

**Discussion on  
Report of the Working Group of SEBI on  
Related Party Transactions**

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# AGENDA - Report of Working Group on RPT

1. Approach of the Working Group
2. RPT - The Regulatory Framework - Companies Act & SEBI LODR
3. Triggers for review of the RPT provisions under SEBI LODR
4. Key Recommendations of the working group
5. Detailed information for Audit Committee
6. Material thresholds for prior approvals
7. Disclosure requirements for shareholders approval
8. Some peripheral reflections....

# 1. Approach of the Working Group

## The approach

- Reviewed case studies
- Empirical evidence
- International Practices
- Feedback from stakeholders
- Meetings with Company Secretaries and Institutional investors

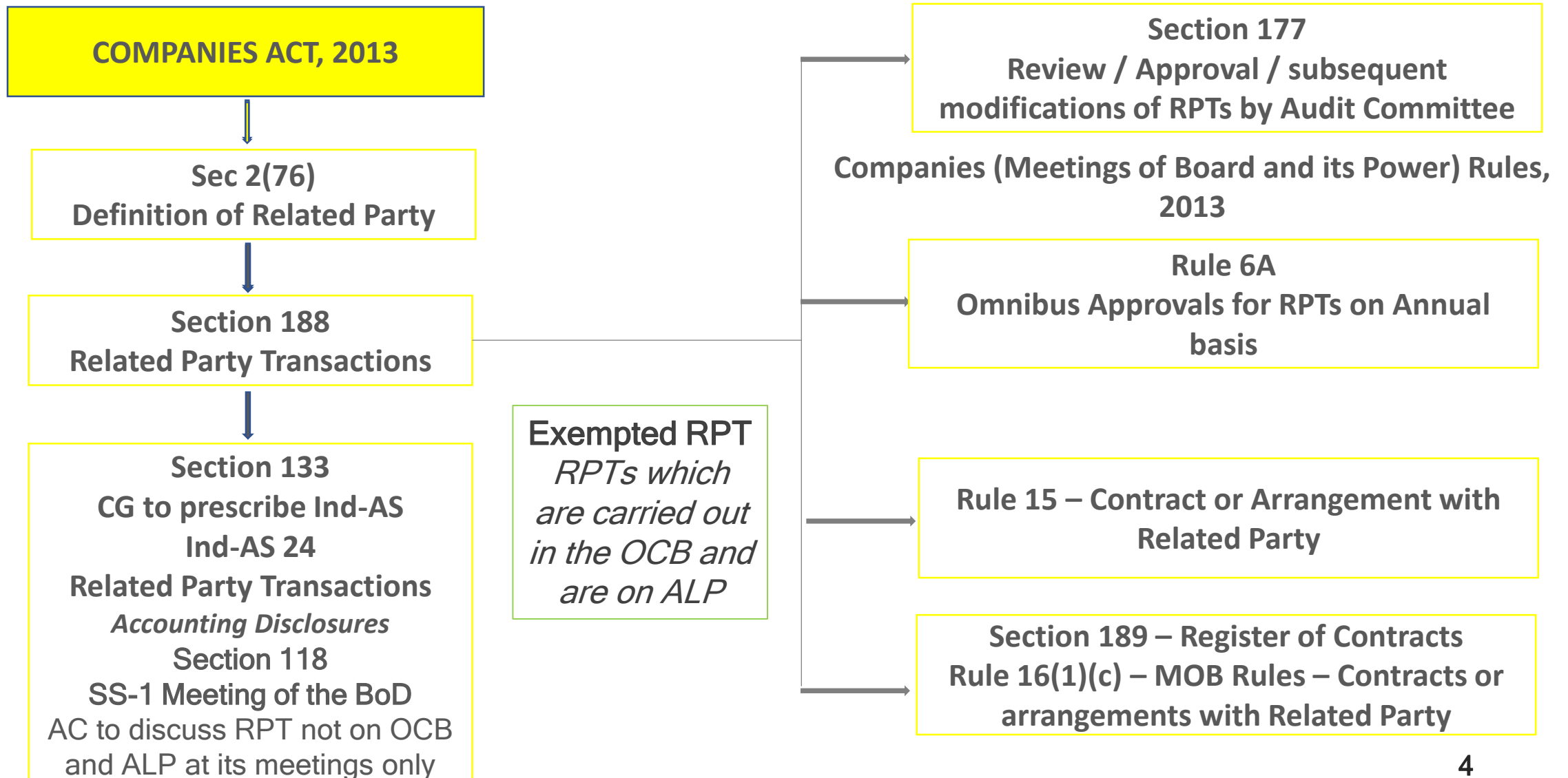
## Objectives

- Investor Protection
- Ease of doing business
- Not to increase compliance burden of Companies

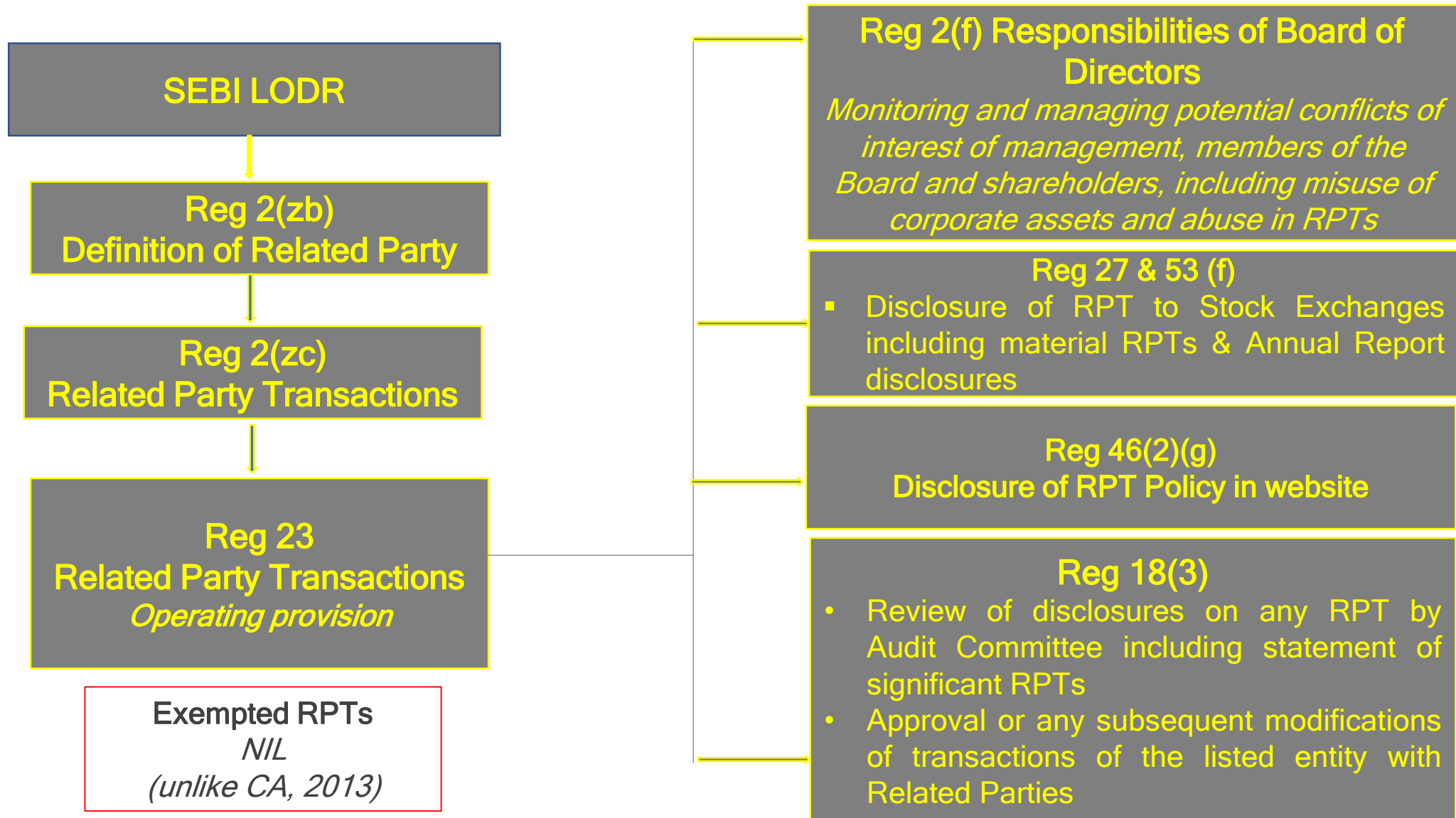
## Strategies to deal with RPTs

- Protective rights to minority shareholders
- Regulatory review of individual transaction to ensure there is no enrichment for controlling shareholders.

## 2. RPT - The Regulatory Framework - Companies Act



## 2. RPT - The Regulatory Framework - SEBI LODR



### 3. Triggers for review of the RPT provisions under SEBI LODR

- Need for periodic review
- Recent issues in relation to RPTs (IL&FS; Raymond)
- Shell or unrelated companies purportedly used for siphoning off funds
- Adopting circular transactions
- Obtaining approvals for continuous lending to group companies
- To strengthen the approval and disclosure processes to assist the Audit Committee and shareholders in informed decision making of RPTs

## 4. Key Recommendations of the working group

- Redefining the term Related Party and Related Party Transactions
- Amending the operating provision relating to RPTs - Reg 23
- Prior approval of shareholders for RPTs
- More detailed information for Audit Committee review - Amendment to Reg 18 and Part C of Schedule II
- More detailed information to shareholders for considering approvals for RPT - Insertion of Reg 36(6)
- Enhanced Annual Report disclosures

## 4. Key Recommendations.. Definition of Related Party

### Current norm

- Any person or entity belonging to Promoter or Promoter Group to come under the term Related Party was required to have 20% shareholding

### Proposed norm

- Shareholding threshold of 20% proposed to be omitted.

### Impact

- The proposed change will enlarge the scope of definition of Related Party given under Reg 2(zb).

### Comments

- Companies have to remap their Related Party list



## 4. Key Recommendations.. Definition of Related Party Transaction

### Current norm

- Neither LODR nor CA, 2013 specifically require approval at the listed entity level i.r.o. transactions by an unlisted subsidiary with any related party of the consolidated entity

### Proposed norm

- To regulate transactions between 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.
- To regulate the transactions between 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 subsidiary

### Impact / Rationale

- Will prevent a Listed Entity from transferring its assets to a subsidiary in India or overseas and then such entity transacting with the related party of the listed entity to move the assets out of the Consolidated entity

### Comments

- Difficulties in identification of such transactions by Companies
- More Group level co-ordination will be required to ensure compliance.
- Determination of whether the RPT benefits a related party may be subjective
- This may prove a onerous task for the CS / CFO and Audit Committee

## 5. Detailed information for Audit Committee

1. Type, material terms and particulars of the proposed transaction
2. Name of the related party and its relationship with the listed entity or its subsidiary, including nature of its concern or interest (financial or otherwise);
3. Tenure of the proposed transaction;

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

4. Value of the proposed transaction;

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

5. The percentage of the listed entity's annual total revenues, total assets and net worth, on a consolidated basis, for the immediately preceding financial year, that is represented by the value of the proposed transaction, provided that, for a 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;

6. 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;

## 5. Detailed information for Audit Committee...Contd.

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 utilized by the ultimate beneficiary of such funds pursuant to the related party transaction;

7. Justification as to why the related party transaction is in the interest of the listed entity;

8. A copy of the valuation or other external report, if any such report has been relied upon;

9. 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

10. Any other information that may be relevant.

11. Status of long-term (more than one year) or recurring related party transactions on an annual basis.

## 6. Material thresholds for prior shareholder approvals

### Current Norms

- Threshold of 10% of the annual consolidated turnover (ACT) [Reg 23(1)]
- Payments to related parties w.r.t. brand usage or royalty if value > 5% of ACT

### \*Year-wise approvals by Cos

CY 2015 - 91; CY 2016-74; CY 2017-72; CY 2018-70; CY - 2019-53

### Proposed Norms

- Threshold REDUCED to 5%
- Benchmarks expanded to include
  - Total Revenue (*instead of total turnover now*)
  - Net worth
  - Total Assets

in addition to *Total Revenues* on a consolidated basis

OR

- New numerical threshold of Rs 1000 Crs introduced.

LOWER of the two will apply

*For Cos with negative net worth, NW criterion will not apply*

### Rationale for change

- The shareholders approval sought by companies were less\*
- No numerical threshold prescribed at present
- An RPT of Rs 1000 Crs by a Listed Entity with a turnover of Rs 10,000 Crs did not warrant shareholder approval
- UK, Singapore and Malaysia prescribe a 5% threshold for material RPTs

# 7. Disclosure requirements for Shareholders approval

## Information to be provided in the Explanatory Statement for the item seeking shareholders approval for RPT

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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

## 8. Some peripheral reflections

### Unlisted Companies

- RPT provisions of SEBI LODR does not apply to unlisted companies which might have high borrowings from banks/ financial institutions

### Debt Listed Companies

- Chapter IV of SEBI LODR (i.e. under which Reg 23 is specified) does not apply to Debt Listed Entities. (i.e. entities which have not listed their equity but only debt) in view of the definition of term “Specified Securities” which means equity shares and convertible securities as per LODR read with SEBI ICDR

### Past changes in RPT framework

- Regulatory framework for RPTs were changed by MCA and SEBI in the last few years - Divergent paths - MCA vs SEBI

### CSR contributions

- CSR contributions to Related Parties / Entities in which Related Parties are interested not expressly exempted under the proposal. Such contributions may come u/s 188 if the related party falls under Sec 2(76) (vi) and (vii).
- The proposal exempts only Corporate actions such as dividend, sub-division or consolidation of shares, rights issues, bonus issue and buyback of securities

### MCA

- Circulars / Spl. Resolution changed to Ordinary Resolution;
- Only the concerned related party not to vote;
- Numerical threshold specified under Rule 15(3) - Rs 100 Crores removed - 18<sup>th</sup> Nov 2019
- Decriminalization of RPT as per CLC Report - prescription of only monetary penalty for RPT violations /

### SEBI

- May 2018 - Brand Royalty Payments - Threshold > 2% of ACT deemed as material RPT
- June 2019 - Above threshold revised to 5% of ACT based on Kotak Committee Recommendation
- Amendments to LODR made on May 2019

## 8. Some peripheral reflections... Contd.

### Consolidation exemption

- Whether available to a related party transaction between a holding company and newly incorporated subsidiary, the accounts of which would be consolidated for the first time only after the RPT.

### OCB and ALP

- No clear definition of Ordinary course of Business and Arms Length pricing.
- Reference can be made to the **Guidance Note on RPT issued by ICSI - March 2019 Edition**

### Abusive RPTs

- Abusive RPTs are intended to be brought under regulatory purview

### Trigger for review of RPT provisions

- Recent Corporate failures / loan defaults / siphoning of funds through subsidiaries

### Penalties for violation of RPT provisions in LODR

- Chapter IX process under LODR
- SEBI Act, 1992
  - Sec 15A(b) - Failure to furnish information - Penalty of Rs 1 lakh or Rs 1 lakh per day of default up to max. of Rs 1 Crore
  - Sect 15HB - Where no separate penalty is provided - Penalty of Rs 1 lakh to Rs 1 Crore
  - Sec 24(1) - Offences - Imprisonment for 10 Years or fine of Rs 25 Crores or with both

Thank You