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Executive Compensation 2011 Year in Review

2011 was the first year of mandatory Say-on-Pay ("SOP"), the non-binding shareholder advisory vote on the compensation of named executive officers as disclosed in the proxy statement, and the frequency of future SOP votes. Other executive compensation developments in 2011 were voting policy changes of certain institutional shareholders and their advisers, dominated by Institutional Shareholder Services ("ISS"), related to SOP and other executive compensation-related proxy statement proposals.

Introduction

Each year Frederic W. Cook & Co. publishes a letter summarizing the major executive compensation developments that occurred in the past year. This letter provides a recap of the key regulatory, governance and technical developments that were detailed in various publications by our Firm throughout 2011 (listed at the end of this document and which are accessible via our website at www.fwcook.com).

Executive Compensation Developments in 2011

The primary topics of interest in 2011, which are discussed in more detail below, can be divided into the following three categories:

- Say-on-Pay
- Institutional Shareholder Voting Policies
    - ISS Policy Updates for 2012
    - ISS Updates to Burn Rate Caps and GRId Analysis
    - Fidelity's Revised Proxy Voting Guidelines
- Regulatory Developments
    - SEC Rules for Compensation Committee and Advisor Independence
    - SEC Updates on Executive Compensation Disclosure Rules

Say-on-Pay

The first proxy season of required SOP advisory votes for most U.S. public companies ended on June 30, 2011. Among the Russell 3000, 2,292 companies had annual shareholder meetings between January 21, 2011, the first meeting date companies were required to have an SOP proposal and thus the unofficial start of the 2011 proxy season, and June 30, 2011, the recognized end of the proxy season. Companies were also required to have an advisory vote on the frequency of future SOP proposals, with annual, biennial, and triennial frequencies permitted. Among Russell 3000 companies, the vast majority of companies (98%) had their SOP proposals pass, with average shareholder support over 90%.

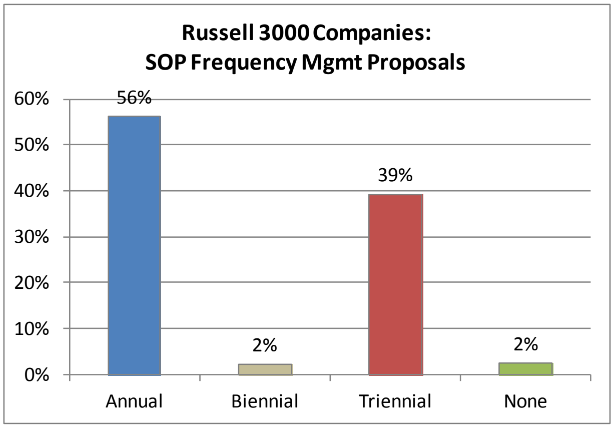
When developing vote recommendations on SOP proposals, each of the major proxy advisory firms evaluated a company's executive compensation program on a holistic basis. Companies with strong alignment between pay and performance generally received a "for" vote recommendation unless (1) the absolute magnitude of CEO pay was deemed to be excessive and/or (2) the company maintained problematic pay practices.

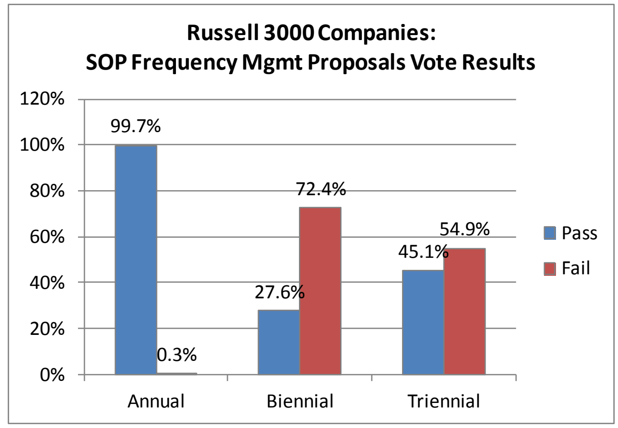
ISS recommended voting "against" SOP proposals at approximately 12% of companies, where support ranged from 70% to 75%. During 2011, 43 companies failed with average support of only 42%. Glass Lewis, another proxy advisory firm, recommended "against" 17.5% of SOP proposals. Glass Lewis uses an "A" to "F" grading scale, and 10% of companies they reviewed received an "F," with average SOP support of 73%.

Lessons learned from the first year of mandatory SOP include:

- High non-performance-based pay and problematic pay practices were key contributors to negative vote recommendations from proxy advisory groups and a poor vote outcome
- ISS' focus has shifted away from problematic pay practices to focus more on an evaluation of the alignment between pay and performance. Eliminating problematic pay practices (e.g., tax gross-ups) will not cure a pay-for-performance disconnect
- Efforts to solicit shareholder support for SOP often included expanded disclosure of the relationship between pay and performance in proxy statements and/or supplementary materials and active engagement with large shareholders
- Failing SOP appears to require more than an "against" vote recommendation from the proxy advisory firms. Issues identified for the companies with failed SOP votes include one or more of the following: multiple years of poor total shareholder return ("TSR") and higher CEO pay relative to peers; unresponsiveness to previously identified compensation issues, in particular when expressed by shareholders through majority withhold votes for compensation committee members; excessively high CEO pay or special retention awards; excessively high year-over-year increases in CEO pay; and egregious problematic pay practices
- An unanticipated consequence of failing the SOP vote is the possibility of being sued. (Six companies were the subject of derivative suits on behalf of shareholders)

Shareholders overwhelmingly supported annual SOP votes driven largely by recommendations from ISS, Glass Lewis and other proxy advisory firms, as shown in the charts on the following page:





2012 Update: Looking at 2012 annual meetings, as of March 19, 2012, one company in the Russell 3000 had a failed SOP proposal (with only a 44.3% vote in favor) and 109 companies have passed. On average, companies that have passed SOP received 91% of votes in support. These results include companies that reported their SOP results between January 21, 2012 and March 19, 2012.

<u>ISS 2012 Policy Updates</u>

On November 17, 2011, ISS issued updates to its voting policies for the 2012 proxy season that apply to all publicly-traded companies with shareholder meetings on or after February 1, 2012. Under the previous ISS policy, pay-for-performance alignment for Russell 3000 companies was assessed by examining a company's one- and three-year TSR relative to all Russell 3000 companies in the same 4-digit GICS industry group[1] and the year-over-year change in CEO compensation for CEOs who have served at least two consecutive fiscal years. Generally, if both one- and three-year TSR were below median and there had not been a meaningful year-over-year reduction in CEO compensation (e.g., 10% or more), the company was deemed to have a pay-for-performance disconnect. This would subject the company's overall executive compensation program to greater scrutiny and raise the likelihood that ISS would recommend "against" the company's SOP proposal.

With the new ISS updates, there are now three components to the quantitative analysis, i.e., 1) Relative Degree of Alignment 2) Multiple of Median and 3) Pay-TSR Alignment

In addition, under the revised policy, the peer group selection process has been changed to include 14-24 companies (vs. 8-12 under the previous policy) that will be used for both the pay and performance comparisons. Peers are selected based on size using revenue (or assets for financial firms), market capitalization, and GICS industry group. ISS aims to position the company being evaluated close to the median with the following guidelines applied:

- There should be between 14-24 peer companies [**2012 Update: In limited special cases 12 peer companies may be used as the minimum]**

[1] GICS refers to the Global Industry Classification Standard ("GICS") developed and maintained by Standard & Poor's for the purpose of classifying companies into 2-digit sectors, 4-digit industry groups, 6-digit industries, and 8-digit sub-industries.

- The universe of companies in ISS' executive compensation database from which peer companies will be selected are those closest in size that are in the same 6-digit GICS industry as the target company. If not enough companies are produced (minimum of 14), the selection is expanded to companies in the same 4-digit GICS then 2-digit GICS
- The companies selected will generally be between 0.45 and 2.1 times the revenue (or total assets for financial firms) and between 0.2 and 5 times the market capitalization of the subject company
- Peer groups will be formed twice a year based on data as of December 1st and June 1st
- 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 "super-mega" peer group and be compared to each other

  2012 Update: 41 "super-mega" companies will be divided into three groups as follows:
  Group 1 **– 16 companies in the Industrial, Energy, Materials, Technology and Telecom GICS sectors**
  Group 2 **– 15 companies in the Consumer and Health Care GICS sectors**
  Group 3 **– the 10 largest financial companies (by assets) in the S&P 500 index -** ***the peers for each Group 3 company will be the other companies in the group, plus the three next largest financial companies in the S&P 500 index (although the standard peer group for each of those three will apply for their analyses)***

The new Relative Degree of Alignment method evaluates both CEO pay and TSR on a relative basis compared to a company's peer group over one and three years, weighted 40% and 60% respectively. This weighting was selected so that more weight would be given to the "longer term." Under the Multiple of Median test, ISS will divide the subject company's CEO pay by the median pay for the peer group. CEO pay and performance alignment will also be evaluated on an absolute basis over a five-year period, under the Pay-TSR Alignment test. This analysis assesses the difference between the trend in annual pay changes and the trend in annualized TSR during the period. Companies with unsatisfactory alignment, as defined and quantified by ISS, will be subject to further qualitative analysis. These changes are intended to bring a tighter and more systematic approach to identifying pay-for-performance disconnects, but not necessarily to result in a higher number of negative vote recommendations.

ISS also updated its policy on vote recommendations on the re-election of compensation committee members (or, in exceptional cases, the full board) to be on a case-by-case basis when the prior SOP vote received shareholder support of less than 70%. This update stresses that company actions should be new and not a reiteration of existing practices, and companies should avoid "boilerplate" disclosure.

ISS' new policy with respect to SOP frequency is as follows:

- Recommend "against" or "withhold" from the entire board of directors (except new nominees, who should be considered case-by-case) if the board implements a frequency that is less than the frequency that received majority support

- Recommend on a case-by-case basis "against" or "withhold" from the entire board if the board implements a frequency that is less than the frequency that received a plurality, but not majority support, taking into account:

- The board's rationale for selecting a frequency that is different from the frequency that received a plurality
- The company's ownership structure and vote results
- ISS' analysis of whether there are compensation concerns or a history of problematic compensation practices
- The previous year's support level on the company's SOP proposal

ISS Updated Burn Rate Table

On November 17, 2011, ISS issued an updated burn rate table for Russell 3000 and non-Russell 3000 companies, which will apply to shareholder meetings on or after February 1, 2012 and which will impact new equity plan proposals, as well as a company's Governance Risk Indicators (GRId) score.

A company's annual burn rate is the number of shares granted during the year as a percentage of total shares outstanding and helps to measure how fast a company will consume its shareholder's capital. Burn rates, which are expressed on an option-equivalent basis with full-value shares converted to option equivalents based on volatility, are calculated on a gross basis (i.e., shares that are later cancelled or forfeited are not deducted). If a company's burn rate is above two percent and the allowable burn rate cap, ISS will recommend a vote "against" a company's stock plan, unless the company publicly commits to a future three-year average burn rate of no greater than the higher of the industry group's mean plus one standard deviation at the time of the commitment, *or* two percent. A company's GRId score will also be negatively impacted if a company's burn rate is above the allowable cap.

ISS Updates to Governance Risk Indicators (GRId)

Two years ago ISS launched GRId as a measure of governance-related risk. GRId evaluates the level of a company's risk throughout four dimensions: Audit, Board, Compensation (our main focus) and Shareholder Rights.

On December 19, 2011, ISS released updates to its GRId model for 2012. The updated model ("GRId 2.0") is designed to better align its ratings with ISS' proxy vote recommendations and became effective for all covered U.S. companies on February 24, 2012. To this end, ISS has (1) expanded and refined the content of the model and (2) refined the scoring methodology such that the risk from individual governance practices is reflected in the category scores and concern levels. The threshold for concern levels has been standardized and the normalization of scores has been simplified. Total category scores will fall within a predefined range that is consistent across all categories.

2012 Update: In March 2012 ISS updated their GRId compensation category of questions (which has the most evaluation criteria out of all the categories) and reorganized the subcategories as follows; pay for performance, non-performance based equity, use of equity, equity risk mitigation, communication & disclosure, and termination/severance. Under the new GRId scoring system it is difficult to identify which areas of compensation are the most/least risky for companies. Companies that have not already done so should review for accuracy ISS' responses to the GRId questions and request changes, as appropriate.

Fidelity's Revised Proxy Voting Guidelines

In March 2011, Fidelity released revised proxy voting guidelines which affect proposals related to the election of directors, changes in corporate control, shareholder rights, and compensation proposals.

The most significant change in the compensation area is the shift in focus from an equity award plan's aggregate dilutive effect to the company's three-year average burn rate as the primary determinant of Fidelity's vote. There are a few areas of concern with this shift, such as timing of equity plan proposals and negative implications the shift may have on companies making special awards. Additionally, because the "simple" burn rate calculation does not account for the value difference between options and full-value shares, it creates an incentive for companies to use full-value share awards rather than options, as options use more shares than full-value awards to deliver an equivalent compensation value.

Regarding SOP proposals, Fidelity will (1) support annual advisory votes on executive compensation, (2) generally vote for proposals to approve executive compensation unless such compensation is misaligned with shareholder interests, and (3) generally vote against proposals to approve golden parachutes[2]**.**

SEC Proposes Rules for Compensation Committee and Adviser Independence

On March 30, 2011, the Securities and Exchange Commission (SEC) issued proposed rules as the next step in implementing Section 952 of the Dodd-Frank Act with respect to the independence of compensation committee members and advisors to compensation committees.

The SEC did not add much to the statutory criteria for compensation committee members, leaving the concrete guidance to the securities exchanges. There is new guidance in one area – the securities exchanges have the authority to provide that representatives of controlling shareholders can serve on compensation committees.

The SEC did not elaborate on independence of compensation committee advisors and leaves the responsibility with the securities exchanges to elaborate on the following five issues:

1) The provision of other services to the issuer by the person that employs the adviser
2) The amount of fees provided by the issuer to the person that employs the adviser as a percentage of total revenues
3) The policies and procedures that the person employing the adviser has in place to prevent conflicts of interest
4) Any business or personal relationships between the adviser and any member of the Committee
5) Whether any of the issuer's stock is owned by the adviser

The SEC specifically noted that the securities exchanges are free to develop additional independence factors for issuers to take into account, so it will be important to monitor the content of the proposed securities exchange rules.

[2] A "golden parachute" is defined as "employment contracts, agreements, or policies that include an excise tax gross-up provision, single trigger for cash incentives, or may result in a lump sum payment of cash and acceleration of equity that may total more than three times annual compensation (salary and bonus) in the event of a termination following a change in control."

The SEC's proposed proxy disclosure rules also require issuers to disclose whether the Committee retained or obtained the advice of a compensation consultant, whether the resulting work has raised any conflict of interest (and the nature of the conflict), and how any such conflict is being addressed. The proposed rules are slightly broader than the current rules in the sense that there will no longer be an exception from the consultant disclosure requirement when the consultant only provides advice on broad-based plans or non-customized benchmarking data. There is no set date as to when final rules will be in effect and it might not be until July 2012. The new disclosure rules apply to definitive proxy statements filed on or after the date the SEC publishes final rules.

2012 Update: Rules on disclosure of pay-for-performance, pay ratios, hedging by employees and directors, and executive compensation clawbacks should be proposed by June 2012 and adopted between the July 2012 and December 2012 timeframe.

SEC Staff Updates Interpretive Guidance on Executive Compensation Disclosure Rules

The SEC staff periodically updates its interpretive guidance on executive and director compensation proxy disclosure rules through the release of Compliance & Disclosure Interpretations. The 2011 updates deal with the disclosure of non-GAAP performance goals in the Compensation Discussion and Analysis and disclosure of the grant date fair value for stock and option awards in the Summary Compensation Table as well as not requiring disclosure for nondiscriminatory group disability benefits in the Summary Compensation Table.

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General questions about this letter may be directed to Logan Carr at (212) 299-3713 or by email at lmcarr@fwcook.com, or to Jeffrey Kanter at (212) 299-3709 or by email at jmkanter@fwcook.com. Questions regarding specific topics covered in this letter may also be addressed directly to the consultant(s) referenced at the end of the related letters listed on the following page, which may be found along with additional information about our firm on our website at www.fwcook.com.

List of 2011 Cook & Co. Letters

4/6/11 – *SEC Proposed Rules for Compensation Committee and Advisor Independence;*
Alexa Kierzkowski (ahkierzkowski@fwcook.com) or David Gordon (degordon@fwcook.com)

4/14/11 – *Fidelity Releases Revised Proxy Voting Guidelines*;
Claudio Schneider (cgschneider@fwcook.com) or Wendy Hilburn (wjhilburn@fwcook.com)

4/29/11 – *Comments on Committee Independence – SEC*;
David Gordon (degordon@fwcook.com)

7/21/11 - *SEC Staff Updates Interpretive Guidance On Executive and Director Compensation Disclosure Rules*; Thomas Haines (tmhaines@fwcook.com) or Richard Alpern (rlalpern@fwcook.com)

8/9/11 – White Paper: *Say-on-Pay: 2011 Proxy Season De-Brief;*
Wendy Hilburn (wjhilburn@fwcook.com) or Ross Perry (rperry@fwcook.com)

10/20/11 – *ISS Draft 2012 Policy Changes*;
Wendy Hilburn (wjhilburn@fwcook.com)

11/18/11 – *ISS 2012 Policy Updates*;
Wendy Hilburn (wjhilburn@fwcook.com)

12/23/11 – *ISS Issues Technical Paper and Updated Burn Rate Tables*;
Wendy Hilburn (wjhilburn@fwcook.com)

12/29/11 - *Institutional Shareholder Services Announces Updates to Governance Risk Indicators (GRId)*;
David Yang (dkyang@fwcook.com) or Ted Simmons (tpsimmons@fwcook.com)