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Newsletter September 2015

Search for New SEBI Chairman

The Finance Ministry has issued a notification inviting applications from eligible candidates for the post of the Chairman of SEBI. Details have been provided on the Finance Ministry website.

Applicability of SEBI Regulations to Phantom Stock Schemes

SEBI recently issued two informal guidances in response to queries raised by *Mindtree Limited* and *Saregama India Limited*. The queries raised by the two companies were in relation to employee benefit schemes called the "Phantom Stock Scheme" granted to their employees. Mindtree granted Stock Appreciation Right ("**SAR**") units to 6 employees who are also promoters of the company, while Saregama granted certain SAR units to its managing director. As per the scheme, notional SAR units were issued at a pre-determined grant price and the promoters/MD were entitled to receive cash payment for appreciation in the share price over the grant price for the awarded units, based on the company achieving the specified revenue targets. The scheme, however, did not involve any actual purchase or sale of shares of the company. The issue involved here was whether the Phantom Stock Scheme fell within the purview of the SEBI (Share Based Employee Benefits) Regulations, 2014 ("**SBEB Regulations**") and whether issuance of SAR units to promoters of the company, who were also employees is fully compliant with the SBEB Regulations. *Saregama*, in addition to queries raised by *Mindtree*, also raised a query as to whether such phantom options could be granted to its managing director.

SEBI in its response stated that the provisions of the SBEB Regulations applied to a scheme involving dealing in or subscribing to or purchasing securities of the company, directly or indirectly. Since the Phantom Stock Scheme did not involve any actual purchase or sale of equity shares of the company, SEBI held that the SBEB Regulations "*may not apply to the instant Phantom Stock Scheme*". Since the Phantom Stock Scheme did not fall within the purview of the SBEB Regulations the other queries posed by them as to whether the same could be granted to promoters or the managing director became irrelevant and SEBI did not answer them.

It has to be noted that while Regulation 1(3)(iii) of the SBEB Regulations provides that it applies to stock appreciation rights schemes, in light of the response given by SEBI in these two cases, the SBEB Regulations shall not apply to those stock appreciation rights schemes that do not involve dealing in or subscribing to or purchasing securities of the company, directly or indirectly.

Amendments to SEBI SBEB Regulations

SEBI in its recent boarding meeting approved certain amendments to the SEBI SBEB Regulations.

The SBEB Regulations mandate that the shareholding of employee benefit trusts must be disclosed in the category of 'non-promoter and non-public' and that shares held by such trusts will not be considered to be public shareholding for the purpose of MPS requirements under the SCRA. However, the effective date of this provision was deferred for five years from the date the regulations came into force. In light of a recent amendment to the SCRR specifically reducing this period to three years, SEBI approved the amendment to the regulations to align the same with the SCRR. Further, the ban for such employee benefit trusts from exercising voting rights in relation to shares held by them, which was scheduled to begin from one year from the date the SBEB Regulations came into place, has now been extended to three years from the date on which the regulations were notified.

Further, the board has also approved an amendment that will now exclude employees of associate companies from the definition of 'employee', thereby rendering them ineligible to receive benefits from employee benefit trusts. This is in light of the amendment to the Companies (Share Capital and Debentures) Rules, 2014, on March 18, 2015, which also excludes employees of associate companies from receiving stock options. However, employees of holding companies and subsidiaries will continue to receive the benefit. Lastly, the regulations have been amended to allow employee benefit schemes to take part in open offers, buy-backs and delisting offers, through the stock exchange mechanism, without having to comply with the minimum holding period requirement of six months imposed therein.

Clarification on exercise of options / applicability of contra-trade norms, etc. in light of SEBI (Prohibition of Insider Trading) Regulations, 2015

The contra-trade rule under Clause 10, Schedule B of the Model Code of Conduct under the SEBI (PIT) Regulations, 2015, prohibits a person from entering into an opposite transaction in securities within six months of having sold/bought securities. Given the broad definition of trading under the PIT Regulations, 2015 and the absence of any exemption pertaining to ESOPs, the contra-trade was being made applicable even to exercise of ESOPs. However, SEBI released a Guidance Note dated 24 August, 2015, clarifying that the contra-trade rule is not applicable to exercise of ESOPs and the sale of shares so acquired. The position is similar to that under the earlier regime, where exercise of ESOPs and the sale of those shares were exempted transactions in relation to the contra trade rule. SEBI has clarified that exercise of ESOPs does not amount to

"trading" for the purposes of the PIT Regulations, 2015. Accordingly, a designated person may now carry on contra trades in their ESOP shares within a period of six months, without being hit by the contra-trade rule under the PIT Regulations, 2015. However, the disclosure related provisions under Chapter III of the PIT Regulations will still have to be complied with.

The Guidance Note makes a few other clarifications, such as, a derivative contract that is cash settled on expiry shall be considered as a contra-trade. However, the contra-trade restriction shall not be applicable in situations such as buy back offers, open offers, rights issues, FPOs, bonus etc. of a listed company. Moreover, it has been clarified that the contra trade rule will be applicable not only to designated persons of a listed company, but also to designated employees of market intermediaries and other persons who have to handle UPSI during business operations.

This clarification from SEBI has removed the uncertainties and difficulties faced by industry participants in interpreting and enforcing the contra-trade rule with respect to ESOPs. Listed companies, especially, non cash-rich ones where ESOPs form a significant aspect of employee compensation, can heave a sigh of relief as designated persons can exercise ESOPs freely, without being hindered by the contra-trade rule.

Public money and listing for start-ups

After a prolonged debate as to how best to facilitate start-up funding through the public markets, SEBI has finally released new listing norms for start-ups with an intention to provide a viable domestic avenue for such companies to raise capital. To this end, SEBI has issued the Fourth Amendment to ICDR Regulations, 2015 and has replaced the existing Chapter XC of the ICDR Regulations. Previously, Chapter XC permitted companies younger than 10 years with revenues under Rs. 100 crore and having paid-up capital of less than Rs. 25 crore to list their shares without making a public issue on an *Institutional Trading Platform* (ITP). The erstwhile ITP did not allow capital raising, but was put in place solely for the purpose of providing an exit to its existing investors. The new ITP not only allows start-ups to raise capital, it also provides several relaxations as compared to the procedures involved in raising capital under the traditional IPO route. Moreover, the age and size requirements from the erstwhile ITP have also been removed. Following is a brief summary of the changes introduced to the ITP platform:

Eligibility: Any entity which is a) "*intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value addition*", b) has 25% of its pre-issue capital in the hands of QIBs and c) with no person, individually or collectively with persons acting in concert, holding 25% or more of the post-issue share capital can make use of the new ITP. For other entities, at least 50% of the pre-issue capital is required to be held by QIBs, for them to access the new ITP.

Issue size: Although the minimum issue size has been brought down (to 20 Cr.) from what was initially stipulated (50 Cr.), the new ITP continues to be a big-player's market where the minimum trading lot shall be Rs. 10 lakh. The allocation in the net offer to public category would be 75% to the institutional investors and 25% to non-institutional investors. SEBI has permitted discretionary allotment for institutional investors but allotment to non-institutional investors has to be on a proportionate basis.

Listing: Listing without a public issue can be done through an *information document,* approved and signed by the board of directors of the entity, the CEO and the CFO, whereas, an entity seeking to raise capital, may do so through an offer document filed with SEBI. The minimum application size shall be Rs. 10 lakh with at least 200 allottees.

Basis of Issue price: Companies would have ample flexibility in relation to pricing their securities. The basis of issue price may be in the form of disclosures, except projections, as deemed fit by the issuers in order to enable investors to take informed decisions.

Objects of the Issue: Although the new norms merely require an issuer to disclose the broad objects of the issue, the expected relaxation allowing companies to use more than 25% of the issue size for general corporate purposes has not been specifically provided for.

Lock-in: The entire pre-issue capital of the shareholders shall be locked-in for a period of six months from the date of allotment in case of a public issue or date of listing in case of listing without a public issue. Pre-issue ESOPs and shares held by VCFs / Cat I AIFs / FVCIs would not be subject to these restrictions, subject to certain conditions.

Exit or Migration: Companies would have the option of exiting the new ITP with the approval of the shareholders through a special resolution through postal ballot where ninety per cent of the total votes and the majority of non-promoter votes have been cast in favor of such proposal. Further, companies would be permitted to migrate to the main board after expiry of three years from the date of listing.

Other Exemptions: The SEBI (Delisting) Regulations would not be applicable to companies listed on the new ITP and the securities listed on the ITP would henceforth be deemed to be *'unlisted securities'* for the purposes of the SEBI (AIF) Regulation and SEBI (SAST) Regulations.

All in all, this is a welcome move and it would be great to see new-age companies including e-commerce ventures accessing the ITP. Now, the recognised stock exchanges would have three primary divisions of equity listing the main board, the SME board, and the ITP. However, some discomfort remains over the conservative attitude of the regulator towards retail investors. Additionally, the requirement of having such a high QIB holding and a diluted promoter holding may prove to be a hindrance for start-ups to list on the platform. SEBI may consider relaxing the same.

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