

17th Current Issues in Retirement Benefits- Online

Date : 10 September, 2020

Time: 1700 - 1830

What has 2020 meant for Employee Shared Based Rewards



Chair- Advisory Group on PEBSSS



Kulin Patel, FIA, FIAI

Chair, Advisory Group for Pensions, Employee Benefits and Social Security, IAI

- CEO (Partner), K APandit
- Senior Consultant, pinbox solutions
- Member, Pension Advisory Committee - PFRDA
- Various client and leadership positions, Willis Towers Watson
- 20+ years Pensions and actuarial consulting experience across UK, North America and Asia

Housekeeping Points



Mute



Q&A



IAI support



Recording



Feedback

**C
P
D**

Moderator n PEBSSS



Hemanshu Jain FIAI

- Member, Advisory Group for Pensions, Employee Benefits and Social Security, IAI
- Member, Task Force on Employee Provident Fund Valuations 2019-2020
- Lead Consulting Actuary - Mercer Consulting (India) Private Limited
- Over 13 years of experience in Pension and Employee benefits
- Worked on multiple geographies like US, South Korea, India etc.

Programme Schedule



10th September 2020; Thursday, 5.00 PM – 6:30 PM India Time
What has 2020 meant for Employee Shared Based Rewards

No	Time	Sessions	Speaker
1	05-00 PM to 05-05 PM	Opening Remarks	Hemanshu Jain , Member AGPEBSS
2	05-05 PM to 05-35 PM	Impact of 2020 economic environment on the trends, design, governance, valuations and relevance of employee share based rewards	Anubhav Gupta , Director Human Capital Consulting Deloitte Touche Tohmatsu India LLP
3	05-35 PM to 06-05 PM	Trends and impact on the work of valuers of employee share based rewards	Vichitra Malhotra , Founder and Consulting Actuary Veritas Actuaries and Consultants
4	06-05 PM to 06-25 PM	Q&A Session	Moderated by Hemanshu Jain , Member AGPEBSS
5	06-25 to 06-30 PM	Vote of Thanks	Suresh Sindhi , Member AGPEBSS

Speaker Profile



Anubhav Gupta

Director, Human Capital Consulting, Deloitte

- Over 15 years of professional experience in the field of Executive Compensation and Governance.
- Prior to Deloitte, Anubhav was a Director with Aon Plc. responsible for managing executive compensation and governance practice for South Asia
- Key areas of expertise include designing long term stock and cash based incentive programs, executive pay benchmarking and structuring.
- Works with Nomination and Remuneration Committees on defining the evaluation process for the Board, Committees and Directors, articulation of remuneration philosophy for Directors, Key Managerial Personnel and Senior Management

Speaker Profile



Vichitra Malhotra FIA, FIAI
Founder and Consulting Actuary
Veritas Actuaries and Consultants

- Actuary with over 9 years of work experience, providing consultancy in various actuarial practice areas.
- Qualified actuary from both Institute of Actuaries of India as well as Institute and Faculty of Actuaries, UK.
- Veritas Actuaries and Consultants, specializes in carrying out end-to-end design, implementation, and valuation of various share-based payments (such as ESOPs, RSUs etc.) along with offering other actuarial services.
- She has worked with large multinationals in India including PricewaterhouseCoopers (PwC), Max Life Insurance and Canara HSBC OBC Life Insurance.

What has 2020 meant for Employee Shared Based Rewards

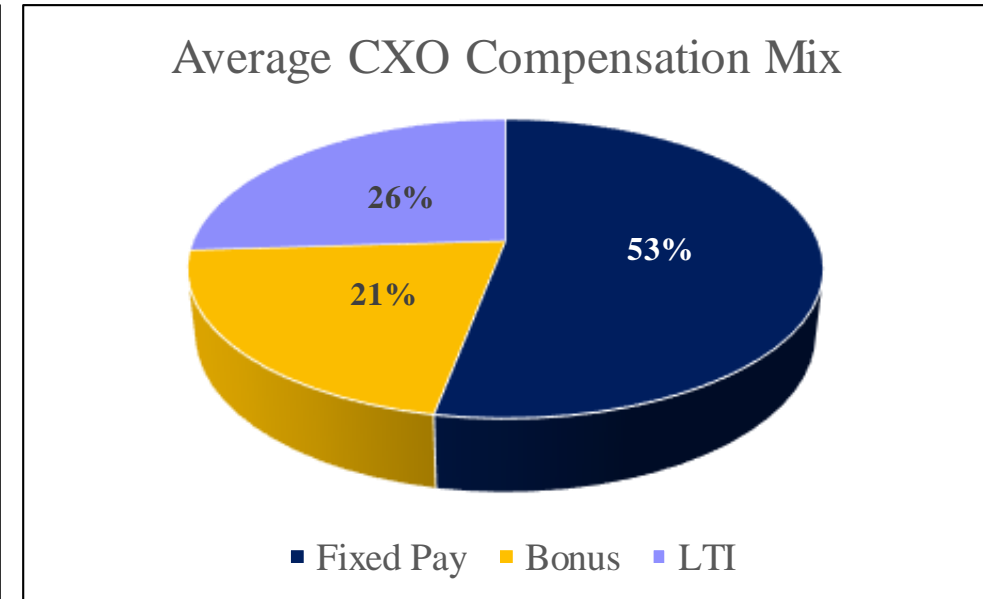
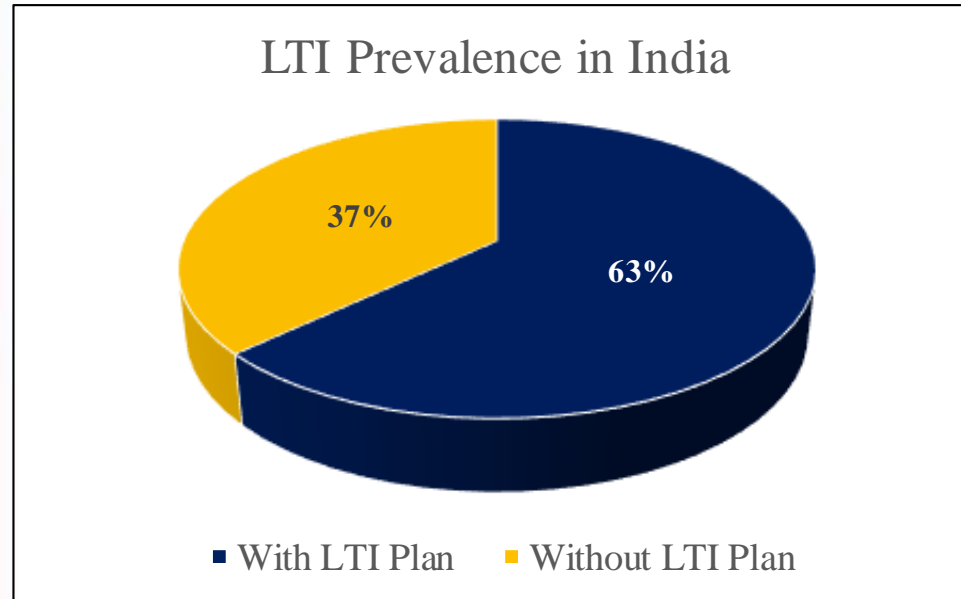
10th September 2020

Impact of 2020 Economic Environment on Employee Share Based Rewards

Anubhav Gupta
Director – Deloitte India



Prevalence of Long Term Incentives

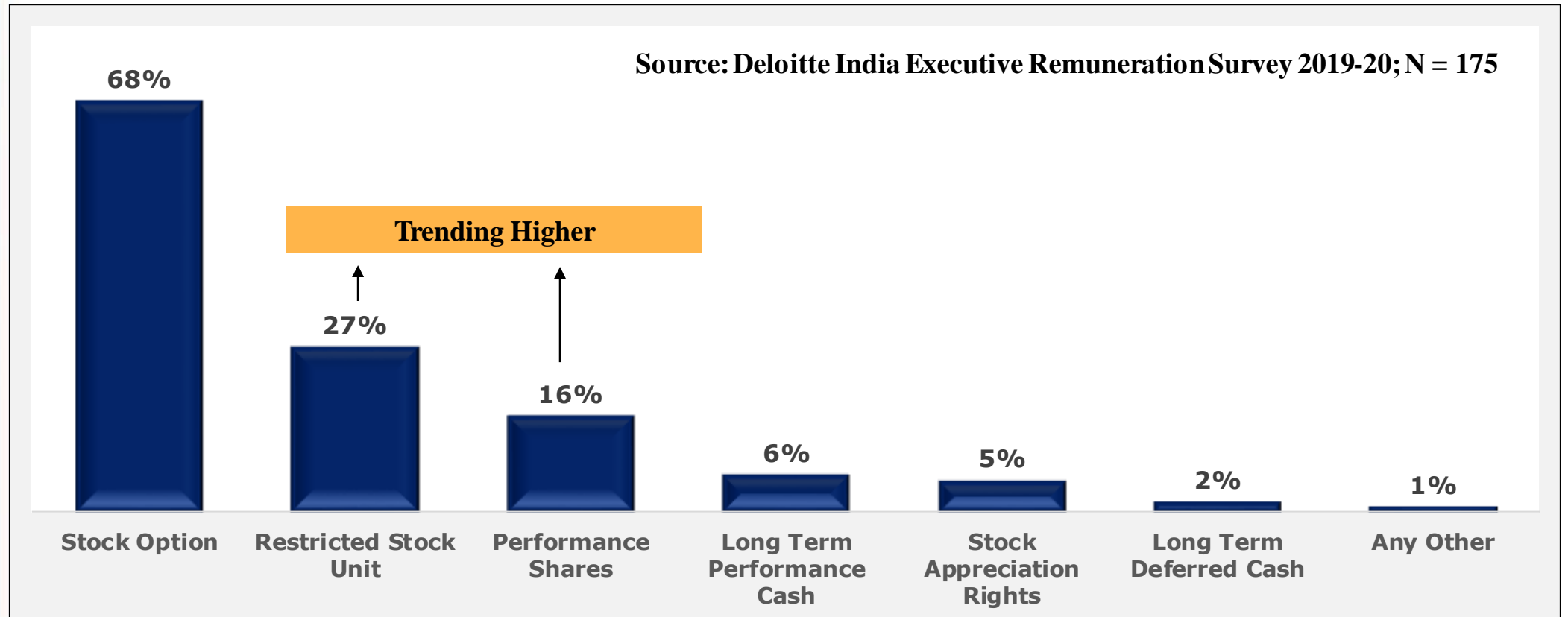


Source: Deloitte India Executive Remuneration Survey 2019-20 (N=278)

- Almost 2 out of 3 companies have a LTI plan
- LTI has become integral part of CXO compensation
- In western markets LTI component is as high as ~ 60%

Current Scenario in India

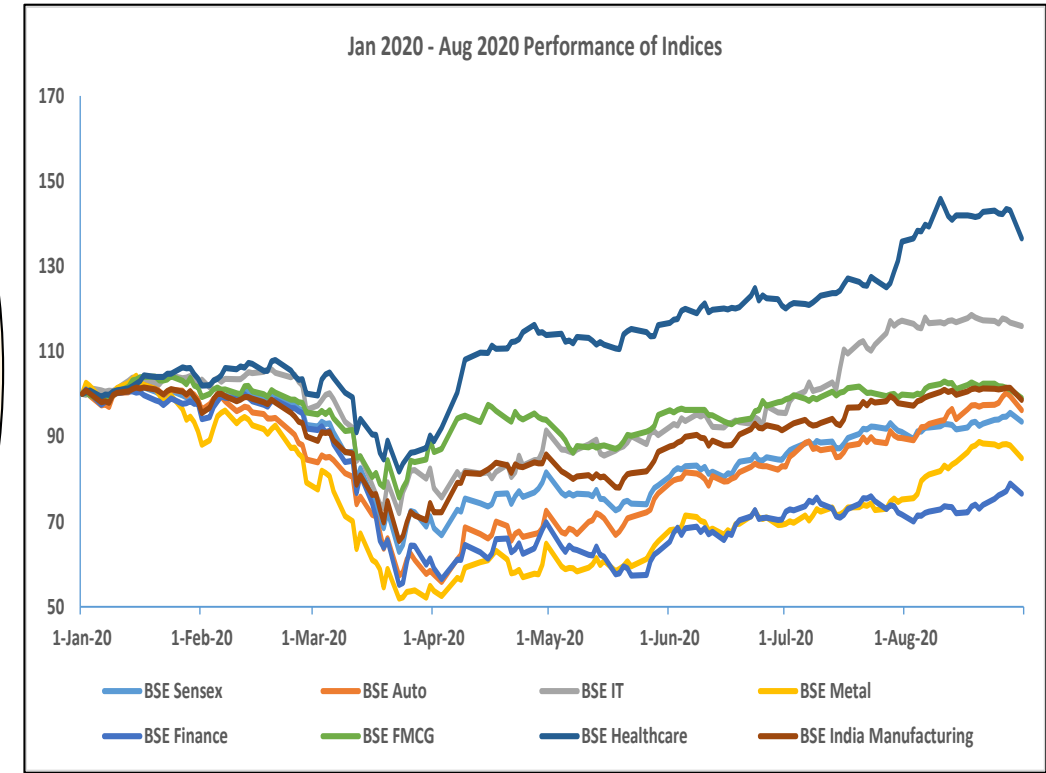
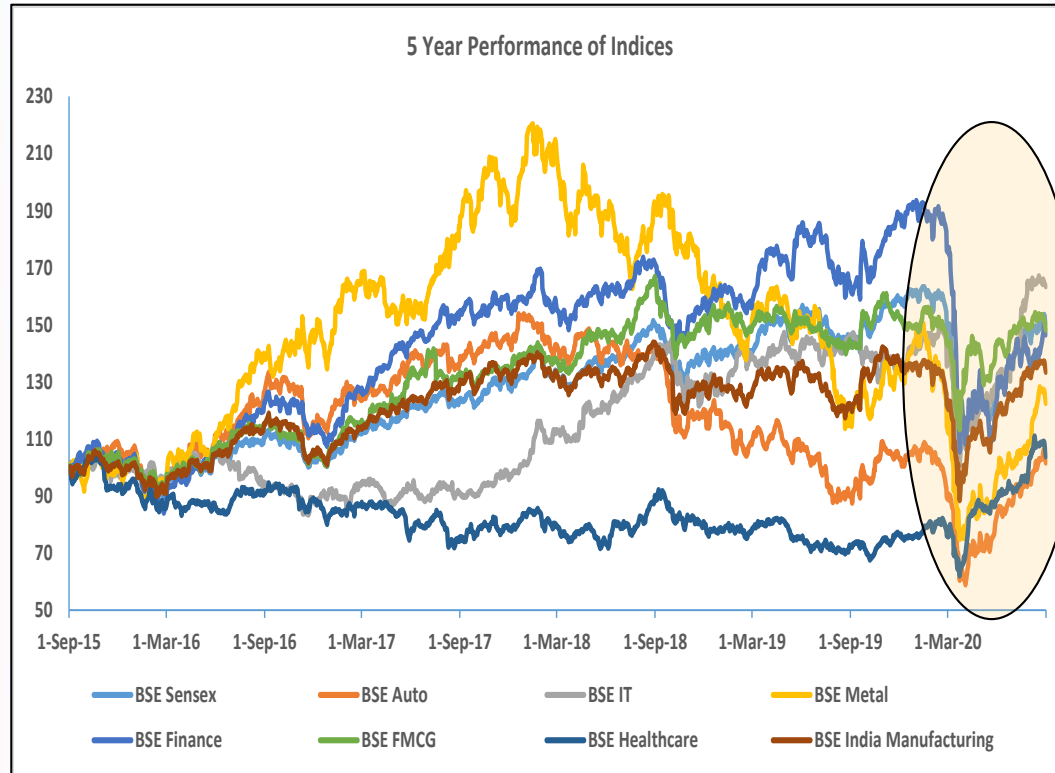
Share based payments are most common form of LTI



- Stock Options most prevalent instrument till date
- Most companies use only one instrument to deliver LTI value

Share Based Payments are for Long Term

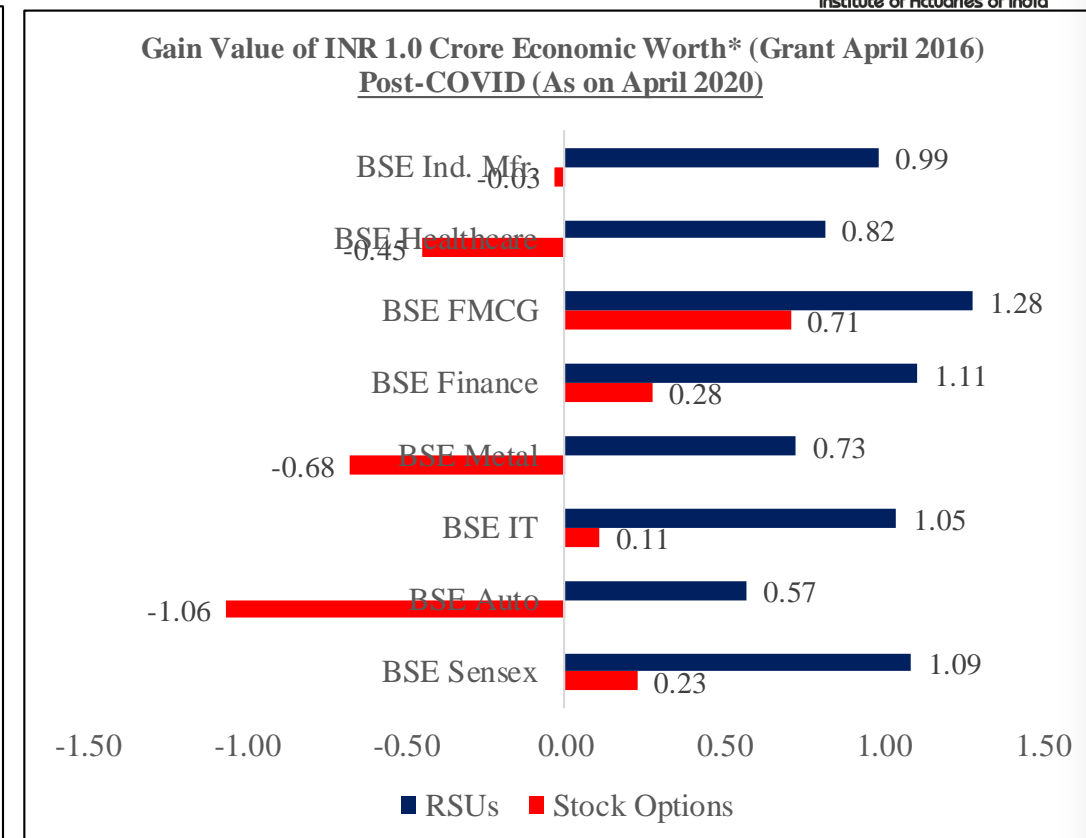
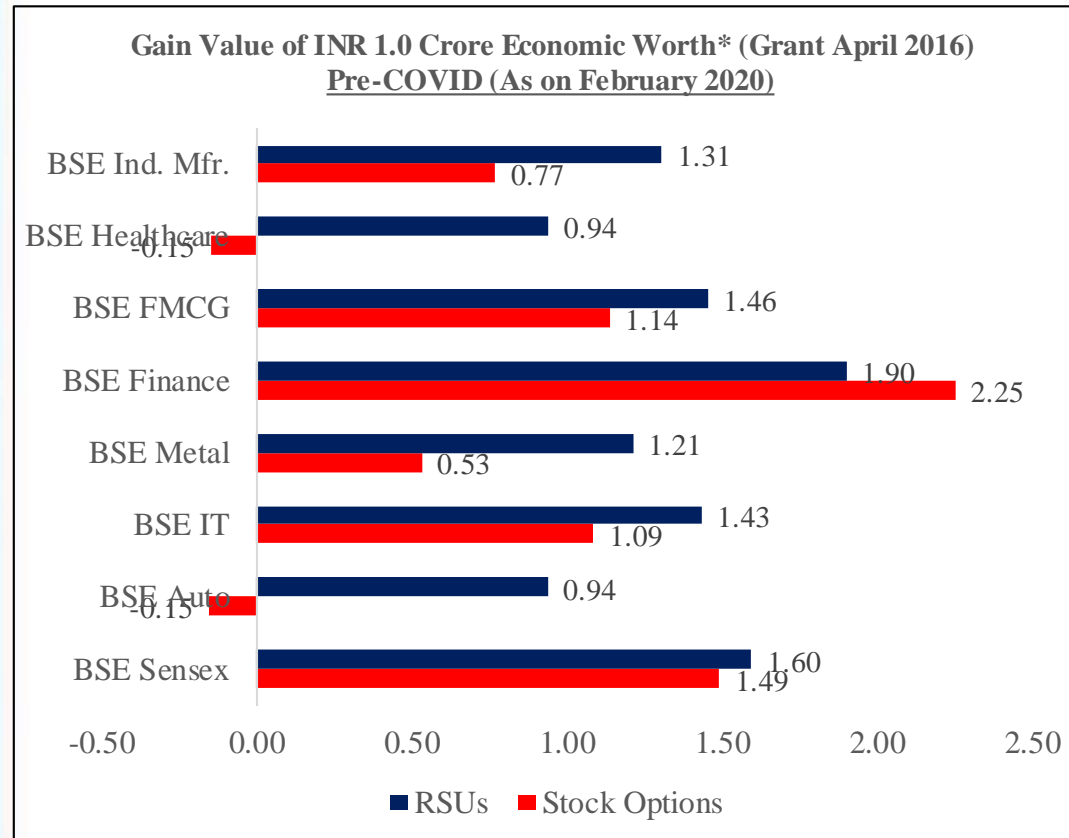
Recent volatility although had considerable impact



- Future outlook and volatility will impact the decisions on share based payments

Impact of COVID-19

Stock Options are Most Affected



*Economic worth determined basis fair value (Black-Scholes Model)

- Greater ROI in full value instruments
- Stock options for most industries are in negative ROI zone

Winds of Change

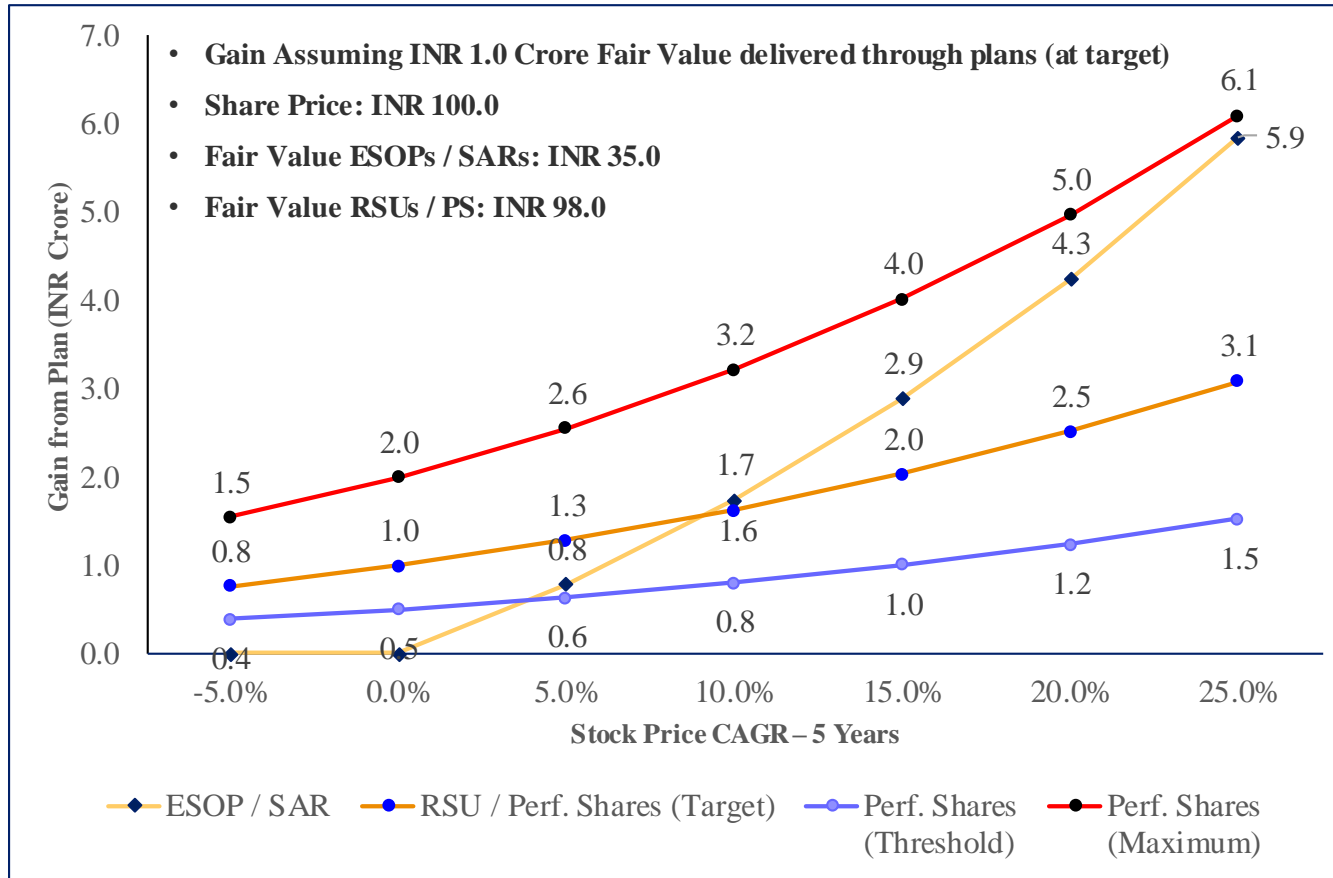
Factors impacting move away from Options



- Uncertain environment (U, V, W...)
- Plan objectives
- More connected world
- Volatility
- Line of sight to performance
- Adoption of IND-AS
- Dilution

Shift towards Full Value Instruments

Payoffs, Dilution and Expense



Dilution

- Assuming paid-up shares as 100 mn.
- ESOP dilution: 0.29%
- RSU / Perf. Share Dilution: 0.10%
- Perf. Shares: Threshold: 0.05%
- Perf. Shares Maximum: 0.20%

Fair Value Expense*

- ESOP: INR 1.0 Crore
- RSU: INR 1.0 Crore
- Perf. Shares (Threshold): INR 0.5 Cr.
- Perf. Shares (Target): INR 1.0 Cr.
- Perf. Shares (Maximum): INR 2.0 Cr.

*Performance share expense assuming non-market performance condition

- Shift to performance based full value instruments could be beneficial for organization and employees

Current Consideration

Value Neutral Exchange

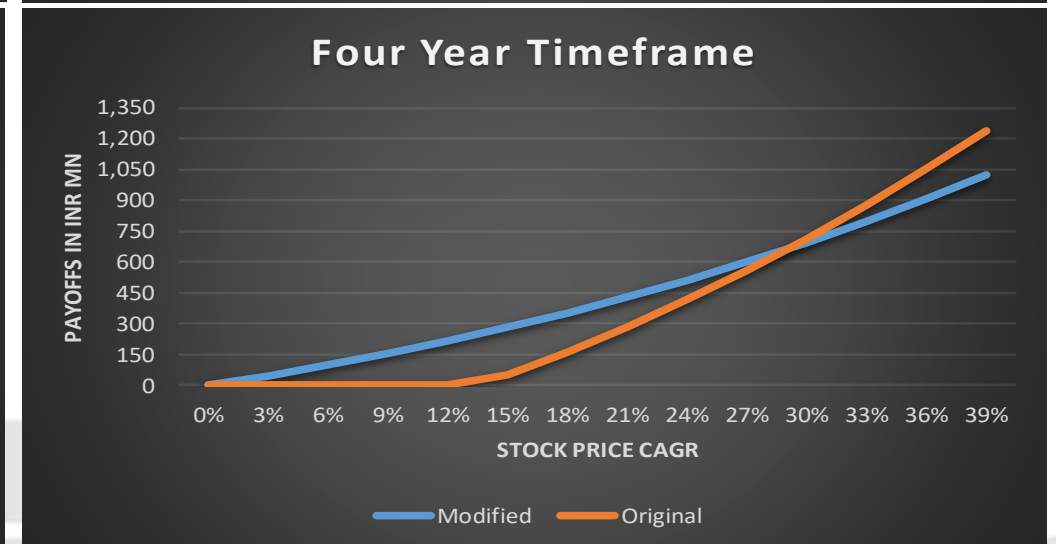
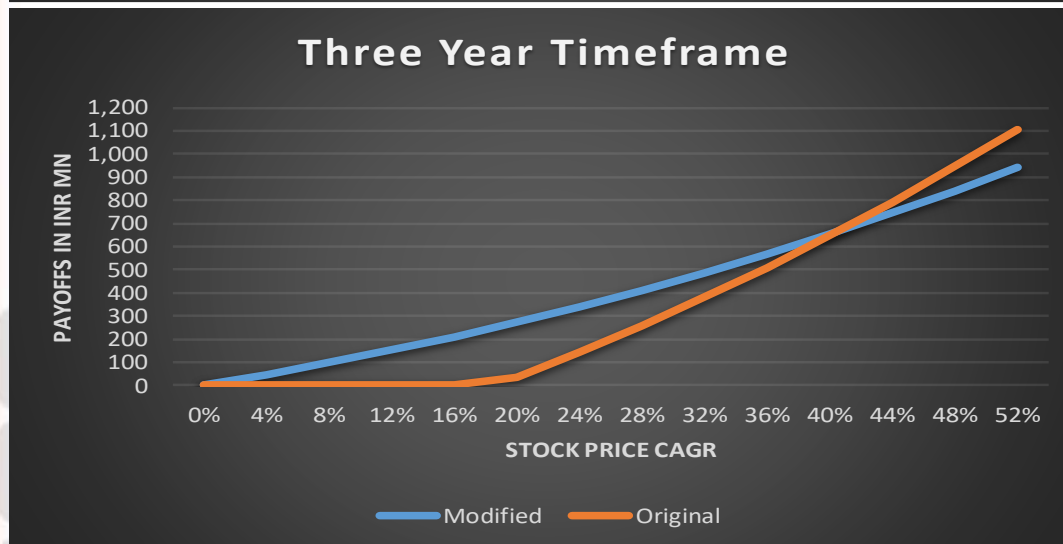
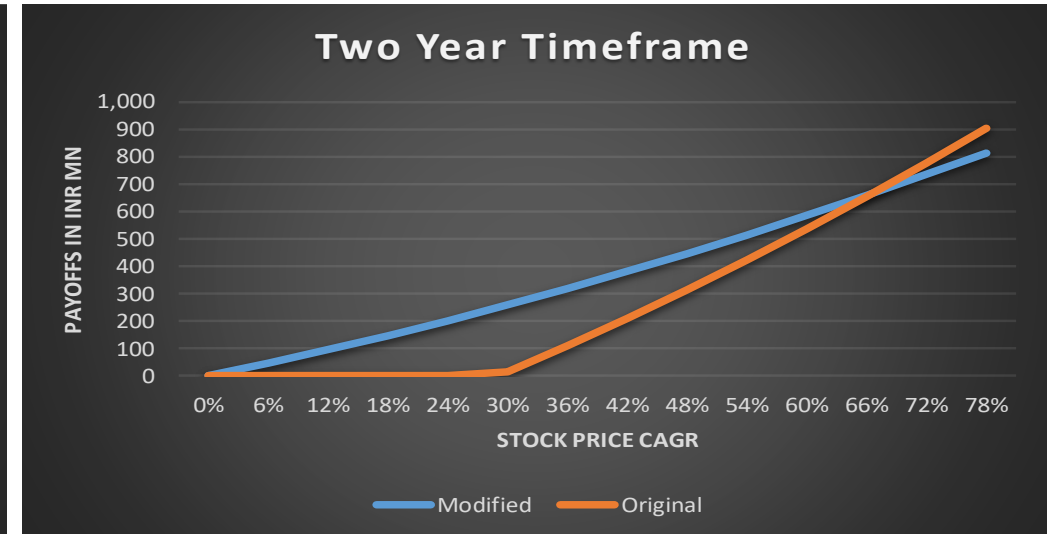
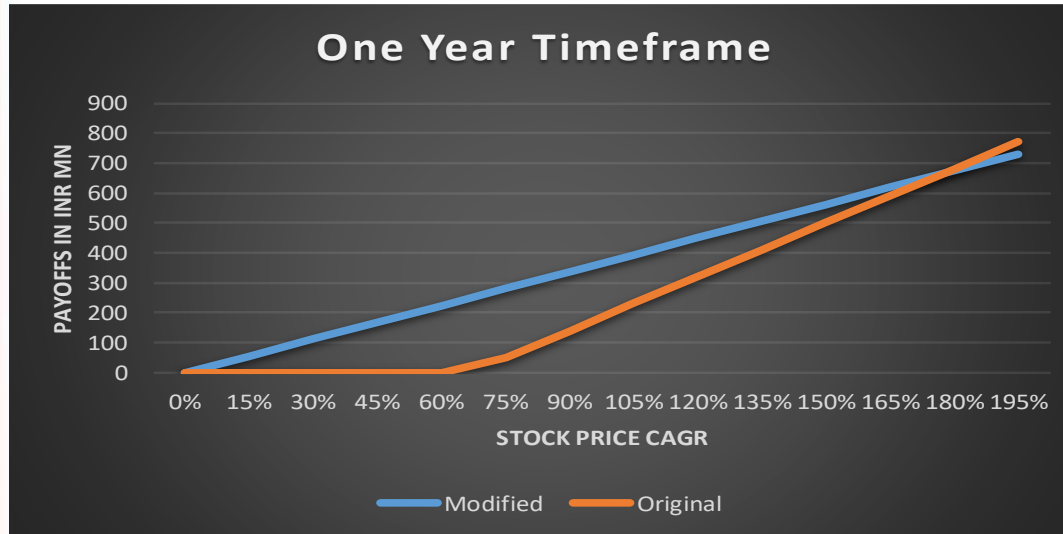


Original Grant Details	
Date of Grant	1-Apr-16
Share Price on Grant Date	₹ 100.00
Exercise Price	₹ 100.00
# of ESOPs Granted	10,000,000
Fair Value as on Grant Date	₹ 40.00
Total Expense (In Million)	₹ 400.00
Vesting Period	3 Years Cliff
Exercise Period Post Vesting	5 Years

Modification	
Date of Modification	1-Sept-20
Share Price on Modification Date	₹ 60.00
Underwater Extent*	66.67%
Fair Value on Modification Date (A)	₹ 16.70
Revised Exercise Price	₹ 60.00
Fair Value with Revised Exercise Price (B)	₹ 26.74
Exchange Ratio (A/B)	0.62

- 0.62 new option for every 1.0 original option
- Since there is no additional value given, there is no additional expense
- Approx. 3.8 million shares are added back to the share pool

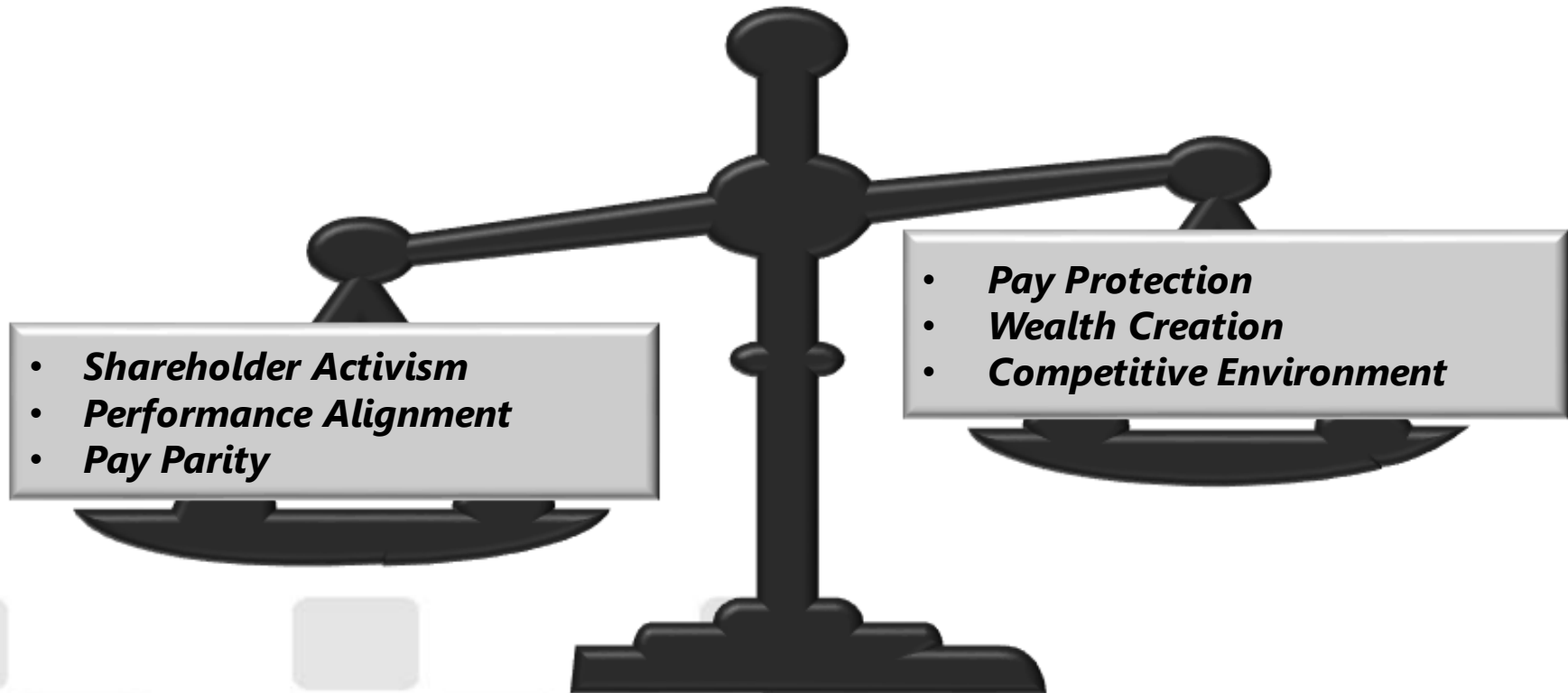
Value Neutral Exchange Payoff Comparison



Boards Need to Balance Objectives

Which are often conflicting

Balancing Competing Objectives



Thank You

17th Current Issues in Retirement Benefit: What has 2020 meant for Employee Share Based Rewards?

10th September 2020

Share Based Rewards: Trends and Impact on the work of Valuers

Vichitra Malhotra

Founder and Consulting Actuary – Veritas Actuaries and Consultants



Agenda



- **Introduction**
- Impact of COVID-19 on design of Share Based Rewards
- Impact on Valuation Techniques
- Impact on Valuation Assumptions
- Conclusion

Share Based Schemes at forefront!



Oyo announces ESOPs for all furloughed employees impacted by Covid-19

ESOP allocation was done as a part of Flipkart's annual performance assessment programme

Niyo rolls out salary hikes, bonuses, ESOPs to employees

The company recently hosted Home-a-thon, a virtual hackathon event, to encourage employees to make the most of the lockdown and focus on innovations in product, design and technology.

30 Jul, 2020, 04.19 PM IST

Employees have been allotted these new shares at a price of \$125-\$130 per unit

Flipkart is also reportedly considering an IPO by 2021

Lenskart expands total ESOP pool

27 Feb, 2020, 08.51 AM IST

ESOPs formed 1.8% of its total shareholding as of December 20, 2019, according to data collated by industry tracker Tracxn.

This start-up boss has rewarded his teams with ESOPs during the pandemic

22 Jul, 2020, 08.33 AM IST

Jitendra Gupta, CEO of digital banking startup, Jupiter, has issued stock options to employees at no cost.

Last month, Paytm, India's most highly-valued unicorn, said it will offer Rs 250 crore in Esops to high performing employees and new hires.

Zerodha's Rs 60-65 crore Esops buyback plan values firm at \$1 billion

Impact on work of Valuers

Changing Valuation Techniques

- Recovery Plans linked with Market Performance
- Increased share-price linkage in Plans
- Use of Simulations and Binomial than Black Scholes

- Low Interest Rate impacts Option Value
- Volatility
- Non-market performance based vesting
- Growing importance of Attrition

Impact on Assumptions

Increased Role of Valuers

- Increased shareholder / investor sensitivity to P&L impact of schemes
- Assessment of financial impact key to designing
- Valuers can support in optimizing the charge in books



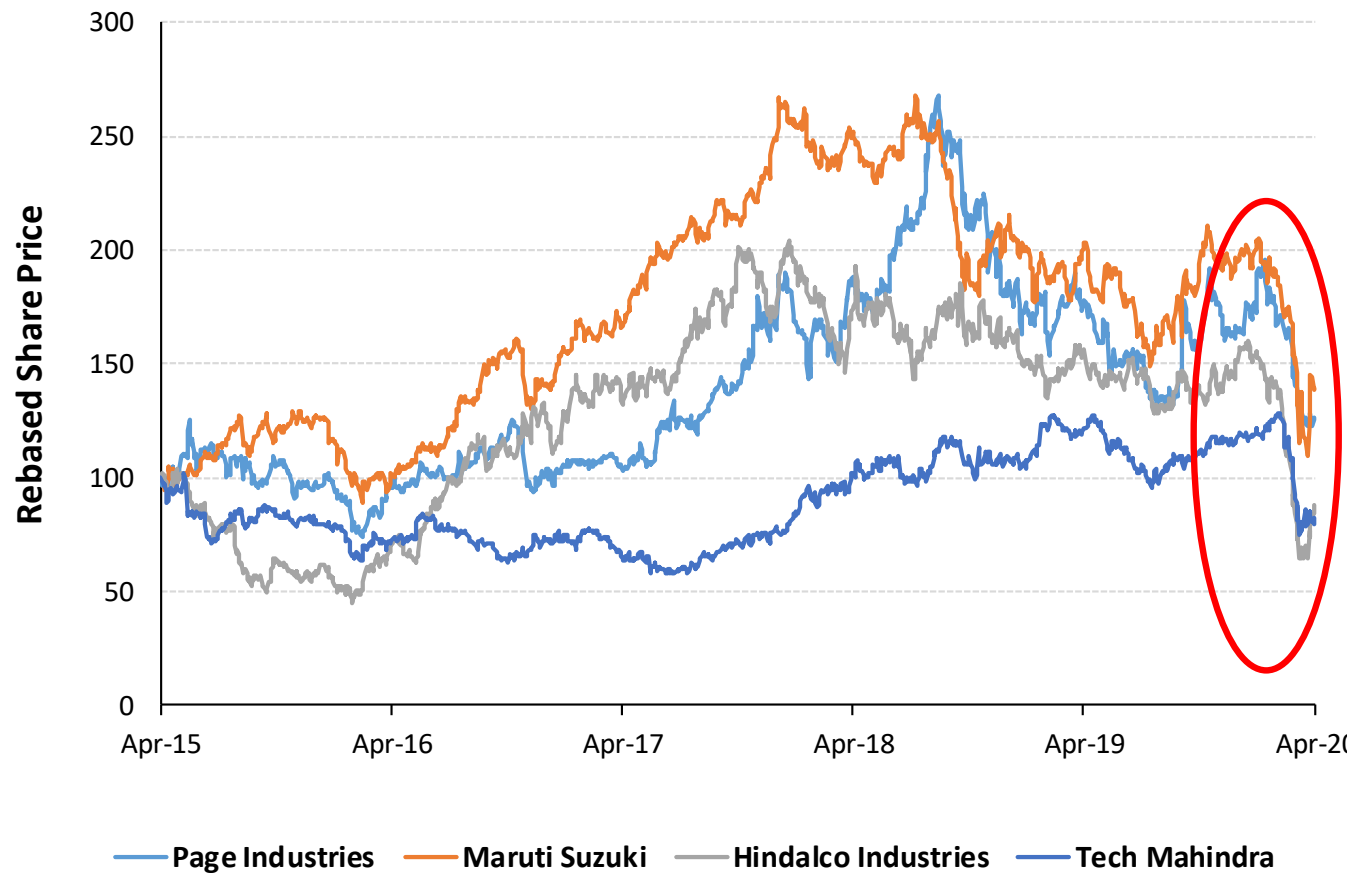
Agenda



- Introduction
- **Impact of COVID-19 on design of Share Based Rewards**
- Consequent Impact on Valuation Techniques
- Impact on Valuation Assumptions
- Conclusion

Move away from Plain Vanilla ESOPs

Share Price comparison



- *Recovery Plans linking Vesting with achieving pre-COVID Share Price*
- *Performance Shares for C-Suite*
- *ESOPs as broad-based compensation*
- *Modification of Existing Grants*
- *Growing P&L Sensitivity for Cash Settled Schemes*

Role of Valuers in Optimizing Design



Form of Grant

- **Volatility of Expense**
- Treatment as **Equity vs. Liability**
- **Risk-return of instrument used with stage of growth of organization**

Size and Terms of Grant

- Objective way of **determining number of options to be granted** (eg: Use of CTC multipliers)
- **Scenario testing** for different exercise price / vesting criteria condition
- **Optimising P&L charge vis-à-vis wealth creation** for employees, particularly for **cash-settled schemes**

Modification of Existing Grant

- Impact of **cancellation during and post vesting period**
- **Optimizing modification terms** for different grant periods
- Advising on **replacement grant versus new grant**

Role of Valuers in Optimizing Design

Helping companies in choosing right form of grant based on stage of growth & its risk-return profile



Stage of business	Founding / Start-up Pre-revenue Negative profits Negative Cash flows	Early stage Revenue started Pre-profitability Pre positive cash flow	Mid to later stage Revenue grows Profitable (breakeven) Positive cash flow	Later Stage Large Revenue Good Profits Positive Cash flow
Investor	Seed/Angel	Venture Capital	Private Equity	Public equity / IPO
Investment team	Entrepreneurs / past founders	Mix of entrepreneurs and bankers/finance	Mostly bankers/finance professionals	Public money comes in!
Potential Return	>100x return targets	>10x return targets	>15% IRR	General cost of equity (10% to 15% return)
Level of risk	Extreme risk, high chance of losing all money	High risk, moderate chance of losing all money	Moderate risk, low chance of losing all money	Low risk, market fluctuations are bigger risk

Risk (and potential return) reduces
 Propensity to give Stocks (than options) increases
 Cash flows become positive, can consider cash schemes

High risk, high return
 Higher propensity to give options than stocks
 Equity schemes preferred as negative (or little positive) cash flows

Role of Valuers in Optimizing Design

Helping companies in optimizing the P&L Charge and Wealth Creation for Employees!



**Minimize P&L charge
for given level of
Wealth Creation**

***Setting Terms of
Grant:
Number of options to
be granted, Exercise
Price, Expiry period &
Vesting conditions***

**Maximize wealth
creation for given level
of P&L charge**

Agenda



- Introduction
- Impact of COVID-19 on design of Share Based Rewards
- **Impact on Valuation Techniques**
- Impact on Valuation Assumptions
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Valuation Techniques



- **Black-Scholes Option Pricing** most commonly used
- Evolving Design structures with **linkage with market prices, targeted Shareholder IRR etc.** require advanced valuation techniques to determine fair value
- Use of **Binomial or Simulation Method** necessitated due to evolving design structures

Worked Example: Black Scholes Option Pricing



1000 ESOPs granted with **exercise price of INR 10**, share price at grant of **INR 15**. Expected exercise period is **4 years**. Simple service based vesting and no market linked exercise conditions.

Exercise Price (X)	INR. 10.0
Stock Price as at Grant Date (S)	INR. 15.0
Time to expiration (T – t, in year)	4 years
Risk-free rate of return (r)	6.00%
Dividend Yield	0.00%
Annualized Volatility (σ)	40%
Fair Value of Option	INR. 8.12

Worked Example: Simulations Approach



1000 ESOPs granted with **exercise price of INR 10**, **share price at grant of INR 15**. Expected exercise period is **4 years**. **Number of options that vest / can be exercised are dependent upon share price at end of 4 years**. If share price at end of 4 years is less than INR 26, then 0% options vest / exercised and if the share price is INR 26 or more, then full 100% vest.

Exercise Price (X)	INR. 10
Stock Price as at Grant Date (S)	INR. 15
Time to expiration (T – t, in year)	4 years (approx.)
Risk-free rate of return (r)	6.00%
Dividend Yield	0.00%
Annualized Volatility (σ)	40%
Fair Value of Option using simulation model	INR. 6.40*

**Subject to number of simulations runs*

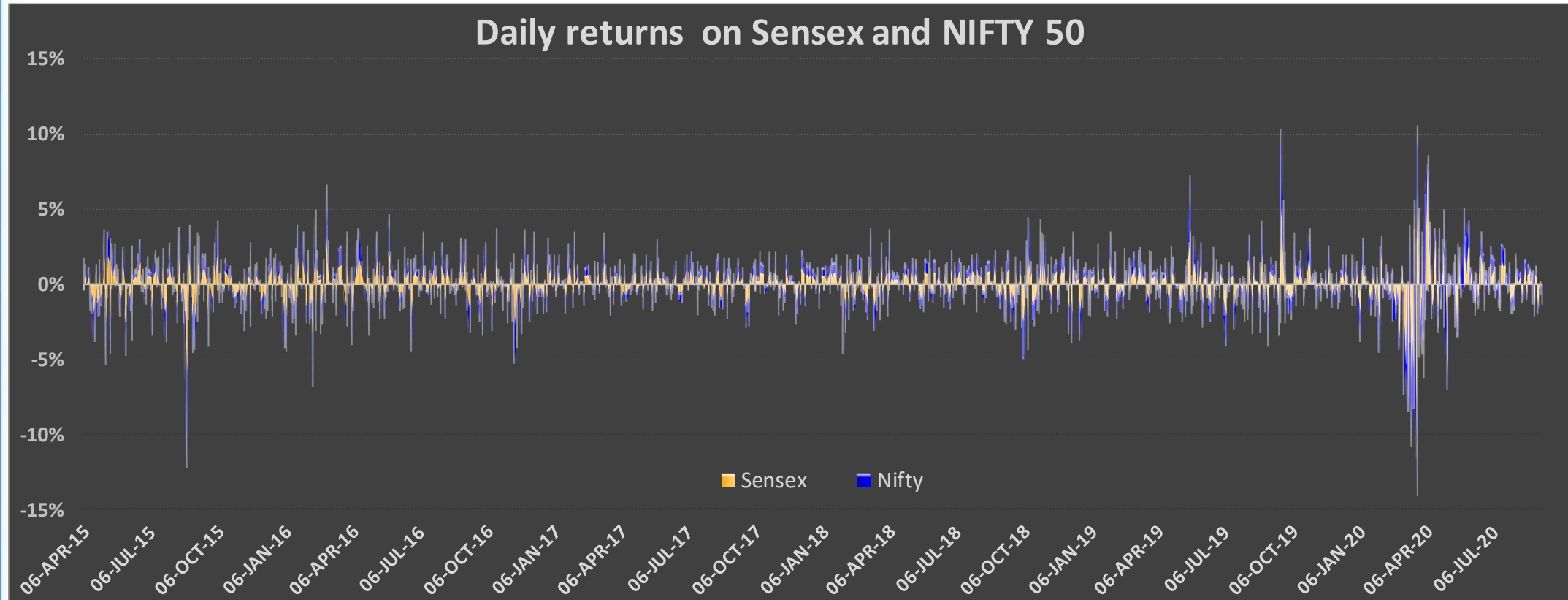
Market based vesting condition needs to be incorporated in the fair value of options and require using valuation models such as Binomial or Monte Carlo Simulation Model.

Agenda



- Introduction
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- Impact on Valuation Techniques
- **Impact on Valuation Assumptions**
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Volatility



- Annualized Volatility **increased considerably due to COVID** (from **c. 20% over 5 year period to c. 40% over last 8 months**)
- Considerations in setting volatility assumption include:
 - **Long term volatility** versus **short term impact**
 - **Expected exercise period** for different schemes & grants
 - **Company specific** considerations

Non-Market Performance Based Vesting



Example of non-market performance based vesting linked to company performance:

Vesting percentages at end of 3 years		CAGR Revenue growth over 3-year period						
		<5%	10%	15%	20%	25%	30%	35% and above
Average EBIT to Revenue ratio over a 3-year period	<3%	0%	5%	10%	15%	20%	25%	30%
	4%	8%	15%	23%	30%	39%	48%	50%
	5%	15%	25%	35%	45%	55%	70%	75%
	6%	25%	35%	45%	60%	70%	80%	90%
	>6%	30%	40%	50%	65%	75%	90%	100%

- Valuation requires assumptions on **how many options will actually vest**
- Management input key on **achievement expected against Plan**
- **Material impact** on year-on-year charge

Other Valuation Considerations



- Impact on **Fair Value of Option** on account of reduced interest rates
- Importance of **attrition in broad-based schemes**
- **Data quality** considerations for start-ups & non-standard schemes

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- Introduction
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- **Conclusion**

Conclusion



- Design & valuation processed to be synergized
- Enhanced role for Valuers in designing the right schemes
- Use of advanced valuation techniques essential with evolving design structures
- Greater consideration of key valuation assumptions needed

Q&A

Upcoming Webinars



S.No	Webinar	Date	CPD
1	3rd Webinar on Pension, Employee Benefits and Social Security - 17th CIRB Module 4 - Pensions in a low to very low interest rate environment	11 September, 2020	1.5 hrs in Pension, Employee Benefits and Social Security
2	3rd Webinar on Health Care Insurance	23 September, 2020	1.5 hrs in Health Care Insurance
3	6th Webinar on Data Science & Analytics	3 October, 2020	1.5 hrs in Any Area of practice
4	Tech Talk on Data Science & Analytics	10 October, 2020	NO CPD
5	Tech Talk on Retirement Benefits- Employee Benefits Valuations under USGAAP - nuances and key differences from IAS19/INDAS19	31 October, 2020	NO CPD