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December 23, 2011

ISS ISSUES TECHNICAL PAPER AND UPDATED BURN RATE TABLES

As promised when the 2012 policy updates were released in November[1], ISS issued its technical paper on December 19 providing additional information on peer group development and the new quantitative assessment methodology for evaluating relative and absolute pay-for-performance alignment in Russell 3000 companies. The updated pay-for-performance evaluation is a key element of ISS' policies for developing vote recommendations on management say-on-pay proposals that will apply to companies with annual meetings on or after February 1, 2012. Also this week, ISS issued its 2012 U.S. Proxy Voting Summary Guidelines, which include updated burn rate tables, and an updated version of its Governance Ratings Indicators, which will be the subject of a separate alert letter. These new releases can be viewed on ISS' website at www.issgovernance.com.

TECHNICAL PAPER

Under its updated policies for 2012, ISS will evaluate pay for performance using two relative alignment assessments applied over one- and three-year periods and an absolute alignment assessment applied over five years. Performance will continue to be measured by total shareholder return ("TSR") and pay will continue to be total compensation for the CEO. The two relative alignment assessments will be based on a peer group formed under a new approach, which will now be used for both the performance and the pay evaluations. Several significant questions were raised when the policy updates were issued earlier in the fall, many of which are answered by the technical paper as discussed below.

Compensation Measurement

ISS confirmed that compensation will continue to be based on proxy disclosure in the Summary Compensation Table, including grant-date fair values for equity compensation rather than realized equity values based on actual performance. ISS will also continue to value equity using common valuation assumptions that will likely produce different and higher values for stock options than the accounting values reported in the proxy.

[1] See our letter dated November 18, 2011, available on our website at www.fwcook.com

Finally, ISS stated that it will continue to use all elements of disclosed compensation because companies not offering one or more components (e.g., a pension plan) may make up the difference through larger equity grants, for example.

Performance Measurement

TSR will be measured as of the last day of the month closest to the company's fiscal year-end rather than as of the closest quarterly download date that ISS uses to refresh its database (i.e., December 1, March 1, June 1 and September 1).

ISS stated that its use of TSR to measure performance does not mean that it is advocating the use of TSR as a metric in companies' incentive programs. Rather, ISS views TSR as objective and transparent and believes this metric should be aligned over the long-term with a company's execution of its business strategy.

Peer Groups

ISS will form peer groups for Russell 3000 companies covered by the new relative alignment assessments in a manner similar to current practice, but with several important differences that ISS believes will result in more comparable peer groups.

- Peer groups will be formed twice a year as of December 1 and June 1
- Potential peer companies will continue to be screened based on size using revenue for non-financial companies and total assets for financial companies as the primary metrics, with market cap used as a secondary metric
    - Measurement of size will be as of the December 1 and June 1 quarterly download dates
    - Revenue is for the most recent trailing four quarters, total assets is as of the most recent quarter-end, and market cap is the 200-day average stock price times common shares outstanding, all as of the applicable quarterly download date
- The universe of companies in ISS' executive compensation database from which peer group companies will be selected will be defined as the companies in each company's 2-digit GICS code between 0.45 and 2.1 times revenue or total assets and between 0.2 and 5 times market cap[2]
    - There can be between 14 and 24 companies selected from a company's 6-digit GICS code. If there are fewer than 14 from the 6-digit code, additional companies will continue to be identified starting with a company's 4-digit GICS code and progressing to the 2-digit GICS code as necessary to have 14 companies

[2] GICS is the Global Industry Classification Standard developed by MSCI and Standard and Poor's. ISS' executive compensation database includes all Russell 3000 companies, supplemented by the public companies disclosed as peer group companies in the proxies of the Russell 3000 companies, for a total of more than 4,000 companies.

- If possible, ISS will select alternating next larger and next smaller companies so that the subject company approximates the median of the peer group in terms of revenue or total assets size

- The market cap range is broader than the revenue or total assets range and will be used to exclude "wildly divergent" companies (e.g., companies that trade at extremely low or high multiples of revenue or total assets, which may call into question their comparability)

- For the approximately 25 largest non-financial companies having over $50 billion in revenue and a market cap of at least $30 billion, ISS stated that it is not possible to construct peer groups with a sufficient number of companies comparable in size and industry. Therefore, these companies will constitute a special peer group and be compared to each other

- For other companies for whom a sufficient number of peers cannot be identified, the revenue range will be expanded, but not the market cap range

Measurement of Alignment

ISS provided detailed information on the backtesting of its new relative and absolute alignment assessments in support of guidelines for determining when a company's pay-for-performance alignment is of "medium" or "high" concern and thus subject to further qualitative review.

- The two relative alignment assessments measure (i) relative degree of alignment, defined as the difference between a company's TSR percentile rank and CEO pay percentile rank (e.g., a weighted-average TSR percentile rank of 75% and a weighted-average CEO pay rank of 50% would result in a value of 25, whereas a TSR rank of 50% and a CEO pay rank of 75% would result in a value of -25; therefore, a positive difference indicates high TSR performance for low CEO pay, while a negative difference indicates high CEO pay for low TSR performance), and (ii) CEO pay as a multiple of median pay

  - The relative degree of alignment assessment weights one-year TSR and CEO pay alignment 40% and three-year TSR and CEO pay alignment 60%

  - The multiple of median is a one-year assessment

- The absolute alignment assessment measures the trend in the company's TSR compared to the trend in CEO pay over five years using regression analysis weighted to place more emphasis on the most recent fiscal years

  - The regression analysis calculates lines of "best fit" to the TSR and CEO pay data for the five years in the assessment period on a normalized basis and then compares the slopes of the lines (i.e., the TSR performance slope minus the CEO pay slope) to determine if a pay-for-performance disconnect is indicated (i.e., a positive difference indicates that TSR is either rising faster or declining slower than CEO pay, while a negative difference indicates that TSR is either rising slower or declining faster than CEO pay)

The table below contains the resulting analytical values deemed to indicate a "medium" or "high" concern. The values are designed to identify outliers who are not within the range of typical values. Having a single high-concern value or more than one medium-concern value will trigger a qualitative review.

	Medium		High	
Measure	Level that may trigger high concern in conjunction with other measures		Level that triggers high concern by itself	
Relative Degree of Alignment	–30	≈25th percentile	–50	≈10th percentile
Multiple of Median	2.33X	≈92nd percentile	3.33X	≈97th percentile
Pay-TSR Alignment	–30%	≈10th percentile	–45%	≈5th percentile

Companies with an apparent pay-for-performance disconnect indicated by the quantitative assessments will be subject to further qualitative review that considers the following:

- The strength of performance-based compensation: for example, the ratio of performance-based to time-based equity awards and the overall ratio of performance-based compensation to total compensation, including whether performance metrics and goals are fully disclosed and are reasonably challenging, whether a single metric or similar metrics are used in either or both of the short- and long-term incentive programs, and whether there is disclosure of adjustments to and the rationale for any non-GAAP metrics used

- The company's peer group benchmarking practices: for example, self-selected peers that are larger and above-median targeting of pay

- Results of financial/operational metrics: for example, recent GAAP results on metrics such as return measures and growth in revenue, profit, cash flow, etc., both absolute and relative to peers, and quality of disclosure

- Special circumstances: for example, exceptional situations such as a new CEO or unusual equity grant practices (e.g., bi- or triennial awards)

<u>UPDATED BURN RATE TABLES</u>

ISS issued updated burn rate tables for Russell 3000 and non-Russell 3000 companies, which will apply to shareholder meetings on or after February 1, 2012.

Under its Burn Rate Policy, ISS recommends against stock plan proposals if a company's three-year average burn rate exceeds its industry group's mean by more than one standard deviation or two percent of weighted common shares outstanding, if higher. Burn rates are calculated on a gross basis, and shares cancelled or forfeited are not excluded. A company can avoid a negative vote recommendation by publicly committing to a future three-year average burn rate of no greater than the higher of (1) the industry group's mean plus one standard deviation at the time of the commitment or (2) two percent.

Burn rates are expressed on an option-equivalent basis with full-value shares converted to option equivalents based on six volatility categories shown below:

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

Burn rates for 2012, shown below and on the next page with four years of historical data, are, in several cases, significantly higher or lower than for 2011 and triggered the cap on year-over-year changes in burn rates of two percentage points implemented last year.

2012 Burn Rates-Russell 3000

		Mean + Standard Deviation				
GICS	**Description**	**2012**	**2011**	**2010**	**2009**	**2008**
1010	Energy	4.02%	4.03%	2.14%	3.09%	3.09%
1510	Materials	3.08%	3.04%	1.63%	2.14%	1.93%
2010	Capital Goods	2.93%	3.34%	1.95%	3.52%	2.55%
2020	Commercial Services & Supplies	4.61%	4.89%	2.89%	4.01%	4.05%
2030	Transportation	2.83%	3.36%	2.13%	3.18%	2.80%
2510	Automobiles & Components	3.40%	3.25%	2.99%	3.05%	2.99%
2520	Consumer Durables & Apparel	4.81%	3.26%	2.97%	3.44%	3.33%
2530	Consumer Services	5.81%	4.80%	2.80%	3.32%	3.33%
2540	Media	5.56%	4.10%	2.28%	3.25%	3.27%
2550	Retailing	4.02%	4.11%	3.10%	3.12%	2.90%
3010, 3020, 3030	Consumer Staples	3.03%	3.76%	2.92%	3.12%	2.92%
3510	Health Care Equipment & Services	4.69%	4.66%	3.65%	4.39%	4.57%
3520	Pharmaceuticals & Biotechnology	7.49%	7.16%	5.16%	5.76%	4.96%
4010	Banks	2.81%	2.78%	2.05%	2.18%	2.15%
4020	Diversified Financials	9.15%*	7.15%	5.15%	5.56%	4.52%
4030	Insurance	2.80%	3.04%	2.02%	2.22%	2.14%
4040	Real Estate	2.34%	2.02%	1.04%	2.05%	1.85%
4510	Software & Services	7.76%	7.26%	5.47%	6.76%	6.11%
4520	Technology Hardware & Equipment	5.73%	5.84%	4.79%	5.52%	4.80%
4530	Semiconductor Equipment	5.83%	6.64%	4.82%	5.72%	5.59%
5010	Telecommunication Services	6.50%*	4.50%	2.50%	3.74%	2.80%
5510	Utilities	2.00%	2.00%	0.80%	1.64%	1.22%

* Capped by maximum +/- 2 percentage points change vs. prior year, which was added to the Burn Rate Policy in 2011.

2012 Burn Rates-Non-Russell 3000

GICS	Description	Mean + Standard Deviation 2012	2011	2010	2009	2008
1010	Energy	7.46%	6.30%	4.30%	5.15%	4.43%
1510	Materials	6.04%	6.54%	4.54%	3.80%	4.49%
2010	Capital Goods	8.69%*	6.69%	4.69%	5.15%	4.39%
2020	Commercial Services & Supplies	5.81%	5.53%	3.53%	4.69%	4.23%
2030	Transportation	2.88%	4.31%	2.31%	3.45%	4.10%
2510	Automobiles & Components	6.99%*	4.99%	2.99%	3.05%	3.78%
2520	Consumer Durables & Apparel	6.27%	5.37%	3.37%	4.79%	4.04%
2530	Consumer Services	6.99%	5.17%	3.17%	5.14%	4.25%
2540	Media	5.65%	6.03%	4.03%	6.13%	5.93%
2550	Retailing	6.62%*	4.62%	4.01%	4.62%	5.80%
3010, 3020, 3030	Consumer Staples	7.17%*	5.17%	3.17%	4.45%	3.85%
3510	Health Care Equipment & Services	11.92%*	9.92%	7.92%	6.64%	6.40%
3520	Pharmaceuticals & Biotechnology	12.58%*	10.58%	8.58%	9.46%	8.69%
4010	Banks	3.49%	4.12%	2.12%	2.89%	2.19%
4020	Diversified Financials	11.31%	10.30%	8.30%	11.05%	9.71%
4030	Insurance	2.31%*	4.31%	2.31%	4.71%	4.35%
4040	Real Estate	3.49%	3.18%	3.13%	2.85%	2.02%
4510	Software & Services	11.58%*	9.58%	7.58%	10.12%	9.27%
4520	Technology Hardware & Equipment	7.69%	9.08%	7.08%	6.30%	5.83%
4530	Semiconductor Equipment	9.78%*	7.78%	7.31%	7.79%	6.81%
5010	Telecommunication Services	9.08%*	7.08%	5.08%	5.92%	5.10%
5510	Utilities	5.64%*	3.64%	1.64%	1.86%	1.25%

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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.