

REGULATORY FRAMEWORK ON RELATED PARTY TRANSACTIONS

Key Discussion Points

Key Concepts

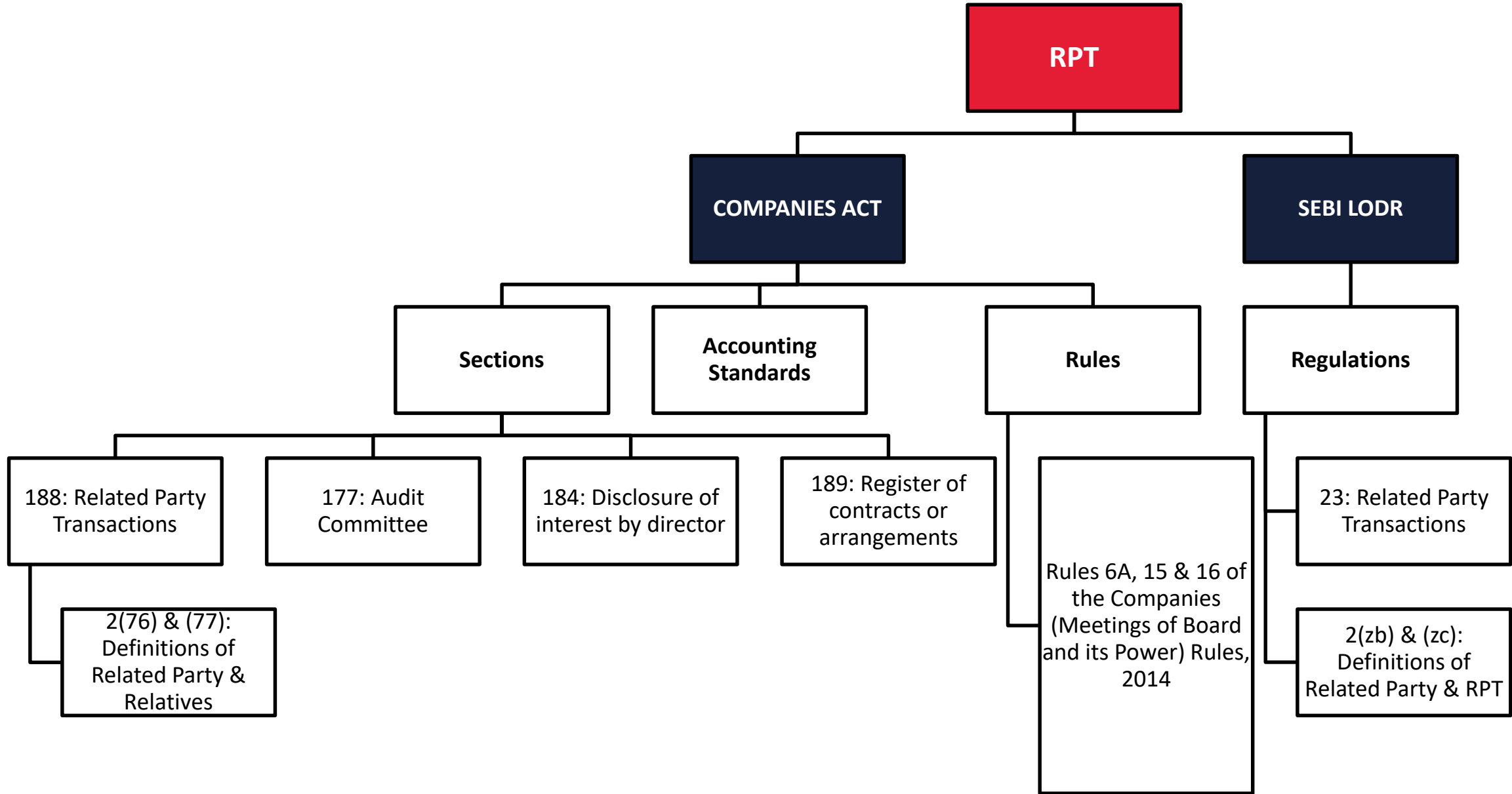
**Approval
Mechanism of RPTs**

**Disclosure &
Compliance
Requirements**

Issues



Governing Provisions for RPT



Key Concepts

Related Party

**Related Party
Transaction**

**Material Related
Party Transaction**





**WHO ALL ARE
RELATED PARTIES?**



Related Party for unlisted companies – Section 2(76) of the Companies Act, 2013

a director / his relative

a KMP / his relative;

a firm, in which a director, manager / his relative is a partner;

a private company in which a director /manager/ his relative is a member or director;

a public company in which a director /manager is a director and holds along with his relatives, more than 2% of its paid-up share capital;

any body corporate whose BoD, MD or manager is accustomed to act in accordance with the advice, directions or instructions of a director / manager;



Related Party for unlisted companies– Section 2(76) of the Companies Act, 2013

any person on whose advice, directions or instructions a director or manager is accustomed to act:

any body corporate which is—

a holding, subsidiary or an associate company of such company;
or

a subsidiary of a holding company to which it is also a subsidiary;

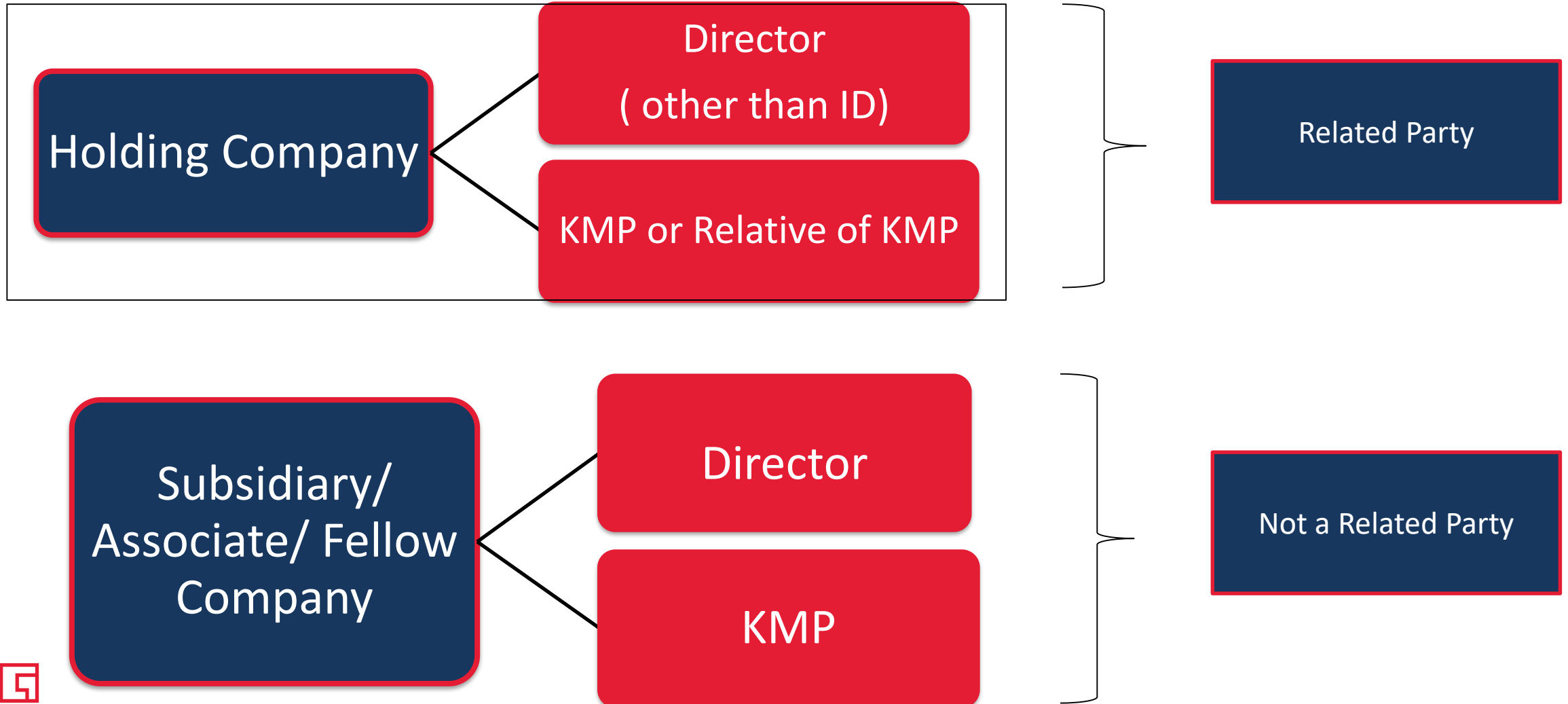
an investing company or venturer of the company

such other person as prescribed in Rule 3 of the Companies (Specification of Definitions Details) Rules, 2014;

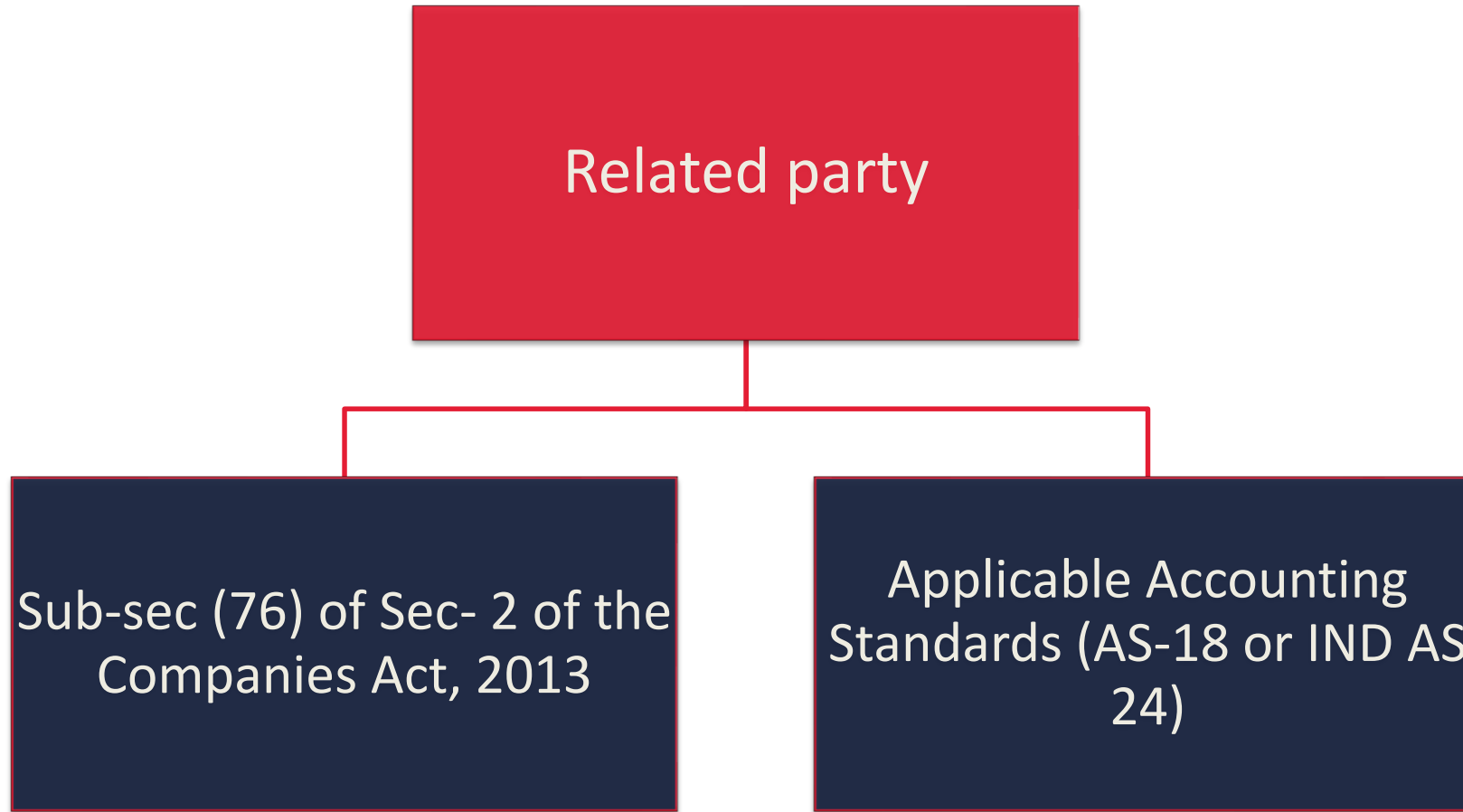


Related Party for unlisted companies

Rule 3 of The Companies (Specification of Definition Details) Rules, 2014



Related Party for listed entities [Regulation 2(zb) of LODR]



Deemed Related Party for listed entities [Regulation 2(zb) of LODR]

- a) any person or entity forming a part of the promoter or promoter group of the listed entity; or
- b) any person or any entity, holding equity shares 10% or more in the listed entity either directly or on a beneficial interest basis as provided under section 89 of the Companies Act, 2013, at any time, during the immediate preceding financial year;



Related Party – As per IND AS 24

- ❖ Related Parties under IND AS 24 are comprehensive in nature.
- ❖ Ind AS 24 generally includes Promoters, KMPs, other entities, etc. whereas Companies Act covers only Directors and entities connected with such directors even without any shareholding.
- ❖ Control/ significant influence is pivotal over the Reporting Company.
- ❖ Other entities that are controlled or significantly influenced by the related parties.



Related Party – As per IND AS 24

S. No	Individual/Entity	Basis for being treated as related party
1.	An individual will be treated as related party	If he / she has control or joint control over the Company
2.		If he / she has significant influence over the Company
3.		If he / she is a key management personnel of the Company or of a parent of the Company.
4.		If he/she is close member of individuals defined (1) to (3)
5.		If they are sponsoring employers in case Company is a post-employment benefit plan for the benefit employees



Related Party – As per IND AS 24

S. No	Individual/Entity	Basis for being treated as related party
6.	A company / other entity will be considered as related party	If it is a holding company
7.		If it is a Subsidiary
8.		If it is a subsidiary of Holding company
9.		If it is an associate entity
10.		If it is a joint venture entity
11.		If it is an associate entity of a member of same group
12.		If it is a joint venture entity of a member of same group
13.		If it is a joint venture of the same third party.
14.		If one entity is a joint venture of a third entity and the other entity is an associate of the third entity
14.		It is a post-employment benefit plan for the benefit employees of either the reporting entity or an entity related to the reporting entity
16.		If it is controlled or jointly controlled by a person identified in (1) to (3) above
17.		If person identified under (1) has significant influence over it
18.		If person identified under (1) is a KMP of it or of its holding company
19.		If it provides key management personnel services
20.		If it provides key management personnel services to the parent entity
21.		If member a group of which it is a part, provides key management personnel services
21.	If member a group of which it is a part, provides key management personnel services to the parent entity	





Related Party Transaction



Related Party Transaction for listed entities [Regulation 2(zc) of LODR]

“Related party transaction” means a transaction involving a transfer of resources, services or obligations between:

- a) a listed entity or any of its subsidiaries on one hand and a related party of the listed entity or any of its subsidiaries on the other hand; or
- b) a listed entity or any of its subsidiaries on one hand, and any other person or entity on the other hand, the purpose and effect of which is to benefit a related party of the listed entity or any of its subsidiaries, w.e.f. 01 April, 2023;

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:



Related party transaction [Regulation 2(zc) of LODR]

Provided that the following **shall not** be a related party transaction:

- a) the issue of specified securities on a preferential basis, subject to compliance of the requirements under the SEBI (ICDR) Regulations, 2018;
- 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. sub-division or consolidation of securities;
 - iii. issuance of securities by way of a right issue or a bonus issue; and
 - iv. buy-back of securities.
- c) acceptance of fixed deposits by banks/ NBFCs at the terms uniformly applicable/ offered to all shareholders/ public, subject to disclosure of the same along with the disclosure of related party transactions every 6 months to the stock exchange(s), in the format as specified by the SEBI.





Purpose and Effect of RPT



Purpose and Effect Test

As per SEBI working group report, the Purpose and Effect Test is intended to cure the mischief where innovative structures are used to bypass RPT-related disclosures



Purpose and Effect Test

- Introduced as an anti-abuse provision
- Test related to both 'Purpose' and 'effect' needs to be fulfilled.
- Transaction which has been designed with objective to benefit RP
- Benefits provided to RP after multiple layers of unrelated parties will also be considered.
- Transactions in normal course of business-like collective bargaining, collateral benefit shall not be considered



Purpose and Effect Test

Examples:

- **A Ltd, a listed NBFC lends to another NBFC, which in normal course of business lends to related party of A Ltd.**
- **A Ltd, a listed NBFC, lends to B Ltd, with the intention that B Ltd will lend the said funds to a related party of A Ltd.**



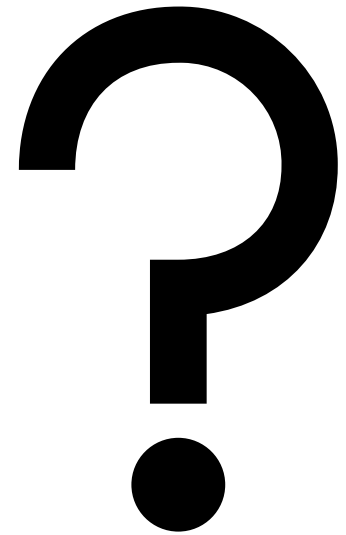
Purpose and Effect Test

- Nature of transactions, which needs careful evaluation:
 - Transactions involving loans or other modes of funding
 - Transactions with a third-party entity that lacks commercial substance or competence
 - Transactions which doesn't appear to be in the ordinary course



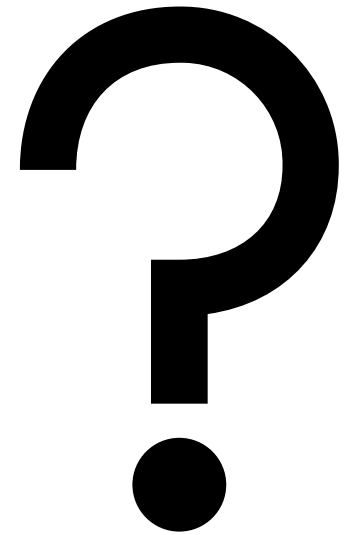
Issues: Purpose and Effect Test

Considering this an anti-abuse provision, will management be eager to present before the Audit Committee a camouflaged related party transaction, where the real purpose is to benefit a related party?




Issues: Purpose and Effect Test

In case of transactions where purpose and effect is to benefit a related party, approval of Audit Committee shall be taken for the entire transaction or benefits that will accrue to the related party??





**SEBI order on transfer
of resources**



SEBI Order on RPT

In Linde India Ltd (“LIL”) (Order dated July 24, 2024), SEBI has taken a much wide meaning of the term ‘transfer of resources’. Facts of the cases are as under

- LIL and Praxair India Private Limited (“PIPL”) entered into a SHA/JVA to form Linde South Asia Services Pvt. Ltd.
- The JV&SHA also contained a clause which provided for the product allocation and geographical allocation of the businesses of LIL and PIPL (“**Business Allocation**”) which provided:
 - a) Geographic Allocation (north, east and west 2 regions were allotted to Linde whereas south, central and west 1 regions were allotted to PIPL), and
 - b) Product Allocation [Linde got exclusivity with respect to the Project Engineering Business and PIPL got exclusivity in HyCO, Hydrogen, Carbon Monoxide and CO2 including carbon capture businesses.



SEBI Order on RPT

- SEBI received complaints about how geographical allocation & product allocation of business would adversely affect the future prospects of the Company and interest of minority shareholders.
- SEBI concluded that it is evident that the business allocation, though characterized as a division of future business rather than a current transaction, effectively alters the distribution of business opportunities between the related parties.
- Therefore, the proposed business allocation between LIL and PIPL prima facie constitutes a transfer of resources by a listed company to a related party, even if there is no physical movement of assets.





Material Related Party Transaction



Material Related Party Transaction [Regulation 23 of LODR]

- 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 Rs. 1,000 crore or 10% of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity, whichever is lower.
- However, a transaction involving payments made to a related party with respect to brand usage or royalty shall be considered material if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceed 5% of the annual consolidated turnover as per the last audited financial statements.



**SEBI order on material
RPT**

SEBI Order on Material RPT

In Linde India Ltd (Order dated July 24, 2024), SEBI has held that all transactions with a related party shall be considered while determining material RPT and not those, who forms part of the same contract.



SEBI Order on Material RPT

Rationale:

- Literal meaning of proviso would indicate that no restriction that confines the calculation to transactions under a common contract can be found in the text.
- The words “*in a contract*” is preceded by the word “*includes*” and not “*means*”. It is a well settled position of law that the word “*include*” appearing in a definition clause serves to expand the scope or meaning of the words occurring in the body of a Statute/Regulation
- The interpretation—limiting the calculation of material *RPTs* to transactions under a common contract— finds no support in the statutory language or practice adopted by companies listed above and is contrary to the regulatory intent and established principles of statutory interpretation.





Audit Committee Approval

Approval of Audit Committee

Regular approvals

Omnibus
approval for
repetitive
transactions

Post facto
approval-
ratification



Regular Approval Mechanism- Audit Committee

Related Party Transaction	Type of company	Approval of Audit Committee
RPT including modification, if any.	Private company	NA
	Unlisted public company	Yes (if company is required to constitute Audit Committee)
	Listed company	Yes



Omnibus Approval Mechanism- Audit Committee

Process of Omnibus Approval	
Contents of Omnibus Approval	<ul style="list-style-type: none">▪ Name of related Party▪ Nature & duration of transaction▪ Maximum amount of transaction▪ Indicative base price & formula for variation▪ Any other information relevant or important for AC to take decision on proposed transaction
Course of action in case of Unforeseen RPT and details not available	In case of Unforeseen, RPT upto Rs. 1 crore per transaction can be entered.
Validity of Omnibus Approval	Only 1 Financial Year
Review Period	As per Policy
Not applicability of Omnibus Approval	In respect of selling or disposing of the undertaking



Transactions that require omnibus approval

1. Transactions which are repetitive in nature or;
2. Transactions where the quantum of transactions can't be ascertained or;
3. Transactions which can't be ascertained.



Transactions that don't require omnibus approval

1. One-time transactions
2. Transactions which are backed by a contract or an agreement
3. Transactions which Audit Committee has excluded from omnibus regime



When omnibus approval shall be taken

Considering the transactions are valid for a financial year, ideally it should be before the start of the financial year or before undertaking the transaction.



Ratification Mechanism- Audit Committee

Nature of Transactions	Transaction(s) involving any amount not exceeding one crore rupees
Period	Within three months from the date of the transaction
Consequences	<ul style="list-style-type: none">➤ Transaction shall be voidable at the option of the Audit Committee➤ If the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the company against any loss incurred by it



Information to be placed before Audit Committee

Unlisted Companies	Listed Companies
N/A	<ul style="list-style-type: none">a) Type, material terms and particulars of the proposed transactionb) Name of related party, relationship with entity/subsidiary, nature of concern/interestc) Tenure of the proposed transactiond) Value of the proposed transactione) Percentage of entity's annual consolidated turnover represented by transaction valuef) For loans, deposits, advances or investments: source of funds, financial indebtedness details, terms, purposeg) Justification for why the RPT is in the interest of the listed entityh) Copy of valuation or external party report, if relied uponi) Percentage of counter-party's annual consolidated turnover represented by transaction value (voluntary)j) Any other relevant information



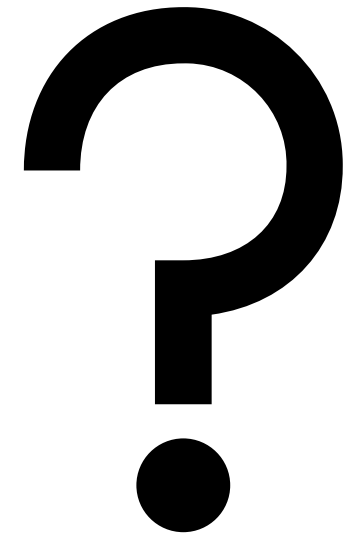


Issues:
Audit Committee



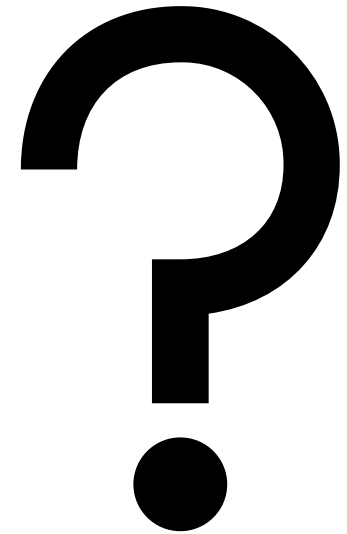
Issues: Audit Committee

Only transactions covered in Section 188 or all transactions with related parties, needs approval of Audit Committee, in the case of an unlisted company?



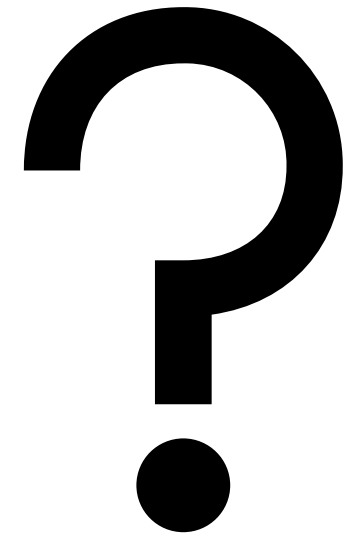
Issues: Audit Committee

**What is meant by material modification,
how the same shall be determined?**



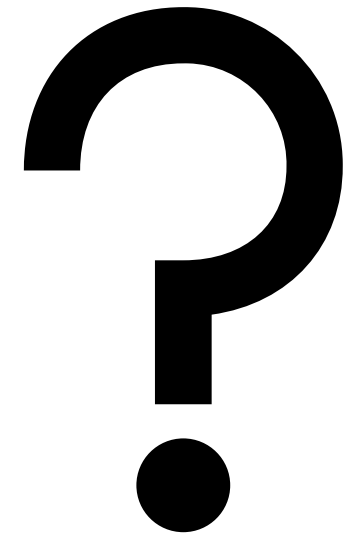
Issues: Audit Committee

All modifications, or only material modifications, shall require approval of the Audit Committee in the case of a listed company.



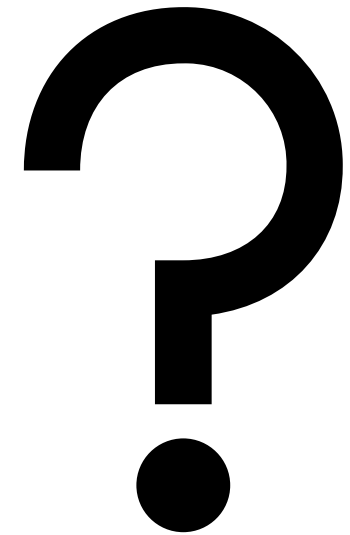
Issues: Audit Committee

Whether transactions involving more than one crores, can't be ratified by the Audit Committee. If no, what will be there fate?



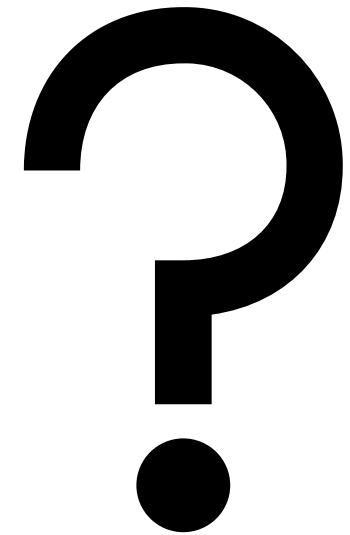
Issues: Audit Committee

Whether only transactions referred to in section 188, between a holding and its wholly owned subsidiary are exempted from audit committee approval, in case of an unlisted company?



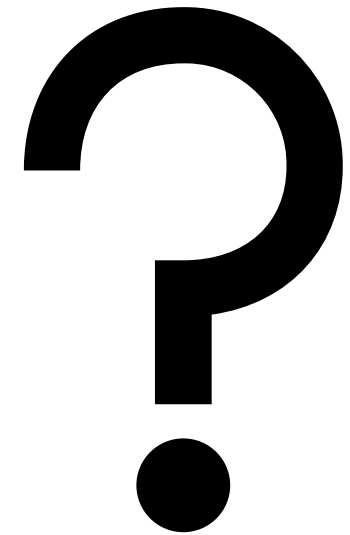
Issues: Audit Committee

Can omnibus approval for repetitive transactions be avoided for entering into a long term agreement for such transactions?



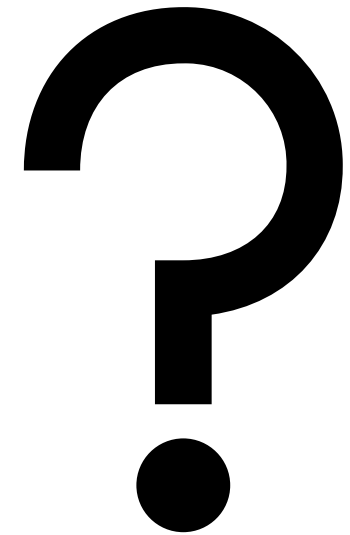
Issues: Audit Committee

Can transactions that exceed the omnibus approval limit approved by the Audit Committee be covered under the unforeseen transaction limit?



Issues: Audit Committee

Can transactions that exceed the omnibus approval limit approved by the Audit Committee be ratified?





Board Approval



Approval Mechanism

Related Party Transaction	Type of company	Approval of the Board
RPT at arm's length and in ordinary course of business	Private company	No
	Unlisted public company	No
	Listed company	No
RPT not in the ordinary course of business or not at arm's length	Private company	Yes
	Unlisted public company	Yes
	Listed company	Yes
All material RPT (whether in the ordinary course of business or not)	Listed company	Yes



Information to be placed before Board (for all companies)

- a) Name of the related party and nature of relationship
- b) Nature, duration, and particulars of the contract or arrangement
- c) Material terms of the contract or arrangement including value, if any
- d) Any advance paid or received for the contract or arrangement
- e) Manner of determining pricing and other commercial terms
- f) Whether all relevant factors have been considered, if not, details of factors not considered with rationale
- g) Any other relevant or important information for Board decision



Approval of Specified Related Party Transactions- Section 188

Meaning of Ordinary Course of Business

“**Ordinary Course of Business**” includes but not limited to a term for activities that are *necessary, normal, and incidental to the business*. These are common practices and customs of commercial transactions. The ordinary course of business covers the usual transactions, customs and practices related to the business.

Based upon various case laws, **three principles** are to be considered:

- i. The transaction is **Normal** or otherwise unremarkable for the business.
- ii. The transaction is **Frequent/Regular**.
- iii. The transaction is a **Source of Income** for the business.



Approval of Specified Related Party Transactions- Section 188

Meaning of Arm's Length Basis

In terms of the Companies Act, 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.

A transaction with a related party will be considered to be on an arm's length basis if the key terms, including pricing of the transaction, taken as a whole, are comparable with those of similar transactions if they would have been undertaken with unrelated parties.



Adjudication Order by RoC

Adani Power Ltd, RoC, Gujarat (Order dated May 16, 2023) has imposed penalty for failure to explain whether the related party transactions undertaken by the company were in ordinary course of business and on arm's length.



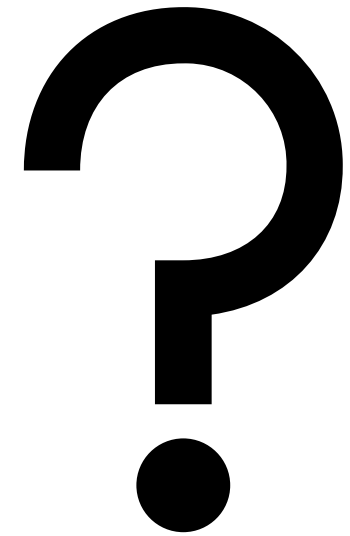


Issues:
Board Approval



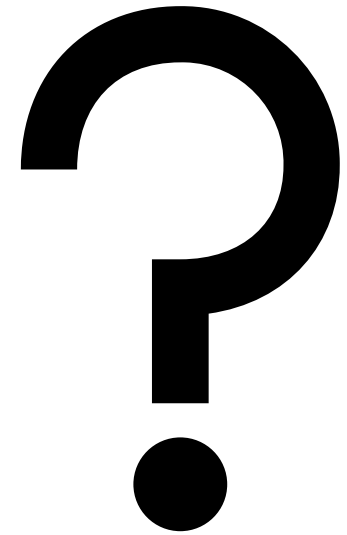
Issues: Board approval

Does an arm's length transaction mean the transaction has to be entered into the exact price determined by the arm's length study?



Issues: Board approval

Whether arm's length pricing has to be backed by CA certificate?

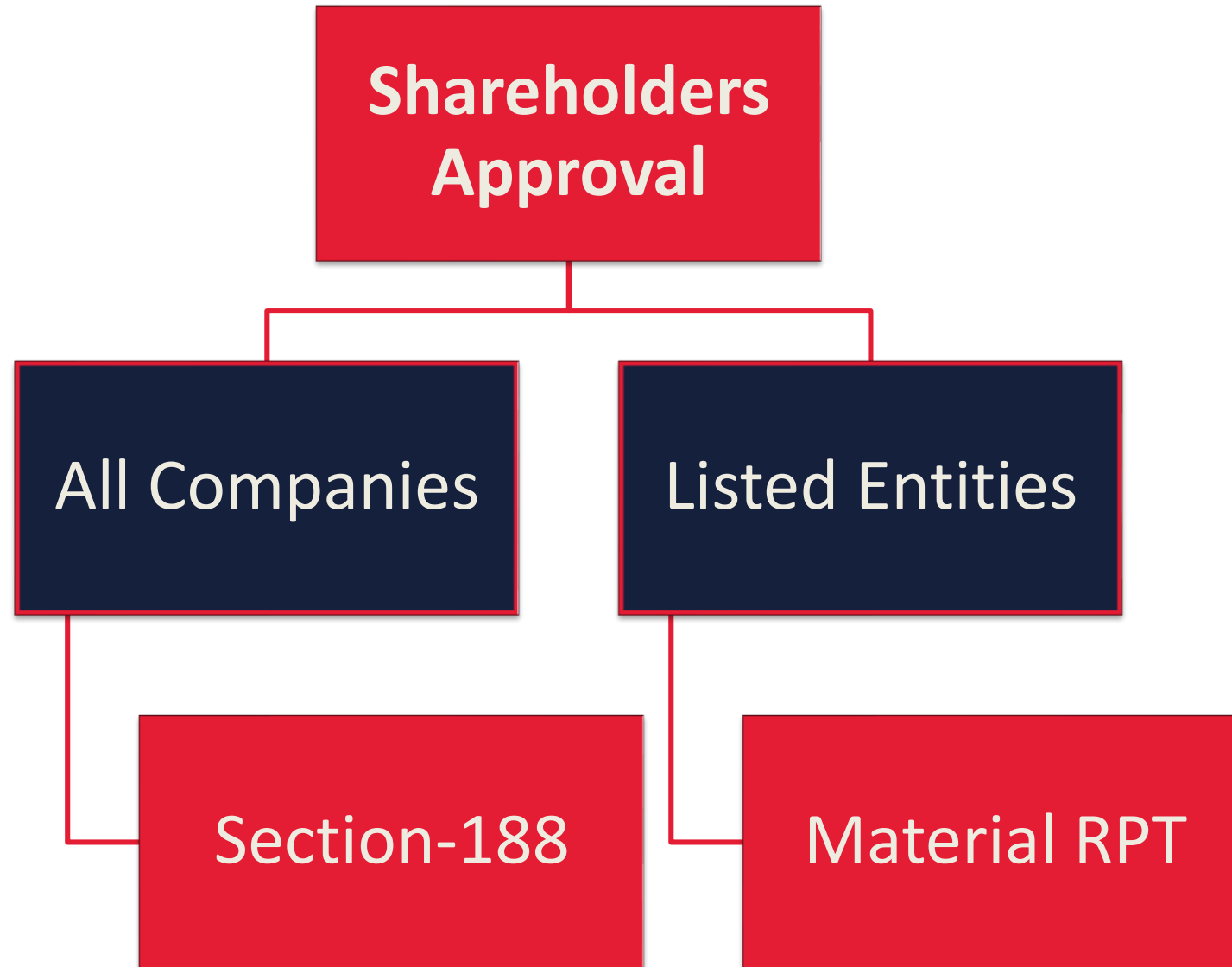




Shareholders Approval



Approval Mechanism



Approval Mechanism

Related Party Transaction	Type of company	Approval of the shareholders at general meeting (ordinary resolution)
RPT referred in Section 188 at arm's length and in ordinary course of business	Private company	No
	Unlisted public company	No
	Listed company	No
RPT referred in Section 188 not in the ordinary course of business or not at arm's length	Private company	Yes (if the value of RPT is more than the applicable limit)
	Unlisted public company	Yes (if the value of RPT is more than the applicable limit)
	Listed company	Yes (if the value of RPT is more than the applicable limit)
All material RPT (whether in the ordinary course of business or not)	Listed company	Yes



Approval Mechanism – voting restrictions

Related Party Transaction	Section 188	Material RPT
Who can vote	The concerned related party is not allowed to vote	No related party can vote to approve



Approval of Specified Related Party Transactions- Section 188

* Threshold Limit for Shareholders Approval for Transactions Other than Material Transactions

Type of Transaction	Limit
Sale, purchase or supply of any goods or material, directly or through appointment of agent	Transactions amounting to 10% or more of the Turnover of the Company
Selling or otherwise disposing of or buying property of any kind, directly or through appointment of agent	Transactions amounting to 10% or more of the Net worth of the Company
Leasing of property any kind	Transactions amounting to 10% or more of the Turnover of the Company
Availing or rendering of any services, directly or through the appointment of agent	Transactions amounting to 10% or more of the Turnover of the Company
Appointment to any office or place of profit in the company, its subsidiary company or associate company	Monthly Remuneration Exceeding Rs. 2.5 lakhs
Remuneration for underwriting the subscription of any securities or derivatives thereof	Exceeding 1% of Net worth

**The turnover or net worth referred to above shall be computed on the basis of the audited financial statement of the preceding financial year.*



Exception from Approvals- unlisted company

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;



Approval of Specified Related Party Transactions- Section 188

- ❖ If a related party transaction exceeds thresholds under the Companies Act, 2013, it requires **shareholder approval*.
- ❖ Members with an interest in the transaction shall abstain from voting on the resolution.



Exception from Approvals- listed entity

- 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.



Ratification Mechanism- Board & Shareholders

Nature of Transactions	Any transaction(s)
Period	Within three months from the date of the transaction
Consequences	<ul style="list-style-type: none">➤ Transaction shall be voidable at the option of the Board or Shareholders➤ If the transaction is with the related party to any director or is authorised by any other director, the director concerned shall indemnify the Company against any loss incurred by it



Information to be placed in Shareholder's meeting

For all Companies	Listed Entities
<ul style="list-style-type: none">a) name of the related party;b) name of the director or key managerial personnel who is related, if any;c) nature of relationship;d) nature, material terms, monetary value and particulars of the contract or arrangement;e) any other information relevant or important for the members to take a decision on the proposed resolution.	<ul style="list-style-type: none">a) Summary of information provided to the audit committee;b) Justification for why the proposed transaction is in the entity's interest;c) Details of loans, deposits, advances or investments as specified in point 4(f);d) Statement on availability of valuation or external report through registered email;e) Percentage of counter-party's annual consolidated turnover represented by transaction value (voluntary);f) Any other relevant information.



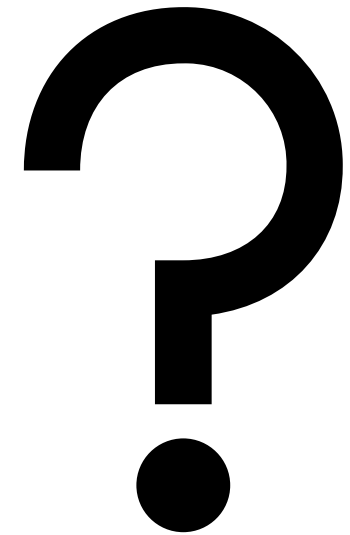


Issues:
Shareholders Approval



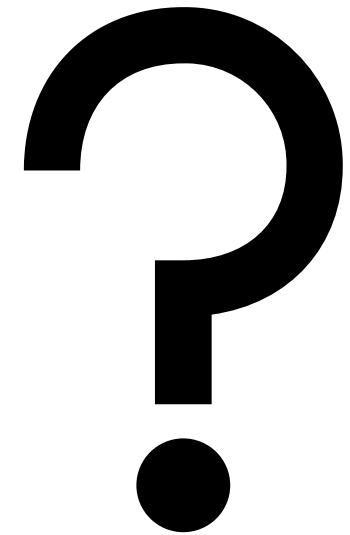
Issues: Shareholders Approval

How to determine limits in case of newly incorporated companies?



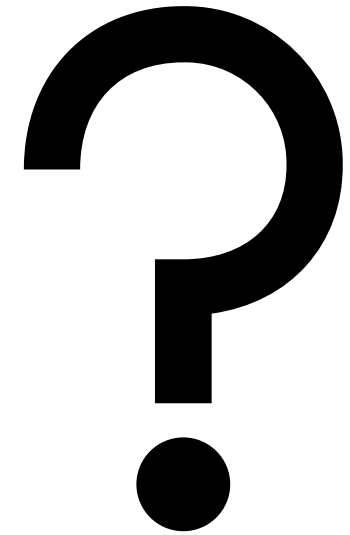
Issues: Shareholders Approval

In case of listed entities, whether shareholders can't vote on any transaction in which they are interested?



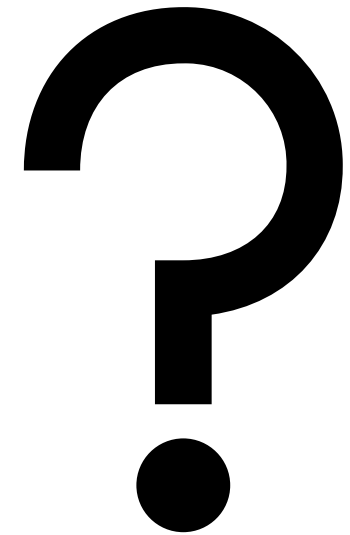
Issues: Shareholders Approval

Whether transactions related to purchase and sale needs of squared off for calculating the limits?



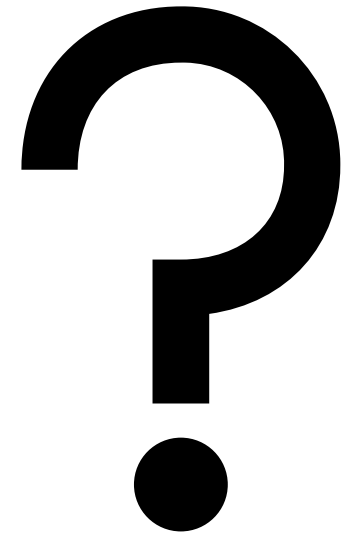
Issues: Shareholders Approval

In case of negative net worth, whether all transactions related to buy or sale of property will need approval?



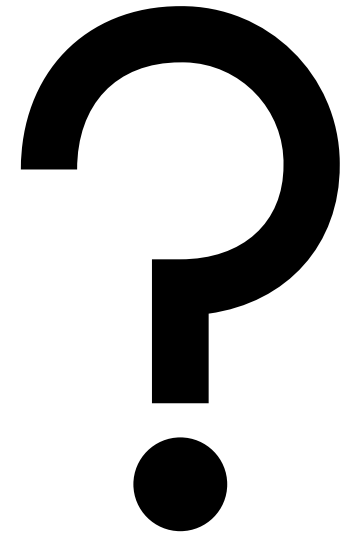
Issues: Shareholders Approval

Whether exemption related to holding subsidiary transaction, will not be applicable to newly incorporated subsidiary until the accounts are consolidated?



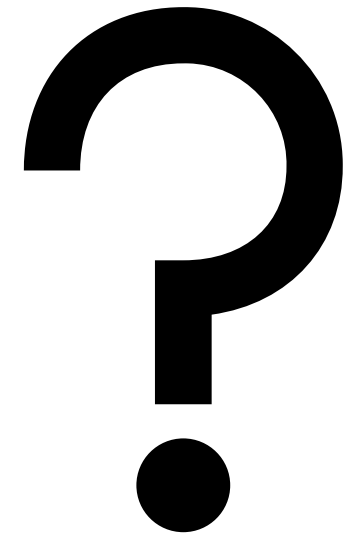
Issues: Shareholders Approval


Whether a material related party transaction executed by a subsidiary company needs approval of shareholders of listed holding entity?




Issues: Shareholders Approval

Whether approval of shareholders is required before executing any material related party transaction or before related party transaction exceeds the limits of 10% of INR 1000 crores, which ever is lower?





Disclosure Requirements



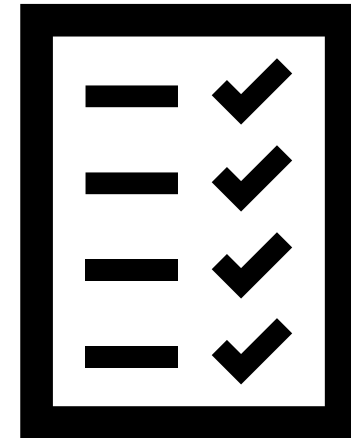
Disclosures: All Companies

**Disclosure by
Directors and KMP in
MBP-1**

**Board's Report:- AOC-
2**

Financial Statement

Register in MBP-4



Listed Entities: Half-yearly Corporate Governance Report (CGR)

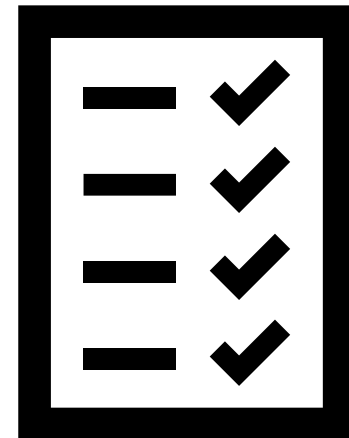
Following information for transactions involving promoters, their groups, directors (and relatives), key managerial personnel (KMPs), or their controlled entities:

Loans/Debt

**Guarantees/
Comfort Letters**

Securities provided

**Affirmation that all
financial support
provided is in the
company's economic
interest**



Listed Entities: Annual Report Disclosures

i. Holding Company

- Loans/advances to subsidiaries, associates, and firms/companies where directors are interested (by name and amount).
- Investments by loanees in the shares of the parent and subsidiary companies if loans/advances were made.

ii. Subsidiary Company

- Same disclosures as the parent company

iii. Disclose transactions with promoter/promoter group entities holding 10% or more shareholding, as per relevant accounting standards

iv. Disclose loans/advances in the nature of loans to firms/companies where directors are interested, applicable to all listed entities except listed banks.

v. Disclosures on materially significant related party transactions that may have potential conflict with the interests of listed entity at large.

 **vi.** Web link of the policy on dealing with related party transactions

Listed Entities: Filing of RPT details

Filing of details of related party transactions with stock exchanges on a half yearly along with the financial results






SOP

SOP


Establish the necessary framework whereby promoters, directors and senior management personnel shall continuously disclose their related parties



Prepare a list of related parties at the end of every financial year.



Prepare a list of possible transactions with related parties in coordination with the finance team



Undertake an arm's length for various transactions proposed to be entered into with related parties



Considering the type of transactions, obtain one-time or omnibus approval of RPTs from the Audit Committee.



SOP

Obtain omnibus approval for unforeseen transactions with related parties considering historical transactions



Monitor changes in related parties on a quarterly basis.



Monitor the limits of RPTs within approved limits on a monthly basis.



Place the transactions for review of Audit Committee/Board on quarterly basis.



THANK YOU

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