

Stock option exchange proposal at SAGE Therapeutics

February 2024

Company: SAGE Therapeutics Inc. (SAGE)

Meeting date: January 31, 2024

Proposal: Approval of a one-time stock option exchange program for non-executive officer employees

How the funds voted

At the special meeting of SAGE, a U.S. biopharmaceutical company that is focused on brain health medicines, the Vanguard-advised funds supported the company's stock option exchange program.¹

The funds' proxy voting policies

Stock-based compensation plans, when administered by an independent board committee, approved by shareholders, and appropriately designed, can be an effective way to align the interests of management, employees, and directors with those of long-term shareholders. As outlined in the Vanguard-advised funds' [proxy voting policy for U.S. portfolio companies](#), we generally prefer plans that do not allow for the repricing or replacement of underwater stock options without

shareholder approval. Vanguard recognizes that in times of underperformance or market volatility, a company's stock price may drop below the exercise price of the issued stock options, leaving the options "underwater." Underwater options can create concerns around employee retention and incentivization. To address this, a company may consider a stock option exchange program for employees, named executive officers, and directors to realign incentives.

Generally, we look for proposals to reprice or exchange stock options to meet the following three considerations:

- **Value neutrality.** An exchange/repricing proposal should be value-neutral, meaning the fair value of the new grants is equal to or less than the fair value of the exchanged options.
- **Exclusion of executive and director participation.** Executives and directors should not participate in an exchange or repricing program. If they do, the board should clearly state why the program is necessary to retain and provide incentives to executives and directors for the benefit of long-term shareholder returns.
- **Additional vesting requirements.** New shares granted in an exchange should vest no earlier than the vesting date of the shares for which they were exchanged, and preferably later.

¹ Vanguard's Investment Stewardship program is responsible for proxy voting and engagement on behalf of the quantitative and index equity portfolios advised by Vanguard (together, "Vanguard-advised funds"). Vanguard's externally managed portfolios are managed by unaffiliated third-party investment advisors, and proxy voting and engagement for those portfolios are conducted by their respective advisors. As such, throughout this document, "we" and "the funds" are used to refer to Vanguard's Investment Stewardship program and Vanguard-advised funds, respectively.

Analysis and voting rationale

We have routinely engaged with directors and management from SAGE. In late 2023, Vanguard engaged with SAGE leaders as part of the company's effort to get shareholder feedback on a possible stock option exchange program. Over the past several years, SAGE's stock price experienced significant volatility, leaving a significant number of options underwater.

During the engagement, SAGE leaders shared that they were considering a variety of structures for the program, potentially including executive participation. We shared our perspective that stock option exchange programs can be an effective tool when they are value-neutral, exclude executives and directors, and have additional vesting requirements. We also shared that plans that deviate from these considerations could misalign executives' incentives with company performance and could have a dilutive impact on other shareholders. In addition, we shared our perspective that, when programs include executives, the funds look to understand the necessity of the program, the rigor of the program, whether the program includes performance-based incentives, and whether there are unique economic circumstances that should be considered.

In early 2024, SAGE held a special meeting to approve a stock option exchange program. We observed that the exchange program was value-neutral, excluded executive and director participation, and contained additional vesting requirements. Moreover, supplementary company filings provided details about the option exchange program and its development, giving shareholders substantial context for the program. The SAGE board shared in the proxy statement that it had engaged with investors regarding their views of option repricing/replacement programs and subsequently elected to exclude executives from eligibility.

Given the program's overall alignment with the funds' proxy voting policies, the funds supported the proposal. We consider it to be a good governance practice for boards to regularly engage with their shareholders to understand shareholder perspectives and allow shareholders to voice feedback. We also consider it to be a good governance practice for boards to disclose shareholder feedback to promote transparency for all shareholders. Effective shareholder engagement can result in better outcomes for shareholders over the long term, an objective shared by both boards and company shareholders.

Vanguard publishes Investment Stewardship Policy and Voting Insights to promote good corporate governance practices and to provide public companies and investors with our perspectives on important governance topics and key votes. This is part of our effort to provide useful disclosure of Vanguard's investment stewardship voting and engagement activities. We aim to provide clarity on Vanguard's stance on governance matters beyond what a policy document or a single vote can provide. Insights should be viewed in conjunction with the most recent region- and country-specific voting policies.

The funds for which Vanguard acts as investment advisor (Vanguard-advised funds) retain the authority to vote proxies that the funds receive. To facilitate the funds' proxy voting, the boards of the Vanguard-advised funds have adopted Proxy Voting Procedures and Policies that reflect the fund boards' instructions governing proxy voting. The boards of the funds that are advised by managers not affiliated with Vanguard (external managers) have delegated the authority to vote proxies related to the funds' portfolio securities to their respective investment advisor(s). Each external manager votes such proxies in accordance with its own proxy voting policies and procedures, which are reviewed and approved by the fund board annually.



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