

SEBI (SHARE BASED EMPLOYEE BENEFITS AND SWEAT EQUITY) REGULATIONS, 2021 - A BRIEF ANALYSIS*

BACKGROUND

SEBI (Issue of Sweat Equity) Regulations, 2002 ("Sweat Equity Regulations") and SEBI (Share Based Employee Benefits) Regulations, 2014 ("SBEB Regulations") were notified on September 24, 2002 and October 28, 2014 respectively. The Sweat Equity regulations provided framework for issuance of Sweat Equity shares by listed companies and the SBEB Regulations provided framework to regulate Employee Stock Option Scheme, Employee Stock Purchase Scheme and other share based employee benefits.

Further, to improve ease of doing business from a regulatory perspective, it was observed that, both the SBEB Regulations and the Sweat Equity Regulations regulate employee benefits arising out of and relating with the equity shares of listed companies, thus the possibility of merging both such regulations may be explored.

Accordingly, the SEBI constituted the Expert Group to analyze the above proposals, and to provide its recommendations on the following:

Revisiting the framework of SBEB regulations and suggesting policy change thereto

Revisiting the framework of SEBI Sweat equity regulations vis-à-vis the Companies Act, 2013 and suggesting policy changes thereto

Suggesting, whether it is advisable to combine both the regulations and if so, providing a draft of combined regulations

The changes in the two regulations and their merger into a single regulation were approved by SEBI in the Board Meeting held on August 06, 2021. Thereafter, the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 (herein referred as "New Regulations") have been notified and become effective on August 13, 2021. Pursuant to this, the SEBI (Share Based Employee Benefits) Regulations, 2014 and SEBI (Issue of Sweat Equity) Regulations, 2002 (herein referred as "Erstwhile Regulations") stand repealed.

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Key highlights of the changes under SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021

1. Definition of “employee” [Regulation 2(1)(i)]

As per the Erstwhile Regulations	As per the New Regulations
<p>Employee Means</p> <p>a permanent employee of the company who has been working in India or outside India; or</p> <p>a director of the company, whether a whole time director or not but excluding an independent director; or</p> <p>an employee as defined in clause (i) or (ii) of a subsidiary, in India or outside India, or of a holding company of the company</p>	<p>Employee, except in relation to issue of sweat equity shares, means —</p> <p>an employee as designated by the company, who is exclusively working in India or outside India; or</p> <p>a director of the company, whether a whole-time director or not, including a non-executive director who is not a promoter or member of the promoter group, but excluding an independent director; or</p> <p>an employee as defined in sub-clauses (i) or (ii), of a group company including subsidiary or its associate company, in India or outside India, or of a holding company of the company</p>
<p>Rationale behind the Change</p> <p>To include employees who are working on non-permanent basis like contractual employees, “gig workers” and employees on probation or deputation.</p> <p>To include clarification on inclusion of a non-executive director (who is not a promoter or member of the promoter group).</p> <p>In the erstwhile regulations, the employees of only holding and subsidiary companies were eligible for the grant of employee stock options or other employee benefits. Now, as per the new Regulations, the employees of group Companies as well as associate companies are also eligible for the grant of employee stock options or other employee benefits.</p>	

2. Definition of “Grant Date” [Regulation 2(1)(q)]

As per the Erstwhile Regulations	As per the New Regulations
<p>“grant date” means the date on which the compensation committee approves the grant.</p>	<p>“grant date” means the date on which the compensation committee approves the grant.</p> <p><i>Explanation, —For accounting purposes, the grant date will be determined in accordance with applicable accounting standards</i></p>
<p>Rationale behind the Change</p> <p>An explanation has been inserted to clarify that for the accounting purposes, grant date will be determined in accordance with applicable accounting standards.</p>	

3. Implementation of the Scheme through Trust [Regulation 3(1)]

As per the Erstwhile Regulations	As per the New Regulations
<p>A company may implement schemes either directly or by setting up an irrevocable trust(s).</p> <p>Provided that if the scheme is to be implemented through a trust the same has to be decided upfront at the time of taking approval of the shareholders for setting up the schemes:</p>	<p>A company may implement a scheme either directly or by setting up an irrevocable trust.</p> <p>Provided that if the scheme is to be implemented through a trust, the same has to be decided upfront at the time of taking approval of the shareholders for setting up the scheme.</p> <p>Provided further that if prevailing circumstances so warrant, the company may change the mode of implementation of the scheme subject to the condition that a fresh approval of the shareholders by a special resolution is obtained prior to implementing such a change and that such a change is not prejudicial to the interests of the employees.</p>
Rationale behind the Change	
<p>Flexibility has been accorded to the companies to switch routes (from trust to direct route or vice versa), subject to the approval of the shareholders by special resolution, subject to the condition that such switch is not prejudicial to the interests of the employees.</p>	

4. Compensation Committee [Regulation 5(2)]

As per the Erstwhile Regulations	As per the New Regulations
<p>The compensation committee shall be a committee of such members of the board of directors of the company as provided under section 178 of the Companies Act, 2013, as amended or modified from time to time.</p>	<p>The compensation committee shall be a committee of such members of the Board of Directors of the company as provided under regulation 19 of the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, as amended from time to time:</p> <p>Provided that a company may also opt to designate its nomination and remuneration committee as the compensation committee for the purposes of these regulations.</p>
Rationale behind the Change	
<p>Flexibility has been given to designate Nomination and Remuneration Committee (NRC) of a company as the Compensation Committee. Since a listed company is already required to have an NRC in terms of Regulation 19 of SEBI (LODR) Regulations. The requirements</p>	

of constitution of the compensation committee can be made part of the NRC, without the requirement to set up a separate committee.

5. Utilization of Fund/ Shares held by Trust in case of Winding Up of the Scheme [Regulation 8]

As per the Erstwhile Regulations	As per the New Regulations
In case of winding up of the schemes being implemented by a company through trust, the excess monies or shares remaining with the trust after meeting all the obligations, if any, shall be utilised for repayment of loan or by way of distribution to employees as recommended by the compensation committee.	In case of winding up of the schemes being implemented by a company, the excess monies or shares remaining with the trust after meeting all the obligations, if any, shall be utilised for repayment of loan or by way of distribution to employees or subject to approval of the shareholders, be transferred to another scheme under these regulations, as recommended by the compensation committee.
Rationale behind the Change	
The assets of the trust are acquired and earmarked for the benefit of the employees of the company. If any surplus remains with the trust upon winding up, an option has been provided for deferring the utilisation of such funds or using it for the benefit of employees through a different scheme. Accordingly, transfer of shares or monies held by such trust upon winding up should be permitted to be transferred to one or more existing share-based employee benefit schemes, subject to approval of shareholders for such transfer.	

6. Applicability of Minimum Vesting Period in case of Death/ Permanent Incapacity [Regulation 9(4)]

As per the Erstwhile Regulations	As per the New Regulations
In the event of death of the employee while in employment, all the options, SAR or any other benefit granted to him under a scheme till such date shall vest in the legal heirs or nominees of the deceased employee.	In the event of death of the employee while in employment, all the options, SAR or any other benefit granted under a scheme to him/her till his/her death shall vest, with effect from the date of his/her death , in the legal heirs or nominees of the deceased employee, as the case may be.
Rationale behind the Change	
To have a more lenient view in the special circumstances of death or permanent incapacity, and permit vesting immediately in such circumstances.	

7. Certificate from Auditor [Regulation 13]

As per the Erstwhile Regulations	As per the New Regulations
In the case of every company that has passed a resolution for the schemes under these regulations, the board of directors shall at each annual general meeting place before the shareholders a certificate from the auditors of the company that the scheme(s) has been implemented in accordance with these regulations and in accordance with the resolution of the company in the general meeting.	In the case of every company which has passed a resolution for the scheme(s) under these regulations, the Board of Directors shall at each annual general meeting place before the shareholders a certificate from the secretarial auditors of the company that the scheme(s) has been implemented in accordance with these regulations and in accordance with the resolution of the company in the general meeting.
Rationale behind the Change	
<p>There was no clarity in Erstwhile Regulations with regards to whether the certificate should be provided by the statutory auditor, internal auditor or secretarial auditor. Now, under the new Regulations, the audit certificate referred to under Regulation 13 should be procured from such secretarial auditor as the secretarial auditor (being an independent practising company secretary) is more conversant with these laws compared to other categories of persons and secretarial auditor is also required under Regulation 24A of the LODR Regulations, to furnish a secretarial audit report on an annual basis.</p> <p>The Institute of Company Secretaries of India (ICSI) has sent a specific request letter to the SEBI dated January 25, 2021, requesting the SEBI to authorise company secretaries in practice to provide the applicable certification under Regulation 13 of the SBEB Regulations.</p>	

8. Objective/ Purpose for the Issue of Sweat Equity Shares [Regulation 30]

As per the Erstwhile Regulations	As per the New Regulations
A company whose equity shares are listed on a recognized stock exchange may issue sweat equity shares in accordance with Section 79A of Companies Act, 1956 and these Regulations to its– (a) Employees (b) Directors	A company whose equity shares are listed on a recognised stock exchange may issue sweat equity shares in accordance with section 54 of the Companies Act, 2013 and these regulations to its employees for their providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Rationale behind the Change

As the Erstwhile Regulations did not specify permissible purpose/objective for issuance of sweat equity shares, as are provided under the Companies (Share Capital and Debentures) Rules, 2014 (applicable only to unlisted companies). Since the purpose of issuance was not provided, the listed companies were not clear as to whether issuance of sweat equity shares was entirely discretionary or permitted only for certain purposes/objectives. Now, to streamline the same, the Objective/ purpose for the issue of sweat equity shares has been specified under the new Regulations.

9. Maximum quantum of Sweat Equity Shares [Regulation 31]

As per the Erstwhile Regulations	As per the New Regulations
	<p>A company shall not issue sweat equity shares for more than fifteen percent of the existing paid-up equity share capital in a year:</p> <p>Provided that the issuance of sweat equity shares in the company shall not exceed twenty five percent of the paid-up equity share capital of the company at any time:</p> <p>Provided further that a company listed on Innovators Growth Platform 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.</p>

Rationale behind the Change

The erstwhile Regulations did not specify a maximum limit on the quantum of sweat equity shares that may be issued by a company. This is provided under the Companies (Share Capital and Debentures) Rules, 2014 (applicable only to unlisted companies). In a view of the same, SEBI has specified the maximum limit upon the quantum of sweat equity shares that may be issued by a company.

10. Lock In Period for Sweat Equity Shares [Regulation 38]

As per the Erstwhile Regulations	As per the New Regulations
The Sweat Equity shares shall be locked in for a period of three years from the date of allotment.	The sweat equity shares shall be locked in for such period of time as specified in relation to a preferential issue under the SEBI (Issue

	of Capital and Disclosure Requirements) Regulations, 2018, as amended from time to time.
Rationale behind the Change	
<p>It was considered that the lock-in period of 3 years provided under the erstwhile Regulations which was having an adverse impact on the attractiveness of sweat equity shares. Therefore, the suitable changes with regards to the lock-in period have been made with a view that the lock-in period should be consistent with the lock-in period prescribed in relation to preferential issue under the ICDR Regulations.</p> <p>Therefore, the Lock-in period for the Sweat Equity shares shall be 3 years from the date of allotment of shares in case such shares are allotted to promoters or promoter groups. However, in case where the shares are issued to any person other than promoters and promoter group, the shares shall be locked in for a period of 1 year.</p>	

References

1. https://www.sebi.gov.in/reports-and-statistics/reports/jul-2021/consultation-paper-on-review-of-sebi-share-based-employee-benefits-regulations-2014-and-sebi-issue-of-sweat-equity-regulations-2002_50960.html
2. https://www.sebi.gov.in/legal/regulations/aug-2021/securities-and-exchange-board-of-india-share-based-employee-benefits-and-sweat-equity-regulations-2021_51889.html
