

Change in treatment of employee stock options schemes under IiAS' Voting Guidelines

IiAS has revised its Voting Guidelines relating to Employee Stock Options Schemes that have an exercise price significantly lower than the market price. These changes are based on the feedback from companies and investors, as well as our own experiences. We have implemented these revisions effective 1 December 2024.

Rationale for changing stance on ESOPs under our voting guidelines:

In March 2024, IiAS updated its voting guidelines for 2024-25 pertaining to disclosure requirement for ESOP schemes, which required vesting of deeply discounted stock options (more than 20% discount to market price) and/or restricted stock units (RSUs) to be based on the achievement of specific pre-defined performance targets.

Some companies have clearly articulated their performance targets in the shareholder resolution. However, during the 2024 proxy season, many companies maintained that disclosing targets was competitive information and / or that these could be considered providing guidance. Some companies also suggested that targets are set annually and given that stock options schemes will run on for a longer duration, disclosing targets at the time of seeking shareholder approval is not possible.

IiAS recognizes that corporate India is not yet ready to make these disclosures and has therefore moderated its position.

IiAS proposes to now support ESOP schemes where, in the shareholder notice:

- (a) Performance measures are clearly articulated; and
- (b) An indicative **range of weightages** assigned to each performance measure is given; and
- (c) We do not expect companies to disclose targets that are to be achieved at an individual levels, since these will vary depending upon the employee's role and department function. Nevertheless, at an individual level, aggregate threshold for achievement of KPIs (e.g., Internal rating) has been disclosed; and/or
- (d) In cases where the company chooses not to disclose these corporate-level targets at the time of proposing the resolution, it has clearly stated that in subsequent annual reports, it will disclose the targets that were expected to be achieved for each of the performance measures and the performance that was achieved, that led to the board's decision to allow any tranche of stock options to vest.
- (e) The disclosures stated above must be unambiguous. Shareholders need clarity on the basis of vesting for stock options, and therefore, the resolution must limit the degree of flexibility to the NRC or the board to change the performance basis and measures.

Further, IiAS will generally not support schemes that carry standalone stock price (or market capitalization) based performance measures, unless the company has disclosed the listed peers or the index against which the company’s stock price performance will be measured. This is largely because standalone stock price movements may be a culmination of several market level issues and is not singularly limited to the company performance. Therefore, a relative stock price performance against peers or an index is more likely to reflect the performance of the company, independent of macro variables.

IiAS is also clarifying its voting guidelines with respect to the extension of stock options schemes to employees of group companies – parent, subsidiaries, associates, and other group companies. While there is no change per se in our policy, we are incrementally clarifying that IiAS will support the extension of such schemes to unlisted subsidiaries (present and future) over which the company has control and unlisted holding companies. However, IiAS does not generally support the extension of stock option schemes to associate companies, group companies, listed holding companies, and listed subsidiaries, but may make exceptions on a case-to-case basis. Further, IiAS will generally not support enabling resolutions that seek blanket shareholder approval to extend the scheme to future associates and group companies.

IiAS expects the company to provide specifically the list of companies whose employees will be eligible to receive stock options under the proposed stock option scheme.

A. Changes to IiAS Voting Guidelines with respect to stock option schemes where the exercise price is at a deep discount to market price

Current voting guidelines on ESOPs	Proposed guidelines (changes highlighted in <i>blue italics</i>)
<p>2024-25 update: IiAS had updated its guidelines on disclosures required for ESOP schemes which is given below:</p> <ul style="list-style-type: none"> ○ In case of deeply-discounted stock options (more than 20% discount to market price) and/or restricted stock units (RSUs), IiAS will require vesting of such options be based on the achievement of specific pre-defined performance targets. Generic disclosures on performance targets such as revenues and EBITDA or stating that it will be a combination of corporate and individual goals, will not be sufficient. ○ IiAS will also require companies to specify the maximum number of options that they expect to grant to employees annually or articulate the 	<ul style="list-style-type: none"> ○ In case of deeply-discounted stock options (more than 20% discount to market price) and/or restricted stock units (RSUs), IiAS will require vesting of such options to be based on the achievement of pre-defined performance targets – <i>which could be either at the corporate level or at the individual level, or a combination of both.</i> ○ IiAS will expect companies to disclose specific <i>corporate-level</i> targets, <i>along with an indicative range of weightages for each of the parameters.</i> Generic disclosures on performance targets such as revenues and EBITDA or stating that it will be a combination of corporate and individual goals, will not be sufficient. In case the company chooses not to disclose these targets at the time

Current voting guidelines on ESOPs	Proposed guidelines (changes highlighted in <i>blue italics</i>)
<p>expected number of years over which the scheme will be exhausted, and the distribution of the scheme (towards senior management – board and one level below board).</p>	<p>of proposing the resolution, <i>IiAS will expect companies to disclose, in the subsequent annual reports, the basis of vesting of these deeply discounted stock options with specific disclosures on the corporate-level performance parameters, the target achievement on these performance parameters, and the achievement during the year, basis which the vesting of stock options was allowed.</i></p> <ul style="list-style-type: none"> ○ <i>The company will clearly articulate its intention to disclose this information in the subsequent annual reports, in the shareholder notice/resolution or in a filing on the stock exchanges.</i> ○ <i>For stock options that will vest on individual performance targets, IiAS expects companies to disclose the aggregate threshold performance achievement required by the employee on their individual performance KPIs (e.g., internal scorecard/rating).</i> ○ <i>Where the stock options grants are based on stock price performance or market capitalization, IiAS will expect companies to disclose relative stock price performance benchmarks along with the list of peers or indices against which the stock price performance will be measured. IiAS will generally not support absolute stock price performance or market capitalization benchmarks.</i> ○ IiAS will also require companies to specify the maximum number of options that they expect to grant to employees annually or articulate the expected number of years over which the scheme will be exhausted, and the distribution of the scheme (towards senior management – board and one level below board).

B. Intended changes to IiAS Voting Guidelines with respect to extension of stock option schemes to group companies

Current voting guidelines on ESOPs	Proposed guidelines (changes highlighted in <i>blue italics</i>)
<p>IiAS generally does not favour stock options schemes that propose to grant options to its listed subsidiaries or holding companies which have their own ESOP plans. Listed holding companies generally have their own ESOP schemes. IiAS also generally does not support extension of ESOP schemes to associate companies.</p>	<ul style="list-style-type: none"> ○ IiAS will generally support the extension of stock option schemes to employees of: <ul style="list-style-type: none"> (a) wholly-owned subsidiaries (present and future); (b) subsidiaries where the company has management and board control, and are not separately listed (present and future); (c) holding / parent companies that are not listed <i>and own a dominant stake in the company</i> ○ IiAS will generally not support the extension of stock option schemes to employees of <ul style="list-style-type: none"> (a) listed subsidiaries <i>and listed holding companies</i> (b) associate <i>and group companies (present and future)</i>

C. Revised IiAS voting guidelines regarding ESOP schemes

ESOP schemes are governed by the SEBI (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 in addition to the Companies Act, 2013.

IiAS will recommend voting on stock options on a case-to-case basis, depending on the following:

- **Dilution**

The conversion of ESOPs into equity shares will raise the issued capital of the company, which may dilute the interests of minority shareholders. IiAS expects the dilution to be restricted to less than 5%.

- **Exercise price and vesting criteria**

- Issuance of stock options at a discount to market price does not align the interests of shareholders with those of employees. Generally, IiAS will recommend voting AGAINST stock option plans where the exercise price is at a significant discount (of over 20%) to the market price on the date of grant including Restricted Stock Units (RSUs).
- IiAS will support such resolutions only if the vesting of such stock options is based on the achievement of pre-defined performance targets – which may be either at the corporate level or at the individual level, or a combination of both. IiAS expects companies to disclose specific corporate-level targets, along with an indicative range of weightages for each of the parameters. Generic disclosures on performance targets such as revenues and EBITDA or stating that it will be a combination of corporate and individual goals, will not be sufficient.
- In case the company chooses not to disclose these targets at the time of proposing the resolution, IiAS will expect companies to disclose, in the subsequent annual reports, the basis of vesting of these deeply discounted stock options with specific disclosures on the corporate-level performance parameters, the target achievement on these performance parameters, and the achievement during the year, basis which the vesting of stock options was allowed. The company will clearly articulate its intention to disclose this information in subsequent annual reports, in the shareholder notice/resolution or in a filing on the stock exchanges.
- For stock options that will vest partly on individual targets, IiAS expects companies to disclose the aggregate threshold performance achievement required by the employee on their individual performance KPIs (e.g., internal scorecards or performance ratings)
- Where the stock options grants are based on stock price performance or market capitalization, IiAS will expect companies to disclose relative stock price performance benchmarks along with the list of peers or indices against which the stock price performance will be measured. IiAS will generally not support absolute stock price performance or market capitalization benchmarks.

- **Vesting/Exercise Period**

IiAS expects a staggered vesting schedule and overall vesting periods to be between one to five years. Most companies have exercise periods of three to five years – we expect companies to explain the rationale for a longer exercise period.

- **Scheme Related Disclosures**

IiAS believes companies must specify the maximum number of options it expects to grant to employees annually or articulate the number of years over which the scheme will be exhausted (that is, all options under the scheme are granted).

- **Distribution of the scheme**

IiAS will not support ESOP schemes where the distribution of the majority options is largely to senior management (board and one level below board). Further, IiAS will not support ESOP schemes which are formulated to reward one single employee. IiAS will also not support ESOP schemes where the majority of the RSUs are granted to senior management and stock options are granted to other employees. In the absence of disclosure on the proposed distribution of the ESOP scheme, IiAS will look at past precedents (track records) to decide its voting recommendation.

Ratification of existing schemes will be reviewed by IiAS as per the same guidelines.

Amendments to existing stock option schemes will be reviewed as per following:

- **Modification of exercise price**

IiAS is not in favour of re-pricing stock options and will generally recommend voting AGAINST unless:

- executive directors and senior management are excluded from the new re-priced scheme
- the reasons for the poor price performance have been beyond the control of the company such as, regulatory changes, the COVID -19 pandemic etc.
- the re-priced options follow a life cycle like that of new stock options, i.e., they have a specified vesting, grant and exercise schedule in the future
- the change in exercise price is driven by regulatory compliance

- **Modification of vesting period/exercise period**

IiAS will take a case-to-case view on the revision in vesting period and expects the companies to provide a detailed rationale for revision in vesting period.

- **Increase in size of stock option scheme**

Some companies propose to add to the pool of stock options in the existing schemes. In such cases, IiAS will support the revision if we support the existing scheme, subject to dilution levels.

Extension of stock option scheme to group companies

- IiAS will generally support the extension of stock option schemes to employees of:
 - wholly owned subsidiaries;
 - subsidiaries where the company has management and board control, and is not separately listed;
 - holding / parent companies that are not listed and own a dominant stake in the company
- IiAS will generally not support the extension of stock option schemes to employees of
 - listed subsidiaries and listed holding companies
 - associates and group companies (present and future)

Resolutions related to implementing the stock option schemes:

Companies are required to seek separate shareholder approval to implement the proposed stock option schemes. If the scheme is being implemented through the trust route, then for the company to lend funds to the trust to buy shares from the secondary market, or to issue fresh equity. For all resolutions that are linked to the implementation of a proposed stock option scheme or require administrative amendments to the scheme, IiAS' voting recommendations will generally be linked to its opinion on the scheme itself.

DISCLAIMER

IiAS' recommendations are guided by the IiAS Voting Guidelines. The policy publication lists the various agenda items on which shareholders are asked to vote, the relevant regulations, the disclosures that IiAS will review, and how IiAS will typically recommend voting on these. The voting policy also factors in data from ADRIAN (www.iiasadrian.com), IiAS' proprietary tool that captures how shareholders vote and their voting rationale. The proposed changes to the document are based on feedback from companies, investors and IiAS' experiences. This document affords market participants viz, companies and investors an opportunity to comment on the changes proposed. The comments received could be made available for public viewing. The proposed changes are informative and should not be considered conclusive. IiAS will at its discretion consider/review the comments received and make necessary modifications as it may deem fit.

About the Voting Guidelines

These voting guidelines outline IiAS' views on the various items that are put to shareholders to vote. It is not intended to be exhaustive and does not address all voting resolutions/issues. This document is provided for assistance only and is not intended to be and must not be taken as the basis for any voting or investment decision or construed as legal opinion/advice. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of the individual resolutions referred to in this document (including the merits and risks involved). IiAS shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this document. The discussions or views expressed may not be suitable for all investors. This information is subject to change without any prior notice. IiAS reserves the right to make modifications and alterations to this document as may be required from time to time; IiAS' Voting Guidelines are reviewed and updated on an annual basis. In this version of the voting guidelines, we have attempted to capture the regulatory changes till 1 April 2024. However, IiAS is under no obligation to update or keep the information current. Nevertheless, IiAS is committed to providing independent and transparent recommendation to its clients and would be happy to provide any information in response to specific queries. Neither IiAS nor any of its affiliates, group companies, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information contained in this document. The distribution of this document in certain jurisdictions may be restricted by law, and persons in possession of this document, should inform themselves about and observe, any such restrictions; IiAS shall not be responsible for the same. All information contained in this document including data, text, graphs, layout, design, original artwork, concepts and other Intellectual Properties, remain the sole property and copyright of IiAS and may not be used in any form or for any purpose whatsoever by any party without the express written permission of IiAS. Regulatory disclosures, wherever applicable, shall form a part of IiAS' voting recommendations and/or made available on IiAS' website.