Employee Stock Option Plan or Scheme issued by the Listed Entities

In our previous [1]article, we outlined the conditions and procedures that private and unlisted public companies are required to adhere to while issuing options through the Employee Stock Option Plan/ Scheme ("**ESOP" or "ESOS**") to their employees. However, certain companies are also required to comply with the relevant regulations prescribed by the Securities and Exchange Board of India ("**SEBI**") in addition to the provisions of the Companies Act, 2013 ("**CA, 2013**").

SEBI has prescribed the SEBI (Share based Employee Benefits and Sweat Equity) Regulations, 2021 ("**SEBI Regulations**") for the schemes prepared by companies to benefit their employees in shares directly or indirectly and to facilitate the smooth operation of such schemes.

Applicability of Regulations

1. To the Companies

These Regulations apply to those companies whose shares are listed on a recognised stock exchange in India and has a scheme for the following purposes:

i. direct or indirect benefit of the employees;
ii. dealing in/ subscribing to/ purchasing securities of the company directly or indirectly; and
iii. satisfies directly or indirectly, any of the following conditions: -
   a. the scheme is set up by the company or any other company in its group.
   b. the scheme is funded/ guaranteed by the company or any other company in its group.
   c. the scheme is controlled/ managed by the company or any other company in its group.

2. To the Schemes

These Regulations apply to the different variants of the employees benefit schemes as mentioned below:

i. **Employee stock option schemes (ESOP/ESOS) –** Options grants to the employees to purchase the shares of the company at a future date at a pre-determined price;

ii. **Employee stock purchase schemes (ESPS) -** The company offers shares to the employees at a discounted price, either through a public issue or other means. The shares can be issued by the company either itself or through a trust.

iii. **Stock appreciation rights schemes (SARs) –** SAR is a right provided to the employees entitling them to receive appreciation for a specified number of company shares, with the settlement of such appreciation either in cash or shares of the company.

iv. **General employee benefits schemes** (**GEBs**) **–** GEBs are schemes dealing in shares of the company or its listed holding company, prepared for employees' welfare covering healthcare benefits, hospital care, sickness, accident, disability, death or scholarship funds, or such other specified benefits.

[1] https://clacorpservices.com/downloads/publication/ccspl-esops-in-India.pdf

v. **Retirement Benefit Schemes (RBS) –** RBS are schemes dealing in shares of the company or its listed holding company, aimed at providing retirement benefits to employees subject to applicable laws relevant to retirement benefits in India.

vi. **Sweat Equity Shares-** Sweat equity shares are defined under the CA, 2013, which means issuance of equity shares to directors or employees at a discount or for non-cash consideration, for providing their know-how or making available rights like intellectual property rights or value additions.

Eligible Employees

The compensation committee of a company determines eligible employees for ESOS. The definition of employee specified in the Regulations is wider than the definition prescribed under CA, 2013, as it covers the employees of a company working in India or outside India, every director of such company *(excluding promoter or member of promoter group and independent director)* and employees of its group company including holding, subsidiary or associate company in India or outside India.

However, in CA, 2013, employees of the group company are not covered in the definition of eligible employees.

Group is defined under the Regulations, when two or more companies, either directly or indirectly, are in the position to:

i. exercise 26% or more of the voting rights in the other company; or
ii. appoint more than 50% of the members of the Board of Directors in the other company; or
iii. control the management or affairs of the other company;

In this article, the focus is to explain the administration of ESOP/ ESOS which is prescribed under Chapter III of the Regulations.

Implementation and administration of ESOP/ESOS

The steps for implementation and administration of ESOP/ESOS, *inter alia*, includes the following:

a. The scheme prepared for ESOS may be implemented either by the company itself or through an irrevocable trust. A compensation committee is required to be constituted that will administer and supervise the scheme. However, if the scheme is implemented by the trust, then the administration of the scheme would be lying with the trust.

b. The compensation committee shall formulate the detailed terms and conditions of the schemes as per the applicable provisions of the Regulations. It shall also frame policies and procedures for smooth implementation of the scheme so that there is no violation of securities laws.

c. If the scheme involves secondary acquisition (i.e., acquisition of shares from the stock exchange) or gift or both, then the implementation of such scheme would be done only through the trust and not by the company.

d. A decision on ESOS implementation, whether by the company or through trust, shall be made at the time of obtaining shareholder approval through a special resolution.

e. An ESOS shall contain the details and manner in which the scheme will be implemented and operated. The disclosures specified in Part G of Schedule I of the Regulations are mandatory to be made while offering the ESOS to the employees. These disclosures include the information about the company, the statement of risk and salient features of the scheme.

f. The company granting ESOS to the employees is free to determine the exercise price. However, such exercise price shall conform with the accounting policies including the disclosure requirements of the Accounting Standards prescribed by the Central Government in terms of the CA, 2013.

g. As under CA, 2013, there shall be a minimum vesting period of 1 (one) year. However, the minimum vesting period of 1 year will be exempt in case of death or permanent incapacity of an employee, where options vest on the date of death or permanent incapacity of such employee.

h. In case, the company has passed a special resolution for ESOS under CA, 2013 and these Regulations, the Board of Directors, shall at each annual general meeting place a certificate before shareholders that would be obtained from the secretarial auditors of the company that the scheme(s) has been implemented in accordance with these Regulations and resolution passed at the general meeting.

i. In case a new issue of shares is made under an ESOS, shares so issued shall be listed immediately on all recognized stock exchange(s) where the existing shares are listed, subject to the following conditions:

    i. The scheme complies with these Regulations;
    ii. A statement, as specified in the Regulations is filed and the company obtains an in-principle approval from the recognized stock exchange(s);
    iii. As and when an exercise is made, the company notifies the concerned recognized stock exchange(s) as per the statement specified in the Regulations.

Consequence of failure to exercise an option

The company may forfeit the amount paid by the employee at the time of grant, vesting, or exercise of the option if not exercised within the exercise period. A refund to the employee may occur if options do not vest due to non-fulfillment of conditions related to vesting as per the ESOS.

Conclusion:

In conclusion, the issuance of Employee Stock Option Plans/Schemes (ESOP/ESOS) is a process involving compliance with both the CA, 2013, and SEBI Regulations. In essence, SEBI Regulations bring clarity and structure to the administration of ESOP/ESOS, ensuring transparency, accountability, and fairness in the implementation of employee benefit schemes by listed companies in India.

Disclaimer: This publication is only based on the understanding with respect to Employee Stock Option/ Ownership Plan under the SEBI (Share-based Employee Benefits and Sweat Equity) Regulations, 2021. This publication has been prepared for information purposes only.