

Frequently Asked Questions On SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021

1 Background

- 1.1 The Securities and Exchange Board of India (“SEBI”) had notified the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 (“New Regulations” with effect from 13th August 2021 (“Effective Date”).
- 1.2 Most of the provisions of the New Regulations contemplate the same provisions as contained in the relevant repealed regulations and rest of the provisions are either modified versions of corresponding erstwhile provisions or altogether new insertions. The objective seemed to bring-in necessary reforms with minimal changes.
- 1.3 Whereas some new provisions seek to give greater flexibility to the companies (e.g. by allowing to make schemes more inclusive), yet other new provisions seek to provide clarity in general, or seek mandatory compliances. Companies sought clarity as to application of these new provisions. E.g. there is a new provision stating that “a company shall be entitled to vary the terms of the schemes to meet any regulatory requirement without seeking shareholders’ approval by special resolution”. This raised questions as to whether all the new provisions can be incorporated by way of variation in the scheme without shareholders’ consent?
- 1.4 In the meantime, on 16th November 2021, SEBI has released clarifications in the nature of Frequently Asked Questions (“FAQs”) covering twenty questions pertaining to the New Regulations. These FAQs amply clarify the position.
- 1.5 This Newsletter seeks to highlight and analyse these FAQs.

2 FAQs

Sl. No.	FAQs	SEBI's clarifications
1	Types of schemes governed under the New Regulations	<ul style="list-style-type: none"> • Employee Stock Purchase Schemes • Stock Appreciation Rights Schemes • General Employee Benefits • Retirement Benefit Schemes • Sweat Equity Shares
2	Coverage of any other scheme say Restricted Stock Units ("RSU") Scheme	Any other scheme say an RSU Scheme in the nature of any of the schemes above shall also comply with the New Regulations.
3	Coverage of Phantom Stock Option Scheme	These schemes contemplate settlement in cash and don't involve direct or indirect dealing in company's shares even though the value is measured in line with market price of shares, such schemes are not covered.
4	"Exclusively working in India or outside India" for being an eligible employee	<p>Employee should work exclusively with the company irrespective of whether he/ she is employed either in India or outside India.</p> <p><i>[Our observations: It seems that the country of work is not relevant. The real criteria is working on exclusive basis.]</i></p>
5	Eligibility of contractual employees	<p>Contractual personnel working on exclusive basis (with the company, its associate / subsidiary/ holding/ group company) are also eligible provided they are designated as employees by the company.</p> <p><i>[Our observations: The term "contractual" is not explicit in the New Regulations but implicit. Even though interpretations suggested inclusion of a contractual personnel, this clarification by the Regulator provides certainty.]</i></p>

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6	Clarification on employee coverage by Group companies	<p>In case Company A and Company B together hold 26% of the share capital of a listed company (Company X), then Company X can cover employees of each of Company A and Company B even if Company A and Company B are not part of same group. Further, Company A and Company B may also cover employees of Company X. However, Company A and Company B cannot cover employees of each other.</p> <p><i>[Our observations: If Company A and Company B are unlisted, they may not cover employees of Company X in the absence of subsidiary/ holding relationship as the current ESOP rules for unlisted companies do not allow this. This may be used cautiously.]</i></p>
7	Eligibility of employees of a joint venture ("JV") company	<p>A JV company is included in the definition of Associate Company. As an Associate Company's employees are already eligible; so that of the JV company.</p>
8	Whether holding company needs to be based in or outside India for coverage of its employees?	<p>The term "Holding Company" used in the definition of employee does not specify whether it should be based in India or outside. In spite of that its employees are eligible for coverage by its listed subsidiary in India.</p>
9	Whether the newly defined term "Employee" seeking to give more flexible coverage can be adopted in the scheme without seeking shareholders' consent?	<p>The new definition of employee seeking to give a wide coverage (than defined earlier) could be incorporated in the scheme by way of variation/ amendment only with the shareholders' approval. SEBI clarifies that only mandatory regulations can be incorporated in the scheme without shareholders' consent.</p> <p><i>[Our observations: We had also specified the same principle in our Newsletter published in August 2021 and also in our Webinar in October 2021]</i></p>

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10	What happens to shares held by the Trust eventually exceeds the statutory ceiling of 5% in case of eventual reduction of capital?	Shareholding by the trust in case exceeds the statutory ceiling specified in Regulation 3(11) of the New Regulations due any capital reduction (e.g. buy-back), is permitted.
11	Whether the extended period for appropriation of unappropriated inventory of shares (not backed by grant) is applicable to such excess shares as on the Effective Date of the New Regulations?	Yes, the benefit of extended period can be taken for such excess shares held by the Trust which not backed by grant even though such excess might have resulted prior to the the Effective Date.
12	What the process of granting benefits to the employees of newly included entities like the Associate or Group companies?	<p>The process shall be same as is followed for covering the employees of Company's subsidiary or holding company. This requires appropriate amendment in the eligible "Employee" definition in the scheme with separate approval of the shareholders.</p> <p><i>[Our observations: The principle is same as observed at FAQ no. 9 that coverage of employees of Associate or Group Company is not a mandatory provision but a flexibility and is an usual point of disclosure to the shareholders. Thus, needs shareholders' consent.]</i></p>
13	Aspects of approval in case of grant proposed to identified employees by more than or equal to 1%	<p>Separate shareholders' resolution needs to be passed for each employee name wise.</p> <p><i>[Our observations: In case a company intends to grant to more than one identified employee, separate resolutions are required so as to afford voting "for" or "against" any particular resolution or employee.]</i></p>
14	Variation of terms of options or of the scheme being subject matter of explanatory statement/ resolution	In case terms of (i) options, or (ii) scheme are sought to be amended which would be in variance with the terms specified in the explanatory statement / resolution already approved by the share-

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		<p>holders, then a company is required to take the approval of the shareholders.</p> <p><i>[Our observations: Given the dynamic nature of business, companies often seek to modify the terms of outstanding options or some provisions of the scheme for better efficiency. This FAQ clarifies that modification of any term (i) within the framework of the explanatory statement, or (ii) that is usually not a part of the explanatory statement can be carried out without shareholders' approval.]</i></p>
15	Mental incapacity of option grantee and role of his/her nominee	<p>It is clarified that provisions should be created in the scheme for approval by the shareholders; so that nominee of such employee can be allowed vesting and exercise afterwards.</p> <p><i>[Our observations: As permanent incapacity may take any form, it shall be prudent for the companies to create enabling provisions in the scheme in advance reserving power with the Nomination and Remuneration Committee to determine each such case on merits]</i></p>
16	Treatment of options or SARs granted to directors upon retirement	<p>Subject to the terms of the company's policies, all options or SARs granted shall continue to vest as per original vesting schedule even after such retirement.</p> <p><i>[Our observations: This is not a mandatory provision by SEBI as is subject to any contrary policy of the company. E.g. a policy that prohibits any benefit to a retiree upon joining a competition may not allow any further vesting]</i></p>
17	Application of lock-in period restriction in case of ESPS implementation through a Trust	<p>The lock-in requirement is applicable at the level of employee and not at the level of Trust. Lock-in in terms of Regulation 22(2) shall be applicable</p>

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		<p>from the day shares are received by the employees.</p> <p><i>[Our observations: Lock-in seeks either retention or non-monetization of shares by the employee. Thus, it is applicable on the employees and not on trust as is a mere conduit]</i></p>
18	<p>Whether the New Regulations shall apply in case shares are held/dealt with for only employee welfare but not to pass-on any share based benefits?</p>	<p>Any employee welfare scheme holding / dealing in shares of the company or the shares of its listed holding company is covered under the scope of the New Regulations.</p> <p><i>[Our observations: As per Regulation 1(4), in case a company (whether listed or unlisted) acquires shares of its listed group company and seeks to provide benefits to the employees of such listed group company, then the New Regulations may apply to such listed group company (even though the benefit scheme is implemented by the former company). It needs cautious structuring of the scheme.]</i></p>
19	<p>Whether shares held by the trust will be considered for determination of percentage of voting rights under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("SAST Regulations")?</p>	<p>Shares held by the trust shall be taken into account for the determination of percentage of voting rights under the SAST Regulations.</p> <p><i>[Our observations: The threshold percentage acquisition that triggers an open offer may reduce (offering bit more leeway to the acquirer) depending on quantum of shares held by the trust]</i></p>
20	<p>Whether issue of sweat equity shares to the employees beyond the threshold limits as per SAST Regulations shall trigger an open offer?</p>	<p>The provisions of the new Share Based Employee Benefits Regulations should be read in harmony with the provisions of the SAST Regulations and thus the beneficiaries of sweat equity shares shall be liable to make an open offer if the acquisition exceeds the threshold limits under SAST Regulations.</p>

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		<p><i>[Our observations: The new Share Based Employee Benefits Regulations has substantially increased the ceiling of sweat equity that may be allotted to one or more eligible employees / directors. Sweat equity</i></p>

3 Conclusion

- 3.1** Apart from our specific observations on the FAQs above, we view all these FAQs as much needed. Some of the provisions for which FAQs are issued were prone to conflicting interpretations. Clarity from the Regulator is valuable as provides certainty.
- 3.2** This will pave the way for adoption of the New Regulations by the companies without any unreasonable apprehension, resulting in uniform practice and better compliance.

