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**Institutional Shareholder Services Announces  
Updates to Governance Risk Indicators (GRId)**

On December 19, 2011, Institutional Shareholder Services (ISS) released updates to its Governance Risk Indicators (GRId) model for 2012.<sup>1</sup> The updated model (“GRId 2.0”) is designed to better align its ratings with ISS’ proxy vote recommendations and will be in effect for all covered U.S. companies beginning February 24, 2012. To this end, ISS has (i) expanded and refined the content of the model and (ii) redesigned the scoring methodology to ensure that risk from individual governance practices is appropriately reflected in the scoring and communicated in a transparent manner.

**GRId 2.0 Content Update**

The previous GRId model (“GRId 1.0”) was introduced in 2010 to serve as a tool for institutional investors to assess the governance-related risk at portfolio companies.<sup>2</sup> The model evaluates a company’s governance practices in four categories: Audit, Board, Shareholder Rights, and Compensation. The basic objectives and structure of GRId 2.0 remain the same. However, ISS has made the following content updates to the model in an effort to respond to client and market feedback:

- Updates to Compensation: The Compensation category has been reworked to reflect ISS’ new quantitative pay-for-performance voting policy<sup>3</sup> and updated to better reflect the range of possible responses on questions related to equity-based compensation.
- Subcategory Refinement: The subcategories within categories have been refined and reorganized to improve the grouping of questions.
- Data Transparency: New or modified questions have been added and/or answers have been refined to provide a clearer understanding of a company’s underlying governance practices.

<sup>1</sup> The full update document can be found on ISS’ website at [www.issgovernance.com/grid/technical\\_document](http://www.issgovernance.com/grid/technical_document).

<sup>2</sup> See our alert letter dated [May 13, 2010](#) for a summary of the GRId 1.0 model.

<sup>3</sup> See our alert letter dated [December 23, 2011](#) for a summary of the new ISS pay-for-performance quantitative evaluation methodology.

A comparison of the categories, subcategories, and questions covered in GRId 1.0 and GRId 2.0 for U. S. companies is provided in the Attachment.

### **GRId 2.0 Methodology Update**

GRId 1.0 measures a company's level of risk in each of the four governance categories based on the responses to questions addressing the risk-related topics in each subcategory. Each question carries an explicit weight in the model with a defined scoring range. The widest range is -5 to +5 points. Negative points are assigned for practices that raise governance concerns and positive points for practices that mitigate concern. The weighted total score for each category ranges from 0 to 100 points. The point total for each category translates to a low, medium, or high "concern" level for that governance area. However, the point thresholds required to meet each concern level are not uniform for all governance categories.

Under GRId 2.0, ISS has refined the scoring methodology such that the risk from individual governance practices is properly reflected in the category scores and concern levels. Key changes to the scoring methodology are as follows:

- Explicit weights have been eliminated.
- The number of points associated with an answer directly reflects the relative significance of any particular answer within its category and is no longer bound by the -5 to +5 point scoring range. However, total points for each subcategory are bounded within a range that reflects the significance of the subcategory's influence on the category's overall level of concern.
- The thresholds for concern levels have 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. The threshold between low and medium concerns and between medium and high concerns is identical across all categories and across all markets. As a result, ISS can and will provide numerical GRId scores for each category, as well as concern levels, to better communicate the degree of concern for each company. The normalized score for each category will range from 0 to 100 points. A category score that is less than or equal to 50 points indicates "high" concern, less than or equal to 75 points indicates "medium" concern, and greater than 75 points indicates "low" concern.

ISS has not yet released the specific scoring and points associated with each answer and subcategory. As a result, companies will not be able to predict their category scores or concern levels under GRId 2.0 until such details are made available.

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**Comparison of “Audit” Questions for U.S. Companies**

<b>GRId 1.0</b>	
<b>Non-Audit Fees (1 question)</b>	Non-Audit fees represent what percentage of total fees?
<b>Controversies (4 questions)</b>	Did the auditor issue an adverse opinion in the past year?
	Has the company restated financials for any period within the past two years?
	Has the company made late financial disclosure filings in the past two years?
	Has a securities regulator taken enforcement action against the company in the past two years?
<b>Other Issues (1 question)</b>	Has the company disclosed any material weaknesses in its internal controls in the past two years?

<b>GRId 2.0</b>	
<b>External Auditor (2 questions)</b>	Non-Audit fees represent what percentage of total fees?
	Did the auditor issue an adverse opinion in the past year?
<b>Audit and Accounting Controversies (6 questions)</b>	Has the company restated financials for any period within the past two fiscal years?
	Has the company made late financial disclosure filings in the past two fiscal years?
	Has a securities regulator taken enforcement action against the company in the past two fiscal years?
	Has a securities regulator taken enforcement action against a director or officer of the company in the past two fiscal years?
	Is a director or officer of the company currently under investigation by a regulatory body?
	Has the company disclosed any material weaknesses in its internal controls in the past two years?

Questions in yellow are new.

Questions in green have been moved to or from a different category.

Questions in red have been deleted.

## Comparison of “Board” Questions for U.S. Companies

GRId 1.0	
<b>Board Composition</b> (2 questions)	What is the independent director composition of the board?
	What is the qualification of the Chairman of the Board?
<b>Committee Composition</b> (3 questions)	What is the independent status of the nominating committee members?
	What is the independent status of the compensation committee members?
	What is the independent status of the audit committee members?
<b>Board Practices</b> (9 questions)	Does the CEO serve on an excessive number of outside boards?
	Do non-executives serve on an excessive number of outside boards?
	Did any directors attend less than 75% of the board meetings without a valid excuse?
	How many directors received withhold / against votes of 50% or greater at the last annual meeting?
	Does the company disclose board/governance guidelines?
	Did outside directors meet without management present?
	What percent of the directors were involved in material related party transactions (RPTs)?
	Do the directors with related party transactions (RPTs) sit on key board committees?
	Does the company have a majority vote standard in uncontested elections?

GRId 2.0	
<b>Board Composition</b> (6 questions)	What is the independent director composition of the board?
	What is the classification of the Chairman of the Board?
	Are the roles of Chairman and CEO separated?
	Has the company an identified Senior or Lead Independent Director?
	What percentage of the board consists of family members?
<b>Committee Composition</b> (3 questions)	What is the independent status of the nominating committee members?
	What is the independent status of the compensation committee members?
	What is the independent status of the audit committee members?
<b>Board Practices</b> (4 questions)	Does the CEO serve on an excessive number of outside boards?
	Do non-executives serve on an excessive number of outside boards?
	Did any directors attend less than 75% of the board meetings without a valid excuse?
	How many directors received withhold / against votes of 50% or greater at the last annual meeting?
	Does the company disclose board/governance guidelines?
<b>Board Policies</b> (3 questions)	Can outside directors meet without management present?
	Can directors hire own advisors without management approval?
<b>Related Party Transactions</b> (3 questions)	What percent of the directors were involved in material related party transactions (RPTs)?
	Do the directors with related party transactions (RPTs) sit on key board committees?
	Are there related party transactions (RPTs) involving the CEO?

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## Comparison of “Shareholder Rights” Questions for U.S. Companies

<b>GRId 1.0</b>	
<b>One Share One Vote</b> (2 questions)	Does the company have classes of stock with different voting rights?
	Are there any directors on the board who are not up for election by all classes of common shareholders?
<b>Takeover Defenses</b> (7 questions)	Are all directors elected annually?
	Is the board authorized to issue blank check preferred stock?
	Does the company have a poison pill (shareholder rights plan) that was not approved by shareholders?
	What is the trigger threshold for the poison pill?
	Does the poison pill have a sunset provision?
	Does the poison pill have a Three-Year Independent Director Evaluation (TIDE) provision?
	Does the poison pill have a qualified offer clause?
<b>Voting Issues</b> (3 questions)	Does the company require a super-majority vote to approve amendments to the charter and/or bylaws?
	Does the company require a super-majority vote to approve mergers/business combinations?
	When does the shareholder rights plan expire? <sup>(1)</sup>
<b>Voting Formalities</b> (3 questions)	What is the percentage of share capital needed to convene a special meeting?
	Can shareholders act by written consent?
	Has the board failed to implement a shareholder resolution supported by a majority vote?

<b>GRId 2.0</b>	
<b>One Share One Vote</b> (2 questions)	Does the company have classes of stock with different voting rights?
	Are there any directors on the board who are not up for election by all classes of common shareholders?
<b>Takeover Defenses</b> (14 questions)	Are all directors elected annually?
	Is the board authorized to issue blank check preferred stock?
	Does the company have a poison pill (shareholder rights plan) in effect?
	What is the trigger threshold for the poison pill?
	Does the poison pill have a sunset provision?
	Does the poison pill have a Three-Year Independent Director Evaluation (TIDE) provision?
	Does the poison pill have a qualified offer clause?
	What is the expiration date of the poison pill? <sup>(1)</sup>
	Is the poison pill designed to preserve tax assets (NOL pill)?
	Was the poison pill approved by shareholders?
	When was the poison pill implemented or renewed?
	Does the company's poison pill include a modified slow-hand or dead-hand provision?
	Does the company have a majority vote standard in uncontested elections?
	If the company has a majority voting standard, is there a plurality carve-out in the case of contested elections?
<b>Voting Issues</b> (2 questions)	Does the company require a super-majority vote to approve amendments to the charter and/or bylaws?
	Does the company require a super-majority vote to approve mergers/business combinations?
<b>Voting Formalities</b> (4 questions)	What is the percentage of share capital needed to convene a special meeting?
	Can shareholders act by written consent?
	Has the board failed to implement a shareholder resolution supported by a majority vote?
	Are there material restrictions as to timing or topics to be discussed, or ownership levels required to call the meeting?

<sup>(1)</sup> Question moved from "Voting Issues" subcategory in GRId 1.0 to "Takeover Defenses" in GRId 2.0

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**Comparison of “Compensation” Questions for U.S. Companies**

GRId 1.0		GRId 2.0	
<b>Pay Practices</b> (3 of 10 questions) <sup>(2)</sup>		<b>Pay for Performance</b> (5 questions)	What is the degree of alignment between the company's cumulative 3-year pay percentile rank, relative to its peers, and its 3-year cumulative TSR rank, relative to peers?
			What is the degree of alignment between the company's cumulative 1-year pay percentile rank, relative to its peers, and its 1-year cumulative TSR rank, relative to peers?
			What is the size of the CEO's 1-year cumulative pay, as a multiple of the median pay for company peers?
			What is the degree of alignment between the company's TSR and change in CEO pay over the past five years?
			What is the ratio of the CEO's total compensation to the next highest paid executive?
	Do any of the NEOs receive tax gross-ups on their perks other than relocation and other broad-based benefits?	<b>Non-performance based pay</b> (7 questions)	Did the company provide dividends on unvested performance shares in the last fiscal year?
	Are any of the NEOs eligible for multi-year guaranteed bonuses?		Has the company reimbursed NEOs for losses on sale of a home?
	Are executives given credit toward pension for years not worked?		Did the CEO receive tax gross-ups on perks other than relocation and other broad-based benefits?
			Are any of the NEOs eligible for multi-year guaranteed bonuses?
			Did the company pay tax gross-ups on a secular trust?
			Are executives given credit toward pension for years not worked?
			What is the ratio of the CEO's non-performance-based compensation (All Other Compensation) as a percentage to Base Salary?
<b>Executive Long Term/Equity</b> (4 of 12 questions) <sup>(2)</sup>	Does at least one of the new and/or amended plans for the last three years permit share recycling for options/SARS?	<b>Use of Equity</b> (9 questions)	Do the company's active equity plans prohibit share recycling for options/SARS?
	Does one or more of the company's equity plans approved or amended in the past three years permit option/ SAR repricing and cash buyouts?		Do the company's active equity plans prohibit option/SAR repricing?
			Do the company's active equity plans prohibit option/SAR cash buyouts?
			Do the company's active equity plans have an evergreen provision?
			Do the company's active equity plans have a liberal CIC definition?
			Do the company's active equity plans provide for automatic vesting of equity awards in the case of change-in-control?
	Has the company repriced options or exchanged them for shares, options or cash without shareholder approval in the last three years?		Has the company repriced options or exchanged them for shares, options or cash without shareholder approval in the last three years?
	Does the company grant equity awards at an excessive rate, according to RMG policy?		Does the company grant equity awards at an excessive rate, according to ISS policy?
<b>Stock Ownership</b> (1 of 4 questions) <sup>(2)</sup>	If a new or amended broad-based plan is proposed, then what is the expected duration of shares?		If a new or amended broad-based plan is proposed, then what is the expected duration of shares?

<sup>(2)</sup> GRId 1.0 questions and subcategories have been reordered to align with GRId 2.0 sequence

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## Comparison of “Compensation” Questions for U.S. Companies

GRId 1.0		GRId 2.0	
<b>Pay Practices (1 of 10 questions)</b> <sup>(2)</sup>	Did the company disclose a claw back provision?	<b>Equity Risk Pay Mitigation (10 questions)</b>	Did the company disclose a claw back or malus provision?
<b>Executive Long Term/Equity (4 of 12 questions)</b> <sup>(2)</sup>	What are the minimum vesting periods mandated in the plan documents for executives' stock options or SARS in the equity plans adopted/amended in the last 3 years?		What are the minimum vesting periods mandated in the plan documents for executives' stock options or SARS in the equity plans adopted/amended in the last 3 years?
	What are the minimum vesting periods mandated in the plan documents, adopted/amended in the last three years, for executives' restricted stock?		What are the minimum vesting periods mandated in the plan documents, adopted/amended in the last three years, for executives' restricted stock?
	What is the holding period for stock options (for executives)?		What is the holding period for stock options (for executives)?
	What is the holding period for restricted shares (for executives)?		What is the holding period for restricted shares (for executives)?
<b>Stock Ownership (3 of 4 questions)</b> <sup>(2)</sup>	Is the CEO subject to stock ownership guidelines?		What proportion of the salary is subject to stock ownership requirements/guidelines for the CEO / Is the CEO subject to stock ownership guidelines?
	Are directors subject to stock ownership guidelines?		Are directors subject to stock ownership guidelines?
	Do all directors with more than one year of service own stock?		Do all directors with more than one year of service own stock?
			Did any executive or director pledge company shares? Does the company have a policy prohibiting hedging of company shares by employees?
<b>Executive Short Term (1 question)</b>	Does the company disclose the performance measures, hurdle rates, and target payout thresholds for the short-term cash incentive plan that generated the awards reported?		<b>Communications and Disclosure (2 questions)</b>
<b>Executive Long Term/Equity (4 of 12 questions)</b> <sup>(2)</sup>	Does the company disclose a performance measure for stock options plans (for executives)?	What is the level of disclosure on performance measures for the latest active or proposed long term incentive plan?	
	Does the company disclose a performance measure for restricted share plans (for executives)?		
	Does the company disclose the performance measures, hurdle rates and target payout thresholds for executives' long-term cash plans?		
	Does the company disclose a performance measure for other long term plans (for executives)?		

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## Comparison of “Compensation” Questions for U.S. Companies

GRId 1.0	
<b>Termination (1 question)</b>	What's the severance trigger under the change-in-control agreements?
<b>Pay Practices (6 of 10 questions) <sup>(2)</sup></b>	What is the multiple of salary plus bonus in the severance agreements for the CEO upon a change-in-control?
	What is the multiple of salary plus bonus in the change-in-control agreements for named executive officers excluding the CEO?
	Does the company provide excise tax gross-ups for change-in-control payments?
	What is the length of the employment agreement with the CEO?
	In the last fiscal year, did the company grant premium priced options of at least 125% of market price that need to be maintained for at least 30 consecutive days?
	Has the company voluntarily adopted a management 'say on pay' advisory vote resolution for the most recent annual meeting or committed to a resolution going forward?

GRId 2.0	
<b>Termination (9 questions)</b>	What's the trigger under the change-in-control agreements?
	Do the CEO's outstanding equity awards vest upon a change in control?
	What is the multiple of salary plus bonus in the severance agreements for the CEO (upon a change-in-control)?
	What is the basis for the change-in-control or severance payment for the CEO?
	What is the multiple of salary plus bonus in the change-in-control agreements for named executive officers excluding the CEO (upon a change-in-control)?
	What is the basis for the change-in-control or severance payment for executives excluding the CEO?
	Does the company provide excise tax gross-ups for change-in-control payments?
	What is the length of the employment agreement with the CEO?
	What is the amount of the CEO's estimated non-Change-in-Control severance amount as of the end of the last fiscal year, as a multiple of the executives' average salary + bonus over the past three years?

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