

ISS' Governance Risk Indicators 2.0

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On December 14th, Institutional Investor Services ("ISS") released a technical document on revisions to its U.S. Governance Risk Indicators ("GRID") which will be released in February 2012 (prior to the upcoming proxy season). In Q3 2012, ISS will release GRID 2.0 for other current markets (Canada, France, Germany, Netherlands, Sweden and United Kingdom); ISS will release details on these GRIDs in Q2 2012. ISS will continue to tailor questions, answers and the rating systems for each market. Additionally, ISS will release GRID 2.0 in new markets in Europe and Asia-Pacific¹ in the second half of 2012.

REVISIONS TO U.S. GRID 2.0

The revised U.S. GRID maintains its primary objective of assessing a company's governance practices (based on Audit, Board, Shareholder Rights and Compensation) but has been refined to provide better insight into governance issues and improve the usefulness of the rating system. ISS made the following changes to the GRID:

- **Revisions to the Compensation category.** Updating the Compensation category of the GRID was a top priority for ISS. These revisions include:
 - New questions relating to ISS' revised pay-for-performance assessment (see ISS' New Quantitative and Qualitative Approach for Evaluating Pay for Performance Alignment CAPFlash).
 - Expansion of potential responses for equity-based pay questions to better assess program features.
- Additional details on the size of severance pay and perquisites.
 - Reorganization of subcategories to better align with the framework of ISS' principles for evaluating say on pay. New categories include: use of equity, equity risk mitigation, communication and disclosure, and termination / severance.

CAP Perspective: With ISS' increasing its focus on compensation practices and reorganizing the subcategories to better align with their say on pay assessment, companies should have a clear and concise disclosure and rationale of their compensation program in the CD&A. Given the short amount of time and the number of companies ISS and other proxy advisory firms will be reviewing, it would be beneficial for a company to have an executive summary at the beginning of the CD&A or have charts to summarize the compensation program that includes rationale and highlight aspects that they believe ISS and shareholders will view positively.

¹ ISS will add countries from the developed-market MSCI EAFE index which includes: Austria, Australia, Belgium, Denmark, Finland, Greece, Hong Kong, Ireland, Israel, Italy, Japan, New Zealand, Norway, Portugal, Singapore, Spain and Switzerland.

ISS has added approximately 40 questions to the GRID with approximately 25 new questions under the Compensation category. Topics covered by the new questions in the Compensation section include degree of alignment between CEO pay and company performance, excessive perquisites, change-in-control and severance benefits and features of the equity compensation plan.

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- **Refinement and reorganization of subcategories.** For the other categories, ISS has revised some of the subcategories to better group questions together. Specifically, ISS has reorganized the following categories:
 - Audit: ISS has targeted the role of the external auditor and will examine if there are any audit or accounting controversies.
 - Board: ISS has separated the prior “Board Practices” subcategory into “Board Practices” (to determine the behavior of the Board) and “Board Policy” (to understand governance policies) as well as added a subcategory on Related Party Transactions (“RPT”) to identify potential governance issues.
 - › The Board Practices subcategory reviews if the CEO or directors serve on an excessive number of outside boards, the number of board meetings attended by directors and how many directors received a withhold/against vote of 50% or greater.
 - › The Board Policies subcategory assesses if the company discloses board/governance guidelines, if directors can meet without management present and if directors can hire their own advisors without management approval.
 - › The RPT subcategory evaluates what percentage of directors were involved in material RPT, if directors with material RPT sit on key board committees and if there are any RPTs involving the CEO.
- **New and modified questions/answers under each category.** ISS has added approximately 40 questions to the GRId with approximately 25 new questions under the Compensation category. See the Appendix (page 4) for a list of new GRId questions under each category. Topics covered by the new questions in the Compensation section include degree of alignment between CEO pay and company performance, excessive perquisites, change-in-control and severance benefits and features of the equity compensation plan. Additionally, ISS has expanded potential responses for its questions to capture the main features of a company’s programs and policies. Similar to their current approach, ISS will review publicly available data to obtain answers for each question.
- **Enhancement and increased transparency in the rating system.** Fundamentally, the rating system is consistent with the prior version of GRId; a company will receive an overall score and a concern level for each of the four categories. The basic changes to the rating system are related to how answers are scored and how the resulting scores are aggregated.
 - Each answer will receive a score. A negative score will denote a practice that raises concern and a positive score will denote a best practice that may lessen concerns elsewhere.
 - › A score of -25 denotes medium concern level and a score of -50 denotes high concern level.
 - ISS has established a threshold and maximum for each subcategory in order to place more weight on certain subcategories. If, for example, in the Termination subsection of the Compensation category a company receives positive points for not having employment agreements, the total positive number a company can receive for this subcategory is +15 and will not eclipse other subcategories in Compensation².

ISS has enhanced the rating system to be more transparent than the prior version. In addition, they will disclose a company's score as well as provide the current “traffic light” system.

² The specific scoring and points are subject to change by ISS upon review and back-testing prior to the launch of GRId 2.0 in February 2012.

- The final score for the overall category will reflect the sum of the subcategories. Each category will be subject to a threshold and maximum (same as the subcategory) and will range from -75 to +25. ISS will add 75 points to the final score to standardize the scale from 0 to 100 for each category. The chart below shows the resulting level of concern based on the total number of points.
- ISS will disclose a company's final score for each category in addition to the current "traffic light" system.

TOTAL POINTS ³	ISS CONCERN LEVEL
<= 50 points	High
<= 75 points	Medium
>75 points	Low

³ The specific scoring and points are subject to change by ISS upon review and back-testing prior to the launch of GRId 2.0 in February 2012.

CONCLUSIONS

ISS will be increasing the transparency of its GRId and its focus on compensation for the upcoming proxy season. We will have to wait and see how the new rating system and questions will affect a company's overall rating in each category but we would expect that companies that have a clear disclosure of their governance practices and rationale for their policies would fair somewhat better than a company that does not.

We would expect that companies with a clear rationale of the governance practices and rationale for their policies would fair better.

APPENDIX – NEW GRId 2.0 QUESTIONS

AUDIT

- Has a securities regulator taken enforcement action against a director or officer of the company in the past two fiscal years?
- Is a director or officer of the company currently under investigation by a regulatory body?

BOARD

- What is the classification of the Chairman of the Board?
- Are the roles of Chairman and CEO separated?
- Has the company identifies a lead / senior independent director?
- What percentage of the board consists of family members?
- What percentage of the board are former or current employees of the company?
- Can directors hire own advisors without management approval?
- Are there related –party transactions involving the CEO?

SHAREHOLDER RIGHTS

- Does the company have a poison pill (shareholder rights plan) in effect?
- What is the trigger threshold for the poison pill?
- Is the poison pill designed to preserve tax assets (NOL pill)?
- Was the poison pill approved by shareholders?
- When was the poison pill implemented or renewed?
- Does the company's poison pill include a modified slow-hand or dead-hand provision?
- If the company has a majority voting standard, is there a plurality carve-out in the case of contested elections?
- Are there material restrictions as to

timing or topics to be discussed, or ownership levels required to call a special meeting?

COMPENSATION

- What is the degree of alignment between the company's cumulative 3-year pay percentile rank, relative to peers, and its 3-year cumulative TSR rank, relative to peers?
- What is the degree of alignment between the company's cumulative 1-year pay percentile rank, relative to peers, and its 1-year cumulative TSR rank, relative to peers?
- What is the size of the CEO's 1-year cumulative pay, as a multiple of the median pay for company peers?
- What is the degree of alignment between the company's TSR and change in CEO pay over the past five years?
- What is the ratio of the CEO's total compensation to the next highest paid executive?
- Did the CEO receive tax gross-ups on perks other than relocation and other broad-based benefits?
- Did the company provide dividends on unvested performance shares in the last fiscal year?
- Has the company reimbursed NEOs for losses on sale of a home?
- Did the company pay tax gross-ups on a secular trust?
- What is the ratio of the CEO's non-performance-based compensation (All Other Compensation) to Base Salary?
- Does the company's active equity plans prohibit options / SAR cash buyouts?
- Do the company's active equity plans prohibit share recycling for options / SARs?
- Do the company's active equity plans prohibit option / SAR repricing?
- Do the company's active equity plans

have an evergreen provision?

- Do the company's active equity plans have a liberal CIC definition?
- Do the company's active equity plans provide for automatic vesting of equity awards in the case of change-in-control?
- What are the minimum vesting periods mandated in the plan documents for executives' stock options or SARs in the equity plans adopted / amended in the last 3 years?
- What are the minimum vesting periods mandated in the plan documents adopted / amended in the last three years, for executives' restricted stock?
- What proportion of the salary is subject to stock ownership requirements / guidelines for the CEO / Is the CEO subject to ownership guidelines?
- Did any executive or director pledge company shares?
- Does the company have a policy prohibiting hedging of company shares by employees?
- What is the level of disclosure on performance measures for the latest active or proposed long term incentive plan?
- What is the multiple of salary plus bonus in the severance agreements for the CEO (upon a change-in-control)?
- What is the multiple of salary plus bonus in the severance agreements for executives excluding the CEO (upon a change-in-control)?
- What is the basis for the change-in-control or severance payment for the CEO?
- What is the basis for the change-in-control or severance payments for executives excluding the CEO?
- What is the amount of the CEO's estimated non-Change-In-Control severance amount as of the end of the last fiscal year, as a multiple of the executives' average salary plus bonus over the past three years?