

## Corpsec Hotline

August 25, 2012

### SEBI CLARIFIES THAT AN EX-EMPLOYEE SHALL NOT BE ELIGIBLE FOR EXEMPTION FROM LOCK-IN POST LISTING

The Securities and Exchange Board of India ("SEBI"), the Indian securities market regulator, recently issued an informal guidance to Multi Commodity Exchange of India Limited<sup>1</sup> ("Company"), in relation to the availability of exemption from lock-in requirement for ex-employees, who were allotted equity shares under employee stock option plans ("ESOP"). SEBI in the informal guidance issued to the Company has clarified that such an exemption is available only to an 'employee' of a company or its holding company and not to former employees of such entities, under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 ("ICDR Regulations").

#### BACKGROUND

1. The Company is engaged in the business of facilitating nationwide online trading, clearing and settlement operations of commodities futures transactions, and recently got listed in March, 2012. Before listing in 2012, the Company had duly implemented two ESOP.
2. The Company implemented the first ESOP scheme in 2006 in which the employees of the Company as well the employees of Financial Technologies (India) Limited ("FTIL"), the erstwhile holding company of the Company, also participated.
3. The then existing ESOP scheme was replaced with a new plan called ESOP 2008.
4. At the time of its listing in March 2012, FTIL was no more the holding company of the Company.
5. Accordingly, equity shares allotted by the Company under the ESOP to: (i) employees who had ceased to be in employment of the Company; and (ii) past or present employees of FTIL, were locked in by the Company for a period of one year from the date of allotment on listing as per regulation 37 of the ICDR Regulations.
6. Some former employees of the Company approached the Company stating that they are eligible for the exemption from lock-in under the ICDR Regulations, as they were covered under the definition of 'employees' under the said regulations, when they were allotted equity shares under the ESOP plans.

#### INFORMAL GUIDANCE SOUGHT BY THE COMPANY

In this regard, the Company had approached SEBI to seek clarification whether former employees of the Company and current & former employees of FTIL, who were allotted equity shares under the two ESOP schemes, are eligible for the exemption from lock-in or not, as is available to 'employees' under the ICDR Regulations?

#### ANALYSIS OF LEGAL AND REGULATORY FRAMEWORK

As per regulation 37 of the ICDR Regulations all persons holding shares of a company other than the promoters are subject to lock-in for a period of one year from the date of allotment unless exempted otherwise. The ICDR Regulations exempt employees of the company who were allotted shares as part of an ESOP, from this requirement<sup>2</sup>. The term 'employee' has been defined in the ICDR Regulations to provide reference to gauge who all are eligible to seek this exemption. The extant definition of 'employee' under ICDR Regulations after amendment in April 2010<sup>3</sup> to include holding company or subsidiary company or associate company reads as follows:

"employee means a permanent and full-time employee, working in India or abroad, of the issuer or of the holding company or subsidiary company or of that material associate(s) of the issuer whose financial statements are consolidated with the issuer's financial statements as per Accounting Standard 21, or a director of the issuer, whether whole time or part time and does not include promoters and an immediate relative of the promoter (i.e., any spouse of that person, or any parent, brother, sister or child of that person or of the spouse)<sup>4</sup>"

Further, the Company highlighted the informal guidance issued by SEBI to Firstsource Solutions Limited<sup>5</sup> wherein SEBI had clarified any person who has ceased to be in employment of the company is not covered in the definition of employee and therefore the exemption from lock-in shall not be available.

#### INFORMAL GUIDANCE PROVIDED BY SEBI

SEBI in its informal guidance has clarified that "any person who ceased to be in the employment of the company as on the date of allotment of shares pursuant to the IPO is not considered as employees and hence the shares held by them would not be considered for the purpose of exemption from one year lock-in under proviso (a) to Regulation 37 of the SEBI (ICDR) Regulations, 2009. In other words, such shares held by ex-employees have to be locked in under Regulation 37 of SEBI (ICDR) Regulations 2009."

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Accordingly, SEBI stated that the former employees of the Company as well as the former & existing employees of FTIL (the erstwhile holding company of the Company) who were allotted shares under the ESOP schemes, will not be exempt from lock-in requirement under the ICDR Regulations, as they were not covered under the definition of ‘employee’ as defined in the ICDR Regulations.

In backdrop of the above, ambiguities remain for e.g. if we consider a situation where shares are allotted pursuant to an ESOP after listing, wherein options under the ESOP became vested before listing but such options were exercised post-listing and such employee leaves the employment of the company after listing. While such allotted shares under ESOP post-listing not being part of the pre-issue capital will not be subject to lock-in under ICDR Regulations, it needs to be seen how regulators will view such a situation.

CONCLUSION

As noted in the Report of the Committee on Employee Stock Options issued in 1999<sup>6</sup>, a typical employee in India is not a hard-nosed investor. To bring a significant number of employees on board a stock option scheme, the scheme has to be sufficiently attractive to convince the average skeptical employee. Such a strict and technical interpretation of the ICDR Regulations by restricting the availability of such an exemption to only current employees may act as a de-motivator for the employees towards accepting ESOPs as part of their compensation and their interests may not be adequately aligned.

– Aditya Shukla, Ruchi Biyani & Vyapak Desai  
You can direct your queries or comments to the authors

<sup>1</sup> Informal Guidance issued to Multi Commodity Exchange of India Limited, CFD/DIL-II/SK/RA/AEA/IG/OW/17246/2012 dated August 3, 2012.  
<sup>2</sup> Regulation 37 (a) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009  
<sup>3</sup> SEBI Notification No. LAD-NRO/GN/2010-11/03/1104, SEBI (Issue of Capital and Disclosure Requirements) (Third Amendment) Regulations, 2010 (April 13, 2010) available at: [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1288255186693.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1288255186693.pdf)  
<sup>4</sup> Regulation 2(1)(m), SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009  
<sup>5</sup> Informal Guidance issued to Firstsource Solutions Limited, CFD/DIL/SC/108412/2007 dated November 14, 2007.  
<sup>6</sup> Report of the Committee on Employee Stock Options (January 14, 1999) available at: <http://www.iimahd.emet.in/~jrvarma/reports/esop/MainRept.pdf>

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