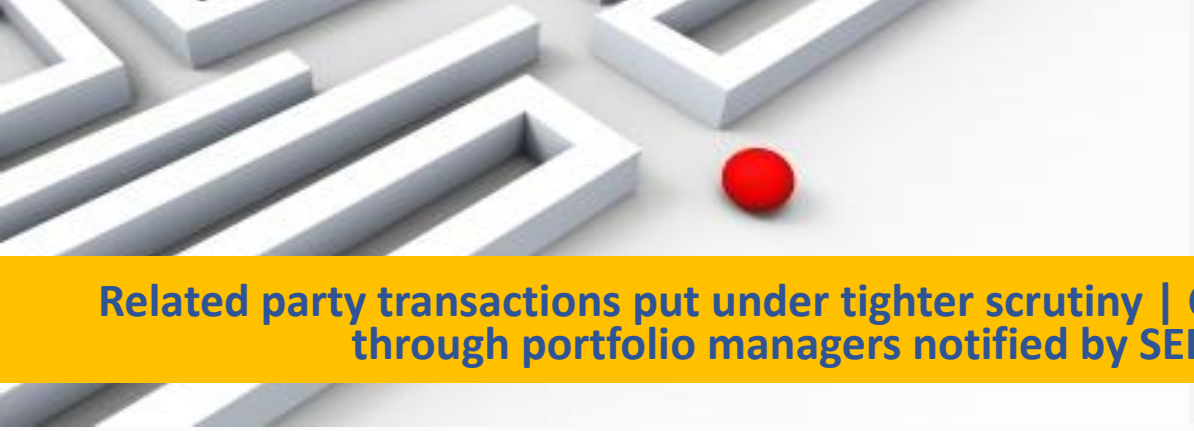

Related party transactions put under tighter scrutiny | Co-investment through portfolio managers notified by SEBI

Certain key decisions with respect to regulatory framework for related party transactions (**RPTs**) and co-investment by investor of Alternative Investment Fund (**AIF**) through portfolio management route have been implemented.

A. Amendment to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR Regulations)

Key changes include following:

- Change in definition of related party | Scope expanded;
- Amendment to the definition of 'related party transaction';
- Revised threshold for materiality of RPT;
- Prior approval of the audit committee for RPTs and subsequent material modifications | Expanded scope of role of the audit committee;
- Prior shareholders' approval for RPTs and subsequent material modifications;
- Exemption from the requirement of prior approval of the audit committee and shareholders for RPTs between two WOS;
- Disclosure of RPTs;
- Amended role of the audit committee.

B. Amendment to the SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations) and SEBI (Portfolio Managers) Regulations, 2020 (Portfolio Managers Regulations):

Key changes include following:

- Insertion of the definition of 'co-investment' and general investment conditions for co-investment;
- Investment conditions for Category III AIFs for investment in listed equities of companies;
- Restriction on advisory services by Manager; and
- Changes to the Portfolio Managers Regulations

The aforesaid amendments have been analyzed below:

A. Related party transactions put under tighter scrutiny | Amendment to the LODR Regulations

Changes	Explanation
Change in definition of related party | Scope expanded	The definition of related party to also include: ▪ All persons or entities forming part of promoter or promoter group irrespective of their shareholding; ▪ Any person/entity holding equity shares in the listed entity, as below, either directly or on a beneficial interest basis at any time during the immediately preceding financial year: – To the extent of 20% or more;

Changes	Explanation
	– To the extent of 10% or more w.e.f. April 1, 2023. With the aforementioned change, it will become critical to understand as to which entities/persons form part of the promoter and promoter group. Earlier, any person or entity belonging to the promoter or promoter group of the listed entity and holding 20% or more of shareholding in the listed entity were deemed to be a related party, however, such threshold has been omitted. Further, even persons holding 20% or more, and 10% or more w.e.f April 1, 2023, will become important in the event they have business relationship with the listed company/its subsidiaries.
Change in definition of related party transaction (RPT)	The definition of "related party transaction" has been revised to mean a transaction involving a transfer of resources, services or obligations between: ▪ A listed entity or any of its subsidiaries on one hand and a related party of the listed entity or any of its subsidiaries on the other hand; or ▪ A listed entity or any of its subsidiaries on one hand, and any other person or entity on the other hand, the purpose and effect of which is to benefit a related party of the listed entity or any of its subsidiaries, with effect from April 1, 2023; regardless of whether a price is charged and a "transaction" with a related party shall be construed to include a single transaction or a group of transactions in a contract. **Exclusions**: The following transactions shall **not** be treated as RPT: ▪ The issue of specified securities on a preferential basis, subject to compliance of the requirements under the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018; ▪ The following corporate actions by the listed entity which are uniformly applicable/offered to all shareholders in proportion to their shareholding: – Payment of dividend; – Subdivision or consolidation of securities; – Issuance of securities by way of a rights issue or a bonus issue; and – Buy-back of securities. ▪ Acceptance of fixed deposits by banks/Non-Banking Finance Companies at the terms uniformly applicable/offered to all shareholders/public, subject to disclosure of the same along with the disclosure of related party transactions every 6 months to the stock exchange(s), in the format as specified by SEBI.
Revised threshold of "materiality" for RPT	A transaction with a related party will be considered material, if the transaction(s) to be entered into individually or taken together with previous transactions during a financial year, exceeds INR 1,000 crore or 10% of the annual consolidated turnover of the listed entity as per the last audited financial statements of the listed entity, whichever is lower.
Prior approval of the audit committee for RPTs and subsequent material	Approval of the Audit committee will be required for:

Changes	Explanation
modifications | Expanded scope of role of the audit committee	▪ All RPTs and subsequent material modifications. The audit committee of a listed entity will need to define "material modifications" and disclose it as part of the policy on materiality of RPTs and on dealing with RPT; ▪ RPTs where subsidiary of the listed entity is a party, but listed entity is not a party, if the value of the transaction whether entered into individually or taken together with the previous transactions during the financial year, exceeds the following threshold: – 10% of the consolidated turnover of the listed entity as per its last audited financial statement; – 10% of the standalone annual turnover of the subsidiary w.e.f. April 1, 2023. **Exception**: Prior approval of the audit committee of the listed entity will not be required for RPTs to which the listed subsidiary is a party, but the listed entity is not a party if Regulation 23 (*Related party* transactions) and Regulation 15(2) (*Compliance with the corporate governance provisions*) of the LODR Regulations are applicable to such listed subsidiary. Further, in case of RPTs of unlisted subsidiaries of a listed subsidiary, prior approval of the audit committee of the listed subsidiary will suffice.
Prior shareholders' approval for RPTs and subsequent material modifications	All material RPT and subsequent material modifications as defined by the audit committee, will require prior approval of the shareholders through resolution and no related party can vote to approve such resolutions whether the entity is a related party to the particular transaction or not. **Exception**: Prior approval of the shareholders of a listed entity not required for a RPTs to which the listed subsidiary is a party but the listed entity is not a party if Regulation 23 (*Related party* transactions) and Regulation 15(2) (C*ompliance with the corporate governance provisions*) of the LODR Regulations are applicable to such listed subsidiary. Further, for RPTs of unlisted subsidiaries of a listed subsidiary as referred above, the prior approval of the shareholders of the listed subsidiary will suffice.
Exemption from the requirement of prior approval of the audit committee and shareholders for RPTs between two WOS	Another exemption has been added to this category and now prior approval of the audit committee and shareholders for RPTs will not be required for transactions entered into between two wholly-owned subsidiaries of the listed holding company, whose accounts are consolidated with such holding company and placed before the shareholders at the general meeting for approval.
Disclosure of related party transactions	The listed entity shall submit to the stock exchanges disclosures of related party transactions in the format as specified by SEBI from time to time, and publish the same on its website, subject to the following conditions: ▪ A 'high value debt listed entity' to submit such disclosures along with its standalone financial results for the half year; ▪ The listed entity to make such disclosures every 6 months within 15 days from the date of publication of its standalone and consolidated financial results; ▪ The listed entity to make such disclosures every 6 months on the date of publication of its standalone and consolidated financial results with effect from April 1, 2023.

Additionally, the following amendments have also been made to the LODR Regulations

Existing Part C of Schedule II of the LODR Regulations *(Role of the Audit Committee and Review of Information by Audit Committee)*	**Revised Part C of Schedule II of the LODR Regulations** *(Role of the Audit Committee and Review of Information by Audit Committee)*
B. The audit committee shall mandatorily review the following information: (1) Management discussion and analysis of financial condition and results of operations; (2) Statement of significant related party transactions (as defined by the audit committee), submitted by management; (3) Management letters / letters of internal control weaknesses issued by the statutory auditors;	B. The audit committee shall mandatorily review the following information: (1) Management discussion and analysis of financial condition and results of operations; (2) Statement of significant related party transactions (as defined by the audit committee), submitted by management; (3) Management letters / letters of internal control weaknesses issued by the statutory auditors; ....
Existing Schedule V of the LODR Regulations *(Annual Report)*	**Revised Part A of Schedule V of the LODR Regulations** *(Annual Report)*
Para A of Schedule V of the LODR Regulations (*Related Party Disclosures*)	
1. The listed entity shall make disclosures in compliance with the Accounting Standard on "Related Party Disclosures".	1. The listed entity which has listed its non-convertible securities shall make disclosures in compliance with the Accounting Standard on "Related Party Disclosures".
3. The above disclosures shall be applicable to all listed entities except for listed banks.	3. The above disclosures shall be applicable to all listed entities except for listed banks. 3. The above disclosures shall not be applicable to listed banks.
Para C of Schedule V of LODR Regulations (*Corporate Governance Report*)	
(10) Other Disclosures: ... (l) Disclosures in relation to the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013: a. Number of complaints filed during the financial year b. Number of complaints disposed of during the financial year c. Number of complaints pending as on end of the financial year.	(10) Other Disclosures: ... (l) Disclosures in relation to the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013: a. Number of complaints filed during the financial year b. Number of complaints disposed of during the financial year c.Number of complaints pending as on end of the financial year.

	(m) Disclosure by listed entity and its subsidiaries of 'Loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount': Provided that this requirement shall be applicable to all listed entities except for listed banks.

The aforementioned amendments have been made vide the SEBI (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2021 dated November 9, 2021 (available here) and shall come into force with effect from **April 1, 2022** unless otherwise specified in the respective regulations.

B. Co-investment through portfolio managers notified by SEBI | Amendment to the AIF Regulations and Portfolio Managers Regulations

In order to facilitate co-investment by investors of alternative investment funds (**AIFs**), SEBI has introduced the following amendments to the AIF Regulations in respect of co-investment by AIFs and investments by Category-III AIFs:

<table>
<tr><th>Changes</th><th>Explanation</th></tr>
<tr><td>Co-investment defined by SEBI</td><td>SEBI has defined the co-investment in the AIF Regulations to mean investment made by a Manager or Sponsor or investor of Category I and II AIFs in investee companies where such Category I or Category II AIFs make investment. However, co-investment by investors of AIF shall be through a Co-investment Portfolio Manager as specified under the SEBI (Portfolio Managers) Regulations, 2020 (Portfolio Managers Regulations). Detailed amendments have been made to the Portfolio Managers Regulations, which are also explained below.

With this amendment, SEBI has recognized that investors of AIFs can make co-investment, however, the same needs to be routed through the portfolio management mechanism of SEBI.</td></tr>
<tr><td>Investment Conditions regarding Co-investment</td><td>▪ The terms of Co-investment in an investee company by a Manager or Sponsor or co-investor, should not be more favorable than the terms of investment of the AIF.
▪ <u>Terms of exit from Co-Investment</u>: The terms of exit from the Co-investment in an investee company including the timing of exit to be identical to the terms applicable to that of exit of the AIF. This is applicable only for co-investment made post the enforcement of this amendment i.e. thirtieth day from November 9, 2021.</td></tr>
<tr><td>Investment Conditions of Category III AIFs for investment in listed equities of companies</td><td>
<table>
<tr><th>Limits</th><th>Investments
(directly or through investment in units of other AIFs)</th></tr>
<tr><td colspan="2">For any Category III AIF</td></tr>
<tr><td>Not more than 10% of the net asset value</td><td>Listed equity of an Investee Company</td></tr>
<tr><td>Not more than 10% of the investable funds</td><td>Securities other than listed equity of an Investee Company</td></tr>
</table>
</td></tr>
</table>

<table>
<tr><th>Changes</th><th>Explanation</th></tr>
<tr><td></td><td>
<table>
<tr><th colspan="2">For large value funds for accredited investors of Category III AIFs</th></tr>
<tr><td>Upto 20% of the net asset value</td><td>Listed equity of an Investee Company</td></tr>
<tr><td>Upto 20% of the investable funds</td><td>Securities other than listed equity of an Investee Company</td></tr>
</table>
</td></tr>
<tr><td>Restritions on advisory services by Manager</td><td>The manager shall not provide advisory services to any investor other than the clients of Co-investment Portfolio Manager as specified in the Portfolio Managers Regulations for investment in securities of investee companies where the AIF managed by it makes investment.</td></tr>
<tr><td>Changes to the Portfolio Managers Regulations</td><td>

Co-investment Portfolio Manager
A new category of portfolio manager has been introduced to allow co-investment under the AIF regime. Co-investment portfolio manager means a Portfolio Manager who is a Manager of a Category I or Category II AIF and

Provides services only to the investors of such Category I or Category II AIFs; and
Makes investment only in unlisted securities of investee companies where such Category I or Category II AIFs make investments,

Co-investment Portfolio Manager may provide services to investors from any other Category I or Category II AIF which are managed by them and are also sponsored by the same Sponsor(s).
Terms of co-investment
In the same way the AIF Regulations provide for terms of co-investment, Co-investment Portfolio Managers are required to ensure the following:

The terms of co-investment in an investee company by a co-investor, shall not be more favourable than the terms of investment of the AIF;
The terms of exit from the Co-investment in an investee company including the timing of exit shall be identical to the terms applicable to that of exit of the AIF;
Early withdrawal of funds by the co-investors with respect to Co-investment in investee companies shall be allowed to the extent that the AIF has also made an exit from respective investment in such investee companies;

Requirement of minimum investment amount per client shall not apply to the Co-investment Portfolio Manager;
The Co-investment Portfolio Manager shall invest hundred percent (100%) of the assets under management in unlisted securities of investee companies where Category I and Category II AIFs managed by it as Manager, make investment;

</td></tr>
</table>

Changes	Explanation
	▪ Every portfolio manager is required to appoint a custodian in respect of securities managed or administered by it, however, this has been exempted in case of Co-investment Portfolio Manager; ▪ **Certain other exemptions for Co-investment Portfolio Manager** There are certain exemptions which have been provided for Co-investment Portfolio Manager, such as, Co-investment Portfolio Manager may designate a member of the Key Investment Team of the AIF Manager as the principal officer, and compliances related to principal officer will not be applicable. Various others such exemptions are detailed in the amendment.

The aforementioned amendments have been made vide the SEBI (Alternative Investment Funds) (Fifth Amendment) Regulations, 2021 dated November 9, 2021 (available here), and SEBI (Portfolio Managers) (Fourth Amendment) Regulations, 2021 dated November 9, 2021 (available here), both effective from the thirtieth day from the date of its publication i.e. November 9, 2021, except for the Investment Conditions of Category III AIFs for investment in listed equities of companies, which are effective from November 9, 2021.

We hope you have found this information useful. For any queries/clarifications please write to us at insights@elp-in.com or write to our authors:

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