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ISS 2008 POLICY UPDATES

On November 19, ISS Governance Services ("ISS"), a business unit of RiskMetrics Group since its acquisition in January, issued updates to its U.S., Canada, International, and U.K. proxy voting policies for 2008, which will be applicable to companies with annual meetings after February 1. This letter summarizes five policy updates pertaining to executive compensation in U.S. companies.[1] ISS' other compensation policies (e.g., pay for performance) are unchanged and will remain in place for 2008.

Advisory Votes on Executive Compensation (Say-on-Pay) Management Proposals

In light of the fact that some U.S. companies have voluntarily agreed to present say-on-pay proposals for a shareholder vote and others have had shareholder say-on-pay proposals receive majority support, ISS has formalized its global policy for such proposals and developed policy guidelines for application in the U.S. market.[2]

Under the new policy, there are five *global* principles that will apply in all markets and underlie specific market policy guidelines, against which *management* say-on-pay proposals will be assessed on a case-by-case basis. These global principles are:

1. Maintain appropriate pay-for-performance alignment with emphasis on long-term shareholder value. Among other factors, consideration will be given to (1) the linkage between pay and performance; (2) the mix between fixed and variable pay; (3) performance goals; and (4) equity-based plan costs

2. Avoid arrangements that risk "pay-for-failure," including long or indefinite contracts, excessive severance, and guaranteed compensation

3. Maintain an independent and effective compensation committee

4. Provide shareholders with clear, comprehensive compensation disclosures

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1 There are several Canadian compensation policy updates of note: (1) amended policy to add limits on non-employee director participation in management equity compensation plans, (2) new policy to vote against single-trigger CIC provisions, and (3) affirmation of the current case-by-case approach for evaluating shareholder proposals on executive or director compensation.

2 The U.S. policies also apply to Bermuda companies whose stock is traded in the U.S.

5. Avoid inappropriate pay to non-executive directors, which could compromise their independence and ability to make appropriate judgments overseeing management pay and performance

The new policy guidelines for U.S. management say-on-pay proposals call for case-by-case assessments based on consideration of the following factors:

1. Relative Considerations – including performance metrics relative to business strategy, peer groups used, alignment of performance and pay trends over time, and disparity of the total pay of the CEO relative to other named executive officers

2. Design Considerations – including balance of fixed vs. variable pay and excessive practices (e.g., perks, severance, SERPs, and burn rates)

3. Communication Considerations – including the quality of the CD&A and the board's responsiveness to investor input and engagement on compensation issues (e.g., to majority-supported shareholder proposals on executive pay topics)

Presumably, if ISS views a company's compensation practices favorably, it will support the management proposal.

Binomial Model: Stock Option Overhang Cost

ISS has recognized that high-performing companies with valuable outstanding grants can be unfairly penalized under its shareholder value transfer methodology for quantifying the cost of proposals for additional shares or new stock plans. Under ISS' new policy, the overhang cost attributable to in-the-money options outstanding in excess of six or more years may be excluded on a case-by-case basis. ISS will use the following criteria to decide whether to carve-out a portion of overhang cost:

1. Performance – sustained positive stock price performance (e.g., five-year total shareholder return, year-over-year performance, and peer performance)

2. Overhang Disclosure – whether optionees have held in-the-money options for a prolonged period, which will require additional disclosure

    — Specifically, companies would need to disclose (1) the number of in-the-money options outstanding in excess of six or more years with a weighted average exercise price and remaining term; (2) the number of options outstanding less than six years and underwater options outstanding in excess of six or more years, each with a weighted average exercise price and remaining term; (3) option vesting provisions; and (4) the distribution of outstanding option grants with respect to the named executive officers

3. Dilution – an expected duration in excess of five years for a new share request in addition to shares remaining available would be problematic

4. Compensation Practices – overall practices, including option repricing provisions, high concentration of grants to top executives, or other practices outlined in the current poor pay practices policy

Burn Rate Multipliers

ISS' current burn rate policy[3] converts full-value share awards to option equivalents based on three multipliers (i.e., 1.5, 2.0 and 4.0) related to categories of annual stock price volatility (i.e., 53% and higher, 25%-52%, and less than 25%, respectively). Under the new policy, there will be six volatility categories and multipliers to enhance precision as shown in the table 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 Rate Table

Each year since it adopted its burn rate policy in 2005, ISS has updated the burn rates by GICS industry group. The 2008 burn rates are contained in the two tables below for Russell 3000 and Non-Russell 3000 companies compared to historical burn rates. Burn rates had been declining over the last two years, but more than half of the industry groups show increases for 2008.

2008 Burn Rates-Russell 3000

		Mean & Standard Deviation			
GICS	**Description**	**2008**	**2007**	**2006**	**2005**
1010	Energy	3.09%	2.29%	2.50%	2.61%
1510	Materials	1.93%	1.85%	2.11%	2.36%
2010	Capital Goods	2.55%	2.57%	2.93%	3.05%
2020	Commercial Services & Supplies	4.05%	3.81%	4.33%	4.40%
2030	Transportation	2.80%	2.31%	3.47%	3.60%
2510	Automobiles & Components	2.99%	2.90%	3.24%	3.48%
2520	Consumer Durables & Apparel	3.33%	3.09%	3.26%	3.90%
2530	Hotels Restaurants & Leisure	3.33%	3.41%	3.31%	3.48%
2540	Media	3.27%	2.70%	3.38%	3.84%
2550	Retailing	2.90%	3.05%	4.12%	4.84%
3010, 3020, 3030	Food & Staples Retailing	2.92%	2.91%	3.13%	3.48%
3510	Health Care Equipment & Services	4.57%	4.19%	4.91%	5.20%
3520	Pharmaceuticals & Biotechnology	4.96%	4.50%	5.57%	5.32%
4010	Banks	2.15%	2.20%	2.46%	2.61%
4020	Diversified Financials	4.52%	3.76%	5.28%	5.66%
4030	Insurance	2.14%	2.22%	2.56%	2.32%
4040	Real Estate	1.85%	2.23%	2.31%	1.90%
4510	Software & Services	6.11%	5.82%	8.00%	8.49%
4520	Technology Hardware & Equipment	4.80%	4.70%	6.11%	6.68%
4530	Semiconductors & Semiconductor Equip.	5.59%	5.40%	7.67%	7.97%
5010	Telecommunication Services	2.80%	2.70%	3.92%	4.95%
5510	Utilities	1.22%	1.35%	1.56%	1.55%

[3] 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, ISS 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.

GICS	Description	2008	2007	2006	2005
	2008 Burn Rates-Non-Russell 3000				
		Mean & Standard Deviation			
1010	Energy	4.43%	3.77%	4.56%	4.78%
1510	Materials	4.49%	4.36%	4.16%	4.46%
2010	Capital Goods	4.39%	4.32%	5.37%	6.17%
2020	Commercial Services & Supplies	4.23%	4.18%	7.61%	8.07%
2030	Transportation	4.10%	3.86%	4.30%	4.66%
2510	Automobiles & Components	3.78%	4.69%	4.51%	5.18%
2520	Consumer Durables & Apparel	4.04%	3.70%	5.35%	6.21%
2530	Hotels Restaurants & Leisure	4.25%	4.17%	5.17%	6.17%
2540	Media	5.93%	5.62%	5.77%	7.01%
2550	Retailing	5.80%	5.14%	8.03%	7.75%
3010, 3020, 3030	Food & Staples Retailing	3.85%	3.90%	4.99%	6.68%
3510	Health Care Equipment & Services	6.40%	5.81%	7.53%	7.79%
3520	Pharmaceuticals & Biotechnology	8.69%	6.85%	10.15%	9.92%
4010	Banks	2.19%	2.25%	2.79%	3.25%
4020	Diversified Financials	9.71%	9.87%	8.47%	8.55%
4030	Insurance	4.35%	3.56%	5.10%	4.24%
4040	Real Estate	2.02%	2.23%	2.79%	3.01%
4510	Software & Services	9.27%	8.46%	12.97%	14.10%
4520	Technology Hardware & Equipment	5.83%	5.92%	8.75%	10.12%
4530	Semiconductors & Semiconductor Equip.	6.81%	6.94%	8.07%	10.74%
5010	Telecommunication Services	5.10%	5.92%	7.11%	8.56%
5510	Utilities	1.25%	1.35%	6.24%	8.38%

Poor Pay Practices

ISS adopted its policy to withhold votes from compensation committee members of companies with poor pay practices in 2006, and expanded the policy in 2007 to (1) identify best practices, (2) provide examples of poor practices, and (3) expand the withhold recommendations to include the CEO and/or the whole board. The 2008 policy update is a further expansion of the policy and clarification of what constitutes poor compensation practices and best practices.

The additional or clarified items are:

- ISS has clarified that it may recommend withhold/against votes where cautionary language has been issued in a prior year concerning poor pay practices, but the practices (unless contractually bound) have not been remedied

- Examples of poor practices has been expanded to include multi-year base salary increases (in addition to multi-year bonuses and equity grants) that are guaranteed as part of an employment contract, and perquisites for former executives such as car allowances, personal use of corporate aircraft, or other inappropriate arrangements

- A category of poor disclosure has been added (e.g., unclear explanation of how the CEO is involved in the pay setting process, retrospective performance targets and methodology not discussed, and methodology for benchmark practice and/or peer group not disclosed and explained)

- Base salary will be used as a relative measure to determine if certain perks are excessive (i.e., the value of the perk will be evaluated on a percent-of-salary basis)

- A category of best practice disclosure has been added, which includes the CD&A written in plain English, with as little “legalese” as possible and formatted using section headings, bulleted lists, tables, and charts where possible. Ultimately, the document should provide detail and rationale regarding compensation, strategy, pay mix, goals/metrics, challenges, competition, and pay-for-performance linkage, etc. in a narrative fashion

Overall, we think companies will view the 2008 policy updates favorably, especially the exclusion of in-the-money options that are held until late in their terms and the expanded volatility and multiplier categories for converting full-value share awards to option equivalents.

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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.