

Framing of Employee Welfare Schemes: Welfare of Company or Employees?



Nowadays, one of the key resources of a successful organisation is its workforce. Human capital, though not recognised as an asset as per the prevailing accounting practices, assumes significant importance in shaping the future of an organisation. There is a positive and definitive relationship between human capital and success of organisations. Organisations are constantly realising the importance of their workforce and, therefore, have been taking many steps to retain the existing workforce and appointing the best talents. One of the ways by which employees are awarded by their organisations for performance, achievement or loyalty is share-based payments. To regulate such share-based payments for listed entities, the Securities and Exchange Board of India (SEBI) issued *SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999*. This article discusses the share-based payments schemes (employee-welfare schemes) framed by listed entities. The author discusses the purpose behind the SEBI (ESOS and ESPS) Guidelines, 1999, and representations made to SEBI and the regulator's response to them, and how these representations have impacted SEBI's decisions. Read on...



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Purpose of SEBI (ESOS and ESPS) Guidelines, 1999 *(as amended from time to time)*

The purpose of SEBI (ESOS and ESPS) Guidelines, 1999 is to enable listed entities to reward their employees through stock option schemes and stock purchase schemes and to ensure that such schemes introduced by the companies are within the regulated framework. To ensure proper regulation, the SEBI (ESOS and ESPS) Guidelines, 1999 have the following clauses (illustrative, i.e., only the clauses which are relevant to the topic have been discussed):

Part A: ESOS

- An employee who is a promoter or belongs to the promoter group, shall not be eligible to participate in the ESOS. (Clause 4.2 of SEBI (ESOS and ESPS) Guidelines, 1999)
- A director who either by himself or through his relative or through any body-corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company, shall not be eligible to participate in the ESOS. (Clause 4.3 of SEBI (ESOS and ESPS) Guidelines, 1999)
- The Compensation Committee shall frame suitable policies and systems to ensure that there is no violation of:
 - (a) SEBI (Insider Trading) Regulations, 1992; and
 - (b) SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 1995, by any employee (Clause 5.4 of SEBI (ESOS and ESPS) Guidelines, 1999)
- There shall be a minimum period of one year between the grant of options and vesting of option. (Clause 9.1 of SEBI (ESOS and ESPS) Guidelines, 1999)
- The company shall have the freedom to specify the lock-in period for the shares issued pursuant to exercise of option. (Clause 9.2 of SEBI (ESOS and ESPS) Guidelines, 1999)
- In the case of every company that has passed a resolution for an ESOS, 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 has been implemented in accordance with these guidelines and in accordance with the resolution of the company in the general meeting. (adapted from Clause 14.1 of SEBI (ESOS and ESPS) Guidelines, 1999)

Part B: ESPS

- An employee who is a promoter or belongs to the promoter group shall not be eligible to participate in the ESPS. (Clause 16.2 of SEBI (ESOS and ESPS) Guidelines, 1999)
- A director who either by himself or through his relatives or through any body-corporate, directly or indirectly holds more than 10% of the outstanding equity shares of the company shall not be eligible to participate in the ESPS. (Clause 16.3 of SEBI (ESOS and ESPS) Guidelines, 1999)
- Shares issued under an ESPS shall be locked in for a minimum period of one year from the date of

Under all the above cases, the company has to cancel the shares bought back. Holding of 'treasury stock' is not within the purview of law, i.e., the company cannot hold its own shares under the Companies Act, 1956.

allotment. (Clause 18.2 of SEBI (ESOS and ESPS) Guidelines, 1999)

- The shares arising pursuant to an ESOS and shares issued under an ESPS shall be listed immediately upon exercise in any recognised stock exchange where the securities of the company are listed. (adapted from Clause 22.1 of SEBI (ESOS and ESPS) Guidelines, 1999)
- In case of ESOS/ESPS administered through a Trust, accounts of the company shall be prepared as if the company itself is administering the ESOS/ESPS. (Clause 22A.1 of SEBI (ESOS and ESPS) Guidelines, 1999)

Certain companies exploiting the intent of the law

A company can buy back its own shares under the following provisions of the Companies Act, 1956 subject to certain conditions specified therein:

- **Section 77A** on Power of company to purchase its own securities, i.e., buy-back
- **Section 100 to Section 104** on Reduction of share capital
- **Section 391 to Section 394** on Arbitration, compromises, arrangements and reconstructions
- **Section 402** on Powers of Tribunal on application under Section 397 or Section 398
- Forfeiture of shares

Under all the above cases, a company has to cancel the shares bought back. Holding of 'treasury stock' is not within the purview of law, i.e., the company cannot hold its own shares under the Companies Act, 1956.

Treasury stock (treasury shares): The portion of shares that a company keeps in its own treasury. Treasury stock may have come from a repurchase or buyback from shareholders; or it may have never been issued to the public in the first place.

(Source: Investopedia)

Also, **Section 77** of the Companies Act, 1956 on Restrictions on purchase by company, or loans by company for purchase, of its own or its holding company's shares prescribes the following:

- (a) No company shall have power to buy its own shares (except under Section 77A, 100-104 391-

394, 402 and forfeiture of shares)

- (b) No public company shall give, whether directly or indirectly, any loan, guarantee, security or financial assistance for the purpose of purchase/subscription of its own shares.

Loophole discovered: Exception to (b) above

“Section 77 of the Companies Act, 1956 does not prohibit provision of money (fund) by a company to a trust set up for the benefit of employees of the company and such trusts utilising such funds for purchase or subscription of shares in the company in accordance with any scheme for the time being in force.”

Though SEBI (ESOS and ESPS) Guidelines, 1999 intended fresh issue of shares, either by way of public issue or other related methods (which is evidenced from its various clauses using the terminology issue), it was silent with regard to acquisition of shares from the secondary market. In view of the law remaining silent, various listed entities framed their own employee benefit schemes wherein trusts were set up to deal in their own securities in the secondary market. This structure was followed by listed entities to avoid dilution of shareholding (control) held by the promoter group. Few of such schemes were framed with the purpose of dealing in a company’s own securities with the object of inflating, depressing, maintaining or causing fluctuation in the price of the securities by engaging in fraudulent and unfair trade practices. Also, there were few listed entities which framed employee benefit schemes which were outside the purview of SEBI (ESOS and ESPS) Guidelines, 1999, thus, allowing even the ineligible employees (under Clauses 4.2 and 4.3 of SEBI (ESOS and ESPS) Guidelines, 1999) being covered under the scheme. Thus, the intention of the law was being defeated.

Action by SEBI (to plug the loophole)

For enhancing market integrity and investor’s confidence, SEBI in its board meeting on 16th August, 2012 approved that listed entities shall frame employee benefit schemes only in accordance with SEBI (ESOS

and ESPS) Guidelines, 1999. Entities whose schemes are not in conformity with the same would be given time to align with the said Guidelines. Further, such schemes will be restrained from acquiring their shares from the secondary market. (Source: Press release no. 77/2012)

On 17th January, 2013, SEBI issued circular no. CIR/CFD/DIL/3/2013 to prohibit the listed entities from framing any employee benefit schemes involving acquisition of own securities from the secondary market.

Amendment in SEBI (ESOS and ESPS) Guidelines, 1999

Clause 22B on Prohibition on acquisition of securities from secondary market was inserted, which provides that no ESOS/ESPS shall involve acquisition of securities from the secondary market.

Amendment in Equity Listing Agreement

Clause 35C was inserted in the Equity Listing Agreement, which is:

- (i) The issuer agrees that all the employee benefit schemes involving the securities of the company shall be in compliance with SEBI (ESOS and ESPS) Guidelines, 1999 and any other guidelines, regulations etc. framed by SEBI in this regard.
- (ii) The issuer further agrees that all the employee benefit schemes already framed and implemented by the company involving dealing in the securities of the company, before the insertion of this clause shall be aligned with and made to conform to SEBI (ESOS and ESPS) Guidelines, 1999 by 30th June, 2013.

Other decisions

In respect of those companies, which have already framed and implemented before the date of this circular any employee benefit schemes involving dealing in the securities of the company, which are not in accordance with the SEBI (ESOS and ESPS) Guidelines, 1999, the following was decided:

- (i) Such companies will be required to inform the details of their schemes to the stock exchanges within 30 days from the date of this circular, in the prescribed format (refer annexure I) and to disseminate the said information on their website.
- (ii) Such companies shall align any existing employee benefit schemes with SEBI (ESOS and ESPS) Guidelines, 1999 on or before 30th June, 2013.

Note: The amendments made vide this circular came into force with immediate effect.

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SEBI received various representations seeking clarification on the applicability of the circular issued on 17th January, 2013, as well as on the continued holding of securities already acquired by employee benefit trusts before the date of the circular, beyond 30th June, 2013.

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Annexure I

Format for furnishing the details of employee benefit schemes involving dealings in secondary market, not covered under the SEBI (ESOS and ESPS) Guidelines, 1999

1. Name of the issuer:
2. Name of the scheme:
3. Date of implementation:
4. Mode of implementation (trust/direct):
5. Brief particulars about the scheme (*modus operandi*): Details of trust, trustees, and their relationship with promoters or directors of the company
6. Whether promoters/persons belonging to the promoter group/directors, are also beneficiaries in the scheme. If so, the details thereof and their entitlements:
7. No. of shares held by Trust/any other agency managing the scheme as on the date of the circular
8. How the Trust/agency is proposing to deal with the existing holding (whether to be transferred to the employees, or to be sold in the market for transferring the benefits to the employees, if so, details regarding proposed date of such transfer or sale shall be given). Such date shall not be later than 30th June, 2013:
9. Details of persons who are entitled to shares or benefits accruing out of the shares, which form part of more than 1% of the paid-up share capital, as on the date of the circular in the following format:

Name of the employee	Whether falling under promoter/promoter group/directors	No. of entitled shares	% of such entitlement over the paid-up share capital	No. of shares transferred/allotted to them/benefits of which is passed on to them out of (3)
(1)	(2)	(3)	(4)	(5)

10. Details of secondary market purchases/sales by the company/trust/any other agency managing the scheme if any, since 1st April, 2012 in the following format:

S. No.	Date/ time	Type of transaction (purchase/ sale)	No. of securities	Price at which purchased/sold

Representations made to SEBI

SEBI received various representations seeking clarification on the applicability of the circular issued on 17th January, 2013, as well as on the continued

Employee benefit trusts which have already acquired securities of the company from secondary market before the date of the circular no. CIR/CFD/DIL/3/2013, i.e., 17th January, 2013, may continue to hold such securities beyond 31st December, 2013, provided that the schemes have been aligned with SEBI (ESOS and ESPS) Guidelines, 1999 and such securities are used only in accordance with such aligned schemes.

holding of securities already acquired by employee benefit trusts before the date of the circular, beyond 30th June, 2013. Representations were made to SEBI to extend the last date by which listed companies are required to align their employee benefit schemes involving securities of the company with SEBI (ESOS and ESPS) Guidelines, 1999 on the following grounds:

- ESOPs are granted to employees and they generally vest based on various criteria such as performance, loyalty, achievement, etc. Transferring the entire shares held by ESOP trust to the employees on or before 30th June, 2013, will cause a lot of hardships to the company.
- Disposing off substantial number of shares is likely to dampen stock prices which are going to adversely impact the company, its employees and its investors.

Also, the apex industry body ASSOCHAM vide its press release dated 12th February, 2013, suggested that trusts (formed by entities) should be allowed to continue to hold these shares, though they should not be allowed to deal with them in any manner other than the SEBI (ESOS and ESPS) Guidelines, 1999.

SEBI's reply to the various representations

SEBI vide its circular no. CIR/CFD/DIL/7/2013 dated 13th May, 2013, issued following clarification on the said topic:

- **Applicability of the circular issued on 17th January, 2013**

The above circular is applicable to all employee benefit schemes involving the securities of the company provided that the schemes are set up, managed or financed by the company directly or indirectly. Thus, the circular shall be applicable if any of the following conditions are satisfied:

- a) the company has set up the scheme or the trust/ agency managing the scheme
- b) the company has direct or indirect control over

the affairs of the scheme or the trust/agency managing the scheme

- c) the company has extended any direct or indirect financial assistance to the employee benefit schemes or the trust/agency managing such schemes

• **Extension of time for aligning the employee benefit schemes with SEBI (ESOS and ESPS) Guidelines, 1999**

SEBI decided to extend the time limit for alignment of employee benefit schemes with SEBI (ESOS and ESPS) Guidelines, 1999 from 30th June, 2013, to 13th December, 2013.

Note: Further grant of options from the date of the circular, i.e. 17th January, 2013, shall be strictly in accordance with SEBI (ESOS and ESPS) Guidelines, 1999.

• **Holding of securities by trusts beyond 31st December, 2013**

Employee benefit trusts which have already acquired securities of the company from the secondary market before the date of the circular no. CIR/CFD/DIL/3/2013, i.e., 17th January, 2013, may continue to hold such securities beyond 31st December, 2013, provided that the schemes have been aligned with SEBI (ESOS and ESPS) Guidelines, 1999 and such securities are used only in accordance with such aligned schemes.

• **Continued holding of securities by non-ESOP employee benefit schemes**

Existing employee benefit schemes involving securities of the company which does not involve granting of options to/purchase of securities by employees shall be permitted to either:

- hold the securities of the company already acquired by them beyond 31st December, 2013 provided the schemes have been aligned with SEBI (ESOS and ESPS) Guidelines, 1999; or
- dispose of the securities of the company held by them by 31st December, 2013

• **Additional disclosures**

Listed companies shall disclose the following information in relation to employee benefit

schemes involving securities of the company which are not in alignment with SEBI (ESOS and ESPS) Guidelines, 1999 to the stock exchanges in the prescribed format:

Information	Time limit	Prescribed format
Details of benefits granted/shares <i>allotted in the past up to 17th January, 2013</i>	30 th June, 2013	Annexure II
Details of benefits due/options granted and pending exercise as on 17th January, 2013	30 th June, 2013	Annexure III
Details of <i>allotments made/benefits granted post 17th January, 2013 up to 31st December, 2013</i>	Seven days from the end of each quarter (<i>refer note below</i>)	Annexure IV

Note: The details pertaining to the quarter ended 31st March, 2013 shall also be disclosed along with the quarter ending 30th June, 2013.

Formats for disclosure of details of benefits granted/shares allotted in pursuance of employee benefit schemes which are not in alignment with SEBI (ESOS and ESPS) Guidelines, 1999

Annexure II

Details of *allotment of shares/grant of benefit* made till 17th January, 2013, pursuant to non-aligned schemes by (name of the company)

Fi-nan-cial year	Type of scheme (ESOP/ non-ESOP)	Brief particulars of the benefits under the scheme	Type of beneficia-ries	Value of the benefit/ allot-ment	Percent-age of shares used for granting benefits/ allotting shares to the total paid-up share capital
			Promoter/promoter group/directors holding > 10%		
			Others		



Annexure III

Details of *outstanding options/allotments/benefits* as on 17th January, 2013, pursuant to non-aligned schemes by (name of the company)

Financial year Type of scheme (ESOP/ non-ESOP)	Brief particulars of the benefits under the scheme	Type of beneficiaries	Value of the benefit/ allotment	Percentage of shares used for granting benefits/ allotting shares to the total paid-up share capital
		Promoter/ promoter group/ directors holding > 10%		
		Others		

Annexure IV

Details of *allotment of shares/grant of benefit made during the quarter ended.....* pursuant to non-aligned schemes by (name of the company)

Financial year Type of scheme (ESOP/ non-ESOP)	Brief particulars of the benefits under the scheme	Type of beneficiaries	Value of the benefit/ allotment	Percentage of shares used for granting benefits/ allotting shares to the total paid-up share capital
		Promoter/ promoter group/ directors holding > 10%		
		Others		

Impact of SEBI's recent decision

- All the existing employee welfare schemes (e.g., ESOS and ESPS) will be aligned with SEBI (ESOS and ESPS) Guidelines, 1999 within the prescribed time, i.e. 31st December, 2013.
- With additional disclosures to stock exchanges being made mandatory, transparency with regard to the employee benefit schemes will be ensured.
- Under the SEBI (ESOS and ESPS) Guidelines, 1999 the auditor has to certify that the scheme has been implemented in accordance with these



guidelines and in accordance with the resolution of the company in the general meeting. With the recent circular of SEBI, auditors' responsibility is enhanced so as to ensure that such schemes are aligned with the SEBI (ESOS and ESPS) Guidelines, 1999 within the time prescribed and necessary disclosures are made to the stock exchanges.

- The accounting treatment given under the Guidance Note on *Accounting for Employee Share-based Payments* issued by ICAI for an 'enterprise providing finance to the ESOP trust to purchase shares from the market at the beginning of the plan' shall not be applicable to listed entities.
- SEBI's recent decision may also have some tax implications.
- New employee welfare schemes will be framed keeping in mind SEBI (ESOS and ESPS) Guidelines, 1999 (*as amended by various circulars from time to time*).
- The employee benefit schemes will be framed for the purpose of rewarding the employees rather than engaging in fraudulent and unfair trade practices. ■