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भारतीय प्रतिभूति  
और विनिमय बोर्ड  
Securities and Exchange  
Board of India

ISD/SR/SKV/SA/ 33059/2011  
October 21, 2011

**Shri Anil Patwardhan**  
Vice President (Finance),  
KPIT Cummins Infosystems Limited ('KPIT')  
35 & 36, Rajiv Gandhi Infotech Park,  
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**Sub: Your request for 'No-action Letter' under SEBI Informal Guidance Scheme, 2003**

Sir,

1. This is with reference to your request letter dated 11.05.2011 sent to SEBI seeking 'No-action Letter' under SEBI (Informal Guidance) Scheme regarding administration of Employees Stock Option Plan ('ESOP') Scheme by KPIT Cummins Infosystems Limited ('KPIT') and guidance sought on applicability of SEBI (Prohibition of Insider Trading) Regulations, 1992.
2. While your request was under examination, you were requested by SEBI vide letters dated 27.07.2011 having no. ISD/SKV/SA/24332/2011 and 07.09.2011 having no. ISD/SKV/SA/28324/2011 to describe the operation of scheme in detail along with a copy of KPIT's ESOP Scheme and Internal Code of Conduct for prevention of insider trading in place.
3. SEBI is in receipt of your letter dated 07.09.2011 providing details as sought above.
4. In above letters under reference you have *inter alia* stated that:
  - i) KPIT, a listed company, have implemented an ESOP for its employees and have also formed an employee Trust to administer such Plans. The Trustees of the Trust are the Promoters of the Company. The Plans as well as Trust formation have been approved by the shareholders in the formats as prescribed by the guidelines.
  - ii) With the intention of helping its employees, KPIT propose to implement the "cashless exercise" as permitted under the clause 11.2 (b) of SEBI (ESOP and ESOS) guidelines, 1999 using the Trust route. The said exercise shall ensure to the benefit of 'Employees' as defined under the guidelines issued by SEBI from time to time and shall not be applicable to the founders / Promoters of the company. The proposed route is as follows:

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*After grant of options to employees and prior to their vesting, the Company will allot shares to the Trust, funded by a loan from the Company or otherwise. These shares will then be listed on the stock exchange. On the exercise date, if the employee chooses to do a cashless exercise, he will authorize the Trust to sell the required number of shares to pay for the exercise price (and applicable taxes). The Trust will sell the required number of shares and pay the amount due to the company (exercise price plus the applicable tax) and transfer the balance shares to the employee. If the employee so decided he may also instruct the Trust to sell all the exercised shares and remit the net proceeds (instead of shares) to him.*

iii) In detail, KPIT has explained the process of Cashless exercise as follows:-

- In order to implement cashless mechanism, the company will route it through welfare Trust set up for the same. The Trust is a private, unregistered Trust.
- The process starts with the company allotting shares to the Trust. The quantum of shares to be allotted is determined on the basis of vested options due for exercise in the near future.
- The price at which shares are allotted to the Trust will be equal to the exercise price of the respective grant which has vested options. In case more than one grant has vested options, the allotment would be at different prices (equal to respective exercise prices of those grants).
- Typically the company will fund the Trust for the subscription amount. The companies Act, 1956 allows this funding (proviso to section 77A of the Act).
- On allotment, the shares will be credited to the demat account of the Trust and listed on the stock exchange.
- On the exercise date, an employee is offered a choice of Exercise against cash or cashless exercise.
  - If he chooses Exercise against cash, he will pay the exercise price and perquisite tax to the trust and the Trust will instantly transfer (electronic transfer) shares into his Demat account.
  - If he chooses cashless exercise:
    - The Trust calculates the number of shares required to be sold to fund the employee's liability (exercise price + perquisite tax) and communicate accordingly to the employee.
    - The employee gives an authority to the Trust to execute the necessary sale on his behalf and pay off his entire liability to the company.
    - On sale of shares, Trust receives proceeds from the Broker and forwards them to the company towards settlement of loan and perquisite tax.

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- The balance shares are transferred by the Trust to the employee's demat account.
- In case the employee wants to sell all the exercise shares, Trust will do so, on his behalf and remit the necessary funds to the company and to the employee (sale value of remaining shares). This scenario is helpful for option holders who are foreign nationals.

iv) The process is further explained through the following illustration:

Particulars	Figures
Options grated	1000
Vested Options	250
Exercise price	Rs. 100
Market price on date of Exercise	Rs.300
Options exercised under cashless route	200
Perquisite tax	Rs.12,000 =[(300-100)*200]*30%
Exercise amount payable	Rs. 20,000 =(Rs.100*200)
Shares required to be sold to cover Exercise amount, Perquisite tax, brokerage and STT	107=[Rs. 20,000+Rs.12,000)/300]
Shares required to be transferred to the employee	93

- v) As per KPIT, this process is within the framework of cashless exercise as laid down in clause 11(2)(b) of the SEBI (ESOP and ESOS) guidelines 1999.
- vi) Based on the Previous Informal guidance given by SEBI, it is understood that in the given case the activities of the Trust will attract the provisions of the SEBI (Prohibition of Insider Trading) Regulations 1992, particularly regulation 12 and 13 and clause 4.2 of Schedule I under Regulation 12(1). With reference to the FAQs on Insider Trading hosted on SEBI website it is understood that restrictions of trading under clause 4.2 of the Regulations is intended for secondary market purchase and not for primary issue as is contemplated in KPIT's process.
- vii) KPIT believe that while the provisions of regulation 12 and 13 with reference to the disclosures and restriction on trading outside the trading window will apply to the Trust, it will be free to transfer the shares to the employees and seek fresh shares from the company within a period of 30 days stipulated in clause 4.2 of schedule I under regulation 12(1). It is mentioned here that the shares issued by the company to the Trust will not be under IPO and the activities of the Trust in terms of seeking primary shares from the company, selling some or all of them in the market and transferring the balance to the employees would be on-going process. The company does not intend to restrict the timing of exercise of options by employees barring the black-out periods which apply to insiders.

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5. A No-action letter is sought on understanding of Regulation 12 and 13 of SEBI (Prohibition of Insider Trading) Regulations, 1992 and confirmation on whether the process of cashless exercise is within the framework as laid down in clause 11(2)(b) of the SEBI (ESOP and ESOS) guidelines 1999.
6. Without necessarily agreeing with your analysis, our view on the issues raised in your letters under reference is as follows:

CONFIRMATION OF INTERPRETATION

- a. The proposed ESOP scheme of the company seems to fall within the ambit of Clause 11(2)(b) of SEBI (ESOP and ESOS) Guidelines, 1999 which states as under:-

*"Under the cashless system of exercise, the company may itself fund or permit the empanelled stock brokers to fund the payment of exercise price which shall be adjusted against the sale proceeds of some or all the shares, subject to the provisions of the Companies Act"*

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- b. Activities of the trust shall attract the provisions of SEBI (Prohibition of Insider Trading) Regulations, 1992 including regulations 12, 13 and clause 4.2 of Schedule made under Regulation 12(1). Since in the proposed scheme, trust is undertaking activities of dealing in securities, *albeit* on behalf of employees exercising option, therefore trust as well as employees shall *inter alia* abide by Code of internal procedures and conduct, restriction on trading outside the trading window, and disclosure requirements including disclosures under Regulation 13 (4) of SEBI (Prohibition of Insider Trading) Regulations, 1992.
- c. You may note that SEBI (Prohibition of Insider Trading) Regulations, 1992 does not contemplate granting exemption from applicability of any of the provisions of the regulations. Therefore, all the relevant provisions apply.
- d. Restriction on trading under Clause 4.2 of Schedule I made under Regulation 12 (1) is intended for transactions in secondary market as clarified by SEBI through *Clarifications on SEBI (Prohibition of Insider Trading) Regulations, 1992* dated July 24, 2009 available on SEBI Website. Hence, such restriction seems not applicable in the process contemplated in your application.

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- e. In terms of Clause 14 to Clause 17 of SEBI (Informal Guidance) Scheme, 2003, the department issuing this no-action letter will not recommend enforcement action to the Board regarding above issues subject to requestee acting strictly in accordance with the facts and representations made in the letters while in compliance with other applicable laws.
7. This position is based on the representation made to the Department in your aforesaid letters under reference. Different facts or conditions might require different results.
8. In terms of Clause 12 and Clause 13 of SEBI (Informal Guidance) Scheme 2003, a no-action letter or an interpretive letter issued by a Department constitutes the view of the Department but will not be binding on the Board, though the Board may generally act in accordance with such a letter and the letter issued by a Department under this scheme should not be construed as a conclusive decision or determination of any question of law or fact by SEBI. Such a letter cannot be construed as an order of the Board under section 15T of the SEBI Act, 1992 and shall not be appealable.
9. You may note that the above views mentioned in Para 6 are expressed only with respect to the clarification sought on the provisions referred by you in your aforesaid letters and do not affect the applicability of any other provision of Regulations or any other law administered by SEBI or any other authority.

Yours faithfully,

  
**Shashi Kumar**