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**ISS RELEASES 2013 DRAFT POLICY CHANGES FOR COMMENT**

On October 16, ISS released for comment its draft policy changes for 2013.<sup>1</sup> The proposed policy changes resulted from the policy survey conducted over the summer, the findings of which were the subject of a separate ISS publication released at the end of September. In the compensation area, the most significant U.S. policy changes pertain to (1) a new approach to peer group selection for evaluating pay-for-performance alignment in connection with advisory Say-on-Pay proposals, and (2) new problematic pay practices for evaluating Say-on-Golden Parachute proposals. A third compensation policy change is the extension of ISS' quantitative pay-for-performance test to Canadian companies, similar to the new test implemented in the U.S. in 2012, which is not addressed in this letter. The comment period closes on October 31, and all comments will be published as received with attribution. Policy updates for 2013 are expected to be issued by the end of November.

**U.S. Management Say-on-Pay Proposals**

***Peer Group Formation***

During 2012, peer group selection continued to be a source of much criticism of ISS' new pay-for-performance test. Total reliance on a company's GICS industry classification sometimes resulted in narrowly scoped peer groups that bore little resemblance to the companies a company views as its peers.

A change under consideration for 2013 is to use a company's self-selected peers meeting ISS' size criteria (currently 0.45 to 2.1 times revenue (or assets if in financial services) and 0.2 to 5.0 times market cap) as an input to peer group formation. ISS would use both a company's GICS peers, with a new focus on companies in the same 8-digit sub-industry, and the GICS sub-industries represented by the company's self-selected peer group. The methodology under consideration "prioritizes peers that maintain the company near the median of the peer group, are in the subject company's peer group, and have chosen the subject company as a peer." ISS will continue to select between 14 and 24 companies for peer groups.

Other proposed changes include: (1) slightly relaxed size criteria, especially for very small and very large companies, and (2) using revenue instead of assets for certain financial companies (e.g., fee-for-service companies that are not asset-intensive).

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<sup>1</sup> The full text can be found at [www.issgovernance.com/policycomment2013](http://www.issgovernance.com/policycomment2013).

Input is requested on:

1. Additional or alternate ways to use a company's self-selected peer group
2. A reasonable size range (revenue/assets) for peer group construction
3. Additional factors for peer group formation that should be considered

### ***Realizable Pay***

As was indicated previously by ISS, they are considering adding realizable pay to the qualitative review for large-cap companies (e.g., the S&P 500) that are identified as “high concern” under the pay-for-performance quantitative test. The draft changes indicate that realizable pay would consist of cash and equity compensation based on actual earned awards and target values for on-going awards using stock price at the end of the measurement period in the case of equity awards, but no details are provided on exactly what this means. It is presumed that realizable pay will be developed only for the CEO as this is the only position considered in the pay-for-performance quantitative test.

Input is being requested on:

1. How to define realizable pay
2. Whether stock options should be based on intrinsic value or Black-Scholes value
3. The appropriate measurement period for realizable pay (e.g., one, three or five years, or some other period)

### ***Pledging of Company Stock***

Pledging of company stock by directors or executives is proposed to be added to the list of most problematic pay practices related to non-performance-based compensation. Such pay practices can potentially lead to “against” Say-on-Pay vote recommendations. Other practices on the list are:

- Repricing/replacing stock options or SARs without shareholder approval;
- Excessive perquisites or tax gross-ups; and
- New or extended agreements providing for change-in-control (“CIC”) payments greater than three times salary and bonus (average/target/most recent), single- or modified single-trigger cash severance, or excise tax gross-ups on CIC payments.

ISS is seeking input on:

1. The level of pledging of company stock that causes concern

2. Whether the vote recommendation should be directed at the (a) Say-on-Pay proposal, (b) the board, or (c) members of a board committee and which committee (e.g., audit, governance or compensation)
3. Whether a company's remedial actions (e.g., commitment not to pledge in the future, commitment to unwind positions within a reasonable time period) should be sufficient to address the concern without a negative vote recommendation
4. Additional factors that should be considered on a case-by-case basis

### **U.S. Say-on-Golden Parachute Proposals**

The Dodd-Frank Act requires say-on-golden parachute advisory votes when companies seek shareholder approval of mergers, sales, etc. The ISS list of most problematic pay practices includes several CIC practices in new or amended agreements (i.e., severance payments greater than three times salary and bonus, single or modified single-trigger cash severance and excise tax gross-ups), and single-trigger equity vesting has been identified as not a "best" practice.

The ISS policy changes would eliminate grandfathering treatment of the practices mentioned above found in current agreements in connection with say-on-golden parachute proposals. Features of CIC agreements that could lead to an "against" vote recommendation include one or more of the following, depending on number, magnitude, and/or timing of the issue(s):

- Single- or modified single-trigger cash severance
- Single-trigger acceleration of unvested equity awards
- Excessive cash severance (greater than three times salary and bonus)
- Excise tax gross-ups triggered and payable (as opposed to a provision to provide)
- Excessive golden parachute payments (on an absolute basis or as a percentage of transaction equity value)
- Recent amendments that incorporate any problematic features or recent actions (such as extraordinary equity grants) that make packages so attractive as to influence merger agreements that may not be in shareholders' best interests
- Company assertion that proposed transaction is conditioned on shareholder approval of the say-on-golden parachute advisory vote

A comparison of the current features to the proposed features is contained in the Attachment.

ISS is seeking input on:

1. Whether investors differentiate between new and existing arrangements when determining whether to support a proposal

2. Whether the number of problematic features is a consideration when evaluating a proposal
3. Additional factors that should be considered

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This letter is intended to alert compensation professionals about developments that may affect their companies and should not be relied on as providing specific company advice. General questions about this letter may be directed to Wendy Hilburn at 212-299-3707 or [wjhilburn@fwcook.com](mailto:wjhilburn@fwcook.com) or to David Yang at 312-894-0074 or [dkyang@fwcook.com](mailto:dkyang@fwcook.com). Copies of this letter and other published materials are available on our website at [www.fwcook.com](http://www.fwcook.com).

**Comparison of 2012 and Proposed 2013  
ISS “Voting on Golden Parachutes” Policy Language**

<b>2012 Policy</b>	<b>Proposed 2013 Policy</b>
<p>Features that may lead to a vote AGAINST vote recommendation include:</p> <ul style="list-style-type: none"> <li>• Recently adopted or materially amended agreements that include excise tax gross-up provisions (since prior annual meeting);</li> <li>• Recently adopted or materially amended agreements that include modified single triggers (since prior annual meeting);</li> <li>• Single-trigger payments that will happen immediately upon a change in control, including cash payment and such items as the acceleration of performance-based equity despite the failure to achieve performance measures;</li> <li>• Single-trigger vesting of equity based on a definition of change in control that requires only shareholder approval of the transaction (rather than consummation);</li> <li>• Potentially excessive severance payments;</li> <li>• Recent amendments or other changes that may make packages so attractive as to influence merger agreements that may not be in the best interests of shareholders;</li> <li>• In the case of a substantial gross-up from pre-existing/grandfathered contract: the element that triggered the gross-up (i.e., option mega-grants at low point in stock price, unusual or outsized payments in cash or equity made or negotiated prior to the merger); or</li> <li>• The company's assertion that a proposed transaction is conditioned on shareholder approval of the golden parachute advisory vote</li> </ul>	<p>Features that may result in an AGAINST vote recommendation include one or more of the following, depending on the number, magnitude, and/or timing of the issue(s):</p> <ul style="list-style-type: none"> <li>• Single- or modified-single-trigger cash severance;</li> <li>• Single-trigger acceleration of unvested equity awards;</li> <li>• Excessive cash severance (&gt;3x base salary and bonus);</li> <li>• Excise tax gross-ups triggered and payable (as opposed to a provision to provide excise tax gross-ups);</li> <li>• Excessive golden parachute payments (on an absolute basis or as a percentage of transaction equity value);</li> <li>• Recent amendments that incorporate any problematic features (such as those above) or recent actions (such as extraordinary equity grants) that may make packages so attractive as to influence merger agreements that may not be in the best interests of shareholders; or</li> <li>• The company's assertion that a proposed transaction is conditioned on shareholder approval of the golden parachute advisory vote</li> </ul>