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RISKMETRICS GROUP 2010 POLICY UPDATES

On November 19, RiskMetrics Group (formerly ISS) issued its policy updates and FAQs for the 2010 proxy season. RiskMetrics issues policies for the U.S., Canada, International and, new for 2010, Europe. This letter describes the executive compensation policy updates applicable to U.S. companies. RiskMetrics will host a webcast on December 10 to present and discuss its policy updates, which can be found on its Policy Gateway at www.riskmetrics.com/policy.

Executive Pay Evaluation

RiskMetrics has reorganized three of its executive compensation policies under a new "integrated, holistic" Executive Compensation Evaluation Policy. The three formerly separate policies now included under this new policy are Pay for Performance, Poor Pay Practices and Management Say on Pay proposals. The Management Say on Pay proposal is proposed to be the primary vehicle for recommending for or against a company's pay practices. However, in "egregious or continuing" situations or when a company does not have a management say on pay proposal (which is presently the case for most companies), RiskMetrics may issue an adverse vote recommendation (i.e., withhold or against) regarding the reelection of directors on the compensation committee (and, in certain cases, the whole board).

Policy updates and clarifications provided by the FAQs for the specific areas now comprising this new policy are described below.

Pay for Performance

Under its current policy, RiskMetrics may issue an adverse vote recommendation on the reelection of compensation committee members and/or against an equity plan proposal if there is a disconnect between CEO pay and company performance. Companies become subject to the policy if one- and three-year total shareholder returns ("TSR") are in the bottom half of their industry groups[1] and CEO pay increases on a year-over-year basis.

For 2010, an additional consideration is being added, which is the alignment of CEO total direct compensation and TSR over time. In voting on management say on pay proposals, director reelections and equity plans, RiskMetrics will consider the alignment of CEO pay with TSR performance over five years, focusing on companies whose TSR has underperformed their peers over one- and three-year periods. RiskMetrics will continue to take into account whether the CEO's total compensation for the most recent year increased vs. the prior year as well as the mix

[1] Industry groups are based on each company's 4-digit Global Industry Classification Standards ("GICS") industry group developed and maintained by *Standard & Poor's*

of performance-based compensation relative to total compensation. For this purpose, time-vesting stock options and restricted stock are not deemed performance-based compensation, which is also the case under the current policy. The policy updates also stress the importance of complete and transparent disclosure of performance metrics and goals, including any adjustments if non-GAAP financial metrics are used, to permit shareholders to evaluate the rigor of performance-based incentives.

The FAQs provide several clarifications of how RiskMetrics intends to apply this policy in 2010, which are as follows:

- The consideration of a CEO pay-for-performance disconnect will take a more nuanced and less formulaic look at whether CEO pay increased *or decreased* and by how much and what accounted for the change

- Generally, an increase in CEO pay due to changes in pension calculation assumptions will not result in an unfavorable vote recommendation

- Demonstration of a pay-for-performance commitment to "cure" a CEO pay-for-performance disconnect requires that 50% of *shares* granted, <u>not value</u>, be performance-based. As noted previously, time-vesting stock options granted at 100% of fair market value are not considered performance-based. For a premium-priced option to be considered performance-based, the exercise price must be set at least 25% above stock price at grant and the option must trade at this price for at least 30 consecutive trading days before it vests. A higher premium may be appropriate for a low-priced stock (e.g., $1.00 per share)

- For purposes of calculating year-over-year change in CEO total compensation, if a company grants equity early in a year for the prior year's performance, RiskMetrics will attempt to match grants with the appropriate performance year <u>if</u> a supplemental table is provided in the CD&A with all the necessary information to value the grant (e.g., shares, stock price at grant, terms of grant). RiskMetrics will <u>not</u> search Form 4 filings to hunt for grant valuation information

Problematic Pay Practices

Under its current policy, which is discretionary and applied on a case-by-case basis, RiskMetrics may issue an adverse vote recommendation on the reelection of compensation committee members, the CEO or the whole board if the company has "poor pay practices." This policy was significantly expanded and clarified for 2009, most notably by identifying change-in-control ("CIC") excise tax gross-ups and modified single-trigger severance (i.e., "walk-away rights") as poor pay practices.

For 2010, in addition to having management say on pay proposals be the initial vehicle for addressing pay practices, key changes are to identify the most serious problematic practices and add a new focus on practices that may encourage excessive risk-taking.

Problematic pay practices will result in (i) an against vote recommendation on management say on pay proposals; (ii) an against/withhold vote recommendation on compensation committee members (and possibly the full board, including the CEO) in egregious situations or where a company does not have a management say on pay proposal or where the board has failed to respond to concerns raised in prior management say on pay proposals; and/or (iii) an against vote recommendation on an equity plan proposal if excessive non-performance-based equity awards are the major contributor to the pay-for-performance disconnect.

The most problematic pay practices, expanded and clarified by greater detail provided in the FAQs, include the following that may result in a negative vote recommendation on their own:

- Egregious employment contracts:
  - Contracts containing multi-year guarantees for salary increases, non-performance-based bonuses and equity compensation
- New CEO with overly generous new-hire package:
  - Excessive "make whole" provisions without sufficient rationale
  - Any other problematic pay practices
- Abnormally large bonus payouts without justifiable performance linkage or proper disclosure:
  - Includes performance metrics that are changed, canceled or replaced during the performance period without adequate explanation of the action and the link to performance
- Egregious pension/SERP payouts:
  - Inclusion of additional years of service not worked that result in significant benefits provided in new arrangements
  - Inclusion of performance-based equity awards in the pension calculation
- Excessive perquisites:
  - Perquisites for former and/or retired executives, such as lifetime benefits, car allowances, personal use of corporate aircraft or other inappropriate arrangements
  - Extraordinary relocation benefits (including home buyouts)
- Excessive severance and/or CIC provisions:
  - CIC payments exceeding three times base salary and bonus
  - CIC payments without loss of job or substantial diminution of job duties (single-triggered)
  - New or materially amended employment or severance agreements that provide for modified single triggers, under which an executive may voluntarily leave for any reason and still receive the CIC severance package
  - New or materially amended employment or severance agreements that provide for an excise tax gross-up. Modified gross-ups would be treated in the same manner as full gross-ups

- Tax reimbursements:
  - Reimbursement of income taxes on certain executive perquisites or other payments (e.g., personal use of corporate aircraft, executive life insurance, bonus, etc.)
- Dividends or dividend equivalents paid on unvested performance shares or units
- Executives using company stock in hedging activities, such as "cashless" collars, forward sales, equity swaps or other similar arrangements
- Repricing or replacing of underwater stock options/stock appreciation rights without prior shareholder approval (including cash buyouts)

The FAQs also list other problematic pay practices that may receive an adverse recommendation or negative commentary in the company's proxy analysis report:

- Excessive severance and/or CIC provisions:
  - Payments upon an executive's termination in connection with performance failure
  - Liberal CIC definition in individual contracts or equity plans, which could result in payments to executives without an actual CIC occurring
- Overly generous perquisites, which may include, but are not limited to, the following:
  - Personal use of corporate aircraft
  - Personal security systems maintenance and/or installation
  - Car allowances
  - Executive life insurance
- Internal pay disparity:
  - Excessive differential between CEO total pay and that of next highest-paid named executive officer
- Voluntary surrender of underwater options by executive officers:
  - May be viewed as an indirect option repricing/exchange program, which is especially possible if the cancelled options are returned to the equity plan and can be regranted to executive officers at a lower exercise price and/or the executives subsequently receive unscheduled grants in the future

The new focus on practices that may encourage excessive risk-taking will assess compensation policies and practices in the areas listed below; taking into consideration the presence of practices that mitigate these risky factors (such as rigorous claw-back provisions and robust stock ownership/holding guidelines):

- Guaranteed bonuses
- A single performance metric used for short- and long-term plans
- Lucrative severance packages
- High pay opportunities relative to industry peers
- Disproportionate supplemental pensions
- Mega annual equity grants that provide unlimited upside with no downside risk

Volatility and Stock Price Assumptions

For 2009, RiskMetrics extended the stock price volatility period used for plan cost modeling and its Burn Rate Policy to 400 days from 200 days and reduced the period for measuring average stock price to 90 days from 200 days. These changes were made because of the unprecedented market volatility experienced at the end of 2008 and expected to continue into 2009. For 2010, RiskMetrics will return to 200-day periods for measuring stock price volatility and averaging stock price. This will take effect with the December 1, 2009, quarterly data download.

Burn Rate Tables

No changes were made to the six volatility categories established for the 2008 proxy season for converting full-value shares to option equivalents under the Burn Rate Policy.[2] These categories are:

Annual Stock Price Volatility	Multiplier
54.6% and higher	1 full-value award will count as 1.5 option shares
36.1% or higher and less than 54.6%	1 full-value award will count as 2.0 option shares
24.9% or higher and less than 36.1%	1 full-value award will count as 2.5 option shares
16.5% or higher and less than 24.9%	1 full-value award will count as 3.0 option shares
7.9% or higher and less than 16.5%	1 full-value award will count as 3.5 option shares
Less than 7.9%	1 full-value award will count as 4.0 option shares

Updated burn rates for Russell 3000 and Non-Russell 3000 companies are shown in the tables below, along with four years of historical burn rates. Comparisons to 2009 are difficult because of the difference in methodology, but, compared to 2008, 77% of Russell 3000 industry groups and 68% of the Non-Russell 3000 industry groups showed declines in burn rates.

[2] If a company's three-year average burn rate exceeds its industry group's mean by more than one standard deviation and is more than 2% of common shares outstanding, RiskMetrics will recommend against the company's stock plan proposal even if plan cost does not exceed the allowable cap. A company can avoid a negative vote recommendation by agreeing to a future three-year burn rate of no greater than the higher of 2% or the industry group's mean plus one standard deviation at the time of the commitment.

2010 Burn Rates-Russell 3000

GICS	Description	Mean + Standard Deviation				
		2010	2009	2008	2007	2006
1010	Energy	2.14%	3.09%	3.09%	2.29%	2.50%
1510	Materials	1.63%	2.14%	1.93%	1.85%	2.11%
2010	Capital Goods	1.95%	3.52%	2.55%	2.57%	2.93%
2020	Commercial Services & Supplies	2.89%	4.01%	4.05%	3.81%	4.33%
2030	Transportation	2.13%	3.18%	2.80%	2.31%	3.47%
2510	Automobiles & Components	2.99%	3.05%	2.99%	2.90%	3.24%
2520	Consumer Durables & Apparel	2.97%	3.44%	3.33%	3.09%	3.26%
2530	Hotels Restaurants & Leisure	2.80%	3.32%	3.33%	3.41%	3.31%
2540	Media	2.28%	3.25%	3.27%	2.70%	3.38%
2550	Retailing	3.10%	3.12%	2.90%	3.05%	4.12%
3010, 3020, 3030	Food & Staples Retailing	2.92%	3.12%	2.92%	2.91%	3.13%
3510	Health Care Equipment & Services	3.65%	4.39%	4.57%	4.19%	4.91%
3520	Pharmaceuticals & Biotechnology	5.16%	5.76%	4.96%	4.50%	5.57%
4010	Banks	2.05%	2.18%	2.15%	2.20%	2.46%
4020	Diversified Financials	5.15%	5.56%	4.52%	3.76%	5.28%
4030	Insurance	2.02%	2.22%	2.14%	2.22%	2.56%
4040	Real Estate	1.04%	2.05%	1.85%	2.23%	2.31%
4510	Software & Services	5.47%	6.76%	6.11%	5.82%	8.00%
4520	Technology Hardware & Equipment	4.79%	5.52%	4.80%	4.70%	6.11%
4530	Semiconductors & Semiconductor Equip.	4.82%	5.72%	5.59%	5.40%	7.67%
5010	Telecommunication Services	2.50%	3.74%	2.80%	2.70%	3.92%
5510	Utilities	0.80%	1.64%	1.22%	1.35%	1.56%

2010 Burn Rates-Non-Russell 3000

GICS	Description	Mean + Standard Deviation				
		2010	2009	2008	2007	2006
1010	Energy	4.30%	5.15%	4.43%	3.77%	4.56%
1510	Materials	4.54%	3.80%	4.49%	4.36%	4.16%
2010	Capital Goods	4.69%	5.15%	4.39%	4.32%	5.37%
2020	Commercial Services & Supplies	3.53%	4.69%	4.23%	4.18%	7.61%
2030	Transportation	2.31%	3.45%	4.10%	3.86%	4.30%
2510	Automobiles & Components	2.99%	3.05%	3.78%	4.69%	4.51%
2520	Consumer Durables & Apparel	3.37%	4.79%	4.04%	3.70%	5.35%
2530	Hotels Restaurants & Leisure	3.17%	5.14%	4.25%	4.17%	5.17%
2540	Media	4.03%	6.13%	5.93%	5.62%	5.77%
2550	Retailing	4.01%	4.62%	5.80%	5.14%	8.03%
3010, 3020, 3030	Food & Staples Retailing	3.17%	4.45%	3.85%	3.90%	4.99%
3510	Health Care Equipment & Services	7.92%	6.64%	6.40%	5.81%	7.53%
3520	Pharmaceuticals & Biotechnology	8.58%	9.46%	8.69%	6.85%	10.15%
4010	Banks	2.12%	2.89%	2.19%	2.25%	2.79%
4020	Diversified Financials	8.30%	11.05%	9.71%	9.87%	8.47%
4030	Insurance	2.31%	4.71%	4.35%	3.56%	5.10%
4040	Real Estate	3.13%	2.85%	2.02%	2.23%	2.79%
4510	Software & Services	7.58%	10.12%	9.27%	8.46%	12.97%
4520	Technology Hardware & Equipment	7.08%	6.30%	5.83%	5.92%	8.75%
4530	Semiconductors & Semiconductor Equip.	7.31%	7.79%	6.81%	6.94%	8.07%
5010	Telecommunication Services	5.08%	5.92%	5.10%	5.92%	7.11%
5510	Utilities	1.64%	1.86%	1.25%	1.35%	6.24%

Option Exchanges

The FAQs clarify that the exercise prices of underwater stock options eligible for a shareholder-approved option exchange should generally be at the higher of the 52-week high or 50% above the current stock price. For a low-priced stock (e.g., $1.00 per share), the premium could be higher. This clarification was precipitated by the fact that in a recovering market, current stock prices may be close to 52-week highs and outstanding options have a reasonable chance of becoming valuable during their remaining term. RiskMetrics believes that option exchanges should be a last resort for stock options that are deeply underwater.

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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. Copies of this letter and other published materials are available on our website at www.fwcook.com.