FAQs on RPT regulatory framework as amended by the 6th LODR Amendment

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Brief introduction

Related party transactions ('RPTs'), particularly in case of listed entities which have substantial public interest, have been a matter of regulatory concern. Besides the provisions of the Companies Act, 2013 (CA, 2013), there are elaborate provisions in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('Listing Regulations'). These Regulations have evolved over a period of time, and to quite an extent, they go beyond CA, 2013. To consider any arbitrage opportunities or gateways of escape and to plug the same, SEBI formulated a Working Group on RPTs, whose recommendations set forth in their report dated January 27, 2020 crystallized in the form of amendments in the provisions. The SEBI (Listing Obligations and Disclosure Requirements) (Third Amendment) Regulations, 2021 ('Third Amendment Regulations'), which is effective from January 01, 2022, stipulate that only Independent Directors ('IDs') who are members of the Audit Committee will approve the RPTs. Further, the SEBI (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2021 ('present amendment'), effective from April 01, 2022, except for a few provisions which will be effective from April 01, 2023, have introduced substantial changes in the RPT framework which pose certain practical difficulties and additional compliance burden on the listed entities, and have, obviously, a lot of practical questions.

We have analyzed and collated questions on the various nuances and impact of the amended provisions for better understanding.

These FAQs continue to develop over time - hence, please do visit again to see an updated version. Also, our FAQs may be read with our other articles on the said topic which can be accessed at Article Corner on RPTs.

Also, the FAQ incorporates several examples. Readers may note that the examples below are quite generic, used solely for the purpose of illustration. Such examples should not be treated as any legal opinion due to mere resemblance of the facts. Legal views/ opinions would depend upon detailed facts and circumstances of each case.

Definition of related party

1. **Subsequent to the present amendment, which all entities will be considered as related parties?**

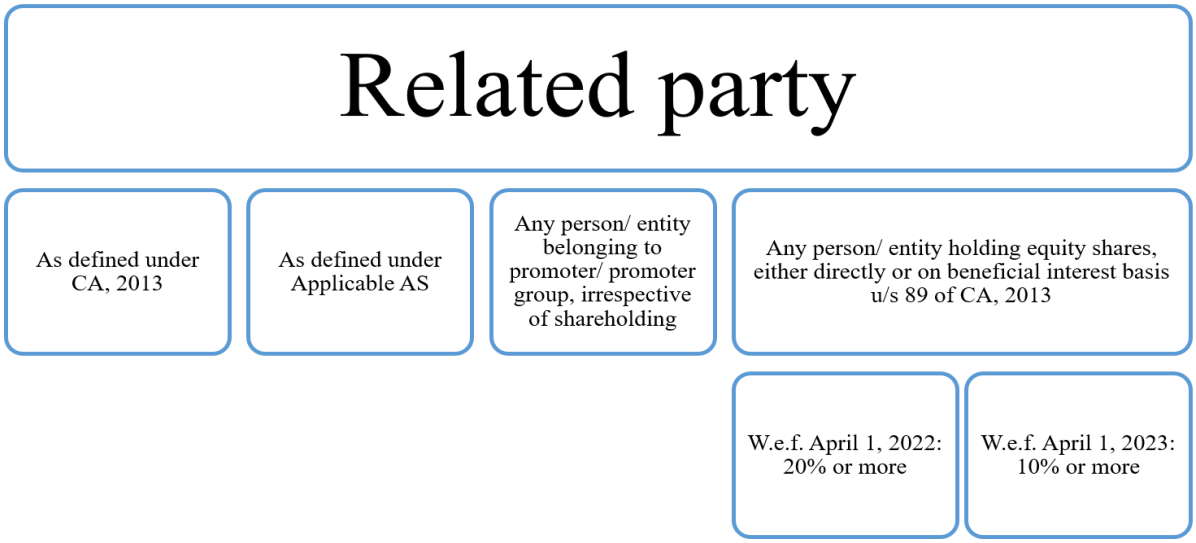
   The current definition of related party covered under its ambit persons and entities as defined under the Companies Act, 2013 as well as applicable accounting standards. Further, persons and entities belonging to the promoter or promoter group holding 20% or more of shareholding in the listed entity were covered under the definition.

   The present amendment has widened the aforesaid definition of related parties. W.e.f. April 01, 2022, following entities will also be treated as related parties:

a. All persons or entity belonging to the promoter or promoter group, irrespective of its shareholding in the listed entity;
b. Any person or entity holding, directly or on a beneficial interest basis under section 89 of the Companies Act, 2013 ('CA, 2013'), 20% or more of the equity shareholding in the listed entity;

Further, w.e.f. April 01, 2023, any person or entity holding, directly or on a beneficial interest basis under section 89 of CA, 2013, 10% or more of the equity shareholding in the listed entity will be regarded as a related party.

Thus, all the entities who will be considered as related parties as per the amended definition is picturised below:



2. What will be the cut-off date for determining whether the person or entity is a related party?

For the purpose of determining whether a person/ entity is a related party due to shareholding, the shareholding of 20% / 10% (w.e.f. April 01, 2023) will have to be seen ***at any time*** during the immediately preceding financial year. The listed entity will have to do a retrospective examination from April 01, 2022 and will have to see the shareholding of a person/ entity at any point of time during FY 2021-22. If such holdings exceed the threshold limit of 20% or such person/ entity falls under promoter or promoter group category, they will be identified as a related party.

For determining whether the person/ entity is a related party for FY 2022-23, the shareholding in the immediately preceding FY i.e., FY 2020-21 will be checked and for FY 2023-24, the shareholding in FY 2022-23 will be checked.

3. What if there is a change in shareholding as compared to the previous year?

The text of the definition of related party explicitly states that a person/ entity will be considered a related party, if '***at any time during the immediately preceding financial year***' his shareholding exceeds 20%/ 10% (w.e.f. April 01, 2023). Therefore, if the shareholding of a person/ entity exceeds the threshold limit in the immediately preceding financial year and subsequently increases or decreases, such person/ entity will be treated as a related party irrespective of its shareholding in the current financial year.

Various scenarios on change of shareholding are discussed below:

Scenario	Shareholding in previous FY	Shareholding in current FY	Whether a related party in the current FY or not?
I	Holding > threshold	Continues to exceed	Yes
II	Holding > threshold	NIL or below threshold	Yes
III	Holding < threshold	Holding > threshold	No
IV	Variation in shareholding in previous FY April 1 - Holding > threshold June 30 - Holding < threshold Dec 30 – NIL holding	NIL	Yes

In scenario I, the shareholding of a person/ entity exceeded the threshold limit in previous FY, thus, such person/ entity will be treated as a related party in current FY. Similarly, in scenario II and IV, since the shareholding exceeded the threshold, such person/ entity will be considered as a related party, even if the shareholding decreased subsequently.

In scenario III, the shareholding of the person/ entity was below the threshold limit in previous FY, therefore, such person/ entity will not be treated as a related party even though the shareholding exceeded the threshold in current FY. However, for the next FY, it will be considered as a related party.

4. Whether a related party of the subsidiary will be a related party of the holding company?

As per the definition of related party, a related party of the subsidiary need not necessarily be a related party of the holding company. However, the transactions undertaken with the said

related party by the holding listed entity will be construed as a related party transaction under the Listing Regulations.

5. Whether a related party of the holding company will be a related party of the subsidiary?

As per the definition of related party, a related party of the holding company need not necessarily be a related party of the subsidiary company. While the promoter and promoter group of the holding company, directors (other than IDs) and KMP and their relatives of holding company may be the related party even for a subsidiary, a person holding 20% or more directly or on a beneficial basis may not be holding similarly in the subsidiary. However, the transactions undertaken with the said related party of the holding listed entity will be construed as a related party transaction under the Listing Regulations.

6. Whether a related party of the fellow subsidiary will be a related party of the other fellow subsidiary?

Except for the holding company, directors (other than IDs) and KMP and their relatives of holding company and the promoter and promoter group, a related party of the fellow subsidiary need not necessarily be a related party of another fellow subsidiary company. However, the transactions undertaken with the said related party of the fellow subsidiary will be construed as a related party transaction under the Listing Regulations.

Hence, to summarise, each of the entities in the group will have its own set of 'related parties'. However, certain cross-transactions (as mentioned below) entered into by an entity would qualify for 'related party transactions' even if the transactions are not with its own related party, but with the related parties of other entities (discussed below).

Beneficial interest

7. What does the term 'beneficial interest' mean?

The term 'beneficial interest' has not been defined under the Listing Regulations. As per section 89(10) of CA, 2013 *"beneficial interest in a share includes, directly or indirectly, through any contract, arrangement or otherwise, the right or entitlement of a person alone or together with any other person to—*

(i) exercise or cause to be exercised any or all of the rights attached to such share; or

(ii) receive or participate in any dividend or other distribution in respect of such share".

In terms of Section 89(2) of CA, 2013, every person holding beneficial interest is required to give a declaration to the company in Form MGT-5 giving details of the registered owner, who holds the shares on behalf of the said beneficial owner.

If a person gives a declaration to the company in Form MGT-5 confirming that such person exercises the rights attached to the shares or enjoys dividend on the shares, such person will be considered as a person holding shares on a beneficial interest basis.

8. Does the term 'beneficial interest' also capture indirect interest?

No, the term beneficial interest does not capture indirect interest; it only captures beneficial interest to the extent a declaration of interest is received under section 89 of the CA, 2013.

The computation of interest beyond that declared under section 89 of CA, 2013 is not within the ambit of "related party" definition. There may be cases where a person or entity indirectly controls the shares of the company through layers of subsidiaries but does not enjoy beneficial interest in the company. Such a person cannot be treated as a "related party".

Will the position be different in case of a "significant beneficial owner" (SBO) declared under sec. 90? An SBO may quite likely be covered by the definition of "promoter" or a person forming part of the "promoter group". However, where the SBO is neither a promoter nor does he form part of the promoter group, there is no reason to include such a person with the statutory definition of "related party". If the definition of "related party" intended to capture SBOs, it was possible for the regulator to include SBOs too.

9. How will the listed entity identify the person's holding in the beneficiary capacity?

The listed entity will have to rely on the declaration received by the person in Form MGT-5 under section 89 of CA, 2013 confirming that such person is holding shares in a beneficiary capacity.

10. In case no disclosure has been received by the listed entity under Section 89 of CA, 2013, is it required to probe or investigate to identify the beneficial owner?

No. In terms of Section 89 it is the duty of the registered owner to declare if the shares are held by it on behalf of some beneficial owner and the beneficial owner is required to declare his shareholding on beneficiary basis. In the absence of any such declaration, the person registered in the Register of Members will be regarded as the beneficial owner of shares.

11. Is there any aggregation of shareholdings for the purpose of related party classification? For example, whether the shares held by the spouse will be clubbed for the purpose of computing the shareholding of an individual on a beneficial interest basis?

No, the shares held by the spouse are in individual capacity. The rights and benefits attached to the shares are enjoyed by the spouse and not by the individual. Therefore, unless a declaration is furnished under Section 89, the shares held by the spouse will not be clubbed for computing the shareholding of an individual on a beneficial interest.

12. In which of the following scenarios will the shareholding of a person be clubbed for determining if such person is a related party for FY 2022-23?

a. Mr. A is holding 15% shares in the company in the individual capacity and 6% shares in the capacity of trustee of a trust.

In case Mr. A is holding shares in the capacity of trustee of a trust, two possibilities would arise:

1. **Discretionary trust**: A discretionary trust is a trust in which the trustee has discretion as regards application of income or property of the trust. For the purpose of SBO determination, the shares held by a trustee of discretionary trust are deemed held by the trustee. However, the definition of "related party" hinges on beneficial interest. A trustee of a discretionary trust is certainly not its beneficiary. The trustee would commonly make a declaration of beneficial interest, though with unascertainable beneficiaries. Where the trustee files no declaration of beneficial interest, the company is entitled to presume that the shares held in the name of the trustee are beneficially held by him, and therefore, there is a fit case of aggregation of such holdings.

2. **Non-discretionary trust**: A non-discretionary trust is a trust in which the trustee does not have any decision-making powers and acts as per the trust deed of the trust. In such a case, all the income and assets of the trust are enjoyed by the beneficiary. The trustee ought to have filed declaration of beneficial interest with ascertainable beneficiaries, in which case the shares will be aggregated with the holdings, if any, of such beneficiaries.

b. Mr. B is holding 14% shares in the company in the individual capacity and 6% shares in the capacity of the beneficiary of a trust.

If Mr. B is holding shares as a beneficiary of a trust, he would be enjoying all the rights and dividend on such shares and would be required to declare his holding in Form MGT-5 under section 89 of CA, 2013. Thus, his holding would get clubbed with his shareholding in individual capacity.

c. Mr. C holds 12% shares in the company in the individual capacity and 8% shares in the capacity of the Karta of a Hindu Undivided Family ('HUF').

The Karta of the HUF is responsible for managing all the affairs of the family. He is entrusted with the responsibility to govern all the income and assets of the HUF on behalf of co-parceners. However, there is a clear distinction between the property of the individual and the property of the HUF. The HUF is a separate person in the eyes of law. Therefore, the shares held in the capacity of the Karta of the HUF will not be clubbed with his holding in individual capacity.

13. Mr. RK is the shareholder of XYZ Ltd. holding 3% of its share capital. He holds 80% shares in RK Ltd. which holds 18% shares in XYZ Ltd. Will the shares held by RK Ltd. be aggregated with that of Mr. RK to determine his beneficial shareholding?

In the given case, Mr. RK holds 3% directly in XYZ Ltd and 18% indirectly through RK Ltd. As discussed in the above FAQs, the percentage of indirect shareholding is kept out of the purview unless disclosed under section 89 of CA, 2013. The 18% shares in XYZ Ltd are held by Mr. RK as a representative of RK Ltd and such indirect shareholding will not be aggregated with the individual direct shareholding of 3%.

Applicability in case of institutional holders

14. In cases where the overseas Depository to ADR/GDR holders holds more than 10% stake, will they be considered as a related party?

Pursuant to the Depository Receipts Scheme, 2014, the overseas depository bank holds the shares on behalf of the ADR/GDR holders unless the same is converted by the holders. As per the Companies (Issue of Global Depository Receipts) Rules, 2014 the underlying shares are required to be allotted in the name of the overseas depository bank and against such shares, the overseas depository bank is required to issue GDRs.

However, the list of GDR holders is not disclosed to the Company in view of secrecy/ confidentiality norms in several jurisdictions. Accordingly, the declaration under Section 89 of CA, 2013 is also not furnished in the instant case. Further, the DRs are typically listed and traded on overseas stock exchange, therefore, it is not even feasible to furnish the list of GDR holders who beneficially own the shares as it keeps changing.

Therefore, this becomes a unique case, where neither the holding by an overseas depository bank can be regarded as direct as the shares are held in fiduciary capacity, given the construct of the law; nor the declaration under Section 89 can be furnished by the overseas depository bank.

From the construct of law, it is clear that the overseas depository bank is merely a fiduciary and therefore, it may not be appropriate to identify it as a related party.

15. Where the shares of the listed entity are held by mutual funds/ SEBI registered investment vehicles beyond 20%/ 10%, will it be considered a related party as per the new definition?

The definition of related party states *"... either directly or on a beneficial interest basis as provided under section 89 of the Companies Act, 2013..."*

The third proviso to rule 9(3) of the Companies (Management and Administration) Rules, 2014 provides an exemption to the trust created to set up a Mutual Fund or Venture Capital Fund, etc. from declaring beneficial interest in the shares.

Further, in terms of the investment restrictions under SEBI (Mutual Funds) Regulations, 1996 ('MF Regulations'), no mutual fund under all its schemes can own more than 10% of any company's paid-up capital carrying voting rights.

Accordingly, the mutual fund cannot be considered as a related party.

16. Are the shareholdings of different mutual fund schemes, managed by the same asset manager, to be clubbed?

Each mutual fund scheme is distinct from other schemes, even though they are managed by the same manager. Hence, we do not see a reason for aggregating the holding of different schemes. Even if the same is aggregated, pursuant to the inherent restriction in the MF regulations, such mutual fund cannot be regarded as a related party as the holding will never exceed 10% of the paid-up capital of the listed entity.

17. Where the shares of the listed entity are held by Foreign Portfolio investors beyond 20%/ 10%, will it be considered a related party as per the new definition?

In terms of Reg. 20 (7) of SEBI (Foreign Portfolio Investors) Regulations, 2019, the purchase of equity shares of each company by a single foreign portfolio investor including its investor group is required to be below 10% of the total paid-up equity capital on a fully diluted basis of the company.

In case it exceeds the threshold, the FPI is expected to divest the excess holding within five trading days from the date of settlement of the trades resulting in the breach. In case of failure to do so, the entire investment in the company by such FPI investor including its investor group will be considered as investment under the Foreign Direct Investment, as per the procedure specified by SEBI and the FPI and its investor group shall not make further portfolio investment in that company under these regulations. In that case, the said FPI will be classified as a related party.

18. In case of creation/ invocation or revocation of pledge of shares held by the promoter in favour of the bank, will such bank be a related party?

Creation of pledge does not result in transfer of legal or beneficial ownership in the shares. A pledge may allow the pawnee to exercise voting rights, but a pledge is essentially a security interest, and neither ownership interest nor beneficial interest. Hence, in our view, mere holding of pledgee/pawnee's interest is not relevant to determination of RP relationship.

Revocation of pledge is simply cancellation/ satisfaction of the pledge created and therefore, the question of the bank becoming a related party does not arise.

In case of invocation of pledge, the pawnee does not become an absolute owner of the property, however, acquires the right to cause the sale of the pledged shares. A pledge may sometimes permit the pawnee to transfer the shares to himself. Where the pawnee, pursuant to such a power, decides to retain the pledged shares as a beneficial owner, and such decision is not merely a transient holding pending the sale, but a decision to hold for indefinite period, in that case an assessment will be required to be done whether the shares so acquired by the pledgee will be counted for the purpose of determining any relationship.

As per Section 19 (2) of the Banking Regulation Act 1949 no banking company can hold shares in any company, whether as pledgee, mortgagee or absolute owner, of an amount exceeding 30% of the paid-up share capital of that company or 30% of its own paid-up share capital and reserves, whichever is less.

The RBI has recognised that if the invocation of pledge is merely protective in nature, that is, with a view to cause their disposal in near term, such a transient shareholding does not have to be counted as beneficial holding[1].

Definition of Related Party Transactions (RPTs)

19. Subsequent to the present amendment, which all transactions will be considered as RPTs?

The current definition of RPT, even though wider than that contained in CA, 2013, has been widened, not in its meaning, but in its scope. The pre-amendment definition included every transfer of resources, services or obligations, irrespective of whether a price is charged or not and included a single transaction or a group of transactions in a contract. Further, the scope was restricted to transactions between the listed entity and a related party of the listed entity.

The present amendment has broadened the definition of RPT. W.e.f. April 01, 2022, RPT would mean a transaction involving transfer of resources, services or obligation between:

i. Listed entity with its related party;
ii. Listed entity with the related party of its subsidiary;
iii. Subsidiary of listed entity with the related party of listed entity;
iv. Subsidiary with its own related party;
v. Subsidiary with the related party of other subsidiary.

W.e.f. April 01, 2023, following transactions will also be considered as related party transactions:

[1] Para 9 of the notification here: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9767

i. Listed entity with any unrelated party,
ii. Subsidiary of listed entity with any unrelated party

the ***purpose and effect*** (discussed in detail below) of which is to benefit a related party of the listed entity or its subsidiaries.

20. In case of foreign subsidiaries or unlisted Indian subsidiaries, which definition of "related party" will be followed? Whether it will be as per the Companies Act, 2013 or as per the governing law in which they are incorporated?

In case of definition of RP to be followed by subsidiaries, there can be two approaches:

1. Identification of RP of the subsidiary as per the law applicable to the listed parent entity
2. Identification of RP of the subsidiary as per the law applicable to it.

Approach One – It applies an entity-agnostic definition, across the parent as well as all its subsidiaries.

Advantage - There is a consistency of definition used by both the entities. There is a common template which is circulated to all the subsidiaries, subsidiaries fill the same and that is how the RPTs at the level of the subsidiaries are identified. In essence, for identification of RPs and RPTs, there is a common group-wide definition. As such, there will be consistency in the law followed by the entire group, making the implementation of RPT framework, right from identification of RPs to approval and disclosure requirements, easier at the parent level.

Disadvantage –

(a) If we closely examine the definition of RPs under reg 2(1)(zb), we get a different view. The parties covered under the proviso (i.e., promoter and promoter group or entities holding shares on beneficial interest basis) specifically refer to listed entities - therefore, these are not relevant for unlisted subsidiaries, or subsidiaries outside India.

(b) As for applicable accounting standards – it very clearly seems to be referring to standards applicable to the entity in question, and therefore, an entity-agnostic approach does not seem implied there. In case of overseas entities, "applicable accounting standards" will obviously mean accounting standard as may be applicable to the entity, therefore, entity-specific accounting standards.

(c) The only clause which is, therefore, left to be applied is the definition under CA, 2013. That definition applies to both listed and unlisted companies in India. However, such an extension by exported jurisdiction may create complexity for the subsidiaries incorporated outside India. At times, the terminologies used in foreign jurisdictions are not the same as that used in India. For example, terms such "relative" (a part of the definition of RP) may have completely different meanings in different jurisdictions. There may be nothing such a "private company". Further, the definition of "subsidiary" or "associate' may also be different.

(d) As a result, there is a strong possibility of inaccuracy or irreconcilability in the list of RPs provided by such foreign subsidiaries.

Approach Two – It lets each company define RPs based on the definition applicable to it. There may or may not be analogous controls on RPTs, but clearly, accounting standards are almost the same all over the countries that matter. Since, a part of the definition of RP even under the Listing Regulations refers to "applicable accounting standards", if we are using the definition as per accounting standards of the jurisdiction, we are serving the requirement of the law. Besides, going by the respective law as applicable to the subsidiaries would be more convenient for the subsidiaries as it would anyways maintain the list of RPs to comply with its applicable law.

Therefore, it can be said that there can be two possible approaches. Listing Regulations, at present, do not provide ample clarity on the approach to be followed. Neither is there any guidance issued by the regulator so far. Therefore, neither of the said approaches can be said to be non-compliant. In our view, allowing subsidiaries to prepare the list by their local laws may be more convenient.

21. Whether the transactions undertaken by foreign subsidiaries will also be covered within the ambit of RPT?

The term 'subsidiary' under Listing Regulations refers to the definition specified under section 2(87) of CA, 2013. As per CA, 2013, the subsidiary company includes body corporate which includes companies incorporated outside India. Thus, the transactions entered into by the foreign subsidiaries will also be covered under the ambit of RPTs.

22. Will the financial transactions such as loan, guarantee and investment which are outside the purview of section 188(1) of CA, 2013 be covered under the ambit of RPT under the Listing Regulations?

The transactions relating to loan, guarantee and investment, are arguably outside the scope of section 188, as they are specifically covered under section 185 and 186 of CA, 2013 respectively. However, this does not preclude such transactions from RPT provisions of the Listing Regulations. Therefore, all financial transactions - giving of loans, taking of loans, making of investments, issue of securities, giving of guarantees, benefiting from a guarantee, etc., are covered by the wide purport of the definition of a "transaction".

23. In case the holding company gives corporate guarantee on behalf of its subsidiary company in favour of the bank, will such transaction be treated as RPT?

Giving a guarantee in favour of the bank on behalf of the subsidiary is also a transaction between the listed entity and subsidiary, as the subsidiary is the beneficiary of the guarantees.

The obligations are contingently shifted from the subsidiary to the holding company. Hence, in our view, this is a transaction with the subsidiary.

Purpose and effect

24. What does the term 'purpose and effect' mean?

In our view, the insertion of the 'purpose and effect' test is not to expand the sweep of RPTs, but to capture transactions with unrelated parties, done with the intent of benefiting a related party, and having such an effect too. This means the transaction was engineered by interposing an unrelated party, so as to wriggle the transaction out of the RPT controls, but really speaking, the transaction was intrinsically an RPT. Thus, the intent of the amendment seems to be to allow the regulator to lift the veil of the unrelated party, and look behind the facade. This is, therefore, an anti-avoidance measure.

The Working group report refers to the observed usage of innovative structures to avoid classification as RPTs and associated compliance and disclosure requirements by use of i) complex structures, ii) transactions undertaken by a listed entity with seemingly unrelated parties, however intended to benefit related parties; and (iii) instances of loans being given to an unrelated party which in turn gives such loan to a related party. Accordingly, this concept, which is also captured in UK legislation, has been inserted in the Listing Regulations.

There are two terms used here - purpose and effect. These terms are connected by an "**and**", meaning these two have to exist together. There should be a predetermined purpose for benefitting a related party and that such purpose has ultimately led to benefitting that related party. The two terms shall always be read conjunctively and if any one of the two components is missing in a transaction, the same would not qualify to be an RPT:

Purpose	Effect	Whether an RPT or not?
Yes	Yes	Yes
Yes	No	No
No	Yes	No
No	No	No

If the listed entity enters into a transaction with the unrelated party without any intent of benefitting the related party, the same will not be treated as RPT as there was no purpose involved to benefit a related party, even if the transaction subsequently obliquely benefited a related party. Similarly, if the listed entity transacts with the unrelated party with a

predetermined purpose of benefiting the related party, but that effect is not achieved, the transaction will not be considered as an RPT.

25. How will the listed entity discover the interest of the related party in case of transactions entered into with an unrelated party?

The purpose of entering into any transaction is never documented. The fact that a related party is entering into a transaction with an unrelated party to benefit a related party will never be disclosed at the instance of that related party and the listed entity or its compliance officer cannot be expected to have known what is not disclosed. It is also clear that such contrived transactions do not happen innocently - on the contrary, there is a machination to structure and grab the appearance of the transaction, though benefiting a related party. Therefore, it is not hard to understand that the inspiration for the transaction comes from a related party. Hence, for complying with the provisions, it is advisable that the listed entities (and their subsidiaries) require their related parties to provide a written declaration to the effect that they have not initiated or inspired any transaction with an unrelated party, with the purpose of benefiting a related party.

Also, as stated above, the inclusion of 'purpose and effect' test is a measure to deter companies from entering abusive RPTs, camouflaged as an unrelated transaction. Such test may be used by regulators and agencies in the course of proceedings to capture such abusive RPTs.

26. Is there any limit of layers upto which a listed entity will have to assess the purpose and effect of a transaction on a related party?

The whole idea of the purpose and effect test is to see through the veil surrounding the real purpose of benefiting a related party. Therefore, the existence of layers needs to be ignored, no matter how many.

27. Which of the following transactions will be treated as RPT?

a. The listed entity advances loan to an unrelated party which utilizes such funds to subscribe to the preferential issue of shares of the related party of the listed entity.

While determining whether a transaction is RPT, one will have to ascertain if the transaction is being entered into with the purpose of benefiting a related party and which subsequently in reality is benefiting a related party. In the instant case, the listed entity provided funds to an unrelated party which, in turn, utilized such funds to subscribe to the preferential issue of shares of the related party. It can be seen from the pattern that the listed entity extends the funds to the unrelated party with an intention of benefiting a related party. This will be all the clearer when the listed entity wouldn't have advanced the loan in the ordinary course of its business.

b. X Mills Ltd. sells cotton yarn to Y Ltd. (unrelated party). Y Ltd. manufactures textiles and sells them to the related party of X Mills Ltd. which is the distributor of textiles.

In the instant case, the transaction entered into between X Mills Ltd and Y Ltd. is purely a business transaction. The intent of selling goods to Y Ltd. was not to benefit the related parties of X Mills Ltd. Merely because the related party of X Mills Ltd, being one of the customers, purchased the goods from Y Ltd. which received raw materials from X Mills Ltd., such transaction cannot be termed as RPT as the 'purpose' and 'effect' was missing from the transaction. The purpose and effect should be immediate and not oblique.

c. ABCD Bank Ltd. advances a loan to AZ Builders (unrelated party) to construct a building. Subsequently, a director of ABCD Ltd. purchased a home in such a building.

It is the business of a bank to provide financial assistance to the corporates and general public. If the Bank advances a loan to a builder who utilises such funds for business purposes, it cannot be treated as RPT. The benefit of building houses is enjoyed by the customers at large which also includes a director of the Bank. Such a benefit is an incidental benefit and not intentional benefit. Therefore, it cannot be termed as RPT.

d. The listed entity transfers one of its business verticals to X Ltd. whose shares are held by entities not related to the listed entity. Subsequently, the unrelated parties transfer the shares of X Ltd. to the related party of the listed entity.

Transfer of business vertical is not a regular business activity. If the listed entity transfers its business vertical to an unrelated party, with a sole intention of handing over the business to the related party, it will be an RPT. In such a transaction, the unrelated party is merely acting as a conduit to give effect to such transfer. The 'purpose' and 'effect', both are existing at the time of transferring business to an unrelated party to establish such a transaction as RPT.

28. The purpose and effect test becomes applicable from 1st April, 2023. Does this imply that prior to that date, a transaction done, admittedly with the purpose and effect of benefiting a related party, if the transaction is entered into with an unrelated party?

If we agree that the purpose and effect test is an anti-avoidance provision, one cannot argue that it is permissible to avoid the law by adopting subterfuges or masquerading an RPT to be an unrelated party transaction. The futuristic applicability of purpose and effect test is, in our view, to give a regulatory backing to the piercing of veil covering RPTs. What is intrinsically an RPT remains within the regulation and not out of it.

29. How will the listed entity compute the value of the transaction where the transaction is entered into with an unrelated party but the purpose and effect of which is to benefit the related party? Whether the entire value of the transaction will be considered or only the benefit which has been passed on to the related party will be considered?

Normally, since the purpose of the contrived transaction with an unrelated party is to benefit a related party, the entire transaction should be treated as an RPT, to be treated as a transaction with that related party for whose benefit the transaction was engineered. However, if the transaction was only partly so devised, the part to which the transaction benefits a related party should be considered as RPT.

30. How will the listed entity and the audit committee identify the purpose and effect of the transaction on the related party?

Transactions with unrelated parties do not come to the audit committee at all. Hence, it is unconceivable as to how such transactions may come to the audit committee. However, as we mentioned above, the onus will be on the concerned related party to bring such transactions to the audit committee. If possible, a business head may also have to identify if any business transaction is having a purpose and effect of benefiting a related party.

Exemption from the definition of RPT

31. Which all transactions have been exempted from the definition of RPT?

The present amendment provides a list of transactions which will be exempted from the definition of RPT. Those are as follows:

a. Issue of specified securities on a preferential basis, subject to compliance of ICDR Regulations;
b. **Corporate actions** which are uniformly applicable/ offered to all the 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.
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 RPTs every 6 months to the stock exchanges.

32. Considering that the present amendment has provided a list of transactions which will not be treated as RPT, can a listed entity specify further exclusions in its RPT policy?

While the present amendment provides a list of transactions which are kept out of the purview of RPT, it does not seem to be the intention of the regulators to consider it as an exhaustive

list. The fact that the present amendment provides an exclusion list, in our view, does not preclude the power of the audit committee through the RPT policy to provide carve out from the definition of RPT. The audit committee may, while approving or reviewing the RPT policy, set forth the exclusion list taking into consideration the following factors:

a. The carve out should be reasonable
b. It should not be intended to provide undue benefit to the related parties;
c. It should not unduly narrow the scope of RPT to be put before the audit committee for approval.

Few instances of such additional carve out that may be provided in the RPT Policy are as under:

a. Receipt of dividend on account of payment of dividend by a related party to all shareholders of such related party in proportion to their shareholding;
b. Reimbursement of expenses incurred in the course of routine business operations, including repairs, maintenance, travel, etc., at actuals.
c. In case of banks, acceptance or provision of Current Account Savings Account (CASA) facilities.
d. Issuance or subscription of debt securities like non-convertible debentures on platforms commonly accessed by investors (including related parties), pursuant to which the securities are allotted to interested investors in accordance with the provisions of the applicable laws and offer letter; and payment of interest on such securities uniformly to all investors.

The Company may also consider seeking shareholder's approval for permitting inclusion of carve outs in the RPT policy. Suitable justifications may be given to the shareholders as to why such carve out is reasonable and in the best interest of the company. Such approval should be in accordance with reg. 23(4) and related parties should abstain from voting on such resolution. The resolution approved by the shareholders can provide a stronger backing to provide exclusions in the RPT policy.

33. Generally, banks offer higher rates of interest on fixed deposits to their own employees including directors as compared to the rates offered to the general public. Will such transactions be exempted from the definition of RPT?

The present amendment gives an exclusion list from the definition of RPT which, *inter alia*, includes acceptance of fixed deposits by banks at the terms uniformly applicable to the general public. Thus, if a bank offers fixed deposit facility to its directors/ employees on similar terms as offered to all customers/general public, the transactions should qualify for exemption from RPT. Provided that the Bank will be required to disclose such a transaction to the stock exchange on a half yearly basis.

However, where there is a substantial deviation from the terms of deposit, the same might attract RPT provisions.

34. Whether transactions such as payment of interest on bonds/ debentures to the related parties, payment of sitting fees to the directors will be covered under the definition of RPTs?

The list of exclusions provided under the definition of RPT includes corporate action such as payment of dividend to the shareholders. The rationale being, dividend is uniformly paid to all shareholders, irrespective that shareholders may be related parties too.

Similarly, interest is paid to bondholders/debenture holders uniformly on the basis of terms of offer. Therefore, payment of interest to the bondholders/ debenture holders, being a corporate action uniformly applicable to all investors, should also be excluded from the definition of RPTs.

Further, as a general practice, companies usually exclude payment of sitting fees to the directors from the purview of RPT as such payment is made as per the limits prescribed in Companies Act and is paid uniformly to all directors.

As discussed in FAQ no. 32 above, the mere fact that the law provides a carve out to certain transactions from the RPT, does not preclude the audit committee from defining its own carve out.

Audit committee approval

35. Whether RPTs of the subsidiary companies will also require prior approval of the audit committee (of the listed entity)?

Currently, the audit committee is required to approve the RPTs of the listed entity. But the present amendment has expanded the scope of the audit committee towards RPT of subsidiaries. As per the present amendment, any RPT entered into by the subsidiary of which listed entity is not a party will require prior approval of the audit committee, if the same is in excess of the following threshold:

a. The value of RPT whether entered into individually or taken together with previous transactions during FY exceeds 10% of the annual consolidated turnover of the listed entity;
b. W.e.f. April 1, 2023, the value of RPT whether entered into individually or taken together with previous transactions during FY exceeds 10% of the annual standalone turnover of the subsidiary.

36. Which transactions do not require approval of the audit committee of the listed entity?

While the present amendment has increased the role of audit committee towards RPTs of subsidiaries, it has also provided certain exclusions to which approval of the audit committee of the listed entity will not be needed:

a. RPT of a listed subsidiary of which the listed entity is not a party, if regulation 23 and 15(2) are applicable to it, i.e.
   - Subsidiaries whose specified securities (equity shares and convertible securities) are listed and the CG provisions provided in Reg. 15 (2) are applicable to the subsidiary and/ or
   - Subsidiaries whose non-convertible debt securities of outstanding principal value of Rs. 500 crore and above are listed (High Value Debt Listed Entities/ HVDLEs).

b. RPT of an unlisted subsidiary of a listed subsidiary covered in (a), if prior approval of the audit committee of the listed subsidiary has been obtained.

c. RPT between two WOS of the listed entity.

37. Whether prior approval of the audit committee of a listed entity is required for transactions to be made by its unlisted WOS with its related parties?

As per the present amendment, prior approval of the audit committee of the listed entity is required for RPTs of subsidiaries if the value of transaction whether entered into individually or taken together with previous transactions during FY exceeds 10% of the annual consolidated turnover of the listed entity or 10% of the annual standalone turnover of the subsidiary (w.e.f. April 01, 2023). However, if the listed entity itself is a party to the transactions done by the subsidiary, then the transaction will come for approval at the listed entity level irrespective.

Thus, if the transaction is being entered into by the unlisted WOS with its related parties in excess of the prescribed threshold, prior approval of the audit committee of the listed entity will to be required.

37A. Whether the audit committee of the subsidiary need to approve every RPT with RPs of the parent listed entity or other subsidiaries?

The RPTs required to be approved by the audit committee of subsidiaries will be governed by the laws applicable to it. Every subsidiary may not even have an audit committee – for e.g. exemption is provided even for certain class of companies under CA, 2013. A listed subsidiary which is covered under the exemptions provided under Reg. 15 of the Listing Regulations may also not have an audit committee.

As per section 177(4)(iv), approval of the audit committee is required only for transactions with own related parties as per CA, 2013. Every RP of the parent listed entity may not be an

RP under Section 2 (76) for the subsidiary. Similarly, in case of a subsidiary incorporated outside India, the requirement may be different.

Therefore, every RPT of the subsidiary need not be taken to the audit committee for approval, unless required under applicable law.

However, where the RPT of the subsidiary is significant in terms of Reg. 23 (2) and is required to be taken to the audit committee of the parent listed entity, in those cases it should be approved and recommended by the audit committee of the subsidiary, if there is one. In cases where the subsidiary does not have an audit committee, it may be placed before the board of directors for necessary recommendation and then approval of the audit committee of the parent listed entity may be obtained.

37B. For the purpose of reporting RPTs of subsidiaries to the stock exchange, whether approval of the audit committee of the subsidiary is required before submitting to the parent listed entity?

The listed entity is required to disclose all its RPTs to the stock exchange on a half yearly basis under Reg. 23 (9). This includes RPTs of the subsidiaries with its own RP or with the RP of the parent listed entity or with the RP of other subsidiaries. While approval of the audit committee is not required, as information relating to the company is being shared with the parent entity and the same will be published on stock exchange, it is strongly recommended to place the information before the audit committee or before the Board, where there is no audit committee, for the purpose of noting.

38. In case a listed entity supplies goods to its WOS, which in turn supplies such goods to its subsidiaries, will such a transaction be exempt from the purview of RPT?

In the given case, the first leg of transaction i.e., supply of goods by the listed entity to its WOS will not require approval of the audit committee as the same is exempt under reg. 23(5).

At first reading, it seems that second leg of transaction, i.e., further supply of goods by the WOS to its subsidiary will require prior approval of the audit committee of the listed entity only if the value of such transaction, entered into individually or taken together with previous transactions during FY exceeds 10% of the annual consolidated turnover of the listed entity or 10% of the annual standalone turnover of the subsidiary (w.e.f. April 01, 2023). This is because the transaction appears to be one where the listed entity is not a party.

However, there is a need for further examination here. Applying the “purpose and effect” test, the transaction may be said to be a transaction with the step-down entity, which is not a WOS. It is also wrong to say that that transaction does not involve the listed entity, because the listed entity is itself a party to the first transaction. Hence, if the first and the second transaction happen in consonance, such that the two are integrated transactions and the purpose and effect

of the first one is to enable the second one, then the second transaction needs RPT approvals at the listed entity level,

39. If an employee of the listed entity is appointed as a director in the WOS, whether approval of the audit committee of the listed entity will be required for payment of remuneration of such employee as a director?

The definition of RPT under regulation 2(zc) of the Listing Regulations covers within its ambit 'transfer of resources' between a listed entity and its related party, regardless of whether a price is charged.

If the listed entity appoints its employee (assuming such employee is not a KMP or a director of listed entity) on the board of WOS, it will be regarded as RPT as it is a transfer of resources from the listed entity to the WOS. However, in terms of regulation 23(5), since such a transaction is being entered into with the WOS, it will be exempt from the requirement of obtaining approval of the audit committee of the listed entity.

With respect to payment of remuneration of such employee as a director of WOS,

a. If the remuneration is being paid by the listed entity, the transaction is between the related party (director) of the subsidiary and the listed entity, requiring prior approval of the audit committee of the listed entity.

b. If the remuneration is being paid by the WOS, the transaction is between the WOS and its related party. Thus, if the remuneration being paid exceeds the threshold limit of 10% of the annual consolidated turnover of the listed entity or 10% of the annual standalone turnover of the WOS (w.e.f. April 1, 2023) (which is highly unlikely), prior approval of the audit committee of the listed entity will be required.

40. Whether the issue of non-convertible debentures ('NCDs') to a related party at arm's length's price, or subscription to debentures issued by a related party, will require prior approval of the audit committee?

The amended definition of RPT specifies the list of transactions which will not be considered as RPT, one of which is 'issue of specified securities on a preferential basis, subject to compliance of ICDR Regulations.

ICDR Regulations define 'specified securities' as equity shares and convertible securities. NCDs are not covered under the definition of specified securities. Thus, issue of NCDs to a related party does not appear in the regulatory carve outs. Thus, unless a carve out for such transactions is incorporated in the RPT policy (see FAQ no. 32) or a generic permission has been given by the shareholders (see Generic Approval of RPTs), the issue of debentures will require prior approval of the audit committee.

Likewise, subscription to debentures by a related party will also require approval.

41. If a listed entity enters into a transaction with a trust whose trustee is a director on the board of the listed entity, will it require prior approval of the audit committee?

The definition of a related party under IND-AS 24 includes an entity that is controlled or jointly controlled by a director of the listed entity. A director may be having the capacity of controlling the economic or other activities of the trust. In such a case, prior approval of the audit committee will be required.

In case the trust is not a related party but the transaction is entered into with the trust has the purpose and effect benefiting the director, it will be regarded as an RPT requiring prior approval of the audit committee.

Material modifications

42. What are the various kinds of modifications likely in an RPT?

The expression "modification" of an RPT is very wide indeed. Any of the terms and conditions of the contract, extension of tenure, renewal of the contract, waiver, subordination, variation in any payment rights, security interest, novation of parties, addition of parties, etc. may all be considered to be a modification.

Exercise of any right already contained in the original contract is not a case of modification. For example, enforcement of security interest provided for in the contract is not a modification. If prepayment of a loan was already provided for in the contract, the same is not a modification. If the contract provides for assignment of the benefits under the contract by the counterparty to a third party, the same is not a modification; however, if this assignment is to a related party, one may have to consider as to whether the act of assigning by the counterparty itself is a related party transaction.

Sometimes, a contract provides for doing something with mutual consent - for example, a loan contract may provide that the tenure of the loan may be varied with mutual consent. Since the consent is mutual, it cannot be considered to be a right provided in the original contract. A right or an option is unilateral, and does not depend on mutual concurrence.

43. What does the term 'material modification' mean? Who will determine the material modifications?

While the term is not defined under the Listing Regulations, it is required to be defined by the audit committee in the policy framed under Reg. 23 (1) on materiality of related party transactions and on dealing with related party transactions.

The audit committee may lay thresholds or criteria for treating a modification as material, if there is a modification in the terms and conditions of any ongoing RPT, as originally approved by the audit committee and/ or shareholders, having a significant impact on the nature, value, tenure, exposure or likely financial impact of such a transaction.

44. What factors should be considered by the audit committee while defining 'material modification' in the RPT policy?

Some illustrative criteria for treating a modification as material may be as follows:

- The terms of the contract cease to be arms' length;
- Any modification of pricing, value, mode of repayment, etc., of a contract which has a financial implication of X% or more of the contract, or Rs Y crores, whichever is higher;
- Granting of any waiver, abatement or any other relief to either party, which results into a financial implication equal to x% or more of the value of the contract;
- Extension of tenure of the contract by z% or more of the original tenure, or continuation of the contract or arrangement beyond the tenure originally agreed upon, except for completion of any residual performances;
- Any modification which results into the claims of either party being subordinated, or relaxation of security interest:
    - Provided that giving any consent for cessation of *pari passu* charge or any other security interest, provided there is adequate asset cover, shall not be deemed as modification of contract
- Any novation of the contract or arrangement to a third party.

These, however, may be a rebuttable presumption as to materiality of the modification.

Also, one must note that 'materiality' threshold for RPT is defined in law; however, 'materiality' threshold for 'modification' has to be defined by audit committee. These thresholds would be different - if materiality threshold for RPT is 10% of annual turnover or Rs. 1000 crores whichever is lower; the threshold for 'material modification' cannot be same, logically.

45. What about a modification which is not material, or material modification to a non-material RPT?

Based on the materiality of the contract, and the materiality of the modification, it is possible to think of the following combinations:

Original RPT	Modification	Implication
Non-Material	Non-material	Requires AC approval, as modification of every RPT requires approval of the AC under sec. 177 (4) (iv).
Non-material	Material	AC approval shall suffice; no need to place for shareholders' approval
Material	Non-material	AC approval shall suffice; no need to place for shareholders' approval
Material	Material	Shareholders' approval required, in terms of reg. 23(4). Also, 'prior' approval of AC is required.

46. If the modification has the impact of turning a non-material transaction to become a material transaction, will the modified transaction be put for shareholders' approval?

Seems logical. The materiality of the transaction should be tested on the basis of modified terms.

47. Whether all modifications (even if not material) to the RPT will require prior approval of the audit committee?

Presently, all subsequent modifications to the RPT undertaken by the listed entity and its related parties, whether material or not, require approval of the audit committee under section 177(4)(iv) of CA, 2013 and Para A (8) of Part C of Schedule II to the Listing Regulations. However, such approval need not be a prior approval and post-facto approval will suffice.

Pursuant to the present amendment, a ***material*** modification to the RPT will require ***prior*** approval of the audit committee.

48. Whether all modifications to the RPT by a subsidiary will require approval of the audit committee of the listed entity?

The existing provisions under CA, 2013 and Listing Regulations provide for audit committee approval for subsequent modification only to the RPT to which the listed entity is a party.

Pursuant to the present amendment, only ***material*** modifications to such RPTs of the subsidiary that have been approved by the audit committee of the listed entity, will require prior approval of the audit committee of the listed entity. In such a case, post-facto approval will not suffice.

Or, say the original RPT by the subsidiary was below the threshold as prescribed in clause (b)/(c) of second proviso to reg. 23(2). However, pursuant to a modification, the threshold gets breached. Then, going by the rationale as indicated in Q. 48 above, such transaction should be

logically regarded as material modification, and should come for approval of audit committee of the listed entity.

For tabulated approval matrix, refer FAQ Nos. 65 and 66 below. Kindly refer to the below table for further understanding of the FAQ No. 47 and 48 stated above:

Party to RPT	Nature of modification	Nature of approval of audit committee of the listed entity	Reason
Listed entity and its related parties	Non-material	Post-facto	Pursuant to Section 177(4)(iv) of CA, 2013 and Para A (8) of Part C of Schedule II to the Listing Regulations
Listed entity and related party of subsidiaries	Non-material	Post-facto	As express requirement for prior approval not stated.
Listed entity and its related party/ related party of the subsidiary	Material	Prior	Pursuant to present amendment
Unlisted Subsidiary	Non-material	Not required	The present amendment requires prior approval of the audit committee of the listed entity only at the time of entering into RPT if the transaction is beyond the prescribed threshold.
Unlisted Subsidiary	Material	Prior	Pursuant to present amendment, only if the original transaction required prior approval of the audit committee of the listed entity.
Equity listed subsidiary (if reg. 23 applicable)	Material / Non-material	Not required	The present amendment provides an exemption to the RPT of the listed subsidiary to which reg. 23 applies.

Party to RPT	Nature of modification	Nature of approval of audit committee of the listed entity	Reason
Equity listed subsidiary (if reg. 23 not applicable)	Material / Non-material	Not required for non-material ones Prior approval required for material modification*	*Only if the original transaction required prior approval of the audit committee of the listed entity.
Debt listed subsidiary which is an HVDLE	Material / Non-material	Not required	The present amendment provides an exemption to the RPT of the listed subsidiary to which reg. 23 applies as the same will be subject of approval of the audit committee of the said subsidiary
Debt Listed subsidiary which is not an HVDLE	Non-material	Not required	Same as above.
Debt Listed subsidiary which is not an HVDLE	Material / Non-material	Not required for non-material ones Prior approval required for material modification*	*Only if the original transaction required prior approval of the audit committee of the listed entity.

Information to be placed before the Audit Committee

49. Pursuant to the SEBI circular dated November 22, 2021, what all information is required to be placed before the audit committee for approval of RPT?

As per Para 4 of SEBI circular dated November 22, 2021, following information is required to be placed before the audit committee for approval of RPT:

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 (particular tenure shall be specified);
d. Value of the proposed transaction;

e. The percentage of the listed entity's annual consolidated turnover, for the immediately preceding financial year, that is represented by the value of the proposed transaction (and for a RPT involving a subsidiary, such percentage calculated on the basis of the subsidiary's annual turnover on a standalone basis shall 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 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; 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 RPT.
g. Justification as to why the RPT is in the interest of the listed entity;
h. A copy of the valuation or other external party report, if any such report has been relied upon;
i. Percentage of the counter-party's annual consolidated turnover that is represented by the value of the proposed RPT on a voluntary basis;
j. Any other information that may be relevant for the audit committee to consider the proposal of RPT.

50. Whether the information required to be placed before the audit committee specified in FAQ no. 49 above is applicable to HVDLE?

Yes. As the provisions of reg. 23 is applicable to HVDLEs pursuant to SEBI (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2021, the said circular will also be applicable to HVDLE pursuant to SEBI circular dated January 07, 2022.

51. As per the SEBI circular, the listed entity is required to disclose the percentage of the annual standalone turnover of the subsidiary, whose RPT is being considered. Will such disclosure be applicable from FY 2022-23?

While the provisions relating to approval of RPTs of subsidiary where the value of transaction exceeds 10% of the annual standalone turnover of the subsidiary, is applicable with effect from April 1, 2023, the requirement of placing minimum information before the audit committee under SEBI circular dated November 22, 2021 is effective from April 1, 2022. Therefore, the requirement to disclose the percentage of annual standalone turnover of the subsidiary whose RPT is being considered will be applicable from FY 2022-23.

52. In case of RPT relating to loans, inter-corporate deposits, advances or investments made or given, the listed entity will be required to disclose the financial indebtedness, if any. What does the term 'financial indebtedness' indicate?

The term 'financial indebtedness' as mentioned in para 4(f)(ii) of the SEBI circular dated November 22, 2021, would mean the financial burden which the listed entity/ subsidiary might be bearing to enter into RPTs. Most listed entities/ subsidiaries have bank/ financial institution borrowings (or even other borrowings) as their liabilities; however, it would be important to establish a 'direct nexus' between such borrowings and the proposed transaction. As to what constitutes 'direct nexus', is a function of various factors depending upon the facts of each case.

53. Where a listed entity advances any loan to a related party, it will be required to disclose the purpose for which such funds will be utilized by the ultimate beneficiary. What does the term 'ultimate beneficiary' mean?

The word "beneficiary" would have been quite easy to understand. That is, if the listed entity gives any loans, advances, or makes any investment, to or in an RP, what is the purpose for which the funds will be utilised by the beneficiary - in this case, we are referring to the RP who is at the receiving end of the funds. So, the listed entity needs to find out (possibly it already knows), what is the end use of such funds by the RP. For example, the listed entity may be making an investment in its subsidiary, which will be used by the subsidiary for its working capital, or a capex proposal.

Sometimes, the listed entity gives a loan to a subsidiary, and the subsidiary in turn gives the loan to its own step-down, and that in turn uses the very same money to give a loan to, say, a director. In that case, the ultimate beneficiary is the director receiving the money. So, if there is a clear nexus between the flow of funds from the listed entity to an RP, and from the RP to another destination, the particulars of the destination may be disclosed. Therefore, the word "ultimate" beneficiary comes in where the RP receiving the funds immediately from the listed entity is not the beneficiary itself, but acquires the funds to route them to any other person or entity.

Shareholders' approval

54. Subsequent to the present amendment, which all RPTs will be considered as material RPT?

Prior to the present amendment, Explanation to Reg. 23(1) of the Listing Regulations provides that if the value of transaction to be entered into individually or taken together with previous transactions during a financial year, exceeds 10% of the annual consolidated turnover of the listed entity, such RPT would be considered as material RPT.

Further, as per reg. 23(1A), in case of transactions relating to brand usage or royalty, it is considered as material RPT if the value of transaction taken together with previous transactions during a financial year, exceeds 5% of the annual consolidated turnover of the listed entity.

Pursuant to the present amendment, effective from April 1, 2022, a transaction or transactions with an RP will be considered material if the value of transactions to be entered into individually or taken together with previous transactions during a financial year, exceeds -

- Rs. 1000 crore, or
- 10% of the annual consolidated turnover of the listed entity, **whichever is lower.**

However, there is no change in the threshold limit for transactions relating to brand usage or royalty.

55. Whether the provisions of the present amendment have prospective effect or retrospective effect?

Reg. 23(6) of the Listing Regulations states that *"The provisions of this regulation shall be applicable to all* ***prospective transactions.****"* However, reg. 23(8) spells out that *"All* ***existing material related party contracts*** *or arrangements* ***entered into prior to the date of notification of these regulations*** *and which may continue beyond such date* ***shall be placed for approval of the shareholders*** *in the first General Meeting subsequent to notification of these regulations."*

While reg. 23(8) has been in place right from the time the Listing Regulations were notified, however, the expression *'these regulations'* would refer to the Listing Regulations as amended from time to time. The regulation, so far, has not been omitted.

Therefore, pursuant to reg. 23(8), all existing material **contracts** [not 'transactions', as used in reg. 23(6)] will be required to be placed before the shareholders for approval, if (a) such contracts result into transactions exceeding materiality threshold in FY 22-23; and (b) the contracts have not been approved already by shareholders.

Detailed discussion in this regard has been done in the article, "New Materiality Threshold for RPTs: Nagging questions on shareholder approval".

56. Whether the terms 'contract' and 'transactions' are used interchangeably?

It is to be noted that all provisions of RPT under the Listing Regulations use the term 'transactions' except for reg. 23(8) which uses 'contract'. Essentially, 'transaction' and 'contract' are not synonymous. There may be a single transaction or a series of transactions pursuant to a contract or arrangement. As per the definition of RPT under the Listing Regulations, a "transaction" with a related party shall be construed to include a single transaction or a group of transactions in a contract. Therefore, the term 'contract' is wider. A

contract may entail a single transaction or even a series of transactions resulting in transfer of resources, service or obligation by a listed entity. For instance, A sells goods to B at a certain price – this is a transaction; and this can as well be a contract. In another example, A agrees to supply goods to B over a period of 3 years at a predetermined price. This is a contract, which can have multiple transactions (multiple supplies of goods to B).

57. The company entered into a contract in the year 2019 the value of which was below the threshold limit of 10%. However, the value of transactions under a contract in a financial year exceeds Rs. 1000 crore. Pursuant to the present amendment, will such transactions require shareholders' approval?

As per reg. 23(8), all existing material related party contracts entered prior to the notification of these regulations (in our case, April 1, 2022) and which may continue beyond such date will require shareholders' approval.

In the given case, the value of transactions under the contract at the time of entering was below the threshold limit of 10%. However, the value of transactions under the contracts in FY 22-23 exceeds Rs. 1000 crore i.e., it crosses the amended threshold limit. Therefore, pursuant to reg. 23(8), such transactions to be entered into under a contract will require approval of unrelated shareholders.

58. At the beginning of the financial year, the listed entity expects that the ongoing RPT will exceed the threshold limit of Rs. 1000 crore. At what stage should it approach the shareholders for approval?

Pursuant to the present amendment, Reg. 23(4) of the Listing Regulations has been made stricter, requiring 'prior' approval of the shareholders in case of material RPT.

In case the listed entity anticipates at the beginning of the financial year that the value of RPT will exceed Rs. 1000 crore, it should take approval of the shareholders at the beginning of the financial year only by calling an EGM or by postal ballot to avoid any violation of the regulations. However, if it is expected that the threshold limit will be crossed at the second half of the financial year, it may take approval of the shareholders at the AGM before the end of September.

59. In case the listed entity enters into different types of transactions with the same related party, for e.g., purchase of goods, giving of loans, etc., whether the value of such transactions will be clubbed for the purpose of determining its materiality?

The language used in explanation to reg. 23(1), clearly says that a transaction will be considered as material if the transaction to be entered into *along with previous transactions* exceeds the threshold limits. Therefore, to determine the materiality threshold, all transactions entered into with the related party, irrespective of the nature of transaction, will be required to

be clubbed. It is to be noted that the aggregation should be done related party wise and not the nature of transaction wise.

60. X Ltd. enters into a transaction with Y Ltd (its related party) for Rs. 800 crore. Z Ltd, a subsidiary of X Ltd. also enters into a transaction with Y Ltd. for Rs. 300 crore. Will such transactions get aggregated for the purpose of determining the materiality thresholds?

The definition of RPT has been expanded to include transactions between listed entity or its subsidiaries on one hand and the related party of the listed entity or its subsidiaries on other hand. Further, the explanation to reg. 23(1) defines material RPT as "… transaction(s) to be entered individually or taken together with previous transaction during a financial year …"

The provisions do not stipulate any requirement of aggregation of transactions entered by the listed entity and the subsidiaries with the common related party. The materiality threshold has to be calculated by aggregating transactions at listed entity/ subsidiary level and not by aggregating at group level.

In the instant case, even though the transaction between Z Ltd and Y Ltd. is an RPT for X Ltd, it is not required to aggregate the said transaction with the transaction between X Ltd and Y Ltd to determine the materiality thresholds. The value of transactions entered by X Ltd. is Rs. 800 crores and by Z Ltd. is Rs. 300 crore, which is below the threshold of material RPT.

61. A listed entity has entered into a 5 year contract with a related party whose aggregate value, over the 5 years' term, is Rs. 4000 crores. However, the transactions done pursuant to such contract do not exceed Rs. 1000 crore in a single financial year. Will such a contract require shareholders' approval?

The explanation to reg, 23(1) emphasises on the value of transactions entered into individually along with previous transactions in a ***financial year.*** If the listed entity enters into a contract whose value exceeds Rs. 1000 crore but the tenure of contract is beyond 1 financial year, it will not be treated as material RPT unless the value of transactions entered into pursuant to such contract is exceeding Rs. 1000 core or 10% of the annual consolidate turnover of the listed entity in one financial year, requiring shareholders' approval.

Here, as is obvious, the contract in such scenarios should be such where it is possible to assess values at transaction level.

62. The listed entity entered into a contract with an unrelated party. Subsequently, such a party became a related party and the transactions under the contract became material. Whether shareholders' approval will be required?

If the listed entity enters into a contract with an unrelated party which subsequently becomes a related party, it will be required to take approval of the shareholders prior to entering into further transactions with the entity pursuant to reg. 23(4) and 23(8) of the Listing Regulations.

63. A Ltd. enters into a contract with its subsidiary for which shareholders' approval was obtained. Subsequently, such a subsidiary gets merged into another subsidiary of A Ltd. Will such a contract again require shareholders' approval?

Typically, a scheme of arrangement such as merger or demerger causes transfer of all existing contracts to the transferee entity. No consent or concurrence of A Ltd is required as a contracting counterparty; approval as a shareholder is a different issue. Therefore, the assumption of the contract by the transferee company does not require any fresh approval.

64. If the listed entity enters into an RPT of more than Rs. 1000 crore (not triggering the threshold specified under section 188 of CA, 2013) without prior approval of shareholders, can such RPT be ratified by the shareholders?

This question is complicated. The issue is, is an RPT done without the shareholders' approval legally void, or the directors (or officer of the company who has authorised the transaction) lacked the authority to do so. Surely enough, the transaction was not beyond the capacity of the company. It is merely because of the apprehension of conflict of interest that the transaction required shareholders' approval. Therefore, the shareholders had the authority, but the directors did not have the authority. If the shareholders, who had the original authority to approve the transaction, after due consideration of the relevant facts, decide to approve it, the approval dates back to the date on which the original act was done. This is backed by the age-old maxim: *Omnis ratihabitio retrorahitur et mandato priori aequiparatur*. Sec. 196 of the Contract Act also incorporates the principle of ratification of the acts of an agent by the principal; in the context, the directors may be regarded as the agents of the company.

Therefore, if there is a ratification by shareholders, the legality of the contract is not disrupted; the contract may continue[2].

[2] The issue itself is not simple - there are several angles to the ratification principles. If the interests of shareholders are in question, the shareholders may ratify the breach of duty of the directors. However, if there is a question of creditors' interest too, for example, funds borrowed from creditors have been hived off into an RPT, there is no question of ratification by shareholders. In a New Zealand ruling in *Nicholson v Permakraft (NZ) Ltd* [1985] 1 NZLR 242, it was held that the concurrence by the shareholders prevents any complaint by them, but compounds rather than excuses the breach as against creditors. Similarly, if there is question involving public policy, there can be no ratification.

However, this is not to deny the implications that the process flaws may have for the directors and other officers - there is a clearly a breach of Reg 23 of the LODR Regulations. There is also a clear gap in the internal controls relating to RPTs and the efficacy of the compliance system.

65. Which modifications to the RPTs of the listed entity will require approval of the audit committee/ shareholders?

We have tried to state below various permutations and combinations to the RPT in which modifications are made requiring approval of audit committee and/ or shareholders:

Sr. No.	Nature of RPT (Original transaction)	Audit committee approval	Shareholders' approval	Nature of modification	Audit committee approval	Shareholders' approval
1	Non-material	Prior approval	Not required	Non-material	Post-facto approval	Not required
2	Non-material	Prior approval	Not required	Material	Prior approval	Not required
3	Material RPT	Prior approval	Prior approval	Non-material	Post-facto approval	Not required
4	Material RPT	Prior approval	Prior approval	Material	Prior approval	Prior approval

66. Which modifications to the RPTs of the subsidiary will require approval of the audit committee/ shareholders of the listed entity?

We have tried to state below various permutations and combinations to the RPT in which modifications are made requiring approval of audit committee and/ or shareholders:

Sr. No.	Value of RPT (Original transaction)	Audit committee approval	Shareholders' approval	Nature of modification	Audit committee approval	Shareholders' approval
Where subsidiary is unlisted or listed but not covered under Reg. 15 or is not an HVDLE						
1	<10% of annual consolidated T/O of listed entity, and <	Not required	Not required	Non-material	Not required	Not required

Sr. No.	Value of RPT (Original transaction)	Audit committee approval	Shareholders' approval	Nature of modification	Audit committee approval	Shareholders' approval
	Rs. 1000 crore					
2	<10% of annual consolidated T/O of listed entity, and < Rs. 1000 crore	Not required	Not required	Material (Assuming not as material so as to breach the threshold itself)	Not required	Not required
3	<10% of annual consolidated T/O of listed entity but > Rs. 1000 crore	Prior approval in order to obtain prior approval of shareholders	Prior approval	Non-material	Not required	Not required
4	<10% of annual consolidated T/O of listed entity but > Rs. 1000 crore	Prior approval in order to obtain prior approval of shareholders	Prior approval	Material	Prior approval in order to obtain prior approval of shareholders	Prior approval
5	>10% of annual consolidated T/O of listed entity	Prior approval	Prior approval	Non-material	Not required	Not required
6	>10% of annual consolidated T/O of listed entity	Prior approval	Prior approval	Material	Prior approval	Prior approval

In case of a listed subsidiary to which reg. 23 applies, neither the material RPT nor material modification to such RPT will require approval of the audit committee and shareholders of the listed entity.

Generic approval of RPTs

67. Is the shareholders' approval expected to be annual, or is it possible to grant an approval for some years, or all years to come? For example, some transactions are done on a continuing basis. Are they to be approved every year, assuming the materiality thresholds are crossed?

In our view, except for matters where a carve-out type approval may be justifiable, the approval to be obtained from shareholders should pertain to the contract(s) to be entered into with related parties during a financial year.

The financial year limitation seems reasonable, because the materiality itself is tested with reference to an annual turnover; therefore, the contracts should also be limited to the financial year, succeeding the one whose turnover was considered for materiality.

The contract itself may have a tenure exceeding one year. For example, approval is taken for a contract, to be entered into in FY 22-23. The contract is a long-term supply contract, whereby supplies will be made to a related party, say, for a term of 5 years. If, having been put wise on the facts of the contract including its 5-years' term, the shareholders have approved the contract, the very same contract does not have to come for approval next year, for the continuing supplies thereunder.

68. How specific should the shareholders' approval be? Should it, for example, contain each of the following:

a. Nature of transaction proposed to be entered into with RPs;
b. The names of the RPs with whom the contracts are proposed;
c. Value or limits of value upto which the contract will be entered into;
d. The terms of the contract, that is, the prices, tenure, and other terms?

Or, is it possible to conceive of a shareholders' approval without specifying either of the above?

First of all, in our view, there is no question of taking any approval without specifying the nature of the transaction. The basic nature of the transaction - is it a transaction for purchase, or supply, of goods or services, and what goods or services, is the key to any approval process, and the approval cannot be so blindfolded so as to defeat the very meaning of approval. By way of a counter argument, it can be contended that ultimately, the approval is being sought from the majority of the minority, and if such majority approves a blanket resolution, that should still serve the purpose. However, taking such a resolution to shareholders will defeat the whole purpose of the RPT policing mechanism.

That having been said, it is possible to think of a carve-out style resolution, which is not specific as to the other particulars enumerated above.

For instance, a listed entity dealing with retail customers may deal with its related parties too, as a part of its regular customer interface. An FMCG company may sell its products at its retail outlets to its directors or their relatives. A hotel company may have their directors or their relatives check in in the ordinary course. An electricity distribution company may supply power to homes of its RPs as well. A bank may provide CASA or remittance services to its RPs too. Each of these transactions may be too small to fall into the materiality thresholds, but they may attract the limits because of the aggregation rule. In such cases, it is not possible to identify the RPs, because all RPs may enter into transactions of generic nature.

Therefore, where the transactions satisfy all the following features, it does not seem unreasonable to have a generic permission from the shareholders, unless the company has already given a carve-out by way of its RPT policy (which if the audit committee deems fit, may be placed before shareholders in accordance with reg. 23(7)):

1. The transaction is done in the ordinary course of business. Of course, the nature of such transactions will be well defined and disclosed to the shareholders.
2. The transaction is by way of public interface, by the usual distribution machinery of the company, pertinent to the nature of its business.
3. The transaction is done with RPs as a part of the public or customer interface of the company; there is no specific consideration or deviation from the ordinary public dealings of the company for the RPs.
4. There is no potential for any conflict of interest between that of the company and the RP in question.

69. Is it possible to pass a resolution without specifying the limit or value of transactions, though with specific RPs?

The question above dealt with whether one or more of the specifications can be avoided, that is, kept generic.

Of the factors that cannot be kept generic, but has to be specific, is the nature of the transaction. In our view, it will be inconceivable to think of a listed entity seeking approval, merely by stating the name of the RP, but giving no details of the transaction [for example, all or any transactions with the X RP be approved]. One cannot expect shareholders to approve without even knowing the nature/extent of transactions.

If the sweep of the language of the approval is such as to leave an open-ended scope for the nature of transactions, that suffers from the same flaw. [For example, to approve loans to, give guarantees for the benefit of, investment in securities to be issued by, or to have any other financial transaction with party X].

However, if the nature of transactions is such where values cannot be specified, the listed entity may try to give an estimate of the limits upto which transactions may be entered into. [For

example, it is not okay to seek approval for transaction(s) of value exceeding Rs 1000 crores or 10% of the consolidated turnover of the company. However, one may seek approval for transaction(s) to be entered into from time to time, however, not exceeding Rs 5000 crores during the financial year 2022-23].

So essentially, the idea is to be as specific as possible, and keep generalisations and open-ended approvals to the minimal.

It must also be noted shareholder's approval is not a substitute for Audit committee's approval. Judgement of the arm's length call is something which is the onus of AC. Hence, even if prior shareholder approval is accorded to a proposed transaction, the AC should anyway look into fulfillment of arms' length criteria as a part of review of RPTs

Information to be placed before the shareholders

70. In accordance with CA, 2013, what information is required to be disclosed in the explanatory statement for obtaining approval for RPT?

In accordance with Section 188 read with Rule 15(3) of Companies (Meetings of Board and its Powers) Rules, 2014, the following information is required to be stated in the explanatory statement for obtaining shareholder approval for an RPT:

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 arrangements;
e. any other information relevant or important for the members to take a decision on the proposed resolution.

71. Pursuant to the SEBI circular dated November 22, 2021, what information is required to be disclosed to the shareholders?

In addition to the information prescribed under Companies Act, 2013, as stated in FAQ no. 70 above, the following will also be required to be stated in the explanatory statement in terms of the aforementioned SEBI Circular:

a. A summary of the information provided by the management of the listed entity to the audit committee (specified in FAQ no. 49 above);
b. Justification for why the proposed transaction is in the interest of the listed entity;
c. Where the transaction relates to any loans, inter-corporate deposits, advances or investments made or given by the listed entity or its subsidiary, the following details to be specified:
   (i) details of the source of funds in connection with the proposed 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; 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 RPT.

It is to be noted that the requirement of disclosing source of funds and cost of funds shall not be applicable to listed banks/NBFCs.

d. 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 made available through the registered email address of the shareholders;
e. Percentage of the counter-party's annual consolidated turnover that is represented by the value of the proposed RPT, on a voluntary basis;
f. Any other information that may be relevant.

72. Whether disclosing information to the shareholders as specified in FAQ No. 71 above is also applicable to HVDLEs?

As discussed in FAQ No. 50 above, the provisions of reg. 23 is applicable to HVDLEs and therefore, the said circular will also be applicable to HVDLEs. This was also clarified by the subsequent SEBI circular dated January 01, 2022.

Disclosure to stock exchanges

73. Kindly refer to our FAQs on half-yearly disclosure of RPTs to the stock exchanges here.

Disclosure in the Annual Report

74. Whether the disclosure of RPT as required under Para A of Schedule V will be applicable to all listed entities? Whether such disclosure will be made in the Annual Report for FY 2021-22?

Prior to the amendment, the disclosure of RPT in the Annual Report as required under Para A of Schedule V was applicable to all listed entities whose specified securities were listed on the stock exchange, except listed banks. Pursuant to the present amendment, only those listed entities which have listed their non-convertible securities other than the listed banks will be required to make such disclosure in the Annual Report.

Since the amendment is applicable from April 01, 2022, the disclosure will continue to be applicable to all the listed entities whose specified securities are listed (except listed banks) for Annual Report as at March 2022. However, for Annual Report as at March 2023 and onwards, the same will be applicable to the listed entities whose non-convertible securities are listed.

75. Pursuant to the present amendment, the disclosure in the Annual report is required to be made w.r.t loans and advances made to firms in which directors are interested. Whether such disclosure is applicable to all listed entities? Whether such disclosure will be made in the Annual Report for FY 2021-22?

The newly inserted clause (m) in point (10) of para C of Schedule V will be applicable to all listed entities including those whose non-convertible securities are listed, except listed entities. Since the amendment is applicable from April 01, 2022, the said disclosure will be applicable for Annual Report as at March 2023 and onwards.

Actionable arising out of the present amendment

76. What actionable arise out of the present amendment?

The present amendment, notified on November 9, 2021 and effective from April 1. 2022, has brought along with it, loads of compliances to be ensured by the listed entities and its subsidiaries.

The immediate actionable arising out of the present amendment are provided as follows:

a. Amend the RPT Policy to bring it in line with the amendments;
b. Revisit the list of RPs and identify the shareholders holding 20% or more in the listed entity either directly or on a beneficial interest basis as provided under section 89 of CA, 2013;
c. Revisit the list of RPTs and identify the transactions currently being undertaken with each of the parties as per the revised RP list;
d. Procure the list of RPs from the subsidiaries to check if any transaction is being entered into with the RPs of subsidiaries;
e. Furnish the list of RPs of the listed entity to every subsidiary and procure information on the nature and quantum of ongoing transactions of the subsidiaries with the RPs of the listed entity;
f. Sensitize the MD/ CEO/ Compliance Officer of the subsidiaries to give effect to the above actionable;
g. Identify the ongoing RPTs with its own RPs which are below 10% of the annual consolidated turnover of the listed entity but above Rs. 1000 crore;
h. Procure the details of ongoing RPTs between -
    - Subsidiary and its RP and
    - Subsidiary and RP of the listed entity
    - Subsidiary and RP of other subsidiaries

    in order to ascertain if any of the above aggregates to either 10% of the annual consolidated turnover of the listed entity or Rs. 1000 crore.

i. Audit committee to determine and define thresholds for material modification. The material modification as defined by the audit committee to be disclosed as a part of the RPT Policy;
j. Basis the definition of material modification, ascertain if there have been any material modifications to the RPTs already approved by the shareholders, requiring prior approval;
k. Obtain approval of audit committee on the existing transactions which have become RPT -
    - Pursuant to revised definition of RP;
    - Pursuant to revised definition of RPT;
l. Obtain approval of the shareholders for the ongoing RPTs crossing the threshold limit of Rs. 1000 crore in FY 2022-23.

77. What will be the revised procedure for approval of RPTs?

Due to the amendment in the provisions of RPT, the revised procedure for obtaining necessary approval of audit committee, board of directors and shareholders will be as follows:

a. Identify if the counterparty with which the transaction is being entered into is a related party - In case of a listed entity, related party will be identified as per the Listing Regulations, in case of unlisted subsidiary - as per CA, 2013, in case of foreign subsidiary - as per the foreign laws applicable to it;
b. Identify whether it is an RPT as per reg. 2(zc) of the Listing Regulations;
c. If it is an RPT, obtain prior approval of the audit committee [except for transactions which are exempt under second proviso to reg. 23(2) and 23(5)];
d. Check if the transaction is in the ordinary course of business or on arm's length;
    - If yes, approval of the board of directors will not be required;
    - If the transaction is not in the ordinary course or not on arm's length, check if it falls under the list of section 188(1) of CA, 2013, if yes, obtain approval of the board of directors;
e. Check if the value of the transaction is crossing the materiality threshold under the Listing Regulations or under Rule 15 of the Companies (Meetings of Board and its Powers) Rules, 2014;
    - If not, shareholders' approval will not be required;
    - If the value is crossing the threshold under the Listing Regulations, obtain prior approval of the shareholders;
    - If the value is crossing the threshold limits and the transaction is not in the ordinary course or not on arm's length and falls under section 188(1), obtain approval of the shareholders.