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## 2014 India Proxy Voting Recommendations

### Benchmark Policy

July 31, 2014

Institutional Shareholder Services Inc.

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## Board of Directors

### Election of Directors

Generally vote for the election of directors unless:

- The nominee is an executive director serving on the audit, remuneration, or nomination committee; or
- The nominee has attended less than 75 percent of board and key committee (audit, compensation and nominating) meetings over the most recent fiscal year, without a satisfactory explanation.

Acceptable reasons for director absences are generally limited to the following:

- Medical issues/illness;
  - Family emergencies;
  - The director has served on the board for less than a year; and
  - Missing only one meeting (when the total of all meetings is three or fewer).
- Any non-independent director nominees where independent directors represent less than one-third of the board when the chairman is a non-executive director, or less than one-half of the board when the chairman is an executive director or a promoter director.

Generally vote for the election of a CEO, managing director, executive chairman, or company founder who is deemed integral to the company.

### Executive Appointment

Vote for executive appointment and remuneration proposals, unless there is evidence of problems in the past or significant concerns with the individual's qualifications, proposed remuneration, or performance or the position.

#### Discussion

In India, companies are required to seek shareholder approval to appoint a director or an individual related to a director to an executive position. This is a standalone proposal separate from director election. Generally, these proposals would seek to approve an executive contract including the remuneration for a period of three to five years. When an executive also sits on the company's board, the executive appointment and remuneration will be judged for their own merit and the policy on director election will not be applied.

### Shareholder Directors

Generally vote against the appointment of shareholder directors unless sufficient information regarding the candidate is disclosed. If sufficient information is provided, the policy for director election applies.

#### Discussion

State-owned corporations or Public Sector Undertakings (PSUs) as termed in India are classified as Public Sector Enterprises (PSEs), Central Public Sector Enterprises (CPSEs) and Public Sector Banks (PSBs). At PSUs, the nomination of directors is endorsed by the Government of India. At PSBs, registered shareholders as of the specified record date other than the Government of India have the right to nominate and appoint one to three directors (or shareholder directors) on the board. The number of shareholder directors is dependent on the level of ownership held by the public as prescribed.

The nominations of shareholder directors are scrutinized by the nomination committee in accordance with the Fit & Proper Guidelines issued by the Reserve Bank of India. If valid nominations matched the number of vacancies to be filled by the election, the candidates so nominated shall be deemed to be elected immediately.

If valid nominations are more than the number of directors to be elected, the candidates polling the majority of votes shall be deemed to have been elected and their names will be published in newspapers.

Unlike most director appointments, the names of the shareholders who nominated the directors and curricula vitae of director nominees are generally not provided in the meeting notices. Without information on the nominees, shareholders are restricted from making an informed decision. As such, until sufficient information becomes available, ISS recommends voting against the appointment of shareholder directors.

## Remuneration

### Director Commission and Executive Compensation

Generally vote for resolutions regarding director fees unless there is a clear indication that directors are being rewarded for poor performance, or the fees are excessive relative to fees paid by other companies of similar size.

Generally vote against the payment of remuneration in excess of the minimum remuneration and the waiver of recovery of excess remuneration paid to directors in the event of loss or inadequate profit unless compelling justification is provided in support of the proposal.

### Discussion

Under the Act 2013, shareholder approval is required to pass the following remuneration related proposals:

- Remuneration by way of commission at a specified percentage of net profits to non-executive directors. Such approval may be sought on an individual basis, but is normally requested for non-executive directors as a group;
- Remuneration of a director or relative of a director appointed to an executive position in the company or in a subsidiary. Executive compensation is broken down into monthly cash salary, perquisites, and commission and/or bonuses;
- Revision in the remuneration package of an executive; and
- Remuneration paid/payable to an executive in excess of the prescribed limits in case of the company having no profits or inadequate profits.

### Equity Compensation Plans

Generally vote for option plans and restricted share plans.

Vote against an option plan if:

- The maximum dilution level for the plan exceeds:
  - 5 percent of issued share capital for a mature company (this may be increased to 10 percent if the plan includes other positive features such as a challenging performance criteria and meaningful vesting periods as these partially offset dilution concerns by reducing the likelihood that options will become exercisable or performance shares are issued unless there is a clear improvement in shareholder value);
  - 10 percent for a growth company; or

- The plan permits options to be issued with an exercise price at a discount to the current market price.

Vote against a restricted share plan if:

- The maximum dilution level for the plan exceeds 5 percent of issued share capital for a mature company or 10 percent for a growth company; or
- The plan does not include a challenging performance criteria and meaningful vesting periods to partially offset dilution concerns by reducing the likelihood that performance shares are issued unless there is a clear improvement in shareholder value.

### Discussion

All equity compensation plans must be approved by shareholders in a special resolution. Employees including directors of the company and its subsidiaries or holding company are eligible to participate in the company's incentive plans. Promoter directors and any director who, either by himself or through his relatives or through any corporate entity that, either directly or indirectly, holds more than 10 percent of a company's outstanding equity shares, are not eligible to participate. In addition, independent directors are not entitled to receive stock options under the Act 2013.

In accordance with the Act, the explanatory statement must accompany the proposal for a compensation plan to the notice, and the resolution proposed to be passed must contain the following information:

- The total number of options to be granted;
- Identification of classes of employees entitled to participate in the Employee Stock Option Plan (ESOP);
- Vesting requirements;
- Maximum period within which the options shall be vested;
- Exercise price or pricing formula;
- Exercise period and process of exercise;
- The appraisal process for determining eligibility of employees to the ESOP; and
- Maximum number of options to be issued per employee and in aggregate.

No ESOP can be offered unless the company establishes a compensation committee for administration of the ESOP. The compensation committee shall be a committee of the board consisting of a majority of independent directors. The compensation committee formulates the detailed terms and conditions of the ESOP.

Employee stock purchase plan (ESPP) in India includes features similar to that of a restricted share plan. The eligibility of an employee is determined by the compensation committee and shares are issued at par value. Performance conditions or vesting of awards are usually not disclosed in meeting materials.

ISS' guidelines for equity plans are for dilution to generally not exceed 5 percent of issued share capital for a mature company and 10 percent for a growth company. However, ISS will support plans at mature companies with dilution levels up to 10 percent if the plan includes other positive features as outlined above.

## Audit

Generally vote for the (re)appointment of auditors and authorizing the board to fix their remuneration, unless:

- There are serious concerns about the accounts presented or the audit procedures used;
- The auditor is being changed without explanation; or
- Non-audit related fees are in excess of standard annual audit fees.

## Discussion

Shareholder approval of auditors and auditor remuneration is required by law. Mandatory rotation of auditors has been introduced in the Act 2013 – every five years for an individual auditor and every 10 years (or two terms of five consecutive years) for an audit firm. As per the disclosure requirements in the Act, the breakdown of payments to auditors must be disclosed in the profit and loss account of the company as (a) auditor (i.e. statutory audit and tax audit); (b) for taxation matters; (c) for company law matters; (d) for management services; (e) for other services; and (f) for reimbursement of expenses or out-of-pocket expenses.

In practice, unless the nature of the tax services was indicated as tax compliance/tax return preparation, ISS categorizes tax audit and taxation matters as other fees, which will be included in the computation of non-audit related fees. In addition, ISS categorizes reimbursement of expenses as audit-related fees based on the premise that these fees are expenses incurred by auditors in carrying out their audit functions.

However, banks in India are not required under the prevailing banking laws to provide the itemized breakdown of audit and non-audit fees paid to the auditor.

The practice of auditors providing non-audit services to companies is problematic. While large auditors may have effective internal barriers to protect against conflicts of interest, an auditor's ability to remain objective becomes questionable when fees paid to the auditor for non-audit services such as management consulting, general bookkeeping, and special situation audits exceed the standard annual audit fees.

While ISS will consider the nature and scope of non-audit fees when assessing their magnitude, where non-audit fees have constituted more than 50 percent of total auditor compensation during the fiscal year, ISS will ordinarily not recommend support for the reelection of the audit firm. ISS will make exception to this policy if excessive non-audit fees are in relation to special projects or due to unusual circumstance, and are not recurring in nature and are unlikely to create conflicts of interest. An example of acceptable "non-audit" fees would be fees for a special audit in connection with an IPO.

## Share Issuance Requests

### General Issuance Mandate

Generally vote for general issuances of equity or equity-linked securities without preemptive rights when dilution is not more than 20 percent of a company's issued share capital.

#### Discussion

Under the Act 2013, shareholder approval is required to disapply preemptive rights in connection with any issuance of equity or debt securities. General issuance requests in India only include the stipulation on the aggregate value of securities to be issued and confer authority on the board to determine the type of securities, issue price, timing, and recipients of such securities, in accordance with the relevant SEBI regulations. The authority is valid for one year, as revoked or renewed by shareholders.

A popular equity fund raising route is the issuance of securities through qualified institutional placement (QIP). The recipients of this issuance include public financial institution, scheduled commercial banks, mutual funds, foreign institutional investor registered with SEBI, multilateral and bilateral development financial institutions, venture capital funds registered with SEBI, foreign venture capital investors, and state industrial development corporations, or collectively termed as qualified institutional buyers.

As per the applicable provisions, the issue price of securities under QIP shall not be less than the average of the weekly high and low of the closing prices of the related equity shares quoted on a stock exchange during the two weeks preceding the relevant date, less a discount of not more than 5 percent.

In case of allotment of equity shares, the relevant date is the date of the meeting in which the board or committee decides to open the issue. While in case of allotment of convertible securities, the relevant date is defined as being the date of the meeting in which the board or committee decides to open the issue or the date on which the holders of such convertible securities become entitled to apply for the equity shares.

Given the limited disclosure on the type of securities and cap on the number of equity shares that it may issue under this enabling authority, ISS computes the potential dilution of the issuance request based on recent trading share prices of the issuer. ISS supports general issuances of equity or equity-linked securities without preemptive rights when dilution is not more than 20 percent of a company's issued share capital.

### Preferential Issuance Requests

Vote case-by-case on requests for preferential issuance (private placements)

#### Discussion

Private placements, called preferential issuance, are fairly common in India, and many firms typically seeks shareholder approve to allot new shares to a promoter/promoter group of the company.

As per the applicable provisions, the issue price of securities offered on a preferential basis shall be not less than the higher of the following: (a) the average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date or (b) the average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

The preferential offering must be completed within a period of 15 days from the receipt of shareholder approval for the issuance and that the securities allotted on a preferential basis to promoter/promoter group are not transferable for a period of three years from the date of allotment of securities or equity shares arising out of exercise of the right attached to the warrants.

### Preferential Issuance of Warrants

Vote case-by-case of requests for issuance of preferential warrants.

#### Discussion

Preferential warrants is fund raising tool that is unique in India. Indian companies offer warrants to select group of individuals, usually the promoter/promoter groups. Each warrant will entitle the holder to subscribe for one equity share in the company at any time before the expiry of 18 months from the date of allotment. An amount equivalent to 25 percent of the fixed price per warrant is payable on the date of allotment and the balance 75 percent upon exercise into equity shares.

### Specific Issuance Requests

Vote case-by-case on issuances of shares for specific purposes.

#### Discussion

A company may request the issuance of shares for an acquisition in the form of a rights issue to raise funds for a cash payment, or else a company could request an issuance without preemptive rights for use in a share-based acquisition or issuance to a third party. A more routine request would be an authority to issue shares without preemptive rights for issuance as needed upon conversion of convertible securities or to service a share option plan. These shares can only be used for the purpose defined in the resolution. Such a request could be of any size.

### Share Purchase Plans

Generally vote for share repurchase programs/market repurchase authorities, provided that the proposal meets the following parameters:

- Maximum volume: 10 percent for market repurchase within any single authority and 10 percent of outstanding shares to be kept in treasury (“on the shelf”); and
- Duration does not exceed 18 months.

Vote case-by-case on authorities to repurchase shares in excess of the 10 percent repurchase limit.

#### Discussion

Indian companies are allowed to purchase its own shares or other securities out of its free reserves, securities premium account, or issue proceeds, provided the following parameters are met:

- Share buyback is authorized by its articles;
- A special resolution has been passed at a general meeting of the company authorizing the buy-back; and
- The funds to be deployed on buybacks should not exceed 25 percent of the paid-up capital and free reserves of a company.



Share buybacks of not more than 10 percent of the total paid-up equity capital and free reserves of the company only require the approval of the board. There should also be a minimum gap of one year between two buyback offers made by the company as required under the relevant regulations.

## Debt Issuance Requests

In evaluating debt-related proposals, consider the following factors:

- *Rationale/use of proceeds*: Why does the company need additional capital? How will that capital be used?
- *Terms of the debts*: Are the debt instruments convertible into equity? What are the interest rate and maturity dates? Any call or put options? Often these terms will not be determined until the time of issuance of debt instruments (or when the actual loan agreement is signed). The terms of the debts would generally be determined by the market conditions, and lack of disclosure concerning these terms should not be a cause for significant concern so long as the debt is not convertible into equity.
- *Size*: At a minimum, the size of the debt issuance/potential borrowing should be disclosed.
- *The company's financial position*: What is the company's current leverage and how does that compare to its peers?
- *The risk of non-approval*: What might happen if the proposal is not approved? Are there any alternative sources of funding? Could the company continue to fund its operations? Would it hinder the company's ability to realize opportunities?

A distinction should be made between a specific debt issuance or pledging of assets, and authority to issue or increase debt; as in the case of specific equity issuances and requests for authority to issue equity.

## Increase in Borrowing Powers

Indian companies are allowed to borrow in excess of the aggregate of its paid-up capital and free reserves, subject to shareholder approval by means of a special resolution.

Vote for proposals to approve increases in a company's borrowing powers if:

- The size of the debt being requested is disclosed;
- A credible reason for the need for additional funding is provided;
- The potential increase in debt is not excessive; and
- There are no significant causes for shareholder concern regarding the terms and conditions of the debt.

For non-financial companies, the following criteria are used to assess whether the potential increase in debt is considered excessive:

- The proposed maximum amount is more than twice the company's total debt;
- It could result in the company's net debt-to-equity ratio, or gearing level, exceeding 300 percent; and
- The maximum hypothetical debt-to-equity ratio is more than three times the industry and/or market norm.

Generally vote for debt-related proposals of financial companies taking into account the current financial standing of the company, including but not limited to:

- The capital adequacy to risk (weighted) assets; or
- Capital adequacy ratio vis-à-vis the regulatory norm;
- Revenue growth; and
- Asset base.

### Pledging of Assets for Debt

Vote for proposals to approve the specific pledging of assets for debt if:

- The size of the debt being requested is disclosed;
- A credible reason for the need for additional funding is provided;
- Details regarding the assets to be pledged are disclosed; and
- There are no significant causes for shareholder concern regarding the terms and conditions of the debt.

For proposals seeking a general authority to pledge assets for debt, the specific assets to be pledged need not be disclosed. However, in such cases, the authority should be limited such that it would not result in an excessive increase in debt. Vote against proposals that grant excessive authority to the board or management.

### Discussion

Directors may not sell, lease, or otherwise dispose of all or substantially all of a company's assets without prior shareholder approval. Mortgages and/or charges against the company's assets in connection with proposed debt issuances can be regarded as disposals under company law and are commonly used by companies in India.

### Financial Assistance

Vote case-by-case on requests for financial assistance. Generally vote against the provision of a guarantee where:

- The identity of the entity receiving the guarantee is not disclosed;
- The guarantee is being provided to a director, executive, parent company, or affiliated entities where the company has no direct or indirect equity ownership; or
- The guarantee is provided to an entity in which the company's ownership stake is less than 75 percent; and such guarantee is not proportionate to the company's equity stake or other parties have not provided a counter guarantee.

When the proposed guarantee does not fall into the above criteria, generally vote for the request provided that there are no significant concerns regarding the entity receiving the guarantee, the relationship between the listed company and the entity receiving the guarantee, the purpose of the guarantee, or the terms of the guarantee agreement. Examples of such concerns include a previous default by the entity receiving the guarantee or a sub-investment grade credit rating.

### Discussion

Indian companies often provide financial assistance in the form of investments in securities, extending securities/guarantees, or loans to subsidiaries, affiliates, and related parties. Prior shareholder approval by means of a special resolution is required when the aggregate amount of financial assistance exceeds 60 percent

of the company's paid-up share capital, free reserves, and securities premium account, or 100 percent of its free reserves and securities premium account, whichever is higher. In most cases, the terms and conditions of the financial assistance (i.e. recipient of such financial assistance and deployment schedule of funds) are not disclosed in the meeting materials.

## Related-Party Transactions

Vote case-by-case on related party transactions.

### Discussion

Transactions that a company may engage in with a related party as identified in the Act 2013 include:

- Sale or purchase of goods or property of any kind;
- Lease of property of any kind;
- Avail or render of any services; and
- Appointment of a related party to any office or place of profit in the company, its subsidiary company or associate company.

A related-party transaction (RPT) requires prior shareholder approval by means of a special resolution when the company's paid-up share capital or the transaction value exceed the prescribed amount and that such transaction is not in the ordinary course of business or is in the ordinary course of business but not on an arm's length basis. Interested parties will be restricted from voting on such transactions to be passed by a special resolution.

## Mergers and Acquisitions

Vote case-by-case on mergers or acquisitions, taking into consideration:

- Valuation - Is the value to be received by the target shareholders (or paid by the acquirer) reasonable? If a fairness opinion has been prepared, it provides an initial starting point for assessing valuation reasonableness, but ISS also places emphasis on the offer premium, market reaction, and strategic rationale.
- Market reaction - How has the market responded to the proposed deal? A negative market reaction will cause ISS to scrutinize a deal more closely.
- Strategic rationale - Does the deal make sense strategically? From where is the value derived? Cost and revenue synergies should not be overly aggressive or optimistic, but reasonably achievable. Management should also have a favorable track record of successful integration of historical acquisitions.
- Negotiations and process - Were the terms of the transaction negotiated at arms-length? Was the process fair and equitable? A fair process helps to ensure the best price for shareholders.
- Conflicts of interest - Are insiders benefiting from the transaction disproportionately and inappropriately as compared to non-insider shareholders? As the result of potential conflicts, the directors and officers

of the company may be more likely to vote to approve a merger than if they did not hold these interests. ISS will consider whether these interests may have influenced these directors and officers to support or recommend the merger.

- Governance - Will the combined company have a better or worse governance profile than the respective current governance profiles of the respective parties to the transaction? If the governance profile is to change for the worse, the burden is on the company to prove that other issues (such as valuation) outweigh any deterioration in governance.

## Sale of Undertaking

Vote case-by-case on asset sale requests, taking into consideration:

- Impact on the balance sheet/working capital;
- Potential elimination of diseconomies;
- Anticipated financial and operating benefits;
- Anticipated use of funds;
- Value received for the asset; accountants' report; fairness opinion (if any);
- How the deal was negotiated;
- Conflicts of interest.

For proposals seeking a general authority to sell non-operating assets, which normally are not accompanied with disclosure of relevant information such as potential buyer(s) and consideration, the rationale of the disposal and the company's history of asset disposals will be closely examined. Generally vote for such requests as long as the authority requested is not excessive and there are no known issues with asset disposals in the past.

## Discussion

The sale or lease of a company's business undertaking or substantially the whole of such undertaking requires shareholder approval by means of a special resolution, when such transaction meets the following criteria:

- The company's investment in the business undertaking exceeds 20 percent of its net worth as per the audited balance sheet of the preceding financial year or an undertaking which generates 20 percent of the total income of the company during the previous financial year. or
- The expression "substantially the whole of the undertaking" in any financial year shall mean 20 percent or more of the value of the business undertaking as per the audited balance sheet of the preceding financial year.

## Miscellaneous

### Dividend Distribution

Generally vote for approval of dividends, unless:

- The dividend payout ratio has been consistently below 30 percent without adequate explanation; or
- The payout is excessive given the company's financial position.

## Discussion

Dividend payouts are generally low in India, but vary significantly between industries. Dividend payout ratio below 30 percent will trigger further analysis, and the company's financial position, growth stage, and past dividend history, among others, will be examined.

### Charitable Donations

Vote against proposed charitable donations, unless:

- Adequate disclosure on the rationale for the donation and exact term of the authority are provided in the meeting materials, and
- The party receiving the charitable donation is an independent third party.

### Discussion

Charitable donations are subject to shareholder approval when the amount of such contributions, in any financial year, exceeds 5 percent of the company's average net profits for the three immediately preceding financial years.

Charitable donations could increase the company's goodwill in the market and further their corporate social responsibility ideals. Public companies are increasingly being asked to be responsible members of the society in which they operate, and returning a portion of the earnings to communities and those in need could be an appropriate way to facilitate the company's sustainability efforts and community engagement. Furthermore, these activities could help improve the company's brand image as well as to gain the community's trust, which in turn may improve financial performance in the long term. Moreover, these activities and charitable giving could improve the company's sustainability ranking and scores as measured by various institutions, potentially providing greater access to funds.

There are, however, concerns about the potential for abuse and lack of accountability. Many corporations give funds to individuals or entities associated with their directors or major shareholders in the name of charitable giving. While these funds may be used for charitable purposes, there is a risk of expropriating shareholders' wealth for the benefit of an affiliate. Additionally, many companies do not disclose the use of the donated funds or the impact the donations have made, and as such the effectiveness of the use of the company's capital is often difficult to ascertain. Hence, there should a reasonable mechanism for monitoring and transparency.

### Increase in Foreign Shareholding Limit

Vote for requests for increases in foreign shareholder limits, unless there are outstanding issues concerning the company.

### Discussion

SEBI registered foreign institutional investors (FIIs) and their sub-accounts are allowed to acquire up to 24 percent of the paid-up capital of an Indian company. However, this ceiling can be raised to the applicable sector cap/statutory limit prescribed by the company law, subject to approval of the company's shareholders in a general meeting.

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