



भारतीय प्रतिभूति और विनिमय बोर्ड Securities and Exchange Board of India

Discussion Paper on 'Review of guidelines governing stock related employee benefit schemes'

Background:

1. SEBI has (i) issued SEBI (ESOS & ESPS) Guidelines, 1999 ("ESOS Guidelines") to enable listed companies to reward their employees through stock option schemes and stock purchase schemes and (ii) notified SEBI (Issue of Sweat Equity) Regulations, 2002 ("Sweat Equity Regulations") to regulate issuance of sweat equity shares by listed companies in accordance with Section 79A of the Companies Act, 1956. The ESOS Guidelines provide the framework for two stock related employee benefit schemes, namely (i) "Employee Stock Option Schemes" – "Part A" and (ii) "Employee Stock Purchase Scheme" – "Part B". These Schemes can either be administered by the company itself or through a Trust.
2. Under the ESOS Guidelines, an ESOS/ESPS Trust can only distribute options/shares to its employees issued by the company. However, ESOS Guidelines, till recently, were silent regarding acquisition of shares from secondary market. It came to the notice of SEBI that some listed companies were framing their own employees benefit schemes wherein Trusts were set up to deal in their own securities in the secondary market, which was not envisaged within the purview of the ESOS Guidelines.
3. It was apprehended that some entities may frame such schemes with the purpose of dealing in their own securities with the object of inflating, depressing, maintaining or causing fluctuation in the price of the securities by engaging in fraudulent and unfair trade practices. Such dealing in the company's shares by the Trusts may also raise regulatory concerns regarding compliance with SEBI (Prohibition of Fraudulent and Unfair Trade Practices

relating to the Securities Market) Regulations, 2003 and SEBI (Prohibition of Insider Trading) Regulations, 1992.

4. In order to address the concerns over acquisition of shares by employee welfare trusts from the secondary market, it was decided to prohibit the listed companies from framing any employee benefit scheme involving acquisition of own securities from the secondary market.
5. Accordingly, pursuant to the approval of SEBI Board in its meeting held on August 16, 2012, SEBI issued a circular dated January 17, 2013, *inter-alia*, prohibiting secondary market acquisitions by employee welfare trusts and requiring existing employee welfare schemes to align themselves with the ESOS Guidelines by June 30, 2013. The companies having non-compliant schemes were directed to disclose the details of such schemes, their beneficiaries and the holdings to stock exchanges within 30 days from date of the circular.
6. Subsequently, representations were received by SEBI from various industry bodies and companies citing difficulties in ensuring compliance with the provisions of the aforesaid circular dated January 17, 2013. To address these concerns, SEBI vide circular dated May 13, 2013 clarified, *inter-alia*, as under:
 - a. The timeline for alignment was extended to December 31, 2013;
 - b. Trusts which have already acquired securities of the company from secondary market before the date of first circular i.e. January 17, 2013 may continue to hold such securities beyond December 31, 2013 provided such schemes have been aligned with the ESOS Guidelines;
 - c. Non-ESOP schemes involving securities of the company were permitted to hold the securities already acquired by them beyond December 31, 2013 provided the schemes have been aligned or else the schemes were required to dispose-off securities of the company by December 31, 2013;
 - d. Additional disclosures regarding details of schemes to the stock exchanges were prescribed in specified formats.

Need for review:

7. It was felt that secondary market acquisitions by Trusts being an internationally accepted practice should be considered subject to necessary safeguards to prevent misuse. It was also noted that secondary market acquisitions allow companies to grant options to employees without having to dilute their existing share capital. Further, it was also recognized that there are many kinds of employee benefit schemes involving own securities which being outside the purview of extant ESOS Guidelines are unregulated. There is also a need to provide for a suitable regulatory framework for such kind of schemes.
8. It was also felt that considering the provisions in Section 11A of the SEBI Act, 1992, it would be appropriate to convert the ESOS Guidelines into Regulations.

Review process:

9. Accordingly, a Group with representatives from corporates, industry body, and trustee firms was formed by SEBI to deliberate on a framework for framing a set of regulations with a view to ensure better enforceability, address the concerns raised with regard to composition of employee welfare trusts, disclosures, etc. and to enable secondary market transactions with adequate safeguards.
10. The report of the Group was placed before the Primary Market Advisory Committee (PMAC) of SEBI for deliberations. PMAC suggested some improvisations and recommended that public comments be sought on the recommendations of the report. Accordingly, various issues along with the recommendations thereon are listed in the **Annexure**.

Public comments:

11. Considering the importance of the stock related employee benefit schemes for listed companies, public comments on the said recommendations in the Annexure are solicited. Specific comments/suggestions as per the format given below would be highly appreciated.

Name of entity / person / intermediary:			
Name of organization (if applicable) / investor:			
Sr.No.	Pertains to serial number -- of recommendation in Annexure in the discussion paper	Proposed / suggested changes	Rationale

12. Such comments may please be e-mailed on or before December 05, 2013, to regsebs@sebi.gov.in or sent, by post, to:-

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Annexure

Sr. No.	Discussion Point	Existing Guidelines	Recommendations	Rationale
1	What types of ESOP Schemes should be covered under proposed new Regulations	Only ESOP & ESPS	<ul style="list-style-type: none">• The proposed regulations should cover all the schemes for the benefit of 'employees' which are set up, managed or financed by the company directly or indirectly through the mechanism of a Trust and which deal in actual securities of the company whether by way of purchase from/sale in the secondary market or grant of shares made by the company. • The proposed regulations shall not be made applicable to Trusts/schemes which are not funded by the company or not having any outstanding loan to the company and also not under the control/management of the company. • 'Employees' shall not include promoters/persons belonging to promoter group and directors holding, directly or indirectly, more than 10% of the outstanding equity shares of the company. • A separate section should be carved out under the proposed Regulations for Stock Appreciation Right	The trusts which are set up, managed or financed directly or indirectly by the company and which deal in actual securities of the company should be regulated.

			<p>(SAR) Scheme. Under such schemes, a Trust purchases shares upon grant of SARs to employees and sells upon vesting of SARs. Employees become entitled to receive the appreciation in value arising from sale of shares acquired under the Scheme subject to a grant and vesting date to such employees being identified in the Scheme and such employees being in employment on date of vesting. Promoters should not be beneficiaries to such SAR scheme.</p> <ul style="list-style-type: none"> • The Regulations should not cover the following Schemes involving: <ul style="list-style-type: none"> a. Phantom options which do not involve purchase or sale of Shares; and/or b. any other scheme where shares of the company are neither given to the employee nor acquired or sold by the Trust for the purposes of giving benefit to the employees by an employer company. 	
2	How would Welfare Scheme like the ones mentioned below be covered? Should there be a different sort of regulations for Trusts covering	No provisions	<ul style="list-style-type: none"> • A separate section should be carved out for General Employee Benefit Schemes in the proposed Regulations. • <i>Beneficiaries</i> of such schemes shall not include promoters/persons belonging to promoter 	<p>Incentive schemes connected with the shares of the company are used in other parts of the world as an effective tool to attract and retain talent.</p> <p>Retirement schemes, if dealing in securities of the company, to be covered as</p>

	<p>below</p> <p>a. General Employee Benefit Scheme: Where benefits like education, scholarship, medical, etc are provided to employees using appreciation from underlying shares or from other funds like corpus, investment in shares of other companies, mutual fund, FDs, donations, etc. OR</p> <p>b. Retirement Benefit Scheme: Superannuation, Provident Fund, Gratuity, etc. OR</p> <p>c. Any other such employee benefit scheme</p>		<p>group, directors holding directly or indirectly more than 10% of the outstanding equity shares of the company.</p> <ul style="list-style-type: none"> • Retirement Schemes involving securities of the company shall be covered under the proposed regulations to the extent the norms, prescribed therein, are not in contravention of the statute governing such schemes. 	<p>far as the regulations do not contravene any existing statute.</p>
3	<p>Mode of setting up of schemes viz.</p> <p>Should they be directly granted and administered by the company or should there be a flexibility in the Regulations to</p>	<p>ESOPs can be administered both by the Company and through the Trust</p>	<ul style="list-style-type: none"> • If fresh shares are issued: Flexibility should be available for grant of options directly to the employees or through Trust. • If shares are issued through secondary market purchase: Only option should be through Trust mechanism. 	<p>Trust mechanism provides better corporate governance since the shares of the company would not belong to the company, nor would they be under the control of the promoters. Appropriate disclosures to the stock exchanges and investors should be prescribed</p>

	grant, manage and administer through a Trust			
4	What are the key provisions, power, duties which need to be captured in the relevant agreement including trust deed meant for administering the scheme through agencies/Trust etc. Supporting explanation, if any	The ESOP Guidelines provide broad guidelines for the same	<ul style="list-style-type: none"> • The agreement/Trust deed should provide for all types of schemes. There could be additional requirements for schemes like SAR & General Benefit Scheme. • The minimum provisions should include the following: <ul style="list-style-type: none"> a)Details of the scheme/s proposed to be administered, b)Constitution of the trust, c)Object and tenor, d)Beneficiaries (exclusion of promoters/persons belonging to promoter group, directors holding directly or indirectly more than 10% of the outstanding equity shares of the company from definition of Beneficiaries), e)Trustee details (appointment, retirement), f)Corpus/trust fund, g)Manner of administering the scheme, h)Powers of trustees (Power to invest, borrow, purchase & sell shares in open market), i) Rights of Trustee, 	The Regulations should provide for the minimum requirements to ensure effective governance.

			<p>j) Liabilities of trustee,</p> <p>k) Procedure and manner in which the trust property(ies) would be dealt with on its dissolution.</p> <ul style="list-style-type: none"> • Companies shall have the flexibility of adding any other requirements; <i>Provided</i> that no clause in the deed would be detriment to the interest of beneficiaries and the deed should be self-contained with respect to protection of beneficiaries' interest. 	
5	<p>Whether Secondary Market acquisitions should be permitted in Company's own or related entity's shares for:</p> <p>a. Employee Share Benefit Scheme (ESOP / ESPS / SAR)</p> <p>b. General Employee Benefit Scheme</p> <p>c. Retirement Benefit Scheme</p>	<p>Only provides for primary allotment. Secondary market purchases prohibited under new clause 22B of ESOS Guidelines.</p>	<ul style="list-style-type: none"> • Yes, the Trust should be permitted to acquire the shares of the company provided that the Trust is administering any of the schemes like ESOP, ESPS, SAR and General Benefit Schemes for the employees of the company. • Shareholders' approval to be obtained in cases where acquisition of shares is from the secondary market. The shareholders should clearly approve maximum % of secondary market purchases that could be allowed subject to maximum ceiling proposed herein below. <i>Provided</i> that no approval of shareholders would be required if the purchases are made by the Trust out of its own funds / income and no loans are outstanding 	<p>Secondary market purchases avoid dilution of capital and do not impact the value of existing shares in the hands of shareholders like EPS, etc. This is very crucial and important in cases where option of expansion of capital base is not available to corporate or is not desirable from their perspective may be on account of undesirable increase in capital base by issue of fresh shares, servicing a bloated equity, etc.</p>

			<p>at the time of making the purchase of shares.</p> <ul style="list-style-type: none"> • Proviso to Section 77 of the Companies Act, 1956 also permits funding by company for purchase of its own shares or its holding company. • Section 67 of the Companies Act, 2013 also provides for funding by company in accordance with any scheme approved by company through special resolution and in accordance with such requirements as may be prescribed, for the purchase of, or subscription for, fully paid up shares in the company or its holding company, if the purchase of, or the subscription for, the shares held by trustees for the benefit of the employees or such shares held by the employee of the company. 	
6	<p>Whether there should be any limit on the quantity of shares acquired through Secondary Market for both ESOP and Non-ESOP i.e. other welfare Schemes? If yes please provide a limit</p>	<p>Secondary market purchases prohibited under new clause 22B of ESOS Guidelines.</p>	<ul style="list-style-type: none"> • There should be limits on secondary market purchases for both ESOP and Non ESOP schemes. • There shall be a ceiling on the number of shares that can be acquired from the secondary market, to be expressed by way of % of the paid up capital of the company as detailed below. If the grant under the various Schemes in that year 	<p>There has to be a limit based upon the end utilization and intent especially since acquisition is from secondary market</p>

			<p>exceeds such limit, then shares should be acquired by way of fresh issuance of shares by the company.</p> <p>For ESOP kinds of Schemes, the ceiling on secondary market acquisition should be:</p> <ul style="list-style-type: none"> • 2% per annum of the paid up equity capital as at the end of the financial year and subject to an overall cap of 5% of the paid up equity capital. <p>In case of General Employees Benefit Trust,</p> <ul style="list-style-type: none"> • There should be an overall limit of 2% of the paid up share capital on secondary market purchases. • The un-appropriated inventory of the ESOP Trust to be capped at 5% of paid up capital at the end of any financial year. • Further, the aforesaid ceilings shall be applicable for all the employee benefit trusts taken together at the company level and not at the level of individual trust, if a company has multiple trust and schemes. • Gifting of shares by Promoters or any other person to Trusts should also be permitted. 	
7	Whether there should be a limit	Proviso to Section 77	<ul style="list-style-type: none"> • The limit on acquisition through secondary 	There should not be any specific limits mentioned for

	<p>on funding provided by the Company for such proposed secondary market acquisition.</p> <p>If yes, please provide proposed limit</p>	<p>of Companies Act, 1956 also permits funding by company only for acquiring own shares or of its holding company.</p>	<p>market automatically provides a check on the level of funding.</p>	<p>funding as this should be self regulated by the company in case it provides funds. Irrespective of source of funding to the trust, funding limit has to be linked to the limit on acquisition.</p>
8	<p>What should be norms or limits (checks & balances) for the Schemes Specifically with respect to the following?</p> <p>a. What should be the minimum holding period for purchase of shares acquired through Secondary Market to ensure that it is for long term and for benefit of employees?</p> <ul style="list-style-type: none"> •For ESOP •For Non-ESOP 	<p>Provides for a minimum vesting period of 1 year</p>	<ul style="list-style-type: none"> • Minimum holding period of 6 months for shares acquired through secondary market. • However, this 6 months period shall not apply where shares are transferred to employees pursuant to exercise of Stock options / SARs. • No off-market transfer should be permitted except to employees pursuant to the Scheme. 	<p>This will ensure that there is no speculation.</p>
9	<p>Should there be a complete ban on sale of shares by the Trust specifically if the intent of the Trust is to use the Secondary Market for the purpose of</p>	<p>No provision</p>	<ul style="list-style-type: none"> • No, there should not be a complete ban on sale of shares in secondary market by Trust. • Sale of shares should be allowed for the purpose of achieving the object of the Trust. • For SARs, sale of shares should be 	<p>There should be flexibility available, this is in line with practices followed internationally where there is no restriction on sale in secondary market</p>

	<p>objective of scheme</p> <ul style="list-style-type: none"> • For ESOP • For Non - ESOP <p>If answer to above is no then in what circumstances should the Trust be allowed to sell shares acquired through Secondary Market?</p>		<p>allowed on vesting of SARs.</p> <ul style="list-style-type: none"> • For General Employee Benefits/Welfare Trusts, the Trust should utilise its internal accruals / income arising out of dividend on underlying shares, interest on deposits etc. for undertaking welfare initiatives. The Trust should be allowed to sell shares in case of emergency for meeting the objectives of the Trust. Money so raised shall be utilized within a definite time period as stipulated under the trust deed. The same should be approved by the Trustees, recording their reasoned decision with respect to the need for the funds to meet their object under the welfare schemes and filing the same with Stock exchanges. • The Trust should be allowed to also participate in other exits available to shareholders like buy back and open offer. • Necessary disclosures should be made under the Insider Trading Regulations. • Exemptions to be provided for cashless exercise of options by employees and winding up the scheme. 	
10	If the Scheme is set up under a Trust whether an	No specific provision	<ul style="list-style-type: none"> • Independent trustees should be appointed. Any of the following 	It is important ensure and demonstrate independency in the administration and governance of the Trust.

	<p>Independent Trustee (s) should be appointed to administer it? What should be the parameters for appointment of such Independent Trustee</p>		<p>persons or entity can be appointed at the discretion of the Remuneration Committee of the Company as Independent trustees:</p> <ol style="list-style-type: none"> a. An Independent Non-Executive Director of the company; b. A Professional familiar with Employee welfare ; c. A Professional familiar with operation of the Stock Markets; d. Professional Trustee Company. 	<p>Independent Trustee is one mechanism of ensuring the same.</p>
11	<p>How should the shares held under the Schemes be classified (Promoter / Public)? Should it be dependent on the mode of setting up of the Schemes?</p>	<p>No provision</p>	<ul style="list-style-type: none"> • Shares held by the Trust should not be part of the public float which needs to be maintained at minimum 25%, as these shares are not available to the public freely. • Even though trustees are independent, the shares held by Trust should be disclosed along with promoter holding. Hence, in the shareholding pattern filed under clause 35 of the Listing Agreement, it should be shown separately under Promoter and Promoter Group. The intention is that the Trust holding is not considered as non-promoter holding (i.e. public float) so long as the shares are held by Trust. 	<p>To prevent misuse of Employee Trusts as alternate modes for promoter holding</p>

			<ul style="list-style-type: none"> • Any Trust/scheme which is funded/managed/controlled by the company shall not be eligible to exercise voting rights on the shares of the company held by them. • Despite such characterisation, the trustees should neither be subjected to any liability of a Promoter nor be required to comply with obligations as promoters with regard to triggering of 'Open Offer', breach of creeping acquisition limit and other liabilities under the Takeover Regulations which are typically applicable to promoters and PACs. Further, no enforcement proceedings shall be initiated against the Trust merely because it is categorised as a part of the promoters/promoter group. Necessary carve outs should be provided in the respective applicable regulations to amply clarify this. • Also, in the event promoter holding in the company is already 75%, then the Trust cannot acquire any shares from the secondary market. • When the Trust transfers the shares to the employees upon exercise of option, then, such shares would automatically become part of public 	
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			shareholding.	
12	<p>What kinds of details on the scheme should be disclosed publicly (e.g. to stock exchange)?</p> <p>What ought to be the continuous disclosure requirements and the periodicity for such disclosures</p>	No provision	<ul style="list-style-type: none"> • Even where the Trust is not a Person Acting in Concert (PAC) – The Trust would be subjected to all disclosures of Insider Trading as it applies to Insiders / Promoters. • The Trust would have to abide by the Insider Trading Regulations such as no purchase / sale during Trading Window Closure period. • However, other obligations and responsibilities of the promoters/ PACs in terms of open offer, disclosures under takeover code etc. should not apply to the Trust or the Trustee. 	It is critical to distinguish between disclosures and promoter obligations. Hence the proposed carve out.
13	<p>Any clause(s) of existing SEBI ESOP Guidelines that may need amendment in the light of the recent developments and the suggested revised clause</p>	Not applicable	<p>Amendment to the following clauses:</p> <ul style="list-style-type: none"> • The Regulations should also allow that when an employee who has been granted options is transferred or deputed to a fellow subsidiary / an Associate of the Company prior to vesting / exercise, the vesting / exercise shall continue as per the terms of the Grant. • The term ‘Stock Appreciation Rights’ and ‘General Employee Benefit’ should be separately defined and necessary regulations governing them should be incorporated. 	To provide flexibility to companies to transfer employees to associates as the companies may like to make strategic investments in Associates and may not want to deprive such employees of the benefits of the company’s employee benefits schemes as the employee benefits of this nature would in turn make positive impact on the growth of the company.

			<ul style="list-style-type: none"> • For accounting treatment, a cross reference shall be given to the Guidance Notes on Accounting Treatment of share based compensation to employees, issued by the Institute of Chartered Accountants instead of defining them in the proposed Regulations. • Retirement Schemes involving securities of the company shall be covered under the proposed regulations to the extent the norms, prescribed therein, are not in contravention of the statute governing such schemes. 	
14	Any other aspects or matter which should be considered while drafting the new omnibus Regulations	Not Applicable	<ul style="list-style-type: none"> • There should be one umbrella Regulation encompassing all the employee benefit schemes like i) ESOP ii) ESPS iii) SARs and iv) Employee Welfare Schemes. • In order to obviate the hardship that may be caused to the corporate to migrate to the new Regulations, Corporates should be given a 2 years transition period. 	To provide smoother transition and yet enable regulation as envisaged.
