



Consultation Paper on amendments to SEBI (ICDR) Regulations, 2018, and SEBI (SBEB & SE) Regulations, 2021, with the objective of streamlining certain processes related to requirements of a public issue.

1. Objective:

1.1. This consultation paper seeks comments / suggestions from the public on the following proposals relating to amendments to SEBI (ICDR) Regulations, 2018, (“ICDR Regulations”) and SEBI (SBEB & SE) Regulations, 2021, (“SBEB Regulations”) with the objective of streamlining certain processes and providing clarifications related to requirements of a public issue:

1.1.1. **Minimum holding period for Equity Shares to be eligible for Offer for Sale (OFS) in public issue**

1.1.2. **Clarification on ESOPs granted prior to filing of DRHP to founders who are classified as promoters at the time of filing of DRHP**

2. Minimum holding period for Equity Shares to be eligible for OFS in public issue:

2.1. **Existing provisions** – As per Regulation 8 of ICDR Regulations, following provisions are prescribed regarding conditions for offer for sale in IPO (for FPO same provisions are under Regulation 105):

“8. Only such fully paid-up equity shares may be offered for sale to the public, which have been held by the sellers for a period of at least one year prior to the filing of the draft offer document:

Provided that in case the equity shares received on conversion or exchange of fully paid-up compulsorily convertible securities including depository receipts are being offered for sale, the holding period of such convertible securities, including depository receipts, as well as that of resultant equity shares together shall be considered for the purpose of calculation of one year period referred in this sub-regulation.

.....

Provided further that the requirement of holding equity shares for a period of one year shall not apply:

a)

b) if the equity shares offered for sale were acquired pursuant to any scheme approved by a High Court or approved by a tribunal or the Central Government under the sections 230 to 234 of Companies Act, 2013, as applicable, in lieu of business and invested capital which had been in existence for a period of more than one year prior to approval of such scheme;

2.2. Need to review - The proviso (b) to Regulation 8 i.e. relevant Regulation 8 proviso, refers to only equity shares acquired pursuant an Approved Scheme, and not fully paid-up compulsorily convertible securities. Therefore, in the event shareholders receive fully paid-up compulsorily convertible securities pursuant to an Approved Scheme, which are then converted into equity shares and offered for sale, there remains ambiguity whether the exemption under the Relevant Regulation 8 proviso extends to such converted equity shares or not.

2.3. Suggestion/ Representation received- The Regulation 8 proviso to be amended and shall read to include equity shares received upon conversion of such fully paid-up compulsorily convertible securities, thereby extending the exemption from the requirement of the minimum holding period of one year to such fully paid-up compulsorily convertible securities.

2.4. Rationale –

2.4.1. In respect to eligibility of shares for Minimum Promoters' contribution (MPC) requirements, in terms of proviso (ii) of Regulation 15(1) (b), **specified securities** acquired pursuant to terms of an Approved Scheme, by the promoters in lieu of business and invested capital that had been in existence for a period of more than one year to such approval, are eligible for MPC. Thus, the exception under Regulation 15(1)(b) proviso(ii) of the SEBI ICDR Regulations extends to all specified securities (and is not limited to equity shares) acquired pursuant to an Approved Scheme.

2.4.2. The rationale behind the one-year holding period under Regulation 8 of the SEBI ICDR Regulations serves objective of demonstration of long term commitment by shareholders before shares are offered for sale. Accordingly,

eligibility of equity shares to be offered for sale would need to be calculated based on the period of existence of “invested capital”.

2.4.3. The relevant Regulation 8 proviso should be read harmoniously with the first proviso to Regulation 8 of the SEBI ICDR Regulations, pursuant to which the holding period of compulsorily convertible securities is also considered in order to calculate the minimum holding period of one year. On this basis, it is submitted that the regulatory intent behind the inclusion of the relevant Regulation 8 proviso extends to specified securities and is not limited to equity shares acquired pursuant to an Approved Scheme.

2.4.4. Above shall also harmonize requirements for MPC under Regulation 15 with requirements for OFS under Regulation 8. Presently, eligibility of equity shares for OFS and MPC is as under (Scenario at point 4 needs to be harmonized) :

	Scenarios	OFS	MPC
1	Equity shares held for at least one year period	Yes	Yes
2	Equity shares received on conversion of fully paid-up compulsorily convertible securities where the holding period of such convertible securities and resultant equity shares together is at least one year period.	Yes	Yes
3	Equity shares received pursuant to approved scheme where invested capital is in existence for more than one year.	Yes	Yes
4	Equity shares received on conversion of fully paid-up compulsorily convertible securities received pursuant to approved scheme where invested capital is in existence for more than one year. <i>(Here holding period of equity shares + fully paid-up compulsorily convertible securities together is less than one year i.e. doesn't meet condition at point 2 above)</i>	No	Yes

2.5. Proposal–

2.5.1. Following clarification be included to the relevant provisions of the Regulation 8 and Regulation 105 of ICDR Regulations :

<u>Existing Provision</u>	<u>Proposed Recommendation</u>
<p><i>“Provided further that the requirement of holding equity shares for a period of one year shall not apply:</i></p> <p>...</p> <p><i>b) if the equity shares offered for sale were acquired pursuant to any scheme approved by a High Court or approved by a tribunal or the Central Government under the sections 230 to 234 of Companies Act, 2013, as applicable, in lieu of business and invested capital which had been in existence for a period of more than one year prior to approval of such scheme;”</i></p>	<p><i>“Provided further that the requirement of holding equity shares for a period of one year shall not apply:</i></p> <p>...</p> <p><i>b) if the equity shares offered for sale were acquired pursuant to any scheme approved by a High Court or approved by a tribunal or the Central Government under the sections 230 to 234 of Companies Act, 2013, as applicable, in lieu of business and invested capital which had been in existence for a period of more than one year prior to approval of such scheme;</i></p> <p><u>Explanation: Equity shares in above provision, includes equity shares arising out of conversion of fully paid-up compulsorily convertible securities acquired pursuant to any such scheme.</u></p>

3. Clarification on ESOPs granted prior to filing of DRHP to founders who are classified as promoters at the time of filing of DRHP

3.1. Existing Regulations

3.1.1. The term “employee” has been as defined in terms of Regulation 2(1)(i) of the Securities and Exchange Board of India (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 as follows:

“

“employee”, except in relation to issue of sweat equity shares, means

(i) an employee as designated by the company, who is exclusively working in India or outside India; or

(ii) a director of the company, whether a whole time director or not, including a non- executive director who is not a promoter or member of the promoter group, but excluding an independent director; or

(iii) an employee as defined in sub-clauses (i) or (ii), of a group company including subsidiary or its associate company, in India or outside India, or of a holding company of the company, but does not include—

a) an employee who is a promoter or a person belonging to the promoter group; or

b) a director who, either himself or through his relative or through any body corporate, directly or indirectly, holds more than ten per cent of the outstanding equity shares of the company;” (Emphasis supplied)

3.1.2. In regards to eligibility to participate in company schemes, Regulation 4 of the SBEB Regulations state the following:

“4. Eligibility.

An employee shall be eligible to participate in the schemes of the company as determined by the compensation committee.”

3.1.3. Regulation 9 of the SBEB Regulation deals with the transferability of the options. Specifically, Regulation 9(6) deals with conditions regarding ESOPs once an employee ceases to be an employee. Regulation 9(6) of the SBEB Regulations is reproduced below:

“(6) In the event of resignation or termination of an employee, all the options, SAR or any other benefit which are granted and yet not vested as on that day, shall expire:

Provided that an employee shall, subject to the terms and conditions formulated by the compensation committee under sub-regulation (3) of regulation 5 of these regulations, be entitled to retain all the vested options, SAR or any other benefit covered by these regulations.”

Explanation,—The cessation of employment due to retirement or superannuation shall not be covered by this sub-regulation, and such options, SAR or any other benefit granted to an employee would continue to vest in accordance with the respective vesting schedules even after retirement or superannuation in accordance with the company’s policies and the applicable law.

3.2. Need to review

3.2.1. In many new age tech companies, with each successful round of investments raised by these companies, the founders' shareholding in the company gets diluted. In order to keep the founders incentivized over the long run despite such dilution and avoid cash flow strains (attributable to enhanced managerial remuneration) on the company, the investors and the management of the company typically offer ESOPs to founders to boost their holdings and drive them to scale their ventures for a longer term. Also, in a number of cases, ESOPs are also performance linked incentives offered to founders to keep them motivated and invested in the company.

3.2.2. Thus, the founders of various new age tech companies often receive ESOPs or equity-linked instruments over cash-based remunerations in formative years of such companies. This also aligns the interest of the founders with the other shareholders in a company.

3.2.3. In terms of SEBI SBEB Regulations, 'promoters' and 'members of promoter group' are not entitled to receive ESOPs. The definition of "employee" in the SEBI SBEB Regulations specifically excludes 'promoters' and 'members of promoter group' as well. Similarly, in terms of Section 62(1)(b) of Companies Act read with Rule 12 of The Companies (Share Capital and Debenture) Rules, 2014 ("Share Capital and Debenture Rules"), a 'promoter' and 'member of promoter group' is not included within the ambit of the term 'employee'.

3.2.4. The existing Regulatory framework as prescribed under the ICDR Regulations requires a person to be promoter who has , inter-alia, control over the affairs of the issuer, directly or indirectly whether as a shareholder, director or otherwise. Thus, there may result scenarios where founders of company may have to be classified as promoter at the time of filing of the Draft Red Herring Prospectus (DRHP), due to their holding including options which are vested/ granted.

3.2.5. Accordingly, if founders are classified as 'promoters' at the time of filing of DRHP, the existing provisions do not clearly state whether an Employee holding ESOPs who is subsequently categorized as Promoter can exercise their granted ESOPs (both vested and unvested).

3.3. Suggestion/ Representation received

3.3.1. Currently, SBEB Regulations neither specifically allow nor disallow exercise of granted ESOPs (both vested and unvested) when Employee holding such ESOPs is subsequently categorized as Promoter. Based on the representations received, it is proposed that an explanation may be added to state that share based benefits granted to founders would continue upon such founder being classified as promoter in the DRHP.

3.3.2. The requirement of no new issuances under Share Based Employee Benefit Scheme to promoters, would continue being applicable to such founders who are categorized as promoter.

3.4. Rationale

3.4.1. On perusal of the Companies Act and Rules, it appears that Employees can be offered shares as part of the Employee Stock Option Scheme. However, it does not specifically prohibit conversion of such option once an individual ceases to be an Employee. In this regard, Regulation 9(6) of the SBEB Regulations already offers a precedence wherein if an individual ceases to be an employee after receipt of vested ESOPs can exercise such ESOPs. Further, in cases of retirement or superannuation, granted ESOPs would continue to vest as per the vesting schedule even after retirement or superannuation.

3.4.2. Thus, it is noted that the existing SBEB Regulations permit to grant ESOPs to an individual when the individual is an employee and its exercise can be made even after the said individual no longer remains as an Employee. Further, in the case of retirement or superannuation, ESOP/ options granted but not vested would also continue to vest.

3.4.3. Companies(Share Capital and Debentures) Rules, 2014 do not permit issuance of ESOPs to Promoters. However, the provision is not applicable for start-up companies up to ten years from the date of its incorporation or registration.

3.4.4. The classification of founder as promoter arises out of practice of considering the shareholding including options which are either vested or granted. These options/ other benefits are part of the remuneration of the employee. Thus, a view that an employee who is later categorised as promoter due to his shareholding including options/ benefits would have to forego their benefits may not be justifiable.

3.4.5. At the same time, allowing options/ other share based benefits just prior to filing of the DRHP may be prone to misuse. Thus, it is necessary that a suitable cooling off period is maintained between the grant of such options/ other share based benefits and the time when the company decides to pursue an Initial Public Offering.

3.5. Proposal

3.5.1. An explanation may be inserted under Regulation 9(6) of the SBEB Regulations, 2023 to state the following:

“Explanation 2: an employee, identified as a “promoter” or “promoter group” in the draft offer document filed by a company in relation to an initial public offering, who was granted options, SARs or other benefits under any scheme prior to being identified as a “promoter” or “promoter group”, as the case may be, shall be eligible to continue to hold, exercise or avail any such option, SAR or benefit, in accordance with its terms and granted, prior to one year from the date when the Company (i.e. its’ Board) decides to undertake Initial Public Offering and, in compliance with these Regulations.”

4. Public Comments:

4.1. Comments / suggestions are invited from public on the following:

- a) Need to amend provisions of SEBI (ICDR) Regulations as proposed at para 2.5 above, to bring in more clarity and streamline process as mentioned at para 2 above.
- b) Need to amend provisions of SEBI (SBEB & SE) Regulations as proposed at para 3.5 above, to bring in more clarity and streamline process as mentioned at para 3 above.

5. Submission of Public Comments:

5.1. Considering the implications of the aforementioned matters on the market participants, public comments are invited on the above-detailed proposals. The comments/ suggestions should be submitted latest by April 10, 2025, through the following link:

<https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes>

5.2. In case of any technical issue in submitting your comment through web based public comments form, you may send your comments through e-mail to consultationcfd@sebi.gov.in with the subject “Consultation Paper on certain Amendments to ICDR Regulations and SBEB Regulations with the objective of streamlining certain processes related to requirements of a public issue”.

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