

Sebi crackdown on employee benefit schemes via trusts may hit investors

Implementing employee benefit schemes through trusts has been a legally accepted concept for companies in India. Many companies use employee welfare trusts to implement various schemes, such as employee stock option or stock purchase plans, providing financial assistance, medical benefit, and so on, as it was feasible legally as well as administratively. However, in light of the rising concerns on insider trading and unfair trade practices, the Securities and Exchange Board of India (Sebi) appears to be losing faith in trusts.

The market regulator, in a circular in January 2013, prohibited listed companies from using the employee welfare trust route for framing any employee benefit schemes involving acquisition of own securities from the secondary market, a move which has been in the pipeline since its board meeting in August 2012. Companies that have already implemented such schemes prior to this circular would need to inform about the same to the stock exchanges within 30 days and align their existing schemes by 30 June 2013.

The Sebi's crackdown against employee welfare schemes through trusts has also come amid concerns that some companies may be funding these schemes to deal in their own securities with an aim to manipulate the share price by engaging into fraudulent and unfair trade practices.

Typically, companies tend to hold shares through trusts, taking shelter of employee incentive schemes to comply with the listing norms. There are inconsistencies in disclosure of such shares held by trusts. In some cases, these shares are disclosed under promoter group, whereas in other cases, these are disclosed as part of public shareholding. Taking note of such issues, Sebi has prohibited incentive schemes that involve dealing in own securities from the secondary market.

While the move is aimed at gaining investor confidence and increasing transparency, the investors would actually be at a loss if the trust starts offloading the shares in the market in bulk to comply with the circular. Also, Sebi's apprehension against a few companies is likely to impact majority of companies and investors of such companies which do not use trust to indulge in unfair trade practices.

Another typical category of companies that would be hugely impacted would be those whose stock options provided to the employees through trusts are currently underwater (i.e., their market price is below the offer price) and the employees refrain from exercising such options.

In such cases, the current price of shares is lower than the price at which the same were acquired by the trust, and in order to comply with the circular, the trust would need to offload the shares in the market at a loss. Such offloading would defeat the purpose of the trust and would lead to uncertainty within the company and among the employees.

Separately, unlisted companies that have implemented employee incentive schemes using the trust route would also need to revisit their existing schemes if they intend to go public in the near future. As the circular prescribes stringent time lines to comply with the requirements, Sebi would do well by extending the timeline to ensure a higher rate of compliance and lower impact on stock prices

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