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New York • Chicago • Los Angeles

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ISS 2004 POLICY CHANGES

Institutional Shareholder Services ("ISS") recently released changes to its 2004 policy guidelines for voting recommendations on proxy analyses for companies with meeting dates on or after February 1, 2004. The policy changes include various executive compensation related matters, the most significant of which concerns equity compensation plans and new CEO pay-for-performance guidelines.

Equity Compensation Plans

In prior years, ISS has recommended against an equity compensation plan if the proposed cost (i.e., shareholder value transfer and voting power dilution) was above an allowable cap and/or the plan violated ISS' repricing guidelines. A company failed to satisfy the repricing guidelines if (1) the company had a history of repricing and did not expressly prohibit repricing without shareholder approval or (2) the plan expressly permitted repricing without shareholder approval.

ISS' new policy will continue to use the cost analysis, but for Russell 3000 companies ISS will also apply a new pay-for-performance guideline in assessing equity compensation plans. Also, ISS' repricing guidelines will be updated to reflect the new stock exchange listing requirements (i.e., for companies listed on the NYSE, NASDAQ, or AMEX, a history of repricing will no longer result in a negative ISS recommendation since all companies are precluded by the stock exchanges from future repricings without shareholder approval).

The pay-for-performance guideline is violated if (1) there is a disconnect between the CEO's pay and sustained company performance (i.e., an increase in pay and a decrease in performance), (2) more than half of the pay increase is from equity-based awards, and (3) the CEO participates in the proposed plan. Specifically, if the company has negative one- and three-year total shareholder returns[1], but the CEO's total direct compensation ("TDC")[2] has increased over the prior year, it would signify a disconnect between pay and performance. If more than half of the increase in TDC is attributable to equity compensation, ISS would generally recommend against the equity plan if the CEO participates.

[1] Total shareholder return is calculated as of the end of the most recent fiscal year.

[2] Total direct compensation is defined as the sum of annualized base salary, cash bonus, other annual compensation, all other compensation, present value of stock options (based on a stock option pricing model), face value of restricted stock, and face value of actual long-term incentive plan payouts.

Other considerations in applying the new CEO pay-for-performance guidelines are: the company must have been publicly traded for at least three years and the CEO must have been in place for at least two years. Finally, where a violation of this guideline exists (irrespective of whether at least 50% of the increase in pay is equity-based or the CEO participates in a proposed equity plan), ISS will generally recommend withholding votes from Compensation Committee members up for reelection.

The rest of this memo describes ISS policy guidelines on the following shareholder proposals affecting executive compensation:

Mandatory Holding Periods

In prior years, ISS has supported shareholder proposals asking companies to adopt stock option holding periods (i.e., requirement to hold stock for a minimum time period subsequent to option exercise) for its executives unless the company already had a holding requirement.

Beginning in 2004, ISS will take a case-by-case approach on shareholder proposals mandating stock option holding periods. The criteria used to evaluate these proposals will include:

- Whether the company already has any holding period or executive ownership guidelines in place. If so, these requirements should consist of rigorous ownership guidelines (e.g., 7x to 10x salary for the CEO, scaling down for other executives), a short-term holding period requirement (e.g., six months to one year) in combination with a significant long-term ownership requirement, or a meaningful retention ratio

- Actual executive stock ownership and the degree to which it meets or exceeds the suggested holding period or the company's own stock option or retention requirements

Performance-Based Stock Options

ISS is increasing its support of shareholder proposals advocating the use of performance-based options. Previously, as long as a company's stock compensation plan met ISS' plan cost criteria and did not violate ISS' repricing guidelines, ISS voted against shareholder proposals calling for the use of performance-based options.

ISS' new policy will be to generally support shareholder proposals advocating the use of all types of performance-based stock awards (e.g., index options, performance-vested awards) unless the proposal is considered overly restrictive (e.g., awards to all employees must be performance-based) or the company's practice is to grant "substantial" performance-based awards to its "top executives." "Substantial" is defined as at least 50% of all stock awards and "top executives" refers to the top five highest-paid executives.

Supplemental Executive Retirement Plans ("SERPs")

In the past, ISS has generally not supported shareholder proposals that would limit the use of SERPs unless there had been evidence of abuse in the SERP program or in post-employment benefits.

ISS' new policy is a substantial change from past practice since it will now generally support shareholder proposals for SERPs to be shareholder approved unless the benefits provided do not exceed what is offered under company-wide plans (i.e., IRS excess benefit plans).

Specific SERP provisions that ISS states should be shareholder approved include credit for years of service not actually worked, preferential benefit formulas, and accelerated vesting of benefits.

Pension Plan Accounting/Executive Compensation

These shareholder proposals would require companies to exclude the impact of pension plan income in the determination of executive bonuses and other performance-based compensation. In past years, ISS examined these proposals on a case-by-case basis, analyzing the extent to which pension income affected reported earnings and the degree to which earnings were a factor in determining performance-based compensation payments.

Beginning in 2004, ISS will support all proposals of this type. ISS states that operating performance should be the basis for determining executive bonuses/compensation rather than pension plan gains, which are subject to manipulation. General Electric, Verizon Communications, and Qwest Communications International have adopted this concept.

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This letter is intended to alert compensation professionals about developments that may affect their companies. General questions about ISS' policy guidelines may be addressed to David Cole or Wendy Hilburn at (212) 986-6330. This letter and other published materials are available on our website, www.fwcook.com.