

# EY Regulatory Alert

## Securities and Exchange Board of India notifies new regulations for Share Based Employee Benefits and Sweat Equity

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### Executive summary

The Securities and Exchange Board of India ('SEBI') has notified Securities and Exchange Board of India (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 ('SBEBSE Regulations' or 'New Regulations') on 13 August 2021. These regulations have merged the erstwhile SEBI (Issue of Sweat Equity) Regulations, 2002 ("Sweat Equity Regulations") and SEBI (Share Based Employee Benefits) Regulations, 2014 ("SBEB Regulations"), into a single Regulation.

Some of the key changes implemented in the New Regulations are as under:

- a. Change in the definition of "employee"
- b. Coverage of employees of Group companies including Associate company
- c. Option for companies to change the manner of administration from direct route to trust route and vice versa, subject to conditions
- d. Increase in time limit for appropriation of shares acquired by the trust under secondary acquisition
- e. Relaxation to vesting conditions and lock-requirements in specific circumstances

## Background

- ▶ On August 6, 2021, SEBI, in its Board meeting took many decisions including the merger of Sweat Equity Regulations and SBEB Regulations into a single regulation. The decisions were published vide Press Release no 24/2021 dated August 6, 2021.
- ▶ On August 13, 2021, SEBI notified the SBEBSE Regulations replacing the SBEB Regulations and Sweat Equity Regulations.
- ▶ This alert covers the key features of the New Regulations as well as highlights the key changes to erstwhile SBEB Regulations and Sweat Equity Regulations.

## What has changed?

- ▶ The New Regulations specifically provide that the same shall apply to companies, whose “equity” shares are listed on a recognized stock exchange in India.
- ▶ The key changes and their impact is summarized as under:

As per SBEB Regulations	As per SBEBSE Regulations	Impact of change
Change in the definition of “employee”		
<ul style="list-style-type: none"> <li>▶ “Employee” means permanent employee of the company.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Except in relation to sweat equity shares, “employee” means an employee as designated by the company, who is exclusively working in India or outside India.</li> <li>▶ Further, definition of “employee” includes a non-executive director, provided such person is not a promoter or member of the promoter group.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Non-permanent employees who are engaged by companies are now eligible to receive share-based employee benefits, so long as they work “exclusively” for such companies.</li> <li>▶ There is additional clarity on the coverage of non-executive director in the definition of employee (independent directors continue to be excluded, given the uniqueness of their role).</li> </ul>
Coverage of employees of Group companies		
<ul style="list-style-type: none"> <li>▶ Only employees of subsidiary companies, in India or outside India and employees of holding company are permitted to be covered for the share-based employee benefits.</li> </ul>	<ul style="list-style-type: none"> <li>▶ In addition to employees of the subsidiary companies in India or outside India and employees of holding company, the New Regulations also permit coverage of employees of associate company, as defined in Section 2(6) of the Companies Act, 2013 (‘Companies Act’), in India or outside India.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Companies would now be able to offer share-based employee benefits to the employees of associate company (example: companies in which the issuing company has significant influence or a joint venture company).</li> </ul>
Manner of administration		
<ul style="list-style-type: none"> <li>▶ A company may implement share-based employee benefit scheme (‘Scheme’) either directly or through a trust. If the Scheme is to be implemented through a trust, the same needs to be decided by the Company upfront at the time of taking approvals of the shareholders for setting up the Scheme.</li> </ul>	<ul style="list-style-type: none"> <li>▶ If the prevailing circumstances warrant, the company may change the manner of implementation of the Scheme provided the change is not prejudicial to the interests of the employees and a special resolution of the shareholders is obtained prior to implementing the change.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Additional flexibility is provided to the companies to switch from Direct route to Trust route or vice-versa, as may be required to effectively administer the Scheme.</li> <li>▶ Existing companies may evaluate changing the manner of implementing the Scheme.</li> </ul>

As per SBEB Regulations	As per SBEBSE Regulations	Impact of change
Increase in time limit for appropriation of shares acquired by the trust under secondary acquisition		
<p>▶ The un-appropriated inventory of shares which are not backed by grants, acquired through secondary acquisition by the trust should be appropriated within a reasonable period, which shall not extend beyond the end of the subsequent financial year.</p>	<p>▶ The time period for appropriating the unappropriated inventory of the trust is extended by one more year, subject to the approval of the Compensation /Nomination and Remuneration Committee for such extension to the second subsequent financial year.</p>	<p>▶ The trust has additional one year to appropriate the shares acquired through secondary market acquisition.</p>
Minimum vesting period and lock-in conditions		
<p>▶ A minimum vesting period of one year from the date of grant is prescribed in case of ESOS and SAR.</p> <p>▶ A minimum lock-in period of one year from the date of allotment of shares is prescribed in the case of ESOS.</p>	<p>▶ Minimum vesting period of one year would not apply in case of death or permanent incapacity of the employee. The company shall frame an appropriate policy with respect to death and permanent incapacity of an employee, subject to compliance with applicable laws.</p> <p>▶ In the event of death or permanent incapacity of an employee, the requirement of lock-in shall not be applicable from the date of death or permanent incapacity.</p>	<p>▶ All the options / rights under an ESOS / SAR shall vest on the date of death or permanent incapacity of the employee.</p> <p>▶ The lock-in period ends on the date of death or permanent incapacity of the employee in the case of ESOS.</p> <p>▶ The above would help support the nominees and employees in times of bereavement or hardship.</p>

- ▶ With regard to utilization of excess funds or shares remaining with the trust upon winding up of a Scheme, the New Regulations provide for an option to transfer such funds or shares to another Scheme under the New Regulations subject to the approval of the shareholders.
- ▶ The New Regulations provide for continuity of vesting of the options, SAR or any other benefit granted to the employees, in accordance with the respective vesting schedule, even after retirement or superannuation in accordance with the company's policies and applicable law.
- ▶ Where an employee who has been granted benefits under a Scheme, is transferred pursuant to scheme of arrangement, amalgamation, merger or demerger or continued in the existing company, prior to the vesting or exercise, the treatment of options in such case shall be specified in such scheme of arrangement, amalgamation, merger or demerger, provided that such treatment shall not be prejudicial to the interest of the employee.
- ▶ Whilst the SBEB Regulations provide for a new issue of shares made under any Scheme, to be listed immediately on "any" recognized stock exchange(s), the New Regulations provide for listing immediately on "all" recognized stock exchange(s) where existing shares of the company are listed.
- ▶ In relation to the certificate to be placed before the shareholders at an annual general meeting certifying that the Scheme(s) is in compliance with the New Regulations, such audit certificate needs to be procured by the Company from its "secretarial auditor". A "secretarial auditor" is defined as a company secretary in practice appointed by a company under Rule 8 of the Companies (Meetings of Board and its Powers) Rules, 2014 to conduct secretarial audit pursuant to Regulation 24A of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.
- ▶ The New Regulations clarify that while variation to the Scheme should not be detrimental or prejudicial to the interests of the employees and requires a special resolution of its

shareholders, such a requirement would not apply in case of a variation to meet any regulatory requirements.

#### **Key updates in connection with issuance of Sweat Equity:**

- ▶ The word “permanent” is deleted from the scope of definition of “employee” under the new Regulations for the purpose of issuance of Sweat Equity as well.
- ▶ Under the erstwhile Sweat Equity Regulations, sweat equity could be issued to a promoter, provided the issue was approved by way of a resolution passed by a simple majority of the shareholders in general meeting. Under the New Regulations, promoter group is also eligible for such an issue. Accordingly, the issue of sweat equity shares under the New Regulations can be made to employees who belong to promoter or promoter group.
- ▶ The New Regulations prescribe that the price of sweat equity shares shall be determined in accordance with pricing requirements stipulated for preferential issue to a person other than a qualified institutional buyer under the SEBI (Issue of Capital and Disclosure Requirements), Regulations, 2018 (‘ICDR Regulations’).
- ▶ The New Regulations have not made any change to the maximum quantum of sweat equity shares that can be issued with regard to the paid-up share capital of the company i.e. fifteen percent of the existing paid up equity share capital in a year and twenty five percent of the paid up equity share capital of the company at any time. An enhancement of such limit is provided to a company listed on the Innovators Growth Platform. Such company shall be permitted to issue not more than fifteen percent of the paid up equity share capital in a financial year subject to overall limit not exceeding fifty percent of the paid up equity share capital of the company, up to ten years from the date of its incorporation or registration.

#### **Detailed schedules:**

- ▶ The New Regulations prescribe detailed schedules for various administrative and disclosure requirements. The details of the schedules are as under:

##### **Schedule I:**

- Part A - Minimum Provisions in the Trust Deed
- Part B - Terms and conditions of the Scheme to be formulated by Compensation Committee / Nomination and Remuneration Committee
- Part C - Contents of explanatory statement to the notice and resolution for shareholders meeting
- Part D - Information required in the statement to be filed with recognized stock exchange(s)
- Part E - Format of notification for issue of shares
- Part F - Disclosures by the Board of Directors
- Part G - Disclosure document

##### **Schedule II:**

- ▶ Contents of explanatory statement to the notice and the resolution proposed to be passed in the general meeting for approving the issuance of sweat equity.

#### **Next steps:**

- ▶ Listed companies and companies that are planning to list their shares should review the terms of their share-based employee benefit scheme(s) to ensure that they comply with the New Regulations.
- ▶ Companies administering the Scheme through a trust should review the terms of the trust deed to ensure compliance with the specific requirements of the New Regulations.
- ▶ Unlisted companies may take guidance from these New Regulations even though the same does not apply to them.

## Comments

The New Regulations notified by SEBI are a welcome step at a point of time when the markets are overwhelmed with positivity owing to many new-gen companies listing their shares.

The widening of definition of employee is a positive change, which takes cognizance of the various new-age practices and employment models - entitling non-permanent employees to also benefit from the share-based employee benefit schemes.

The New Regulations shall provide additional flexibility, transparency and good governance in relation to dealing with equity shares in connection with share-based employee benefit schemes.

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