news flash

November 2014

SEBI ISSUES NEW ESOP REGULATIONS 2014

Introduction

Securities and Exchange Board of India **("SEBI")** on 28 October 2014 notified the SEBI (Share Based Employee Benefits) Regulations, 2014 ("**ESOP Regulations**") repealing and replacing the earlier SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 ("**Old ESOP Guidelines**").

Conditions for applicability of the ESOP Regulations

The ESOP Regulations are applicable to a company which fulfills all of the following conditions:

1. The company must be listed on a recognized stock exchange in India.
2. The company has a scheme ("**Scheme**").
3. The Scheme must be for the direct or indirect benefit of employees.
4. The Scheme must involve dealing in or subscribing to or purchasing securities of the company, directly or indirectly;
5. The Scheme must satisfy, directly or indirectly, any one of the following conditions:
   a. Scheme is set up by the company or its group company;
   b. Scheme is funded or guaranteed by the company or its group company;
   c. Scheme is controlled or managed by the company or its group company.

Types of Stock Options

The Regulations apply to the following types of Schemes:

- *Employee Stock Option Schemes (**ESOS**)* – under which a company grants employee stock option directly or through a trust.

- *Employee Stock Purchase Scheme (**ESPS**)* – under which a company offers shares to employees, as part of public issue or otherwise, or through a trust where the trust may undertake secondary acquisition[1] for the purposes of the scheme.

[1] A "**secondary acquisition**" is defined to mean acquisition of existing shares of the company by the trust on the platform of a recognized stock exchange for cash consideration.

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- *<u>Stock Appreciation Rights Schemes (**SAR scheme**)</u>* – under which a company grants stock appreciation rights (**SAR**) to employees. SAR means a right given to an employee to whom SAR is granted (**SAR grantee**) entitling him to receive appreciation for a specified number of shares of the company where the settlement of such appreciation may be made by way of cash payment or shares of the company.

- *<u>General Employee Benefits Schemes (**GEBS**)</u>* - dealing in shares of the company or of its listed holding company, for the purpose of employee welfare including healthcare benefits, hospital care or benefits, or benefits in the event of sickness, accident, disability, death or scholarship funds, or such other benefit as specified by such company.

- *<u>Retirement Benefit Schemes (**RBS**)</u>* - dealing in shares of the company or of its listed holding company, for providing retirement benefits to the employees subject to compliance with existing rules and regulations applicable to retirement benefits in India.

Implementation of the Scheme

The company may implement the scheme either:

- *Directly; or*
- *By setting up an irrevocable trust:*

Formation of a Scheme through a trust

- It must be decided upfront at the time of taking approval of the shareholders for setting up the Scheme through a trust.

- The Scheme must be through a trust if it involves secondary acquisition or gift or both.

- SEBI may specify minimum provisions to be included in the trust deed.

Who can be appointed as a trustee?

- In case an individual or a one person company is appointed as trustees, there must be a minimum of 2 such trustees.

- Corporate entity can act as a sole trustee.

- The following persons cannot be appointed as trustees:

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i. a director, key managerial personnel or promoter of the company or its holding, subsidiary or associate company or any relative of such director, key managerial personnel or promoter; or

ii. a person beneficially holding 10% or more of the paid-up share capital of the company.

Important Do's and don'ts of the Trust / Trustees

Do's

(i) The trustee is to ensure that approval from shareholders has been obtained to implement the scheme and undertake secondary acquisition for the purpose of the Scheme.

(ii) The company may lend money to the trust (subject to compliance with the Companies Act 2013 and the rules) to acquire the shares either through new issue or secondary acquisition.

(iii) The shareholding of the trust shall be disclosed to the stock exchange as "non-promoter and non-public" shareholding.

(iv) A trust will have to mandatorily hold shares acquired through secondary market for a minimum period 6 months except as provided in para (v) (b) below.

(v) A trust can undertake an off-market transfer of shares only under the following circumstances:

(a) transfer to the employees pursuant to the Scheme;

(b) when participating in an open offer under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, or when participating in buy-back, delisting or any other exit offered by the company generally to its shareholders.

Don'ts

(i) The trustees cannot vote in respect of the shares held by the trust.

(ii) The trust shall not deal in derivatives and shall undertake only delivery based transactions for the purpose of secondary acquisitions.

(iii) Secondary acquisitions by the trust in a financial year shall not exceed 2% of the paid up equity capital of the company as at the end of the previous financial year.

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(iv) The total number of shares under secondary acquisition held by the trust should not exceed the below mentioned prescribed limits:

SR.NO.	PARTICULARS	LIMIT (% of the paid up equity capital at the end of the financial year immediately prior to the year in which shareholders approval is obtained)
1	ESOS, ESPS or SARS	5%
2	GEBS or RBS	2%
3	All the schemes in aggregate	5%

(v) The trust must not become a mechanism for trading in shares and hence cannot sell the shares in secondary market except under circumstances specified in the ESOP Regulations.

Disclosures & Procedures

- The trust deed and any modifications must be filed with the stock exchange in India where the shares of the company are listed.
- The trust is required to make disclosures and comply with other requirements applicable to insiders or promoters under the SEBI (Prohibition of Insider Trading) Regulations, 1992.
- The Company is required to constitute a compensation committee for administration and superintendence of the Scheme as per section 178 of the Companies Act 2013.
- Special resolution of shareholders is required prior to offering any Scheme to employees.
- The board of directors shall at each AGM place before the shareholders a certificate from the auditors of the company that the Scheme has been implemented in accordance with these regulations and in accordance with the resolution of the company in the general meeting.
- In addition to the disclosures required to be made under the Companies Act, 2013 in relation to employee benefits, the board must also disclose the details of the Scheme being implemented, as specified by SEBI in this regard.
- Manner of administration & implementation of each of the Schemes (referred to above) has been provided in separate chapters in the ESOP Regulations.

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Schemes implemented by unlisted companies

The shares arising after the IPO of an unlisted company, out of options or SAR granted under any scheme prior to its IPO to the employees are to be listed immediately upon exercise in all the recognised stock exchanges where the shares of the company are listed subject to compliance with the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and the conditions prescribed in the ESOP Regulations.

Transition Provisions

- Notwithstanding the repeal of the Old ESOP Guidelines, the prohibition on acquiring securities from the secondary market as provided in SEBI circular dated 27 June 2014 will continue till the existing schemes are aligned with the ESOP Regulations.

- A transition period of 1 year has been provided to all listed companies having existing schemes to which the ESOP Regulations apply to comply with them.

- A longer transition period has been provided in the following cases:

  (a) Trust holding shares beyond the permissible limits (as set out above) is allowed a period of 5 years to bring down its shareholding.

  (b) Trust holding shares, for implementing GEBS and RBS, which exceed 10% of the total value of the total assets of the trust is allowed to bring down its holding within 5 years.

  (c) Trusts which are shown as 'promoter' or 'public' shareholding are permitted to continue to be shown as such for a period of 5 years.

Conclusion

- SEBI has introduced new schemes such as SARS and GEBS under the ESOP Regulations.

- Companies are now permitted to purchase shares from the stock exchange through its trust for implementing the employee benefit schemes.

- Listed companies have been given a 1 year window within which it must ensure compliance of the ESOP Regulations. Companies would need to have a re-look at their existing trust deeds, schemes and policies and suitably modify them to bring them in line with the ESOP regulations.

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