REGULATORY APPROACH TO RELATED PARTY TRANSACTIONS

Dr. Pradnya Saravade, Executive Director, SEBI.
RPT: ROLE OF THE MARKET REGULATOR

- IOSCO (International Organization for Securities Commissions) Principles for Issuers
  - (16) There should be full, accurate and timely disclosure of financial results, risk and other information which is material to investors’ decisions.
  - (17) Holders of securities in a company should be treated in a fair and equitable manner.

- Underlying theme: protection of minority / outside shareholders
Section 297 of the Companies Act, 1956: Board’s sanction is required for contracts in which particular directors are interested.

Also 299, 314(1A) of the Companies Act, Companies Audit Report Order, Section 44AB of the Income Tax Act.

IAS 18: Related party disclosures – defines RPT and applies to audited financial statements.

Clause 49 of listing agreement: Compulsory review of RPTs by Audit Committees (2/3\(^{rd}\) independent) and public disclosure on the basis of RPTs.
SATYAM RPT 2008 – THE REASON BEHIND

- Hole in the balance sheet as per subsequent confession – Rs. 7,136 crore
  - Fictitious cash – Rs. 5,040 crore
  - Non existent accrued interest – Rs. 376 crore
  - Overstated debtors - Rs. 490 crore
  - Understated liability to Raju – Rs. 1,230 crore

- Gap of around 1.6 billion USD
Satyam to acquire 100% of Maytas Properties for 6,240 crore 51% of Maytas Infra for 1,440 crore

Thus Rajus would receive around Rs. 7,107 crore directly. Another Rs. 50 crore could accrue by tendering their shares in the open offer which could even go up considering that there were many other shareholders who were connected to them but not identified as promoters.

The entire gap of 1.6 billion USD would be closed.
The stock fell from 225 (previous closing) to 151 in 2 minutes of trade on 17/12/2008, before the company announced its decision to cancel the deal.

Reputation of the company was damaged beyond repair.

Even though the decision was reversed, the prices did not recover and the scrip closed at Rs. 157.10.
 FLASHBACK : YEAR 2000

- Satyam Computers merged its subsidiary Satyam Enterprise Solutions (SESL) into it, at a swap ratio of 1:1.

- Before the merger, SESL had a rights issue of 12 lakh shares at par, out of which $\frac{1}{3}$rd was subscribed by Satyam Computers and the remaining 8 lakh shares were renounced in favour of Srinivasa Raju (the then ED of Satyam Computers and brother-in-law of Ramalinga Raju).
Effectively, the deal meant that Srinivasa Raju received 800,000 shares of Satyam Computers @ Rs. 10 each when the market value of the share was around Rs. 1,900, at the cost of Satyam Computer shareholders.

Shortly after, Srinivasu Raju resigned from Satyam Computers and went away to set up his own business.
COMPARISON OF RPT 2000 VS 2008

- In 2000, there was a furore in the AGM but Ramalinga Raju in a remarkable display of nonchalance, skipped the meeting.

- In 2008, the decision had to be reversed within 8 hours and ultimately led to Raju’s confession, 3 weeks later.

- The difference possibly lies in the collective awareness and voice of shareholders today.
INVESTOR AWARENESS : IS IT ENOUGH?

- Disclosure regime has promoted awareness.
- Promoters are aware of market perception around RPTs.
- RPTs are driven underground, through structured transactions: to escape disclosure.
- Diminishing effectiveness of additional disclosures.
DO WE NEED MORE OF?

- Ex-post controls
  - Class action suits
  - Derivative suits

- Appropriate incentive / compensation structure through legal redressal.

- Lowering of threshold for challenging management decisions
THANK YOU