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Analysis

Employee Incentivisation in InvITs – What is SEBI regulating?

Key Takeaways

- SEBI introduces framework for unit-based employee benefit plans for employees of the investment manager of the InvIT. All such plans now to be managed through an EBT
- Trust can acquire units from the secondary market or get them from the manager (swapped for management fees) – in each case subject to 60% unit-holder approval
- Cashless unit linked schemes likely to be replaced with the new framework driven by the EBT
- Employees run the risk of paying actual tax for notional gains on receipt of units, which may not be liquid enough to be sold
- Since related parties to the transaction and their associates cannot vote, IM and Sponsor are likely to be required to sit out of vote
- Move aligns InvIT regulations closer to listed companies where investor – employee relationships are regulated

Starting with the sunsetting of private unlisted InvITs, SEBI seems to be favoring a clear move toward a regime based on the principles of disclosure, and transparency for InvITs. Its light touch approach is slowly being replaced with a regime that is more aligned to the strictures applied to listed companies. Fitting in with this larger change in approach are the recent changes to the InvIT regulations that broadly seek to govern incentive payments to employees of Investment Managers (***IM***) of InvITs.

Overview – what was it before and what has changed?

SEBI has now brought in a comprehensive framework, under Chapter IVB, to govern the set-up and implementation of ESOPs or unit-based employee benefit plans (***the New Framework***). The new framework requires all unit-based employee benefit (***UBEB***) plans for employees of IMs to be setup as 'employee unit option scheme' and housed under an 'employee benefit trust' (***EBT***).

1) Who is covered under the unit-based employee benefit scheme?

All employees of the IM, along with the directors are covered. Any unit linked incentivization to the employees of the IM must now be done through an EBT. All prior unit linked incentivization schemes are also required to transition to an EBT and comply with Chapter IVB.

2) Can the trust sell units on the exchange and give cash to those who exercise their options?

No. Units are locked in and can only be unfrozen for a transfer to employees.

3) When are unitholder approvals required?

a) At the time the scheme is adopted.
b) At the time of swap of management fees of IM for units to the trust.
c) For the trust to acquire units by way of a secondary (*one-time approval*).
d) For the scheme to be altered.
e) For an employee to be given more than 1% of total InvIT units.

All unitholder approvals are 60% on a present and voting basis (votes in cast favor must not be less than 1.5 times the votes against).

4) Can the trust acquire units on the exchange?

Yes. Advance notice of 7 working days should be provided to the exchanges.

5) What are the ways the trust can acquire units?

a) Primary (by way of swap for management fees).
b) Secondary (from the market) using funds received from the IM or from receipt of exercise price on options received from the employees, if any.

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c) Gift (that is, without consideration) from IM or its shareholders; however, if Sponsor is a shareholder (which it almost invariably is), then the Sponsor and its associates can also transfer their units (even if the associates themselves are not shareholders of the IM).

6) Can the InvIT or the SPVs fund the trust?

No. All costs are to be borne by the IM (or its shareholders).

7) Are unitholder approvals for acquisition of units "one time" or have to be refreshed?

For primary – it has to be refreshed every year. For secondary, it can be a blanket approval.

8) Can subordinate units be included in the scheme?

No. Only regular units can be allotted as part of the scheme.

9) Are the units held by EBT classified as "public"?

No. They are part of "non-public non-sponsor", and therefore won't affect the public float requirements.

10) Are there limits to the number of units acquired by the trust?

No. Though, the trust cannot acquire more than 2% of total units a year by way of a secondary; and at any point the trust cannot hold more than 5% of total units (if these are acquired by way of secondary, not including by way of gift).

11) Is there a lock-in period on units acquired by the trust?

Yes. Units in a trust have a lock-in period of six months post which they can be transferred to the employees.

12) Is there a vesting period for units acquired by the employees?

Yes. There shall be a minimum vesting period of one year on units acquired through the New Framework.

Let's now deep-dive into the EBT Framework.

1) *No more cashless unit-based benefit schemes?*

The language of amendment suggests that all UBEBs (in other words unit linked employee incentives), and all existing UBEBs going forward, must now be orchestrated through an EBT under the New Framework. Since the New Framework requires employees to take delivery of

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the units, it does appear to us that the regulator is not comfortable with the idea of cashless UBEBs, also commonly known as stock linked incentives, where employees are simply given the cash equivalent of the unit upside without the need to actually acquire the units.

Earlier, few InvITs had instituted such incentive schemes on a cash basis – i.e., linking the cash bonuses granted to performance of the InvITs units (similar to stock appreciation rights). Such schemes, which allowed employees to gain exposure over the performance of the underlying InvIT's units without having to put capital at risk, are likely to be discontinued, and be housed under an EBT.

Unfortunately, unless the EBT or the IM makes good the tax hit for the employees when they receive the units, the employee is likely to pay actual tax on notional gains (since units received will be taxed at fair value under the head income from salary, but there may not be immediate liquidity for these units in some cases).

2) *Active role for unitholders in regulating IM employees pay*

Unitholders now have a more direct role in regulating unit based benefits granted to employees of IMs. Earlier, the IM could have received its managerial compensation, acquired InvIT units and transferred them to the employees, or transferred the cash to the employees to purchase units.

Now, any purchase of units (by way of swap or even a simple purchase from the market) will need unitholder approval. This seems quite different to commonly understood rules – that as long as the company/ InvIT is not paying for something then their shareholders/ unitholders should not be required to weigh in.

Earlier, any incentives given to employees of InvITs was wholly out of the purview of the InvITs unitholders.

Why and why now?

Fundamentally, SEBI wants to ensure that any incentives paid to employees of InvITs are structured in a manner that takes into account the interest of all unitholders of an InvIT, and probably also moderate the incentive-driven conduct of the IM employees.

While an IM is a legally distinct entity, for all practical purposes it acts as the central unit or the brains of an InvIT (directing investments and running day to day operations) and with such broad influence on the InvIT – allowing for limited unitholder oversight might be helpful.

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Are there any challenges for employees/ IMs due to the new framework? Does the Sponsor get to vote?

Yes – mainly related to the unitholder consent requirements.

At the threshold, each scheme is subject to approval of unitholders. Further, any secondary or primary acquisition of units (other than a gift from IM etc. - which may not be the normal course) have to be further approved by unitholders.

The tricky part of this is whether the 60% consent turns into a de-facto "majority of minority" vote (with the Sponsor sitting out).

For a primary through swap for management fees, the answer is straightforward – since the IM would be a party to the transaction, it will have to sit out the vote along with its associates (practically, this means the Sponsor as well).

For secondaries (purchases on the market), the IM and Sponsor, though not directly involved in the transaction may still have to sit out since the benefit is due to the beneficiaries being employees of the IM (and benefit is linked to this employment). Therefore, due to this link, the IM (and Sponsor) may well have to sit out of any unitholder votes on such matters.

While the primary approval has to be refreshed every year (and only one primary is allowed a year), a blanket approval for the duration of the scheme can be taken for secondaries therefore minimizing the risk that a beneficiary is left without units to fund the exercise.

The secondary acquisition, to avoid sending any false signals to the market, requires prior disclosure of 7 working days, but a sufficiently calibrated acquisition schedule should ensure that there is no run up in unit prices that drives up costs for the IM.

Conclusion

The shift in SEBI's regulation of InvITs, heralded by the end to the private unlisted InvIT regime, appears to be gaining steam with the introduction of the regulations governing unit linked employee benefits.

Given the fact pattern that in most cases the IM is majority held by the sponsor, with substantial stakes also held by larger unitholders – opening up employee incentivization to unitholder scrutiny introduces transparency while giving all unitholders a say in what "targets" are to drive the functioning of their InvIT. In fact, SEBI LODR prescribes shareholder approval for any share-based compensation or profit-sharing agreement between employees and investors of a listed entity. SEBI seems to be applying part of the same yardstick for InvITs now.

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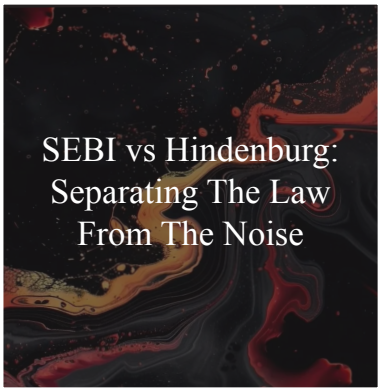
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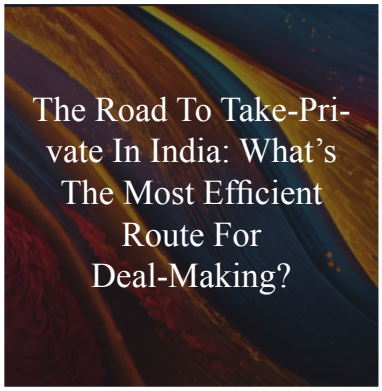
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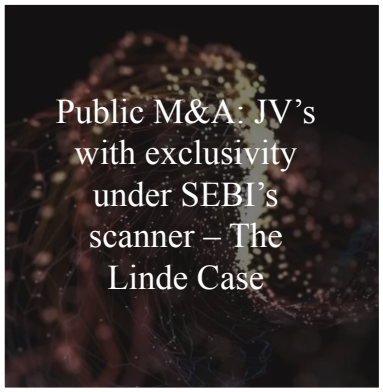
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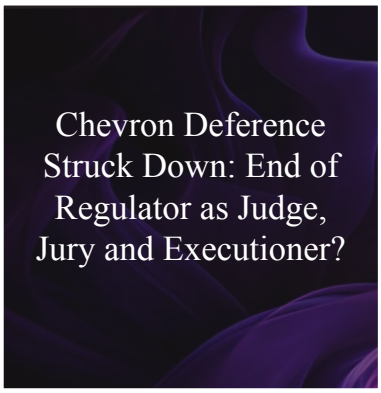
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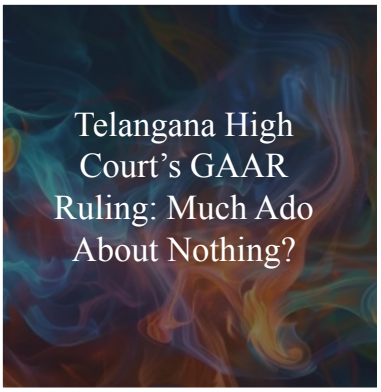






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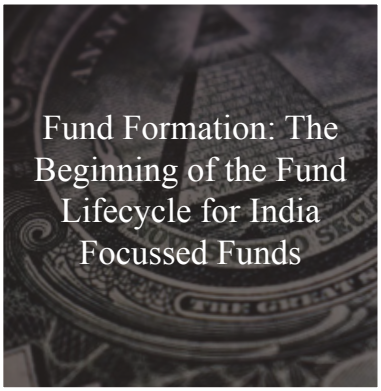






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