

## Recent Changes to Framework Governing Related Party Transactions involving Listed Entities

On September 28, 2021, the Securities and Exchange Board of India (the “SEBI”) approved certain changes to regulations governing related party transactions (“RPTs”) involving listed entities under the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the “Listing Regulations”). The changes were announced in a [press release](#) dated September 28, 2021. Subsequently, the SEBI has amended the Listing Regulations pursuant to the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2021 dated [November 9, 2021](#) (the “Amendment Regulations”). Most of the changes take effect from April 1, 2022, with certain provisions taking effect from April 1, 2023.

This note sets out an overview of the amendments introduced by the Amendment Regulations, some of which are based on the recommendations of a working group constituted by the SEBI, in their [report](#) dated January 27, 2020 (the “Report”). The Report was made publicly available by the SEBI, feedback obtained and subsequent changes have been made to the regulations.

### REGULATORY FRAMEWORK

RPTs involving listed companies are regulated by the Companies Act, 2013 (the “Companies Act”) and the Listing Regulations.

The Companies Act *inter-alia* defines the term “related party”, requires audit committee approval for RPTs and modifications thereof, and specifies categories of RPTs which require approval of the board of directors and shareholders of a company (subject to specified exemptions). There are differences in the RPT framework under the Companies Act and the Listing Regulations and a listed company needs to analyze both regulations in respect of any proposed RPT.

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This note focuses on specific aspects of the framework governing RPTs involving listed companies under the Listing Regulations which have been amended.

## AMENDMENTS

### 1. Definitions and scope

#### a. Related Party

The Listing Regulations defined “related party” to mean all persons and/or entities covered by the definition under the Companies Act or applicable accounting standards.

Additionally, any person or entity belonging to the promoter or promoter group of the listed entity and holding 20% or more shareholding in the listed entity is also deemed to be a “related party”. The SEBI has amended this prong of the definition to include the following:

- (i) all members of the promoter and promoter group irrespective of their shareholding with effect from April 1, 2022. Such change was also suggested in the Report on the basis that promoters may exercise control over a company irrespective of their shareholding in the company;
- (ii) persons or entities holding 20% or more of the equity shares, either directly or on a beneficial interest basis, at any time during the immediately preceding financial year. The 20% threshold will be reduced to 10% with effect from April 1, 2023. Accordingly, this would include transactions with persons and entities that hold at least 20% (reducing to 10%), whether or not they are categorized as promoters or promoter group.

Promoters and promoter group are persons and entities identified as such by the listed entity in its ongoing filings (and based on definitions under the SEBI regulations) and essentially comprise controlling shareholders.

#### b. Related Party Transaction

The Listing Regulations define an RPT as a *transfer of resources, services or obligations between a listed entity and a related party*, regardless of whether a price is charged, and a transaction with a related party is construed to include a single transaction or a group of transactions in a contract. This is wider than the definition under the Companies Act.

The Amendment Regulations have, on the one hand, widened the scope of this definition by including all transactions between:

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- (i) the listed entity or any of its subsidiaries on one hand and a related party of the listed entity or any of its subsidiaries on the other hand (with effect from April 1, 2022); and
  - (ii) the listed entity or any of its subsidiaries on one hand and any other person or entity on the other hand, where the purpose and effect of such transaction is to benefit a related party of the listed entity or any of its subsidiaries (with effect from April 1, 2023).

The Report had suggested such amendments on the basis that listed entities should be regulated as a whole on a consolidated basis. Under the current definition, there has been ambiguity on related party transactions involving only the subsidiary and the extent to which these are covered under the Listing Regulations.

Also, item (ii) above (effective April 1, 2023), includes a purpose and effect determination and will require the listed company, including its audit committee, to undertake a more detailed analysis of the purpose, justification and intended beneficiary of each RPT.

On the other hand, in line with suggestions in the Report, the SEBI has clarified that the following are not RPTs:

- (i) preferential issues carried out in compliance with the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018; and
- (ii) payment of dividend, subdivision or consolidation of securities, rights or bonus issue and buy-back of securities, which are uniformly applicable or offered to all shareholders in proportion to their shareholding in the listed entity. Acceptance of fixed deposits by banks/non-banking finance companies at terms uniformly applicable/offered to all shareholders/public have also been excluded from the definition of RPTs, subject to prescribed disclosure.

## **2. Approval requirements**

### ***a. Audit committee***

Under the current Listing Regulations, all RPTs require the prior approval of the audit committee. Also, pursuant to an amendment to the Listing Regulations, with effect from January 1, 2022, only independent directors who are members of the audit committee

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can approve RPTs. The current Listing Regulations also permit approval of certain RPTs through an omnibus approval process, subject to certain conditions.

Pursuant to the Amendment Regulations, with effect from April 1, 2022, the following will require prior audit committee approval:

- (i) all RPTs as well as their subsequent material modifications (the audit committee will be required to define the term “material modification” and disclose it as part of the materiality policy); and
- (ii) transactions to which a subsidiary of the listed entity is a party (but the listed entity is not) and whose value is 10% or more of the consolidated turnover of the listed entity, and with effect from April 1, 2023, whose value is 10% or more of the standalone turnover of the subsidiary. However, such prior approvals by a listed entity’s audit committee will not be required if the subsidiary of such listed entity is itself a listed company to which the RPT framework under the Listing Regulations applies.

Accordingly, the audit committee of a listed entity should review its materiality policy to include a definition on “material modification to an RPT” and disclose such changed policy prior to April 1, 2022.

#### ***b. Shareholders***

The Listing Regulations require all “material RPTs” to be approved by the shareholders through an ordinary resolution (a majority of those voting on the resolution). Related parties cannot vote to approve the RPT. Currently, a transaction is considered “material” under the Listing Regulations if, taken individually or together with previous transactions during a financial year, it exceeds 10% of the annual consolidated turnover (revenue) of the listed entity as per its last audited financial statements; in addition, the listed entity is required to formulate a policy on materiality of RPTs.

Pursuant to the Amendment Regulations, the “materiality” standard has been revised. Prior approval of the shareholders will be required for RPTs and their subsequent material modifications (as defined by the audit committee), having a value equivalent to the lower of: (i) Rs.1,000 crore (Rs.10.0 billion); and (ii) 10% of the consolidated annual turnover (revenue) of the listed entity, with effect from April 1, 2022. Further, such prior approval of the shareholders of a listed entity will not be required if the subsidiary of such listed entity is itself a listed company to which the RPT framework under the Listing Regulations applies.

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The Report had suggested the addition of an absolute numerical threshold to the existing turnover-linked threshold because for certain listed entities with a high turnover, several high valued RPTs did not require shareholder approval due to lack of such an absolute threshold.

### ***c. Additional exemption***

With effect from April 1, 2022, the Amendment Regulations have also provided for an exemption from audit committee and shareholder approval requirements for RPTs between two wholly-owned subsidiaries of the listed entity whose accounts are consolidated with such listed entity and placed before the shareholders at the general meeting for approval.

## **3. Disclosure requirements**

In addition to requirements under the Companies Act in relation to disclosure of RPTs, the Listing Regulations require a listed entity to disclose details of RPTs on a consolidated basis in a prescribed format, to the stock exchanges and on its website, within 30 days from the date of publication of the standalone and consolidated financial results for the half year.

Pursuant to the Amendment Regulations:

- (i) with effect from April 1, 2022, the above 30-day period has been reduced to 15 days; and
- (ii) with effect from April 1, 2023, disclosure of RPTs to the stock exchanges will be required to be made simultaneously with the release of financial results.

With effect from April 1, 2022, the Amendment Regulations require disclosures relating to “loans and advances in the nature of loans to firms/companies in which directors are interested by name and amounts” to be made by the listed entity and its subsidiaries in the corporate governance report.

Further, the Amendment Regulations have restricted the disclosures to be made in accordance with the accounting standards on RPTs to entities which only have listed non-convertible securities.

In the press release, the SEBI had also proposed an increase in amount of information to be provided to the audit committee and shareholders in respect of proposed RPTs, when such RPTs are placed before them for approval. This additional information requirement is consistent with the suggestions made in the Report. Clarity on the

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format and extent of disclosures is awaited, and expected to be included in subsequent amendments to the Listing Regulations.

Listed entities should prepare to provide more detailed and meaningful information to the audit committee and the shareholders prior to seeking their approval for an RPT.

## CONCLUSION

The above amendments will require increased monitoring and compliance by listed entities, their audit committees and management. There is also clarity to ease compliance – for example, the exclusion of preferential issues and specified corporate actions from the purview of RPTs. Overall, these changes are expected to strengthen oversight and scrutiny of RPTs involving listed entities in India.

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