Frederic W. Cook & Co., Inc.
New York • Chicago • Los Angeles • San Francisco

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ISS 2007 POLICY CHANGE PUBLIC COMMENT PERIOD

For the first time, Institutional Shareholder Services ("ISS") is making use of a public comment period as it considers certain policy changes for 2007. The two topics that are most relevant to compensation professionals are (1) the corporate performance test in evaluating the effectiveness of directors and (2) options backdating and springloading policies. The public comment period ends on October 11, 2006; comments may be provided via the ISS website[1].

CORPORATE PERFORMANCE TEST FOR DIRECTOR NOMINEES

ISS introduced a performance test in 2006 that could result in a recommendation to withhold votes for director nominees at companies within the Russell 3000 index. The policy consisted of two parts: (1) identifying underperforming companies with regard to total shareholder return ("TSR")[2] and (2) performing a case-by-case analysis of each company identified under the TSR test[3]. For companies that fail both tests, ISS would recommend withholding votes for directors at the annual meeting.

For 2007, ISS is considering adopting a new framework for its corporate performance test. The new ISS methodology would weight evenly (a) operational performance (consisting of management effectiveness, "top-line evaluation" and "bottom-line evaluation") over a five-year period and (b) five-year TSR.

ISS would identify the two worst "performers" within each of the 24 GICS groups (48 companies) in the first year. These companies would automatically receive cautionary language in their analysis for 2007. In the second year (2008), ISS would re-evaluate the original 48 companies. In order to avoid a recommendation to withhold votes at the next annual meeting, a company would need to demonstrate improvement in both its one-year operational metrics and one-year TSR for the most recent fiscal year. This policy would continue on a going-forward basis.

ISS is requesting comments on the following questions, as well as any issues that are considered important to consider with regard to its director performance test policy:

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1 www.issproxy.com

2 ISS identified the "worst performers" within each industry group based on weighted-average TSR: 20% on 1-year TSR, 30% on 3-year TSR and 50% on 5-year TSR

3 This review includes any recent changes in stock price, as well as recent management or strategic changes that may indicate future improvement.

- Should ISS adopt the proposed methodology and two-phase approach? Please be as specific as possible in your comments.

- When measuring corporate performance, what is the most appropriate time horizon to consider?

- Should share price measurements and operating metrics be weighted evenly in the proposed evaluation?

- Which financial metrics are most appropriate? (i.e., ROIC, ROE, ROA, etc.)

- Should the director performance test policy be quantitative or should it also consider situational circumstances at the company?

- How many companies (or what percentage of companies) within each GICS grouping should be evaluated in the initial screening process described above?

OPTIONS BACKDATING AND SPRINGLOADING

Options backdating and springloading[4] falls under ISS' policy of executive compensation practices. ISS' policy recommends withholding votes from compensation committee members if the company has poor compensation practices. To date, ISS has recommended withholding votes for compensation committee members at only a few companies for options backdating, and has issued cautionary language at several companies.

ISS is considering a case-by-case approach in determining the vote recommendations for directors and equity plan proposals for companies that have a history of options backdating[5]. In its approach, ISS would consider the following factors:

- Reason for options backdating, such as poor administration or "inadvertent" backdating as opposed to deliberate modifications of option grants

- Time period during which options were backdated

- Size of financial restatement

- Action taken by the board, compensation committee, or audit committee to correct these practices, such as canceling backdated options, recouping of option gains on grants, or adopting a grant policy

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4 Options backdating occurs when a company retroactively sets the exercise price for a stock option to an earlier date. Springloading occurs when a company grants an option right <u>before</u> the release of positive news or right <u>after</u> the release of negative news.

5 In cases where companies are under some form of investigation, ISS would recommend no action on the directors or proposed equity plans as any action might be premature.

ISS is requesting comments on what action should be taken if a company is found guilty of options backdating or is practicing option springloading, including the following questions:

Questions

- Should investors take action on companies that practice options backdating or option springloading? If so, what action is warranted? Examples of types of actions include "no" votes for compensation committee members, equity plan proposals, audit committee members, or auditors.

- What factors should be considered in withholding votes on directors for options backdating? Examples of factors include reasons for backdating, time period, size of restatement, or actions taken by the board, such as adopting an option grant policy.

- If a company confesses to options backdating, but corrects their practice going forward, would the correction be sufficient to cure a "no" vote on directors? Should the company be required to adopt some form of stock option grant policy to cure the "no" vote

- What types of option grant policies should be considered as best practices policies and why? Examples of option grant policies include fixed grant schedules and window period policies (defining a window of time for grants).

- Should an equity plan proposal prohibit options backdating or springloading in the plan language?

- In light of the options backdating scandal, do you think that "clawback" proposals, those asking for clawing back of ill-gotten bonuses, will receive more attention and support in 2007?

- Please feel free to add any additional information or comments on how this issue may develop in 2007.

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This letter is intended to alert compensation professionals about developments that may affect their companies. General questions about ISS' policy guidelines may be addressed to David Cole or Wendy Hilburn at (212) 986-6330. This letter and other published materials are available on our website, www.fwcook.com.