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# Related Party Transactions – Approval, Disclosures & Reporting under SEBI's Listing Regulations

- SEBI has notified (Listing Obligations and Disclosure Requirements) Regulations, 2015 on Sept. 2, 2015, which are effective from Dec. 1, 2015. The Listing Regulations consolidates and streamlines the provisions of existing Listing Agreements for different segments of the capital market. There has been a change in the mode of obtaining shareholders' approval, making disclosures and reporting of certain Related Party Transactions ('RPTs'). There is also a change in the timelines with respect to compliances. The article contains the analysis and impact of such changes w.r.t. the basic provisions, disclosures, reporting and approval requirements of RPTs by listed entities.

## INTRODUCTION

**O**n March 22, 2015, the SEBI Board reviewed<sup>1</sup> the requirements pertaining to the disclosures being made by listed companies on continuous basis with a view to enable investors to make well-informed investment decisions. In this meeting the SEBI Board had approved changes to the proposed SEBI (Listing Obligations and Disclosure Requirements) Regulations. Some of the approved changes include the following:

- (i) Listed company shall first make disclosure of all events/information, to stock exchange(s), as soon as reasonably practicable and not later than 24 hours of occurrence of event/information;

- (ii) Disclosure of outcome of board meetings shall be made within 30 minutes of conclusion of the meeting of Board of Directors;
- (iii) In addition to current requirement of making disclosure at the time of occurrence and after the cessation of the event, updation of disclosure on 'material' developments shall also be made on a regular basis till such time the event/information is resolved/closed with relevant explanations;
- (iv) Listed company shall disclose on its website all events/information which has been disclosed to stock exchange(s) and such information shall be hosted for a minimum period of 5 years and thereafter as per the archival policy of the listed entity, as disclosed on its website;

After elaborate deliberation and consultation process, SEBI

<sup>1</sup> (Vide SEBI Press Release No. 70/2015)



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➤ The Listing Regulations consolidates and streamlines the provisions of existing listing agreements for different segments of the capital market. According to the SEBI Press Release, the Listing Regulations have thus been structured to provide ease of reference by consolidating into one single document across various types of securities listed on the Stock exchanges.

notified<sup>2</sup> the Listing Obligations and Disclosure Requirements, Regulations, 2015 ('Listing Regulations') on September 2, 2015. Vide the notification, SEBI has provided 90-days for implementation of the Listing Regulations. However, following two provisions of the Listing Regulations are applicable with immediate effect:

- (i) Passing of ordinary resolution (instead of 'special resolution') in case of all material related party transactions subject to related parties abstaining from voting on such resolutions, in line with the provisions of the Companies Act, 2013, and
- (ii) Re-classification of promoters as public shareholders under various circumstances.

The Listing Regulations consolidates and streamlines the provisions of existing listing agreements for different segments of the capital market. According to the SEBI Press Release, the Listing Regulations have thus been structured to provide ease of reference by consolidating into one single document across various types of securities listed on the Stock exchanges. SEBI has clarified that a shortened version of Listing Agreement (2 page approximately) will be prescribed which will be required to be signed by a company getting its securities listed on Stock Exchanges. Existing listed companies will be required to sign the shortened version within 6 months of the notification of the regulations.

The article is an analysis of the basic provisions, disclosures, reporting and approval requirements of Related Party Transactions ('RPTs') under the SEBI's Listing Regulations, along with the impact on corporates and practicing professionals by introduction of the Listing Regulations.

## Basic concepts and essentials of RPTs under the SEBI's Listing Regulations

- (i) Related Party Transaction: Clause (zc) of Regulation 2 of the Listing Regulations defines RPTs as 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. The definition of RPTs in the Listing Regulations is in alignment with the Clause 49 of the Listing Agreement;

- (ii) Relative: Clause (zd) of Regulation 2 of the Listing Regulations defines 'relatives' as defined under sub-section (77) of section 2 of the Companies Act, 2013 and rules prescribed there under. The definition under the Listing Regulations have been aligned with the Companies Act, 2013, which was not the case under the Listing Agreement;

**Related Party:** 'Related Party' has been defined in Clause (zb) of Regulation 2 of the Listing Regulations to mean 'related party' as defined under sub-section (76) of section 2 of the Companies Act, 2013 or under the applicable Accounting Standards (which can be Accounting Standards or Indian Accounting Standards). Pursuant to the Listing Regulations, the listed company is at a liberty to apply any definition of 'related party' whether under the Companies Act, 2013 or Accounting Standards. Depending upon the selection of the definition (i.e. Companies Act, 2013 or Accounting Standards), the scope and coverage of 'associate company', 'holding company', 'subsidiary company' will change. Vide the proviso to the sub-regulation, SEBI has clarified that the definition of 'related party' is not be applicable for the units issued by Mutual Funds which are listed on a recognised stock exchange(s).

**Essentials for RPT compliance by listed Companies under the Listing Regulations:** It is very important to first identify the trigger point of compliance of the RPT provisions under the Listing Regulations. If the listed company fails to identify any of the trigger point, then compliance of the Listing Regulation is not contemplated appropriately. Following all three conditions which ought to be satisfied for compliance and disclosures:

- (i) Transacting company is a 'listed company',
- (ii) Such transacting company enters into a 'prescribed transaction', i.e. a prescribed 'related party transaction' as defined in Listing Regulations,
- (iii) Such transaction by the listed company is with a 'related party', i.e. as defined in the Listing Regulations.

If all the above conditions are satisfied, then the listed company is required to comply with the Listing Regulations for the compliance of the RPT provisions.

Vide sub-regulation (6) of Regulation 23 of the Listing Regulations, SEBI has clarified that the provisions of the Listing Regulations do not have any retrospective application and are applicable to all prospective transactions.

## Role of the Board of Directors

In the Listing Regulations, there is no explicit provision requiring

<sup>2</sup> vide the Press Release No. 226 / 2015 dated September 3, 2015



approval / ratification / review of RPTs by the board of directors. However, Chapter II of the Listing Regulations relating to 'Principles governing disclosures and obligations of listed entity', SEBI has prescribed the key functions of the directors, in which it states that Board of Directors are required to monitor and manage 'potential conflict of interest' by the company.

### Audit Committee

Schedule II of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 relates to 'Corporate Governance' and Part C relates to 'Role of the Audit Committee and review of information by Audit Committee'. The role of Audit Committee in relation to the compliance of the RPTs is as follows:

- (1) It is required to review, with the management, the annual financial statements and auditor's report thereon before submission to the board of directors for approval, with particular reference to disclosure of any RPTs;
- (2) It is required to granting approval or any subsequent modification to the RPTs of the listed company;
- (3) Audit Committee is under obligation to review the statement of 'significant' RPTs submitted by management of the company; (herein, significant RPTs are as defined by the Audit Committee)
- (4) Audit Committee may grant omnibus approval for RPTs proposed to be entered into by the listed entity. Such omnibus approval is subject to following prescribed conditions:
  - (a) Audit Committee shall lay down criteria for granting omnibus approval in line with the policy on RPTs of the listed entity and such approval shall be applicable in respect of transactions which are 'repetitive' in nature;
  - (b) Audit Committee shall satisfy itself regarding the need for such omnibus approval and that such approval is in the interest of the listed entity;
  - (c) Omnibus approval shall specify:
    - (i) Name(s) of related party, nature of transaction, period of transaction, maximum amount of transactions that shall be entered into,
    - (ii) Indicative base price / current contracted price and the formula for variation in the price if any; and
    - (iii) Such other conditions as the audit committee may deem fit.
  - (d) Where the need for RPT cannot be foreseen and aforesaid details are not available, the Audit Committee may grant omnibus approval for such transactions subject to their value not exceeding Rupees 1 crore per transaction;
  - (e) Audit Committee shall review, at least on a quarterly basis, the RPT details entered into by the listed entity pursuant to each of the omnibus approvals given;
  - (f) The omnibus approvals shall be valid for a period not

➤ Pursuant to sub-regulation (7) of Regulation 23 of the Listing Regulations, all entities falling under definition of related parties are abstained from voting on the ordinary resolution placed before members, whether such entity is a related party to the particular transaction or not. Such abstinence from voting on the ordinary resolution is not in alignment with Companies Act, 2013, wherein only the 'related party' is restrained to vote on the resolution.

exceeding 1 year and shall require fresh approvals after the expiry of one year.

### Shareholders' approval

Sub-regulation (4) of Regulation 23 of Listing Regulations requires approval of the shareholders through ordinary resolution for all 'material' RPTs. The threshold prescribed for the 'materiality' of the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, is a transaction which exceeds 10% of the annual consolidated turnover as per last audited financial statements of the company. Vide the Listing Regulations, shareholders' approval is required by passing an Ordinary Resolution, and such provision aligns with the Companies Act provisions. The requirement of obtaining the members approval by ordinary resolution (instead of 'special resolution') was introduced in the Companies Act, 2013 vide Companies (Amendment) Act, 2015.

Pursuant to sub-regulation (7) of Regulation 23 of the Listing Regulations, all entities falling under definition of related parties are abstained from voting on the ordinary resolution placed before members, whether such entity is a related party to the particular transaction or not. Such abstinence from voting on the ordinary resolution is not in alignment with Companies Act, 2013, wherein only the 'related party' is restrained to vote on the resolution.

It is further noteworthy, that the shareholders' approval under Listing Regulations is triggered on breaching of any of the prescribed monetary limit. Such approval is not dependent on whether or not the transaction is in ordinary course of business and at arm's length. Therefore, a listed company is required to obtain shareholders' approval even when the transactions are in ordinary course of business and at arm's length, but has breached the prescribed threshold.

Sub-regulation (8) of Regulation 23 of Listing Regulations states that the requirement of obtaining fresh shareholders' approval for



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the material related party transactions, whereby, all the existing 'material' related party contracts or arrangements entered into prior to the date of notification (i.e. September 3, 2015) of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and which may continue beyond such date shall be placed for shareholders' approval in the first General Meeting subsequent to notification of said Regulations.

## Policy on materiality of Related Party Transactions

Sub-regulation (1) of Regulation 23 of the Listing Regulations mandates that the listed company shall formulate a policy on 'Materiality of RPTs and also on dealing with RPTs'. The criteria for 'materiality' remain the same for the policy on RPTs. SEBI has neither prescribed the contents of RPT policy nor provided any model policy on materiality of RPTs. Therefore, the board of directors and the Audit Committee are under obligation in defining the same.

## Exemptions from compliance of certain RPT provisions under Listing Regulations

The transactions prescribed in sub-regulation (5) of Regulation 23 of Listing Regulations are exempt from the compliance of certain provisions of the Regulations, such transactions are:

- (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.

For the above transaction, listed companies are exempt from:

- (a) Obtaining the prior approval of the Audit Committee [As required under Sub-Regulation 23(2) of Listing Regulations],
- (b) Obtaining the omnibus approval of the Audit Committee [As required under Sub-Regulation 23(3) of Listing Regulations],
- (c) Obtaining shareholders' approval through ordinary resolution [As required under Sub-Regulation 23(4) of Listing Regulations].

## Reporting & Disclosures

SEBI has prescribed the reporting and disclosure requirements at various places in the Listing Regulations. The compilation of the same is given below:

- (1) Quarterly Compliance Report on Corporate Governance: Regulation 27 of Listing Regulations relates to "Quarterly Compliance Report on Corporate Governance, wherein the listed company is required to submit the report (in prescribed format as specified by SEBI) to the stock exchange(s) within 15 days from close of the quarter. The Report shall contain

the details of 'all material transactions with related parties' and shall be signed either by Compliance Officer or Chief Executive Officer.

- (2) Website: Regulation 46 of Listing Regulations states that the listed company is required to maintain a functional website containing the basic information and the website shall disseminate "Policy on dealing with Related Party Transactions".
- (3) Corporate Governance Report: In the Corporate Governance Report which is part of the Annual Report, the company is required to make the disclosures of the 'materially significant' RPTs that may have potential conflict with the interests of listed entity at large. The Corporate Governance Report shall also provide with a web link with respect to the policy on dealing with RPTs.
- (4) Annual Report: Pursuant to Regulation 53 of Listing Regulations, the Annual Report shall contain the following RPT disclosures:

Sr. No.	In the Accounts of	Disclosures of amounts at the year end and the maximum amount of loans/ advances/ Investments outstanding during the year.
1	Holding Company	Loans and advances in the nature of loans to subsidiaries by name and amount. Loans and advances in the nature of loans to associates by name and amount. Loans and advances in the nature of loans to firms/companies in which directors are interested (as defined in Section 184 of the Companies Act, 2013) by name and amount.
2	Subsidiary Company	Same disclosures as applicable to the parent company in the accounts of subsidiary company.
3	Holding Company	Investments by the loanee in the shares of parent company and subsidiary company, when the company has made a loan or advance in the nature of loan.

The above disclosures shall be applicable to all listed entities except for listed banks.

## CONCLUSION

The Listing Regulations which streamlines and consolidates the compliances and disclosures as required under the Listing Agreement also enhances the disclosure and reporting requirements of listed companies. With respect to the RPTs, the Listing Regulations introduce a change in the requirement for obtaining shareholder's approval, making disclosures and reporting of certain RPTs. Considering the above discussion, there has been a significant change in interpreting and applying concepts of RPTs under the Listing Regulations and Listing Agreement, and also a change in timeline with respect to compliance of the provisions of the Listing Regulations. CS