Sebi cracks down on misuse of Esops

Restricts buying by schemes from secondary market
N Sundaresha Subramanian & Sameer Mulgaonkar / New Delhi/ Mumbai
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The Securities and Exchange Board of India (Sebi) has cracked down on the misuse of Employee Stock Option Plans (Esops) and other employee benefit schemes by promoters. In its latest board meeting, the regulator decided such schemes would not be allowed to make purchases from the secondary market.

"Such schemes will be restrained from acquiring their shares from the secondary market," the Sebi decided last week. An employee stock option gives directors, officers or employees the benefit or right to purchase or subscribe at a future date securities offered by the company at a predetermined price. In the absence of any express provision in the companies' law or Sebi guidelines, companies use both fresh issuances and secondary market purchases to accumulate shares for these schemes.

Some employee welfare schemes accumulated a disproportionate amount of shares from the market, evoking fear among some analysts that these schemes, originally devised to encourage employee participation in creating shareholder value, were used by promoters as vehicles to "reduce float in the market and increase control surreptitiously". There were also reported instances where the schemes borrowed heavily from group entities to finance share purchases.

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Ashvin Parekh, national leader, Ernst & Young, said, "Such schemes often become vehicles to disguise real wealth or income. The latest move suggests that Sebi is going to be strict in the implementation of the guidelines." The employee benefit schemes by listed companies are governed by Sebi (employee stock option scheme and employee stock purchase scheme) guidelines, 1999.

According to a BS Research Bureau study of listed companies that have declared their shareholding patterns as of June 30, there were over a hundred companies that had employee welfare schemes as shareholders. Of these, 15 employee welfare schemes had holdings of over five per cent in their respective companies. L&T Employee Welfare Foundation, which holds 12.14 per cent in diversified major Larsen & Toubro, is the largest such scheme. Esop trusts with high holdings include PSPL ESOP Management Trust, which holds 8.67 per cent in Persistent Systems. Patel Engineering (8.66 per cent), B2B Soft Tech (5.18 per cent), Solix Technologies (4.72 per cent) and Agrotech Foods (4.01 per cent) also have significant holdings by employee welfare schemes.

Pavan Kumar Vijay, managing director, Corporate Professionals, said, "Esop trusts have a specific purpose. They are meant to hold shares on behalf of employees. These trusts should not be used as portfolio managers for promoters."

Earlier this month, the Canada-based ***Veritas Investment Research*** pointed out how Indiabulls' employee welfare trust (EWT), an Esop trust of the Indiabulls group, held a huge chunk of shares in Indiabulls Real Estate. According to ***Veritas***, EWT was formed in October 2010 and soon after bought some 26.8 million shares of Indiabulls Financial Services (IBFSL) at a cost of Rs 480 crore. It also purchased 39.7 million shares of Indiabulls Real Estate during FY11 and FY12. In response, Indiabulls had said the EWT was not a 100 per cent subsidiary and operated at an arm's length through independent trustees. "IBFSL has maintained a very healthy practice of grant of Esops to employees even before it went public in 2004. The Esop scheme of the company is in line with the other leading housing finance companies and NBFCs," Indiabulls had said.

Parekh said regulatory guidelines on the timeline for non-compliant schemes to fall in line were expected. "If everyone unwinds in one go, there could be some impact on the market. They might have to phase it out," he said.