News: The committee set up by the Securities and Exchange Board of India (SEBI) on related party transactions (RPTs) has proposed sweeping changes to strengthen the monitoring and enforcement of norms and bring in more transparency and improve governance.

Background

- The capital markets regulator (SEBI), in November 2019, constituted a Working Group to review the policy space pertaining to RPTs.

- Many firms which defaulted on bank loans were found to have indulged in related party deals to siphon off funds.

What is Related Party Transactions (RPT)?

- Generally, RPT means a transaction involving a transfer of resources, services between the listed entity or its subsidiaries on the one hand and a related party of the listed entity or its subsidiaries on the other hand.

- Transaction between listed entity or its subsidiaries and any other entity which is aimed to benefit a related party should be considered as a RPT.

Need for the reform

- The Working Group noted that the current RPT regulatory framework may be insufficient to cover transactions where the listed entity could transfer its assets/value to a subsidiary, whether in India or overseas, and such entity could then transact with the related parties of the listed entity to move the assets out of the consolidated entity.
• The need to regulate the consolidated entity as a whole was also recognised specifically in the report of the Kotak committee on corporate governance.

• Several listed entities in India operate through a network of entities – where some companies have over 200 subsidiaries, step-down subsidiaries, associates, and joint ventures.

• While investors hold direct equity only in the listed holding company, they have valued the entire business structure at the time of investment. Therefore, it is important for boards to ensure that good governance trickles down to the entire structure.

Recommendations of the committee

1. Who should be considered as a related party?
   • The panel has said that a related party should be any person or entity belonging to the promoter or promoter group of the listed entity.
   • Besides, any person or any entity, directly or indirectly (including with their relatives), holding 20 per cent or more of the holding in the listed entity should also be considered as related party.

2. The Sebi committee has also proposed changes to the process followed by a company’s audit committee for approval of RPTs that are material. Further, a format for reporting of RPTs to the stock exchanges has been mooted.

3. Prior approval of the audit committee of the listed entity should be mandatory for transactions carried out between the listed entity or any of its subsidiaries with a related party.

4. The materiality threshold should be amended to 5 per cent of the annual total revenues, total assets or net worth of the listed entity on a consolidated basis or Rs 1,000 crore, whichever is lower.
5. The net worth criterion should not apply to companies with negative net worth. Further, companies can specify a lower materiality threshold as per their RPT policies.