ESOP VISTAS

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The New 'SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021' : Key Changes by SEBI

As we are aware, pursuant to the requests of various stakeholders, the Securities and Exchange Board of India ("SEBI") had constituted an Expert Group with a mandate to provide recommendation on further streamlining and rationalization of the provisions of the SEBI (Issue of Sweat Equity) Regulations, 2002 ("SE Regulations") and the SEBI (Share Based Employee Benefits) Regulations, 2014 ("SBEB Regulations") with a view to make these more robust in line with best global practices. The Expert Group after deliberations had submitted its report to SEBI on which SEBI had sought public comments. In this regard, ESOP Direct had submitted detailed comments in respect of SBEB Regulations.

After consideration of the public comments, SEBI in its Board meeting on August 06, 2021 has approved the merger of the SE Regulations and the SBEB Regulations into a single regulation called the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 ("New Regulations") with following key amendments to the existing provisions of the merged regulations:

1. *"The companies will be allowed to provide share-based employee benefits to the employees, who are exclusively working for such company or any of its group companies including its subsidiary or its associate".*

Definition of 'Employee widened

SEBI has given the flexibility to the companies to decide the eligibility of the employees by removal of the word "permanent", at the same time the mandate for "exclusivity" of employee engagement seeks to maintain a counter balance against any potential misuse of such flexibility. This would also result in achievement of uniformity in employee selection process across the sectors.

Further, as the new definition of "employee" includes grant to eligible employees of group companies including that of the associate companies. This would certainly widen the employee coverage and would promote co-ownership across the group.

2. *"The companies will have flexibility in switching the administration of their schemes from the trust route to the direct route and vice versa with the approval of the shareholders, subject to the condition that the switch is not prejudicial to the interest of the employees."*

Flexibility to use Trust Route

Hitherto, the SBEB Regulations required upfront decision making as to implementation of a scheme through direct or trust route. Owing to dynamics of business and for better utilization of resources, it was seen that companies use to perceive the need for change of route decided earlier but could not do. This provision in the New Regulations seeks to facilitate change of route during course of implementation of a share-based benefits scheme.

3. *"The time period for appropriating the unappropriated inventory of the trust has been extended from existing 1 year to 2 years subject to the approval of the Compensation/Nomination and Remuneration Committee for such extension."*

Extension to dispose unappropriated shares

There was a requirement in the SBEB Regulations that in case shares are sourced from secondary acquisition and the number of shares acquired exceeds that of the options outstanding, then excess shares not backed by grants (referred to as "unappropriated inventory") should be appropriated by end of the subsequent financial year. Now, the corresponding provision in the New Regulations seeks to provide an extended time period to appropriate such excess shares by the end of second subsequent financial year giving further leeway for planning an efficient way of appropriation.

4. *"It has been decided to dispense with the minimum vesting period and lock-in period for all share benefit schemes in the event of death or permanent incapacity (as defined by the company) of an employee."*

Minimum vesting period relaxed

It may be noted that SEBI vide its Circular dated June 15, 2021 sought to provide relaxation from the requirement of minimum vesting period in case of death of employee(s) under the SBEB Regulations. Whereas, the New Regulations seek to extend this benefit to an employee suffering from permanent incapacity too. Moreover, the new provision also seeks to provide the same relaxation from the minimum lock-in requirement in cases of death and permanent incapacity.

5. *"Maximum yearly limit of sweat equity shares that can be issued by a company listed on the main board has been prescribed at 15% of the existing paid up equity share capital within the overall limit not exceeding 25% of the paid-up capital at any time. Further, in case of companies listed on the Innovators Growth Platform ("IGP"), the yearly limit will be 15% and overall limit shall be 50% of the paid-up capital at any time. This enhanced overall limit for IGP shall be applicable for 10 years from the date of company's incorporation."*

Larger pool for Sweat Equity Allotment

With a view to encourage and reward innovation in the companies listed on the Innovators Growth Platform being engaged in intensive use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology, the New Regulations seek to provide issue of sweat equity up to overall limit of 50% of the paid-up capital till 10 years of incorporation of such company.

The merger of SBEB Regulations and SE Regulations indicates that all the equity-based benefits for employees shall be regulated under one regulation i.e. the New Regulations which would ensure not only single point reference and but also convenient compliance.

Widening of the employee definition would enable the companies to select from a broad array of employees across the group which would help achievement of the underlying objectives including corporate growth by larger participation.

It is a welcome reform by SEBI which would hopefully enable the industry to sync with best global practices and ease of doing business.

This is based on SEBI's Board minutes. There shall be complete clarity in respect of the provisions as and when the New Regulations are notified. We shall come out with a Newsletter giving insight on the detailed provisions.