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July 20, 2012

2012 Glass Lewis Policy Updates

On July 12, 2012, Glass Lewis released an enhancement to its current pay-for-performance model. The changes in methodology will be effective for public companies holding annual shareholder meetings on or after July 1, 2012. The following alert explains the changes made by Glass Lewis, how these enhancements will affect companies, and provides a brief perspective on the changes. Additional information about the changes can be viewed on the Glass Lewis' website at www.glasslewis.com.

Pay-for-Performance Methodology

Peer Group

Glass Lewis' pay-for-performance test will no longer compare companies to multiple peer groups developed in-house by Glass Lewis and based on size (enterprise value), sector (2-digit GICS), sub-industry (8-digit GICS), and geography. Instead, each company will now be compared to a single peer group developed using Equilar's Market-Based Peer Group. This new peer group will be constructed based on the subject company's self-disclosed peer group and the peer groups disclosed by the company's self-disclosed peers ("peers of peers"). The new peer group will consist of 30 peer companies, rather than the average of 100 peer companies under the old methodology, and Glass Lewis will now disclose the specific companies comprising the peer group. The goal is to align more closely the data used by investors and public companies in assessing compensation practices, and encourage more productive engagement between the two.

Pay-for-Performance Evaluation and Grade

In assessing the pay and performance relationship, Glass Lewis will compute the company's relative performance percentile ranking and compare it to its CEO's and other NEO's pay percentile ranking relative to the new peer group. The difference in these two percentiles will be used by Glass Lewis to determine the pay-for-performance grade depending on the degree to which the difference is positive or negative.

The following table shows how Glass Lewis will assign a pay-for-performance grade based on the gap between pay and performance (expressed as the difference in percentile rank of a subject company's relative performance and pay versus peers):

Percentile Difference (Performance minus Pay)	Grade
60 to 100	A
30 to 59	B
29 to -29	C
-29 to -59	D
-60 to -100	F

This approach will replace the prior Glass Lewis method that graded every company using a forced curve.

Performance Metrics

Company performance will continue to be measured relative to peers using a three-year weighted average[1]. Going forward a company's performance will be measured against its peers using the following performance metrics:

- Total shareholder return (TSR)
- Change in operating cash flow
- EPS growth
- Return on equity
- Return on assets

Two of the performance metrics previously used, change in stock price and change in book value per share, are no longer considered

Compensation Measurement

The new pay-for-performance model will now measure compensation using a three-year weighted average[1] of total compensation for the CEO and other named executive officers, instead of the one-year total compensation previously used. Total compensation will continue to be defined as the sum of salary, bonus, non-equity incentive plan compensation, grant date fair value of new equity awards, and all other compensation.

[1] Weighting was not disclosed

Qualitative Assessment

Glass Lewis appears not to have changed its methodology for identifying compensation risk and will continue to evaluate the following items on a qualitative basis:

- Sufficient disclosure of compensation philosophy and policy
- Clear disclosure of incentive plan design and payout determination
- Appropriateness of a company's peer group
- Mix of performance-based and non-performance based pay
- Rigor of performance goals
- Internal pay equity
- Best Practices (e.g., clawbacks, whether or not the company offers golden parachute excise tax gross-ups, stock ownership requirements, etc.)

Application and Observations

We assume Glass Lewis will continue to use a company's pay-for-performance grade, supplemented by the qualitative assessment, to determine its vote recommendation. Specifically, we believe companies graded "F" will likely receive a vote "against" recommendation. And some portions of those graded "D" are also likely to receive a vote "against" recommendation, depending on the qualitative assessment of risk and best practices. Glass-Lewis disclosed that it has issued vote "against" recommendations for 16% of companies' Say-on-Pay proposals during the 2012 proxy season.

At first examination, it appears Glass Lewis has made changes that filers may embrace. The selection of peer companies may be viewed as more intuitive than the previous method. Narrowing the number of peers to 30 companies that are most often referenced by the filer's peers increases the likelihood that the pay analysis will include companies against which the company actually compares its own compensation and performance. However, the Glass Lewis approach continues to lack transparency as the weighting of each performance measure is still not disclosed.

Upon closer examination of the pay-for-performance gap analysis, it appears the Glass Lewis approach is counter-intuitive. Instead of rewarding companies with a strong correlation between pay and performance (e.g., high-performer and high-payer), it appears to reward companies with a disproportionate performance return on compensation (i.e., high-performer and low-payer). Only companies whose performance meaningfully exceeds their pay will be rewarded with a pay-for-performance grade of "A". In contrast, companies with pay and performance that is closely aligned (either high or low) could expect a grade of "C". In addition, no distinction will be made between high-performing, high-paying companies and low-performing, low-paying companies.

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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 Matt Lum at (713) 427-8344 or by email at mjlum@fwcook.com, or to Steve Cross at (713) 427-8333 or scross@fwcook.com. Copies of this letter and other related materials are available on our website at www.fwcook.com.