaction, specifying justification for why the transaction is in the interest of the listed entity; (3) Where the transaction relates to any loans, inter-corporate deposits, advances or investments made or given by the listed entity or its subsidiary, the details specified under paragraph B (2) (f) of Part C of Schedule II; (4) Whether the approval of the related party transaction 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 related party transaction: 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.

II. Format for Reporting of RPTs to the Stock Exchanges

One of the terms of reference of the Working Group was to discuss formats for the periodic disclosures of RPTs by listed entities to the stock exchanges. The Working Group commenced its deliberations with an objective to ensure that the format in which data is received from the listed entities is easily readable by investors as well as regulatory authorities for monitoring.

The existing requirements governing the disclosure of RPTs by a listed entity under the LODR and the Companies Act are set out below:

(i) The listed entity is required to disclose its related party transactions on a consolidated basis in a format prescribed under the relevant accounting standard for annual results. Such disclosure should be made within 30 days from the date of publication of its standalone and consolidated financial results for the half-year.

(ii) 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.

(iii) The corporate governance report forming part of the annual report of the listed entity is required to include "*disclosures on materially significant related party transactions that may have potential conflict with the interest of the listed entity at large*".

(iv) The 'details of all material transactions with related parties' are required to be disclosed in the quarterly compliance report on corporate governance to be submitted by listed entities to the stock exchanges within 15 days from the end of the quarter.

(v) Listed entities are also required to disclose to the stock exchanges any agreements, including loan agreements (as a borrower) which are binding on the listed entity and not in the normal course of business. Subsequent amendments made to such agreements or termination of such agreements are also required to be disclosed. The above mentioned disclosures are however, be subject to the materiality guidelines under Regulation 30(4) of the LODR.

(vi) Every company is required to attach to its financial statements,
   (a) the auditor's report; and
   (b) particulars of contracts or arrangements with related parties referred to in Section 188 of the Companies Act in Form AOC-2[8].

[8] Form AOC-2 requires disclosure of (i) related party transactions entered into by the company which are not at arm's length basis and (ii) material related party transactions which are entered into on arm's length basis.

(vii) Details of RPTs in which directors are interested are required to be entered into the register of contracts or arrangements.

Working Group deliberations and recommendations

The Working Group discussed the format of the half yearly disclosures (i.e., in respect of the two six-monthly periods of a financial year). Based on the existing regulation 23(9) of the LODR, it was observed that there was no consistency in such disclosures across listed entities, more so since there is no specific format prescribed in the Ind AS. Thus, there is asymmetry in information due to varied reporting formats and the Working Group felt the need to standardize the same through a prescribed format.

While developing the format, the Working Group first examined the existing disclosures as per Ind AS such as value of transactions, outstanding balances and their terms and conditions including whether they are secured, details of any guarantees given or received, among others. Further, the Working Group noted that Ind AS requires these disclosures only at an aggregate level with a specific category of related party such as parent, subsidiary etc. In this respect, the Working Group was of the opinion that 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, considering that significant misuse of RPTs has been happening by way of loans/advances/inter-corporate deposits to related parties, the Working Group was of the view that such transactions need more detailed disclosures. Taking into consideration the above, the Working Group has built upon the existing disclosures and codified the same into a standardized format as provided in Appendix-II of this Report.

Separately, the Working Group also discussed whether the listed entity can make the prescribed RPT disclosures simultaneously with the publication of financial results. Currently, the listed entity is required to make such RPT disclosures within 30 days from the date of publication of its standalone and consolidated financial statements. The Working Group considered 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.

While the LODR mandates certain disclosures relating to loans and advances under Schedule V in the Annual Report of the listed entity, the format recommended by the Working Group covers such disclosures except with respect to “loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount”. Accordingly, in order to avoid duplicity in disclosures, the Working Group recommended that these disclosure requirements under Schedule V in the Annual Report should be applicable only to companies with listed debt securities. 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.

The Working Group therefore recommended the following changes to the LODR:

Current Provision in the LODR	Proposed Changes
23(9) 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 related party transactions 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.	23(9) The listed entity shall submit ~~within 30 days from the date of publication of its standalone and consolidated financial results for the half year,~~ to the stock exchanges disclosures of related party transactions ~~on a consolidated basis~~, in the format ~~specified in the relevant accounting standards for annual results to the stock exchanges~~ prescribed by SEBI and publish the same on its website. The listed entity shall make such disclosures every six months on the date of publication of its standalone and consolidated financial results.
SCHEDULE V: ANNUAL REPORT The annual report shall contain the following additional disclosures: A. Related Party Disclosure: …. 2. The disclosure requirements shall be as follows: …. C. Corporate Governance Report: ……. (10) Other Disclosures: (a)….	<u>Modification of paragraph A.(2.) and insertion of new paragraph (m) in (C)(10) of Schedule V of the LODR</u> SCHEDULE V: ANNUAL REPORT The annual report shall contain the following additional disclosures: A. Related Party Disclosure: …. 2. The ~~disclosure requirements shall be as follows:~~ disclosures under A.(2.) and A.(2A.) of Schedule V below, shall be applicable only to entities with listed debt securities. …. C. Corporate Governance Report: ….. (10) Other Disclosures: (a)…. (m) disclosure of 'Loans and advances in the nature of loans to firms/companies in which directors are interested by name and

Current Provision in the LODR	Proposed Changes
	amount' for a listed entity and its subsidiaries.

Chapter 5: Strengthening the Monitoring and Enforcement of Regulatory Norms relating to Related Party Transactions

This chapter of the Report sets out certain other recommendations of the Working Group in respect of strengthening the monitoring and enforcement of regulatory norms relating to RPTs.

I. Introduction

The monitoring and enforcement of regulatory norms prescribed under the LODR, including in relation to RPTs is four tiered:

(i) exercise of due diligence by, and active involvement of, the persons identified by the regulatory mechanism to review and consider RPTs. The directors on the audit committee of the listed entity are the first gatekeepers to review the proposed RPT, conduct due diligence and seek external or expert opinions where necessary.

(ii) second level of check is provided by the shareholders of the listed entity (whether for matters that come up for shareholder approval or otherwise when the RPTs are disclosed periodically).

(iii) independent professionals such as statutory auditors and secretarial auditors also provide third tier of check on RPTs.

(iv) The final level of monitoring and enforcement of regulatory norms relating to RPTs is by the relevant regulatory authority.

Under the current regulatory framework, a director is disqualified from being appointed as a director of any company, if he/she has been convicted of any offence relating to RPTs under Section 188 of the Companies Act, in the last five years. Depending on the nature of the violation, SEBI can also initiate action against a listed entity and other concerned persons for violation of any provision of LODR relating to RPTs including caution, warning, adjudication (levy of penalty), and/or debarment, depending on the gravity of the violation.

Further, in respect of any contract or arrangement entered into by a listed entity in violation of Section 188 of the Companies Act, the concerned director or employee of the company is liable to a fine ranging from Rs.25,000 to Rs.5 lakh or imprisonment for up to one year or both. The company may also proceed against a director or any other employee who had entered into such contract or arrangement in contravention of Section 188 of the Companies Act for recovery of any loss sustained by it as a result of such contract or arrangement.

Working Group Deliberations and Recommendations

The Working Group considered improvements in monitoring and enforcements in three main areas:

(i) the use of structured data (iXBRL) to augment enforcement;
(ii) the use of standardised identifiers to identify RPTs; and
(iii) capacity building, both human and technological, at SEBI and the stock exchanges.

(i) Use of Structured Data

At present, LODR mandates that the disclosures made by a listed entity to the stock exchanges shall be in XBRL format, unless there is a statutory requirement to make such disclosures in formats which may not be searchable, such as copies of scanned documents. This provides users, including investors with better quality, reliability and enables deeper analysis of financial information and allows other parties such as auditors to use audit data analytics to make the audit more efficient. It also allows regulators to use data analytics to identify violations of regulatory norms.

While SEBI has already mandated the XBRL format for reporting, the Working Group recommended that there should be one filing format, which could be based on inline XBRL (iXBRL), an open standard that enables a single document to provide both human-readable and structured, machine-readable data. Further, SEBI and the stock exchanges could consider enhancing their technological capabilities to leverage the benefits of developments in structured reporting.

(ii) Introduction of Standardised Identifiers

To ensure better monitoring of RPTs in view of concerns such as mismatch in reporting, routing through multiple entities, etc., there is a need for standardised identification of related parties. In the section on disclosure formats, one of the recommendations made by the Working Group is the use of Permanent Account Number ("**PAN**") of the parties involved in related party transactions.

(iii) Capacity building at the SEBI and the Stock Exchanges

The Working Group also notes and reiterates the following recommendation of the Kotak committee on corporate governance, as regards capacity building at SEBI (which the Working Group noted could also apply to the stock exchanges):

The staff strength at SEBI needs to be increased to strengthen its monitoring and enforcement functions. Successful enforcement actions by SEBI can have the twin effect of penalising the guilty, on the one hand, and creating a significant deterrent effect on the other hand. However, for such deterrent effects to be felt in India, SEBI must equip itself so that it can adroitly gather evidence with the objective of "investigate to litigate." SEBI needs to develop teams comprising data scientists, accountants, lawyers specialised in corporate law, software engineers. The members need to have depth of knowledge within their respective areas as also possess broad expertise across functional areas. In addition, SEBI should build its market intelligence through regular review of market research.

Annexure A

1. Definition of 'Related Party'

Companies Act	Ind AS 24
2. (76) "related party", with reference to a company, means— (i) *a director or his relative;* (ii) *a key managerial personnel or his relative;* (iii) *a firm, in which a director, manager or his relative is a partner;* (iv) *a private company in which a director or manager or his relative is a member or director;* (v) *a public company in which a director or manager is a director and holds along with his relatives, more than two per cent of its paid-up share capital;* (vi) *any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;* (vii) *any person on whose advice, directions or instructions a director or manager is accustomed to act:* *Provided that nothing in sub-clauses (vi) and (vii) shall apply to the advice, directions or instructions given in a professional capacity;* (viii) *any body corporate which is—* *(A) a holding, subsidiary or an associate company of such company; or*	*A related party is a person or entity that is related to the entity that is preparing its financial statements (in this Standard referred to as the 'reporting entity').* *(a) A person or a close member of that person's family is related to a reporting entity if that person:* (i) *has control or joint control of the reporting entity;* (ii) *has significant influence over the reporting entity; or* (iii) *is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.* *(b) An entity is related to a reporting entity if any of the following conditions applies:* (i) *The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).* (ii) *One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).* (iii) *Both entities are joint ventures of the same third party.* (iv) *One entity is a joint venture of a third entity and the other entity is an associate of the third entity.*

Companies Act	Ind AS 24
(B) a subsidiary of a holding company to which it is also a subsidiary; or *(C) an investing company or the venture of the company.* *Explanation.-For the purpose of this clause, "the investing company or the venturer of a company" means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.* (ix) *such other person as may be prescribed*;* **Rule 3 of the Companies (Specification of Definitions Details) Rules, 2014 prescribes that a director (other than an independent director) or key managerial personnel of the holding company or his relative with reference to a company, shall be deemed to be a related party.*	(v) *The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.* (vi) *The entity is controlled or jointly controlled by a person identified in (a).* (vii) *A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity)* (viii) *The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.*

2. Section 188 of the Companies Act

188. Related party transactions.

1. Except with the consent of the Board of Directors given by a resolution at a meeting of the Board and subject to such conditions as may be prescribed, no company shall enter into any contract or arrangement with a related party with respect to–

(a) sale, purchase or supply of any goods or materials;
(b) selling or otherwise disposing of, or buying, property of any kind;
(c) leasing of property of any kind;
(d) availing or rendering of any services;
(e) appointment of any agent for purchase or sale of goods, materials, services or property;
(f) such related party's appointment to any office or place of profit in the company, its subsidiary company or associate company; and
(g) underwriting the subscription of any securities or derivatives thereof, of the company:

Provided that no contract or arrangement, in the case of a company having a paid-up share capital of not less than such amount, or transactions exceeding such sums, as may be prescribed, shall be entered into except with the prior approval of the company by a resolution:

Provided further that no member of the company shall vote on such resolution, to approve any contract or arrangement which may be entered into by the company, if such member is a related party:

Provided also that nothing contained in the second proviso shall apply to a company in which ninety per cent or more members, in number, are relatives of promoters or are related parties:

Provided also that nothing in this sub-section shall apply to any transactions entered into by the company in its ordinary course of business other than transactions which are not on an arm's length basis:

Provided also that the requirement of passing the resolution under first proviso shall not be applicable for 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.

Explanation. In this sub-section,

(a) the expression "office or place of profit" means any office or place –

(i) where such office or place is held by a director, if the director holding it receives from the company anything by way of remuneration over and above the remuneration to which he is entitled as director, by way of salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

(ii) where such office or place is held by an individual other than a director or by any firm, private company or other body corporate, if the individual, firm, private company or body corporate holding it receives from the company anything by way of remuneration, salary, fee, commission, perquisites, any rent-free accommodation, or otherwise;

(b) the expression "arm's length transaction" means a transaction between two related parties that is conducted as if they were unrelated, so that there is no conflict of interest.

2. Every contract or arrangement entered into under sub-section (1) shall be referred to in the Board's report to the shareholders along with the justification for entering into such contract or arrangement.

3. *Where any contract or arrangement is entered into by a director or any other employee, without obtaining the consent of the Board or approval by a resolution in the general meeting under sub-section (1) and if it is not ratified by the Board or, as the case may be, by the shareholders at a meeting within three months from the date on which such contract or arrangement was entered into, such contract or arrangement shall be voidable at the option of the Board or, as the case may be, of the shareholders and if the contract or arrangement is with a related party to any director, or is authorised by any other director, the directors concerned shall indemnify the company against any loss incurred by it.*

4. *Without prejudice to anything contained in sub-section (3), it shall be open to the company to proceed against a director or any other employee who had entered into such contract or arrangement in contravention of the provisions of this section for recovery of any loss sustained by it as a result of such contract or arrangement.*

5. *Any director or any other employee of a company, who had entered into or authorised the contract or arrangement in violation of the provisions of this section shall,–*

   (i) in case of listed company, be punishable with imprisonment for a term which may extend to one year or with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees, or with both; and

   (ii) in case of any other company, be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.

3. Definition of 'promoter' and 'promoter group' under the ICDR

2(1)(oo). "promoter" shall include a person:

i) who has been named as such in a draft offer document or offer document or is identified by the issuer in the annual return referred to in section 92 of the Companies Act, 2013; or

ii) who has control over the affairs of the issuer, directly or indirectly whether as a shareholder, director or otherwise; or

iii) in accordance with whose advice, directions or instructions the board of directors of the issuer is accustomed to act:

Provided that nothing in sub-clause (iii) shall apply to a person who is acting merely in a professional capacity;

Provided further that a financial institution, scheduled commercial bank, foreign portfolio investor other than individuals, corporate bodies and family offices, mutual fund, venture capital fund, alternative investment fund, foreign venture capital investor,

insurance company registered with the Insurance Regulatory and Development Authority of India or any other category as specified by the Board from time to time, shall not be deemed to be a promoter merely by virtue of the fact that twenty per cent or more of the equity share capital of the issuer is held by such person unless such person satisfy other requirements prescribed under these regulations;

2(1)(pp) "promoter group" includes:

i) the promoter;

ii) an immediate relative of the promoter (i.e., any spouse of that person, or any parent, brother, sister or child of the person or of the spouse); and

iii) in case promoter is a body corporate:

A) a subsidiary or holding company of such body corporate;

B) any body corporate in which the promoter holds twenty per cent or more of the equity share capital; and/or any body corporate which holds twenty per cent or more of the equity share capital of the promoter;

C) any body corporate in which a group of individuals or companies or combinations thereof acting in concert, which hold twenty per cent or more of the equity share capital in that body corporate and such group of individuals or companies or combinations thereof also holds twenty per cent or more of the equity share capital of the issuer and are also acting in concert; and

iv) in case the promoter is an individual:

A) any body corporate in which twenty per cent or more of the equity share capital is held by the promoter or an immediate relative of the promoter or a firm or Hindu Undivided Family in which the promoter or any one or more of their relative is a member;

B) any body corporate in which a body corporate as provided in (A) above holds twenty per cent or more, of the equity share capital; and

C) any Hindu Undivided Family or firm in which the aggregate share of the promoter and their relatives is equal to or more than twenty per cent of the total capital;

v) all persons whose shareholding is aggregated under the heading "shareholding of the promoter group":

Provided that a financial institution, scheduled bank, foreign portfolio investor other than individuals, corporate bodies and family offices, mutual fund, venture capital fund, alternative investment fund, foreign venture capital investor, insurance company registered with the Insurance Regulatory and Development Authority of India or any other category as specified by the Board from time to time, shall not be deemed to be

promoter group merely by virtue of the fact that twenty per cent or more of the equity share capital of the promoter is held by such person or entity:

Provided further that such financial institution, scheduled bank, foreign portfolio investor other than individuals, corporate bodies and family offices, mutual fund, venture capital fund, alternative investment fund and foreign venture capital investor insurance company registered with the Insurance Regulatory and Development Authority of India or any other category as specified by the Board from time to time shall be treated as promoter group for the subsidiaries or companies promoted by them or for the mutual fund sponsored by them;

Appendix – I : Consolidated List of Recommendations

Current Provision in the LODR	Proposed Changes
Definition of "related party"– *Refer to paragraph I of Chapter 2 (page 10) for the rationale for the proposed amendment*	
2(zb) "related party" means a related party as defined under sub-section (76) of section 2 of the Companies Act, 2013 or under the applicable accounting standards: Provided that any person or entity belonging to the promoter or promoter group of the listed entity and holding 20% or more of shareholding in the listed entity shall be deemed to be a related party. Provided further that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s);	2(zb) "related party" means a related party as defined under sub-section (76) of section 2 of the Companies Act, 2013 or under the applicable accounting standards: Provided that: (i) any person or entity belonging to the promoter or promoter group of the listed entity ~~and holding 20% or more of shareholding in the listed entity shall be deemed to be a related party~~; or (ii) any person or any entity, directly or indirectly (including with their relatives), holding 20% or more of the equity shareholding in the listed entity, shall be deemed to be a related party. Provided further that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s);
Definition of "related party transaction"- *Refer to paragraph III of Chapter 2 (page 13) and paragraph I of Chapter 3 (page 15) for the rationale for the proposed amendment*	
2(zc) "related party transaction" means a transfer of resources, services or obligations between a listed entity and a related party, regardless of whether a price is charged and a "transaction" with a related party shall be construed to include a single transaction or a group of transactions in a contract:	2(zc) "related party transaction" means a transaction involving a transfer of resources, services or obligations between ~~a listed entity and a related party~~: (i) the listed entity or any of its subsidiaries on the one hand and a related party of the listed entity or any of its subsidiaries on the other hand; or

Provided that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s);	(ii) the listed entity or any of its subsidiaries on the 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, regardless of whether a price is charged or not ~~and a~~. Such "transaction" ~~with a related party~~ shall be construed to include a single transaction or a group of transactions~~.in a contract~~: Provided that the following shall not be treated as related party transactions: (a) the issue of specified securities on a preferential basis, subject to requirements under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 being complied with; and (b) the following corporate actions by the listed entity which are uniformly applicable/offered to all shareholders in proportion to their shareholding: i. payment of dividend; ii. subdivision or consolidation of securities; iii. issuance of securities by way of a rights issue or a bonus issue; and iv. buy-back of securities. Provided further that this definition shall not be applicable for the units issued by mutual funds which are listed on a recognised stock exchange(s);
Regulation 18(3). Audit Committee – *Refer to paragraph III of Chapter 3 (page 27) for the rationale for the proposed amendment*	

18(3) –The role of the audit committee and the information to be reviewed by the audit committee shall be as specified in Part C of Schedule II.	18(3) –The role of the audit committee and the information to be reviewed by the audit committee, including while considering related party transactions, shall be as specified in Part C of Schedule II.
Regulation 23(1). Related party transactions– *Refer to paragraph II of Chapter 3 (page 25) for the rationale for the proposed amendment*	
23(1) The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions including clear threshold limits duly approved by the board of directors and such policy shall be reviewed by the board of directors at least once every three years and updated accordingly: Explanation.- A 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 ten percent of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity.	23(1) The listed entity shall formulate a policy on materiality of related party transactions and on dealing with related party transactions including clear threshold limits duly approved by the board of directors and such policy shall be reviewed by the board of directors at least once every three years and updated accordingly: Explanation.- A ~~transaction with a~~ related party transaction shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds ~~ten~~ Rs.1,000 crore or five percent of the annual ~~consolidated turnover~~ 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.
Regulation 23(2). Related party transactions– *Refer to paragraph I of Chapter 3 (page 15) for the rationale for the proposed amendment*	
23(2) All related party transactions shall require prior approval of the audit committee.	23(2) All related party transactions and subsequent material modifications shall require prior approval of the audit committee of the listed entity. Provided that a related party transaction 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 only if the value of such

	transaction (whether entered into individually or taken together with previous transactions during a financial year) exceeds 10% 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. Provided further that prior approval of the audit committee of the listed entity shall not be required for a related party transaction to which the listed subsidiary is a party but the listed entity is not a party, if such listed subsidiary is not exempt from regulation 23 and the other corporate governance provisions of these regulations specified in regulation 15(2). Explanation: for related party transactions of unlisted subsidiaries of a listed subsidiary specified above, the prior approval of the audit committee of the listed subsidiary would suffice.
Regulation 23(4). Related party transactions– *Refer to paragraph I of Chapter 3 (page 15) for the rationale for the proposed amendment*	
23(4) 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: Provided that the requirements specified under this sub-regulation shall not apply in respect of a resolution plan approved under section 31 of the Insolvency Code, subject to the event being disclosed to the recognized stock exchanges within one day of the resolution plan being approved;	23(4) All material related party transactions 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: Provided that prior approval of the shareholders of a listed entity shall not be required for a related party transaction to which the listed subsidiary is a party but the listed entity is not a party, if such listed subsidiary is not exempt from regulation 23 and the other corporate governance provisions of these regulations specified in regulation 15(2).

	Explanation: for related party transactions of unlisted subsidiaries of a listed subsidiary specified above, the prior approval of the shareholders of the listed subsidiary would suffice. Provided further that the requirements specified under this sub-regulation shall not apply in respect of a resolution plan approved under section 31 of the Insolvency Code, subject to the event being disclosed to the recognized stock exchanges within one day of the resolution plan being approved;
Regulation 23(5). Related party transactions– *Refer to paragraph I of Chapter 3 (page 15) for the rationale for the proposed amendment*	
23(5) The provisions of sub-regulations (2), (3) and (4) shall not be 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; Explanation. - For the purpose of clause (a), "government company(ies)" means Government company as defined in sub-section (45) of section 2 of the Companies Act, 2013.	23(5) The provisions of sub-regulations (2), (3) and (4) shall not be 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; (c) 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. Explanation. - For the purpose of clause (a), "government company(ies)" means Government company as defined in sub-section (45) of section 2 of the Companies Act, 2013.

Regulation 23(9). Related party transactions– *Refer to paragraph II of Chapter 4 (page 36) for the rationale for the proposed amendment*	
23(9) 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 related party transactions 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.	23(9) The listed entity shall submit ~~within 30 days from the date of publication of its standalone and consolidated financial results for the half year,~~ to the stock exchanges disclosures of related party transactions ~~on a consolidated basis~~, in the format ~~specified in the relevant accounting standards for annual results to the stock exchanges~~ prescribed by SEBI and publish the same on its website. The listed entity shall make such disclosures every six months on the date of publication of its standalone and consolidated financial results.
Regulation 36. Documents & Information to shareholders– *Refer to paragraph I of Chapter 4 (page 33) for the rationale for the proposed amendment*	
36. Documents & Information to shareholders ….	<u>Insertion of new sub-regulation 36(6)</u> 36(6). The notice being sent to shareholders seeking approval for any proposed related party transaction shall, in addition to the requirements under the Companies Act, 2013, 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 pursuant to paragraph B(2) of Part C of Schedule II; (2) The recommendation of the audit committee in respect of the proposed transaction, specifying justification for why the transaction is in the interest of the listed entity; (3) Where the transaction relates to any loans, inter-corporate deposits, advances or investments made or

	given by the listed entity or its subsidiary, the details specified under paragraph B (2) (f) of Part C of Schedule II; (4) Whether the approval of the related party transaction 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 related party transaction: 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.
Modification of paragraph (2) and insertion of new paragraph (7) in Part B of Schedule II – *Refer to paragraph III of Chapter 3 (page 27) for the rationale for the proposed amendment*	
Part C of Schedule II of the LODR B. The audit committee shall mandatorily review the following information: ….	Modification of paragraph (2) and insertion of new paragraph (7) in Part B of Schedule II of the LODR B. The audit committee shall mandatorily review the following information: …. (2) ~~statement of significant related party transactions (as defined by the audit committee), submitted by management;~~ with respect to approval of a related party transaction, the following information as

	provided by the management of the listed entity: (a) Type, material terms and particulars of the proposed transaction; (b) 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); (c) Tenure of the proposed transaction; Explanation.- The transaction should have a particular tenure or term and should not be indefinite or open-ended. (d) 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. (e) 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 related party transaction 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; (f) If the transaction relates to any loans, inter-corporate deposits, advances or investments made or given by the listed entity or its subsidiary: i. details of the source of funds in connection with the proposed related party transaction;

	ii. where any financial indebtedness is incurred to make or give loans, inter-corporate deposits, advances or investments, • nature of indebtedness; • cost of funds; and • tenure; iii. applicable terms, including covenants, tenure, interest rate and repayment schedule, whether secured or unsecured and if secured, the nature of security; and iv. the purpose for which the funds will be utilised by the ultimate beneficiary of such funds pursuant to the related party transaction; (g) Justification as to why the related party transaction is in the interest of the listed entity; (h) A copy of the valuation or other external report, if any such report has been relied upon; (i) Percentage of the counter-party's annual total revenues, total assets and net worth, that is represented by the value of the proposed related party transaction: Provided that the information mentioned in this sub-clause may be placed before the audit committee on a voluntary basis; and (j) Any other information that may be relevant. ……. 7. status of long-term (more than one year) or recurring related party transactions on an annual basis.

Modification of paragraph A.(2.) and insertion of new paragraph (m) in (C)(10) of Schedule V – *Refer to paragraph II of Chapter 4 (page 36) for the rationale for the proposed amendment*	
SCHEDULE V: ANNUAL REPORT The annual report shall contain the following additional disclosures: A. Related Party Disclosure: …. 2. The disclosure requirements shall be as follows: …. C. Corporate Governance Report: ……. (10) Other Disclosures: (a)….	Modification of paragraph A.(2.) and insertion of new paragraph (m) in (C)(10) of Schedule V of the LODR SCHEDULE V: ANNUAL REPORT The annual report shall contain the following additional disclosures: A. Related Party Disclosure: …. 2. The ~~disclosure requirements shall be as follows:~~ disclosures under A.(2.) and A.(2A.) of Schedule V below, shall be applicable only to entities with listed debt securities. … C. Corporate Governance Report: ….. (10) Other Disclosures: (a)…. (m) 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.

Appendix – II: Prescribed Disclosure Format

Details of related party transactions

A. Name of listed entity

B. Annual consolidated total revenue, total assets and net worth of the listed entity for the preceding financial year (and if there are related party transactions involving a subsidiary, the relevant subsidiary's annual total revenues on a standalone basis)

C. Format for disclosure of related party transactions every six months – Refer Attachment