Securities and Exchange Commission of Pakistan

Public Consultation on

Draft Guidelines

for

Issuance of Shares by Unlisted Companies under the Employees Stock Option Scheme

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Contents

Guidelines for Structuring and Offering of the Employees Stock Option Scheme for Unlisted Companies

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CHAPTER I – Introduction & Scope

1. Introduction:

This document outlines the legal framework and the key requirements to be considered before proceeding with the issuance of shares under the Employees Stock Option Scheme (ESOS) by an unlisted company. Issuance of shares under ESOS by an unlisted company requires careful consideration of several factors including review of the company's articles of association, obtaining shareholders' approval through special resolution, and ensuring legal compliance.

2. Scope of guidelines:

These shall apply to all Employee Stock Option Schemes offered by unlisted companies in Pakistan under Section 83A of the Companies Act, 2017 (the Act).

3. Legal Provisions:

Section 83A of the Act read with regulation 112 of the Companies Regulations, 2024 (the Regulations) primarily deals with the legal framework for the issuance of shares under ESOS by unlisted companies.

Section 83A of the Act provides that "*notwithstanding anything contained in section 83 or any other provision of this Act, a company may, under the authority of special resolution, issue shares in accordance with its articles under employees' stock option in accordance with such procedure and subject to such conditions as may be specified.*"

CHAPTER II - Eligibility and Approvals

4. Eligibility:

An unlisted company may offer the scheme to the directors, officers or employees of a company or of its holding company or subsidiary company, if any.

5. Required Approvals:

a. Articles of association of the company expressly provides and authorizes the offer of scheme.
b. Board shall consider and resolve to offer the scheme.
c. The offer of the scheme must be authorized by a special resolution of the shareholders.
d. In case shares are to be issued at discount to the face value, the company shall also obtain approval of shareholders and the Commission under section 82 of the Act.

6. Approval of the Scheme by Board:

The decision of the board shall provide following information in addition to details of the scheme structured:

a. quantum of the issue both in terms of the number of shares and percentage of existing paid up capital;
b. issue price per share and justification for the same;
c. consideration against which shares are proposed to be issued;
d. name of person(s), their brief profile, existing shareholding, if any, in the company, to whom the shares are proposed to be issued;
e. purpose and justification of the issue by way of other than right;
[ref regulation 112 of the Regulations]

7. Approval of Scheme by Shareholders through Special Resolution:

a. An unlisted company may raise its capital through issuance of employee stock option scheme with the approval of the shareholders through special resolution passed in the general meeting or through circulation in accordance with sections 130, 133, 134 and 149 of the Act. A resolution through circulation may be passed if the requirements of section 149 of the Act are fulfilled.
b. Separate special resolutions are required for:
    i. grant of option to employees of a subsidiary or holding company; and
    ii. grant of option to identified employees, during any one year, equal to or exceeding one per cent of the issued capital (excluding outstanding conversions) of the company at the time of grant of option.
c. ESOS by the issuer has to be announced within six months of passing of special resolution, and in case of failure to do so, fresh resolution will be required.
d. Agenda of the EOGM should explicitly provide details of any litigation or legal proceedings in the context of the current or previous ESOS along with management's stance.
[ref regulation 112 of the Regulations]

CHAPTER III - Structuring the Scheme

8. Key definitions:

a. **Employees' stock option** means the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the right to purchase or to subscribe for shares of the company at a price to be determined in the manner as may be specified [ref section 2(1)(29) of the Act].

b. **Option** means a right but not an obligation granted to an employee in pursuance of a scheme to apply for shares of a company at a pre-determined price;

c. **Exercise** means making of an application by an employee to a company for issue of shares against option vested in him in pursuance of a scheme;

d. **Exercise period** means the time period after vesting within which an employee may exercise his right to apply for shares against an option vested in him in pursuance of the scheme;

e. **Exercise price** means the price payable by an employee for exercising an option granted to him in pursuance of the scheme;

f. **Vesting** means to give or earn a right to apply for conversion of the options, granted under a scheme, into shares of the company; and

g. **Vesting period** means the period during which the vesting of an option granted to an employee in pursuance of a scheme takes place.
[ref regulation 2 of the Regulations]

9. Entitlement Pool:

a. The maximum number of shares or options under the scheme must be determined and disclosed.
b. Entitlement pool is capped at 10% of the enhanced paid capital of the company in a year; and 25% of the enhanced paid up capital of the company at any point in time.

"Entitlement Pool" means number of shares that can be issued under an employee stock option scheme determined by the compensation committee and approved by the shareholders through special resolution.
[ref regulation 112 of the Regulations]

10. Exercise Price:

The company shall set the exercise price. Although mechanism of determining price is not provided in the Act or the Regulations, however, it may be based on:

- Breakup value per share.
- Earnings per share (EPS).
- Return on equity (ROE) or other financial metrics.
- Any other manner determined by the company.

11. Grant, Vesting, and Exercise:

a. The date of grant of options, the vesting period and the exercise period shall be provided in the scheme. There should be minimum period of one year between the grant of options and vesting of options.
b. In case of failure to exercise the option, the options granted shall lapse.
c. Lapsed options may be reallocated to other employees within 30 days.
d. Exercise period can commence any time after expiry of the vesting period.

12. Lock-In Period:

The company may specify a lock-in period for shares issued upon exercise of options, during which these shares cannot be transferred or sold.

13. Variation of Scheme:

A company shall not vary the terms of a scheme in any manner which may be detrimental to the interests of its employees. However, a company may by special resolution in a general meeting vary the terms of a scheme offered pursuant to an earlier resolution but not yet exercised by its employees provided that such variation is not prejudicial to the interests of the option holders.

CHAPTER IV - Administration of the Scheme

14. Compensation Committee:

a. The board shall constitute a Compensation Committee to oversee the scheme.
   - For public sector companies, the chairman must be an independent director.
   - For other companies, the chairman may be the CEO or any director or an officer authorized by the board.

b. The committee shall ensure:
   - administration of the scheme; and
   - superintendence of the scheme.

[ref regulation 112 of the Regulations]

15. Restrictions and Prohibitions:

a. Options granted under the scheme are non-transferable to any other person except to an entitled employee of the company, except that:
   (i) in the event of death of an employee while in employment of a company, all options granted to him till the date of his death shall vest in his legal heirs or nominees;
   (ii) in case an employee suffers a permanent incapacity while in employment of a company, all options granted to him, as on the date of permanent incapacitation, shall vest in him on that day;
   (iii) in the event of resignation or termination of service of an employee, all options not vested as on that day shall expire. Provided, the employee shall, subject to the terms and conditions of the scheme, may be entitled to retain all the vested options.

b. Directors and senior management shall not participate in discussions related to their own allocations of options under the scheme.

c. An option granted to an employee shall not be pledged, hypothecated, mortgaged or otherwise alienated in any other manner.

d. An employee shall not have the right to receive any dividend or to vote or be entitled to rights of members in respect of option granted to him, till shares are issued to such employee on exercise of option.

e. Where options are granted by a company under its scheme in lieu of options held by the same person under a scheme in another company, which has merged or amalgamated with

the first mentioned company, the period during which the options granted by the merging or amalgamating company were held by him shall be adjusted against the minimum vesting period required under these regulations.
[ref regulation 112 of the Regulations]

Disclaimer:

These are general guidelines to facilitate the unlisted companies and do not set aside, replace or substitute any existing regulatory requirements applicable to unlisted companies under the prevalent laws and regulations.

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