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India: RBI Liberalises Grant of ESOP by Foreign Companies & Defines Norms for Repurchase by Companies

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Through a Notification[1] dated April 5, 2006, addressed to all banks authorised to deal in foreign exchange, the Reserve Bank of India ("RBI") has rationalised the norms for issuance of shares of a foreign company under an Employee Stock Option ("ESOP") Scheme, and announced norms for repurchase through the automatic route of such shares from the employees.

These changes pertain to Regulation 22 of the Foreign Exchange Management (Transfer or Issue of Any Foreign Security)(Amendment) Regulation, 2004[2] ("Regulation").

I. Issue of Shares by Trust, SPV or Step Down Subsidiary

Under the Regulation 22 (2), Authorised Dealer Banks were authorised to allow remittances by Indian resident individuals without any monetary limit to the foreign company for acquiring shares offered under an ESOP Scheme by such foreign company, provided the resident individual was an employee of the foreign company's branch or liaison office in India or an employee or director of an Indian company, which was the subsidiary of the foreign company or in which the foreign company held at least a 51 percent stake. It is now proposed to permit remittance for acquiring shares under ESOP Schemes, irrespective of the method of the operation of the scheme. Now therefore, the Authorised Dealer Banks are permitted to allow remittance for acquiring shares under an ESOP Scheme, where the shares under the scheme are offered directly by the issuing company or indirectly through a trust/Special Purpose Vehicle ("SPV")/step down subsidiary, provided:

- the company issuing the shares effectively, directly or indirectly, holds in the Indian company, whose employees/directors are being offered shares, at least 51percentt of its equity;
- the shares under the ESOP Scheme are offered by the issuing company globally on a uniform basis; and
- an Annual Return is submitted by the Indian company to the RBI through the Authorised Dealer Banks, giving details of remittances/beneficiaries etc., in the prescribed format.

Implications: Now foreign companies will not have to wait for clearance from the RBI when granting ESOPs through a trust or an SPV or by their step down subsidiary, provided the conditions mentioned above are satisfied.

However, the companies are now required to file a report, which is an additional compliance requirement.

II. Repurchase of Shares

It is further proposed to grant General Permission to foreign companies to repurchase the shares issued to residents in India under any ESOP Scheme provided the following conditions are satisfied:

- the shares should have been issued in accordance with the Rules/Regulations framed under Foreign Exchange Management Act, 1999;
- the shares should be repurchased in terms of the initial offer document; and
- an Annual Return in the prescribed form should be submitted through the Authorised Dealer Banks, giving details of remittances, beneficiaries, etc.

Implications*: The above rationalisation seems to be a retrogressive step since such permission was already granted under sub regulation 4 of Regulation 22 of 2004. Now, by this recent Notification, the RBI has imposed certain conditions for repurchase through the automatic route. In particular, the condition that the repurchase should be in terms of the initial offer document takes away the ability of a private company to repurchase the shares if the employee leaves employment. This can prove to be a substantial hurdle for private companies to liberally give stock options as a retention strategy.*

1 Source: RBI/2005-06/353 A.P. (DIR Series) Circular No. 30, April 5, 2006

2 http://rbi.org.in/scripts/NotificationUser.aspx?Id=2817&Mode=0 as viewed on April 7, 2006

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