Request for comments | Treatment of employee stock options schemes under IiAS' Voting Guidelines

IiAS intends to revise its Voting Guidelines relating to Employee Stock Options Schemes that have an exercise price significantly lower than the market price. These proposed changes are based on the feedback from companies and investors, as well as our own experiences. We aim to implement these revisions, subject to market feedback, effective 1 December 2024. Stakeholders are requested to provide their feedback to the proposed changes on or before 28 November 2024.

Rationale for changing stance on ESOPs under our voting guidelines:

In a few companies, stock options have been generously granted with time-based vesting and significantly discounted exercise prices, essentially serving as remuneration for merely showing up to work. In some cases, a substantial portion of these stock options were awarded to founders (who are not classified as promoters) or professionals nearing promoter status. To align with investor interests, we believe stock options should be issued at market price. However, due to the high costs of the Indian capital markets over the past year, several companies have opted to issue stock options at a deep discount to market price. While IiAS acknowledges that issuing stock options within this framework is legally permissible, it does not align with the principle of investor interest. Therefore, IiAS asserts that stock options issued at a deep discount to market price should include performance-based vesting to ensure that recipients are rewarded for their contributions to the company's success, rather than simply for their presence.

In making disclosures with respect to performance-based vesting, IiAS recommends companies provide clarity with respect to:

(a) the performance measures; and
(b) the targets for each measure; and
(c) the weightages of these measures while deciding if the deeply discounted stock options are to vest.
(d) The disclosures above must be unambiguous and must not provide significant flexibility to the NRC and the board to make changes.

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 is therefore moderating its position.

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

(a) performance measures are clearly articulated; and
(b) weightages assigned to each performance measure is given; and
(c) the company has 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.
(d) The disclosures stated above are unambiguous and do not provide substantial flexibility to the NRC or the board to change the performance basis and measures.

In a handful of ESOP resolutions, companies have stated stock price performance as a performance measure. However, on a standalone basis, stock price performance is likely to be a function of several variables, not limited to company performance. Therefore, IiAS believes that a better measure is a relative stock price performance, compared to listed peers or an index. With stock-price based measures, IiAS will expect the company to disclose the listed peers or the index against which the company's stock price performance will be measured. Therefore, IiAS will generally not support schemes that carry standalone stock price (or market capitalization) based performance measures.

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 over which the company has control. IiAS does not generally support the extension of stock option schemes to holding companies, associates and group companies, but may make exceptions on a case-to-case basis. Further, IiAS will no longer support enabling resolutions that seek shareholder approval to extend the scheme to future subsidiaries, 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. Intended 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 *blue italics*)**
2024-25 update: IiAS had updated its guidelines on disclosures required for ESOP schemes which is given below: • 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	• 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 pre-defined performance targets *– both at the corporate level and at the individual level*.

Current voting guidelines on ESOPs	Proposed guidelines (changes highlighted in ***blue italics***)
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 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).	• IiAS will expect companies to disclose specific *corporate-level* targets, *along with 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.* • *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.*

Current voting guidelines on ESOPs	Proposed guidelines (changes highlighted in *blue italics*)
	• 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).

** Subject to market feedback*

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 *blue italics*)
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.	• IiAS will generally support the extension of stock option schemes to employees of: (a) wholly-owned subsidiaries; (b) subsidiaries where the company has management and board control, and is not separately listed; (c) 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 (a) listed subsidiaries (b) associate *and group companies* *(c) holding companies* • *IiAS will not support enabling resolutions that allow the extension of stock option schemes to <u>future</u> subsidiaries, associate or group companies.*

** Subject to market feedback*

Request for comments: We will be happy to receive comments from companies, investors, and other market participants on these changes. Please write to us with your feedback at reports@iias.in or solutions@iias.in on or before **28 November 2024**.

Illustration: The Procter & Gamble Company's 2023 Disclosure on Performance Stock Program

"The C&LD Committee recognized that the Company's longer-term incentives include a balanced portfolio of stock options, restricted stock units, and performance stock units. These longer-term incentives incorporate a variety of payout horizons that focus executives on long-term performance: 10-year terms with three-year cliff vesting for stock options, three-year cliff-vesting for restricted stock units, and a three-year performance period for performance stock units granted under the Performance Stock Program, or PSP. The C&LD Committee also noted that the design of the PSP reduces the likelihood that an executive will focus too much on a single performance measure by including four different performance categories with ***weightings of 20% or 30% each*** *to provide a balanced risk profile.* ***The categories are: organic sales growth relative to competitive peers, constant currency core before-tax operating profit growth, core earnings per share growth, and free cash flow productivity. In addition, actual performance against goals with respect to each of these performance measures will yield a payout from a minimum of 0% to a maximum of 200% of a senior executive's target incentive opportunity.*** *We believe that using this sliding scale approach, versus an all-or-nothing approach, discourages participants from taking unnecessary risks. Furthermore, the PSP also includes* ***a relative Total Shareholder Return Multiplier to ensure further alignment with shareholder interests****."*

"The Company's targets for FY 2022-23 were as follows: 3-5% Organic Sales Growth, 0-4% Core EPS Growth, and greater than 90% Adjusted Free Cash Flow Productivity. The Company met or exceeded its going-in targets for its key financial measures."

The actual performance for FY2022-23 was as under

+7% ORGANIC SALES GROWTH	+2% CORE EPS GROWTH	95% ADJUSTED FREE CASH FLOW PRODUCTIVITY
133 YEARS OF DIVIDEND PAYMENTS	67 YEARS OF DIVIDEND INCREASES	> $16B RETURNED TO SHAREHOLDERS[2]

Source: P&G's 2023 proxy statement

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.