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ISS RELEASES 2013 POLICY UPDATES

On November 16, ISS (Institutional Shareholder Services) released updated policies for the 2013 proxy season. In the executive compensation area, there were no surprises or significant changes to the draft policy changes released for comment on October 16.[1] ISS will host a global webinar on December 6 to review its revised policies. The policy updates and registration for the webinar can be found at www.issgovernance.com. ISS will release updated FAQs in December that will provide additional guidance for certain updated policies.

Pay-for-Performance Evaluation

ISS' pay-for-performance evaluation is central to developing vote recommendations on advisory say-on-pay proposals. For 2013, ISS will update its peer group selection approach for purposes of running its pay-for-performance assessment of Russell 3000 companies and will add a realizable pay analysis to the qualitative review conducted on large-cap companies identified as "high concern" on the quantitative screen. "Large cap" was not defined, and may be addressed in the updated FAQs, but we have been told this refers to S&P 500 companies.

Peer Groups

Several changes have been made to the ISS process of determining peers for purposes of evaluating a company's alignment between pay and performance. The most significant change, which is intended to improve the process of identifying companies outside the subject company's primary GICS (Global Industry Classification Standard) industry group, is that ISS will consider a company's self-selected compensation peer group. ISS will also focus initially on a company's 8-digit sub-industry code, rather than the 6-digit industry code, to identify peers that are more closely related.

Selection criteria will continue to include screens for size using market cap and revenue, or assets for certain, but not all, financial companies. In addition, ISS has relaxed the size criteria "slightly," especially for very small and very large companies. Peer companies will be prioritized so that the subject company is near the median and include companies in the subject company's self-selected peer group as well as those that include the subject company in their disclosed peer groups.

[1] A summary of the draft policy changes can be found in our alert letter dated October 19, 2012, available on our website.

Realizable Pay

In the event that a large-cap company (i.e., an S&P 500 company) fails the quantitative assessment of pay and performance alignment, ISS will consider "realizable pay" as part of its qualitative assessment. The outcome of the realizable pay analysis may mitigate or exacerbate CEO pay-for-performance concerns.

Realizable pay will consist of the sum of cash and equity awards made during a specified performance period, with equity values reflecting the actual earned awards or target values for ongoing awards calculated using stock price at the end of the period. Stock options and stock appreciation rights will be revalued using the remaining term and updated assumptions as of the end of the performance period using a Black-Scholes option pricing model.

ISS has not defined the performance period, which may be addressed in the FAQs to be released in December.

Canada

A quantitative pay-for-performance screen and qualitative review of "high concern" companies similar to that used in the U.S. has been added to ISS' Canadian policies for 2013. The qualitative review will not include realizable pay.

Say-on-Golden Parachutes Proposals

ISS will no longer "grandfather" pre-existing problematic change-in-control severance practices (i.e., severance payments greater than three times salary and bonus, single- or modified single-trigger cash severance and excise tax gross-ups) when considering say-on-golden parachutes.

As a result, the presence of one or more of the following features could lead to an "against" vote recommendation on a say-on-golden parachute proposal:

- 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 value)
- Recent amendments that incorporate any problematic features 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
- The company's assertion that a proposed transaction is conditioned on shareholder approval of the golden parachute advisory vote

Pledging or Hedging Company Stock

In a change from ISS' draft proposal, "significant" pledging of company stock will not be a problematic pay practice under ISS' say-on-pay evaluation. Instead, it will be considered, on a case-by-case basis, as a potential failure in overall board-level risk oversight. As such, situations deemed to be problematic could adversely affect ISS "for" vote recommendations on the re-election of directors.

Under its current policies, ISS considers hedging of company stock to be a problematic pay practice under its say-on-pay evaluation. Under its updated policies, ISS will also consider any amount of hedging of company stock by directors or executives to be a potential failure of board-level risk oversight that warrants an "against" vote recommendation for the re-election of directors. Hedging includes a covered call, collar or other derivative transactions.

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This letter is intended to alert compensation professions about developments that may affect their companies. It 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, or David Yang at 312-894-0074 or dkyang@fwcook.com. Copies of this letter and other published materials are available on our website at www.fwcook.com.