SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021

1 Background

1.1 The Securities and Exchange Board of India ("SEBI") has notified the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 ("New Regulations") by repealing and merging the SEBI (Share Based Employee Benefits) Regulations, 2014 ("SBEB Regulations") and the SEBI (Issue of Sweat Equity) Regulations, 2002 ("SE Regulations") (collectively referred to as "Erstwhile Regulations") with appropriate modifications. The New Regulations have come into force from 13th August 2021 ("Effective Date") i.e. the day of its publication in the official gazette.

1.2 As a background of the New Regulations, SEBI pursuant to the requests of various stakeholders, had constituted an Expert Group with a mandate to provide recommendations on further streamlining and rationalization of the provisions of the Erstwhile Regulations. After consideration of the recommendations of the Expert Group and public comments thereon, SEBI has notified these New Regulations.

1.3 Earlier, the share-based employee benefits and sweat equities used to be regulated separately read with Circulars issued thereunder from time to time. Now, with the consolidation of the Erstwhile Regulations along with all Circulars issued thereunder, all share based employee benefits shall be regulated under a single regulation for ease of reference and compliance.

1.4 The New Regulations have kept most of the provisions of the Erstwhile Regulations intact. Whereas, some provisions underwent modification and some new provisions have been inserted in the New Regulations. As far as modifications or new provisions are concerned, those aim to provide either flexibility/ clarity in some cases, or seek mandatory compliance.

1.5 This Newsletter seeks to highlight and analyse these key modifications and new provisions.

2 Comparative Analysis

A comparative study of key modifications and new provisions in the New Regulations vis-à-vis the Erstwhile Regulations is given as under:

Sl. No.	Parameters	Erstwhile Regulations	New Regulations	Our Brief Comments
1	Definition of Employee	• "Permanent employee" of the company • Director whether whole-time or not, of the company • Employees as defined above of subsidiary and holding company	• "Employee as designated by the company" working on exclusive basis • Director whether whole-time or not, of the company including Non-Executive Director • Employees as defined above of group companies including subsidiary, associate and holding company	• Companies have the freedom to designate a personnel working on exclusive basis as an eligible "employee" • Permanent employment is no more a pre-requisite • Employees of group companies (including associate companies) are eligible
2	Grant Date for the purpose of accounting	Not provided	For the purpose of accounting, the "Grant Date" shall be as per relevant accounting standard	This provides clarification on option valuation and cost amortization
3	Decision on route of implementation	• Upfront decision making as to route of implementation whether directly or through trust route • Decided prior to shareholders' resolution	• Route of implementation can be switched in case situation so warrants • Shareholders' prior approval would be required • Switching must not be prejudicial to the interests of the employees	• Often deciding of a route at inception is difficult for some companies • In case, the situation so warrants, this provides the flexibility of switching over at any stage of implementation of the scheme
4	Eligibility of a trustee	No specific exclusion of Director, KMP, promoter of group company/ associate company or their relatives	This specific exclusion is now prescribed	• The list of exclusion as to who cannot be a trustee is extended • This will avoid cross appointment of specified personnel of group/ associate companies as a trustee

5	Overall ceiling for secondary acquisition	Overall ceiling for secondary acquisition was required to be adjusted in line with expanded capital	Overall ceiling for secondary acquisition shall also be adjusted in line with capital reduction	Now, the overall ceiling shall automatically reduce in case of events of capital reduction like buy-back or scheme of arrangement
6	Unappropriated inventory	Shares acquired through secondary acquisition and not backed by grants were required to be appropriated by the end of subsequent financial year	• Besides the existing provision, such excess shares can be appropriated by the end of 2nd subsequent financial year • This would need prior approval of the committee	Now, companies would get more time to plan for effective appropriation of unappropriated inventory of shares
7	Sell of shares by the trust for facilitating cashless exercise	• Trust can sell [some or all] shares with a view to facilitate cashless exercise	• Removed the term 'cashless exercise' • Trust can sell such number of shares to fund the employee for payment of exercise price, taxes, and other charges	• It appears that as if the trust can sell only a calculated part of shares but not all sharesbut not all shares • The decade old facility of "sell all" shares upon employees' requisition seems not coming clearly or rather confusing • Assuming removal of facility to "sell all" shares is not the intention, this needs further clarification by SEBI
8	Procedure to effect variation in the terms of scheme	There was no clarity whether shareholders' approval would be required for variation in the terms of a scheme to factor-in regulatory changes	Terms of a scheme can be varied to meet regulatory requirements without approval of the shareholders	This provides clarity and relaxation to companies

9	Winding up of scheme	In winding up of a scheme, the trust was required to use excess money/shares: • To meet any liability • To repay loan • To distribute to employees	• In addition to erstwhile provisions, any such excess money/shares can be transferred to another scheme framed under the New Regulations • This needs prior approval of the shareholders	• This is beneficial for the companies who have multiple schemes • This ensures resources of a liquidated scheme being effectively used under another scheme
10	Vesting of options/ SARs in case of Retirement/ Superannuation	There was no specific provision on this aspect	• Unvested options/ SARs granted shall vest in accordance with originally prescribed vesting schedule • The vesting is permitted even after date of Retirement/ Superannuation	• As this provides clarity, and thus, there is no requirement of accelerated vesting nor forfeiture of unvested options/ SARs as per practice of some companies • Retirees shall be the beneficiary of this provision
11	Certificate from auditor	Obtain auditor's certificate for placing at each AGM	Obtain Secretarial Auditor's certificate for placing at each AGM	This provides the clarity that Auditor for this purpose means a Secretarial Auditor
12	Applicability of min. vesting period/ lock-in period in case of death or permanent incapacity	Not specified	Min. vesting period in case of options/ SAR and lock-in period in case of ESPS shall not be applicable in case of death or permanent incapacity	This provides the clarity that there is no forfeiture/ lock-in in case of death or permanent incapacity
13	Timing of obtaining of in-principle approval from stock exchange(s)	Any time prior to exercise of options/ SARs	Prior to grant of options/ SARs	With a view to ensure that there is no delay in allowing exercise, this requires companies to obtain the approval before hand i.e. before the grant

14	Buy-back of options/ SARs	There was no such provision	• Buy-back of options/ SARs is permitted • This requires specific terms and conditions (triggering such buy-back) to be predefined in the scheme with approval of the shareholders	Under specific conditions as predefined in the scheme (say, as a result of a regulatory requirement, shares cannot be issued upon exercise), a company shall have a choice to settle options/ SARs in cash upon exercise
15	Extension of overall ceiling for issue of sweat equity	Overall ceiling was governed under the Companies Act	Apart for usual overall ceiling of 25%, up to 50% of ceiling shall be applicable for companies listed on the Innovators Growth Platform (IGP)	This extended ceiling is provided with a view to encourage and reward innovation in the companies listed on the IGP
16	Lock-in period for sweat equity	Three years from the date of allotment	Lock-in as applies in case of preferential issue under SEBI (ICDR) Regulations shall apply	The revised lock-in period is synchronized with that of preferential issue with a view to make it not excessive

3 Our Broad Observations

3.1 Wider coverage:
Under the new definition of employee, a personnel working on exclusive basis needs to be designated as an employee by the company for being eligible under a scheme. This infers that personnel working on a contractual engagement, may also qualify. This new provision has not only expanded the employee base within the implementing company, but also embraces the eligible personnel of its group companies including the associate companies.

This would enable a wider participation helping in attainment of common corporate objective(s), rationalization of cash compensation for a wider cross section of employees at the group level.

3.2 Freedom in switching the route of implementation:
The flexibility of switching over from trust route to direct route and vice versa at any stage of implementation of the scheme definitely appears to be soothing. However, practically seen, in case of switching from trust to direct route may bring-in other issues as to disposability of shares or money if held by such trust. Because, there is a solution for liquidation of scheme but there is nothing similar for liquidation of the trust while the scheme still survives. Thus, in our view, switching vice versa is not always hassle free.

3.3 Widening of the exclusion list for trusteeship:
In addition to the existing exclusions, a Director, KMP, promoter of group company/ associate company or their relatives shall not be eligible for trusteeship. This indicates that the intention of the regulator is to delink the specified top management personnel of the group from having a direct control over the administration of the trust.

3.4 Extended timelines for appropriation of excess shares with trust:
In response to the genuine difficulties of the companies in appropriating the excess shares not backed by grants (referred to as "unappropriated inventory") by end of the subsequent financial year, limitation has been extended by one more additional year. This provides further leeway to plan for a more efficient way of appropriation.

3.5 Adjustment of overall ceiling in case of capital reduction:
The new provision envisages automatic downward adjustment in the overall holding limit of shares acquired through the secondary acquisition in case of a capital reduction including buy-back of shares. This may lead to a situation of shortfall of shares where company might have granted say maximum of 5% capital equivalent of options due to capital reduction. However, this situation can be overcome by issue of new shares even though the scheme contemplates use of shares only from secondary acquisition.

3.6 Significant changes in cashless exercise mechanism:
Cashless exercise contemplates either (i) "Sell All" meaning sale of all shares and remitting of proceeds net of exercise price, applicable taxes and other expenses, or (ii) "Sell to Cover" meaning sale of a calculated part of shares so as to recover the exercise price, applicable taxes and other expenses and transfer of balance shares to the demat of the employee. These had been maintained from the SEBI Guidelines era since year 1999.

However, the New Regulations allow sale of such number of shares so as to fund the payment of exercise price, applicable taxes and other expenses. It appears that the decades old cashless on "Sell All" basis is not contemplated.

Assuming that the removal of "Sell All" is not the intention, this issue should be taken up with SEBI for appropriate clarification.

3.7 Vesting in case of retirement/ superannuation:
The new provision clarifies in case of retirement/ superannuation that the retiree shall not be deprived of the unvested options what normally happens in case of resignation/ termination and that the unvested options/ SARs shall continue to vest as per original vesting schedule even after date of retirement subject to company's policies.

3.8 Minimum vesting/ lock-in period in case of death/ permanent incapacity:
The new provisions on this aspect have given much awaited clarity that in case of death or permanent incapacity the minimum vesting period in case of options /SARs and the lock-in period in case of ESPS shall not be applicable.

4 Way Forward

4.1 Way forward for outstanding options/ SARs granted before the Effective Date:
The New Regulations provide that any rights or privileges accrued under the Erstwhile Regulations provide that any rights or privileges accrued under the Erstwhile Regulations shall remain intact as if the later regulations are in force. This infers that any rights granted to the employees prior to the Effective Date will continue. However, the procedural aspects of the New Regulations must be incorporated in the existing scheme(s) for effective compliance.

4.2 Way forward for new grants made on/ after the Effective Date:
The New Regulations must be incorporated in the existing scheme(s) before any fresh grant of options/SARs or issue of shares thereunder.

4.3 No shareholders' approval would be required for alignment of the existing scheme(s) with the mandatory provisions of the New Regulations. However, in respect of alignment with the provisions of the New Regulations that seek to provide flexibility (i.e. not mandatory), in our view, should be done with prior approval of the shareholders of the company.