

MEPL CLASSES

CS PROFESSIONAL – CORPORATE FINANCE

RAISING OF FUNDS – NON FUND BASED

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(TIME ALLOTTED – 1 HOUR)

(MARKS ALLOTTED – 30 MARKS)

EACH QUESTION CARRIES 5 MARKS

Question 1.

The Board of Directors of Prakash Limited are planning to introduce an Employee Stock Option Scheme (ESOS) for select category of employees. The Board has requested the Company Secretary to prepare the required documentation for obtaining in-principle approval from Stock Exchanges. Advise.

Answer to Question 1.

Options to purchase securities including any ESOP/ESPS Scheme shall be disclosed to the stock exchange upon application of the guidelines for materiality.

In terms of the SEBI circular dated September 09, 2015, the details which a listed entity need to disclose for events on which the listed entity may apply materiality in terms of Para B of Part A of Schedule III of Listing Regulations are:

a) brief details of options granted; b) whether the scheme is in terms of SEBI (SBEB) Regulations, 2014 (if applicable); c) total number of shares covered by these options; d) pricing formula; e) options vested; f) time within which option may be exercised; g) options exercised; h) money realized by exercise of options; i) the total number of shares arising as a result of exercise of option; j) options lapsed; k) variation of terms of options; l) brief details of significant terms; m) subsequent changes or cancellation or exercise of such options; n) diluted earnings per share pursuant to issue of equity shares on exercise of options.

The listed entity shall first disclose to stock exchange of all events or information which are material, as soon as reasonably possible and not later than 30 minutes from the closure of the meeting of the board of directors in which the decision pertaining to the event has been taken.

Pre-Issue Formalities Checklist - Prior In-principle under Regulation 28(1) of the SEBI (Listing Obligations and Disclosure Requirements), Regulations, 2015 for ESPS/ESOS/SARS/GEBS/RBS:

- 1. Certified copy of Stock Option/Stock Purchase Scheme/ Stock Appreciation Rights Scheme/ General Employee Benefits Scheme/ Retirement Benefit Schemes, certified by the Company Secretary.**
- 2. Certified copy of statement to be filed with the Stock Exchange as required under Regulation 10(b) of the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.**
- 3. Certified true copy of the notice of AGM/EGM for approving the Scheme/for amending the Scheme/for approving grants under Regulation 6 of the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021, certified by the Company Secretary.**
- 4. Certified true copy of special resolution along with the explanatory statement passed by the shareholders of the Company approving/ amending the Scheme.**
- 5. Certificate of Secretarial Auditors on compliance with SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.**
- 6. Certificate of Merchant Banker on compliance with SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.**
- 7. List of Promoters as defined under the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.**
- 8. Details of employee (wherever applicable) –**
 - a) Who have been granted options/issued shares in excess of 5% of option/shares issued in one year.**
 - b) Who have been granted options/issued shares equal to or exceeding 1% of issued capital during any one year.**
- 9. Copy of latest Annual Report.**
- 10. Specimen copy of Share certificate (where shares are issued in physical form).**
- 11. Confirmation from the Company.**
- 12. Undertakings as required by SEBI.**

13. Reconciliation statement.
14. Certified true copy of irrevocable trust deed.
15. Certified true copy of Disclosure document (applicable only for ESOS and SARS).
16. Processing fees.

Question 2.

Explain the provisions of the Companies Act, 2013 for Issue of Sweat Equity Shares. To what extent the Sweat Equity Shares can be issued to an Independent Director ?

Answer to Question 2.

A. Provisions pertaining to Sweat Equity Shares under the Companies Act, 2013

Section 2 (88) of the Companies Act, 2013 defines “sweat equity shares” means such equity shares as are issued by a company to its directors or employees at a discount or for consideration, other than cash, for providing their know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

According to Section 54 of the Companies Act, 2013, a company may issue sweat equity shares of a class of shares already issued, if the following conditions are fulfilled:

- (a) The issue is authorized by a special resolution passed by the company in the General Meeting.
- (b) The resolution specifies the number of shares, current market price, consideration, if any and the class or classes of directors or employees to whom such equity shares are to be issued.
- (c) The sweat equity shares of a company whose equity shares are listed on a recognized stock exchange are issued in accordance with the Regulations made by SEBI in this regard and if they are not listed the sweat equity shares are to be issued in accordance with Rule 8 of the Companies (Share Capital and Debenture) Rules, 2014.
- (d) The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank pari passu with other equity shareholders.

Rule 8 of the Companies (Share Capital and Debentures) Rules, 2014 provides that a company other than a listed company, which is not required to comply with the SEBI Regulations on sweat equity, shall not issue sweat equity shares to its directors or employees at a discount or for consideration other than cash, for their providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called, unless the issue is authorised by a special resolution passed by the company in general meeting.

The Companies (Share Capital and Debentures) Rules, 2014 have defined 'value additions' to mean actual or anticipated economic benefits derived or to be derived by the company from an expert or a professional for providing know-how or making available rights in the nature of intellectual property rights, by such person to whom sweat equity is being issued for which the consideration is not paid or included in the normal remuneration payable under the contract of employment, in the case of an employee.

Question 3.

What are the documents required to be prepared by the company secretary for listing approval for Bonus Shares issued by the company for documentation purpose ?

Answer to Question 3.

Documents required for granting in-principle approval for listing under Regulation 28(1) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, for the companies proposing Bonus Issue

1. Certified copy of the resolution passed by the Board of Directors of the Company approving the bonus issue.
2. Certified true copy of the notice convening the AGM/EGM of shareholders along with the explanatory statement annexed thereto where the proposal for issue is to be put for approval.
3. Certified copy of the resolution passed by the shareholders at the AGM/EGM approving the Bonus issue; and/or Increase in the authorised share capital, if applicable.
4. Certificate from Statutory Auditors / Practicing Chartered Accountant / Practicing Company Secretary confirming that the proposed bonus issue is being made in accordance with the requirements of Chapter XI of SEBI (Issue of Capital & Disclosure Requirement) Regulations, 2018.
5. Statement of total bonus entitlement as per the existing capital, bonus shares to be allotted and shares kept in abeyance, if any to be given by the Company Secretary.
6. Certified true copy of the amended copy of the Memorandum and Articles of Association of the Company. In case the Memorandum and Articles of Association is not amended, confirmation from the company regarding the same.
7. Confirmation by the Managing Director/ Company Secretary.

8. Processing fee.

9. Copy of the latest audited annual report.

10. Name & Designation of the Contact Person of the Company. Telephone Nos. (landline & mobile) Email address.

Question 4.

Explain the implementation of ESOP Schemes through Trust in accordance with SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021.

Answer to Question 4.

Implementation of Schemes through Trust

1. A company may implement a scheme(s) either directly or by setting up an irrevocable trust(s). 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(s). However, 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. Further it is provided that if the scheme(s) involves secondary acquisition or gift or both, then it shall be mandatory for the company to implement such scheme(s) through a trust(s).

2. A company may implement several schemes as permitted under these regulations through a single trust.

However, such single trust shall keep and maintain-

– proper books of account; – records and documents;

for each such scheme so as to explain its transactions and to disclose at any point of time the financial position of each scheme and in particular give a true and fair view of the state of affairs of each scheme.

3. The trust deed, under which the trust is formed, shall contain provisions as specified in Part A of Schedule – I of these regulations and such trust deed and any modifications thereto shall be mandatorily filed with the recognised stock exchange(s) in India where the shares of the company

are listed. According to Part A on “Minimum Provisions in Trust Deed” under Schedule I the trust deed shall, inter alia, cover the following:

I Details of the trust, include the Name of the trust; Object of the trust; Details of settlor; Details of scheme(s) administered; Source(s) of funds; Description of the manner in which the trust funds shall be used for meeting the objects of the trust; Description of the classes of beneficiaries along with their rights and obligations; Details of trustee(s).

I Powers and duties of trustee(s), including:

- To frame rules for administration of the scheme(s) in compliance with the scheme documents, object(s) of the trust and these regulations;
- To maintain books of account of the trust as required under law including these regulations.

I Provisions for dissolution of the trust.

I Trust deed shall provide that it would be the duty of the trustees to act in the interest of employees who are beneficiaries of the trust and subject to provisions of these regulations, it shall not act in any manner or include any provision in the trust deed that would be detrimental to the interests of the beneficiaries.

I Such other clauses which are necessary for safeguarding the interests of the beneficiaries.

4. Any person can be appointed as a trustee of the trust, except in cases where such person —

- i. is a director, key managerial personnel or promoter of the company or its group company including its holding, subsidiary or associate company or any relative of such director, key managerial personnel or promoter; or
- ii. beneficially holds ten percent or more of the paid-up share capital or the voting rights of the company.

However, where individual(s) or “one person company” as defined under the Companies Act, 2013 is appointed as trustee(s), there shall be a minimum of two such trustees, and in case a corporate entity is appointed as a trustee, then it may be the sole trustee.

5. The trustees of a trust, which is governed under these regulations, shall not vote in respect of the shares held by such trust, so as to avoid any misuse arising out of exercising such voting rights.

6. The trustee should ensure that the requisite approval from the shareholders has been obtained by the company in order to enable the trust to implement the scheme(s) and undertake secondary acquisition for the purposes of the scheme(s).

7. The trust shall not deal in derivatives and shall undertake only delivery-based transactions for the purposes of secondary acquisition as permitted by these regulations.

8. Subject to the requirements of the Companies Act, 2013 read with Companies (Share Capital and Debenture) Rules, 2014, as amended from time to time, as may be applicable, the company may lend monies to the trust on appropriate terms and conditions to acquire the shares either through new issue or secondary acquisition, for the purpose of implementation of the scheme(s).

9. For the purpose of disclosures to the recognised stock exchange, the shareholding of the trust shall be shown as “non-promoter and non-public” shareholding. Explanation,—The shares held by the trust shall not form part of the public shareholding which needs to be maintained at a minimum of twenty five per cent as prescribed under the Securities Contracts (Regulation) Rules, 1957.

10. Secondary acquisition in a financial year by the trust shall not exceed two per cent of the paid up equity capital of the company as at the end of the previous financial year.

11. The total number of shares under secondary acquisition held by the trust shall at no point of time exceed the below mentioned limits as a percentage of the paid up equity capital of the company as at the end of the financial year immediately prior to the year in which the shareholders’ approval is obtained for such secondary acquisition:

Sl. No.	Particulars	Limit
A	For the schemes enumerated in Part A (ESOS), Part B (ESPS) or Part C (SAR) of Chapter III of these regulations	5%
B	For the schemes enumerated in Part D (GEBS), or Part E (RBS) of Chapter III of these regulations	2%
C	For all the schemes in aggregate	5%

12. The unappropriated inventory of shares which are not backed by grants, acquired through secondary acquisition by the trust under Part A, Part B or Part C of Chapter III of these regulations,

shall be appropriated within a reasonable period which shall not extend beyond the end of the subsequent financial year, or the second subsequent financial year subject to approval of the compensation committee/nomination and remuneration committee for such extension to the second subsequent financial year

13. The trust shall be required to hold the shares acquired through secondary acquisition for a minimum period of six months except where they are required to be transferred in the circumstances enumerated in these regulations, whether off-market or on the platform of recognised stock exchange.

14. The trust shall be permitted to undertake off-market transfer of shares only under the following circumstances: -

- (a) transfer to the employees pursuant to scheme(s);
- (b) while participating in an open offer under the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 or while participating in a buy-back, delisting or any other exit offered by the company generally to its shareholders.

15. The trust shall not become a mechanism for trading in shares and hence shall not sell the shares in secondary market except under the following circumstances:

- (a) to enable the employee to fund the payment of the exercise price, the amount necessary to meet his/her tax obligations and other related expenses pursuant to exercise of options granted under the ESOS;
- (b) on vesting or exercise, as the case may be, of SAR under the scheme covered by Part C of Chapter III of these regulations;
- (c) in case of emergency for implementing the schemes covered under Part D and Part E of Chapter III of these regulations, and for this purpose – (i) the trustee(s) shall record the reasons for such sale; and (ii) money so realised on sale of shares shall be utilised within a definite time period as stipulated under the scheme or trust deed.
- (d) participation in buy-back or open offers or delisting offers or any other exit offered by the company generally to its shareholders, if required;
- (e) for repaying the loan, if the unappropriated inventory of shares held by the trust is not appropriated within the timeline as provided above;

(f) winding up of the scheme(s); and

(g) based on approval granted by the Board to an applicant, for the reasons recorded in writing in respect of the schemes covered by Part A or Part B or Part C of Chapter III of these regulations, upon payment of a non-refundable fee of rupees one lakh to the Board along with the application by way of direct credit in the bank account through NEFT/RTGS/IMPS or any other mode allowed by the Reserve Bank of India.

16. The trust shall be required to make disclosures and comply with the other requirements applicable to insiders or promoters under the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 or any modification or re-enactment thereto.

Question 5.

“In a growing company, ESOP are being used to retain talent.” Discuss

Answer to Question 5.

A company always wants to retain the top talent in the company those already working within the company for the future success of the organization. One of the ways in which companies attract and retain key employees is by rewarding them with equity shares, traditionally, which are called Sweat Equity Shares and through various employee benefits schemes like ESOP. The aim of ESOP or sweat equity is to retain the best employees by offering a good enough carrot.

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:

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

Question 6.

What are applicability and non-applicability of the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021?

Answer to Question 6.

Applicability

The provisions of the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 shall apply to the following: -

- (i) employee stock option schemes;
- (ii) employee stock purchase schemes;
- (iii) stock appreciation rights schemes;
- (iv) general employee benefits schemes;
- (v) retirement benefit schemes; and
- (vi) sweat equity shares.

Non- Applicability

The provisions pertaining to preferential issue as specified in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 shall not be applicable in case of a company issuing new shares in pursuance and compliance of these regulations except wherever specifically provided for in these regulations.