EXEQUITY

Independent Board and Management Advisors

Client Alert

ISS Posts 2011-2012 Policy Survey

Institutional Shareholder Services, Inc. (ISS) recently posted its 2011-2012 Policy Survey.[1] The survey is scheduled to remain open through **August 3, 2011**. ISS will use the results of the survey in formulating its policy updates for the 2012 proxy season. Organizations that wish to influence ISS's future voting policies and guidance should respond to the survey. This survey offers an avenue to provide input on a number of ISS positions that have been controversial, and that will continue to have a significant impact unless resistance is registered with ISS.

We strongly encourage companies to respond to ISS's survey. Furthermore, we suggest that companies not necessarily limit their responses to the questions directly posed. Instead, companies should also voice their opinions on other issues of concern with ISS's policies.

Compensation-Related Survey Questions

The survey questions related to ISS's U.S. Compensation policies are as follows:

11. When determining whether executive pay is aligned with company performance, how relevant are the following factors?

- Pay that is significantly higher than peer pay levels
- Pay levels that have increased disproportionately to the company's performance trend

Responses: Not relevant, Somewhat relevant, Very relevant

Comment: *ISS does not address the definition of pay, or whether it is appropriate to utilize a different valuation of stock options than the FASB ASC Topic 718 expense disclosed in the proxy. That is a fundamental issue that ISS's subscribers should be asked for input on since most public companies view the use of non-U.S. GAAP values for stock options as being undesirable and inconsistent with accounting and securities disclosure requirements.*

Additionally, if ISS is trying to assess the relationship between pay and performance, why does it utilize grant date values for pay, instead of actual pay delivered? Using the grant date values and comparing those to after-the-fact actual performance achieved does not make sense to us. Rather, it would make more sense to compare the actual pay delivered to the performance achieved during a particular period.

[1] The survey is available at http://www.issgovernance.com/policy/2011survey.

12. Does your organization consider discretionary annual bonus awards (i.e., not based primarily on attainment of pre-set goals) to be problematic in the following circumstances:

- Always—annual incentives should always be tied mainly to attainment of specific goals related to the company's business and/or strategic plan.
- Sometimes—if the awards are not aligned with company performance.
- Never—companies should have flexibility to design incentive plans according to culture and the board's determination.
- Other (please specify).

Comment: *ISS could be angling to try and further demonize any annual incentives that are not explicitly tied to preestablished goals. That may end up tying the hands of management and boards when it comes to motivating employees if the performance goals that had been set for a performance period have to be abandoned partway through the period because of external changes, as happened at many companies during the recent financial crisis.*

13. At what level of opposition on a say-on-pay proposal should there be an explicit response from the board regarding improvements to pay practices?

- More than 10%
- More than 20%
- More than 30%
- More than 40%
- More than 50%
- Not applicable

Comment: *ISS is likely looking for its subscribers' input into what level of opposition should warrant an affirmative statement from the company. Knowing how ISS policies have been constructed in the past, we expect that whatever that level gets set at, if a company hits it and fails to make an affirmative statement, there will be consequences under one or more of the ISS policies, most likely related to the Say on Pay vote and the election of directors.*

14. How does your organization view the new Advisory Votes on Golden Parachutes that are on ballot at meetings where shareholders are voting on a change-in-control transaction?

- Always vote for the Golden Parachute proposal if you vote for the transaction
- Vote against the Golden Parachute proposal, to express concerns about the nature and/or amount of executives' parachute arrangements, even if you support the transaction
- Not applicable
- Other (please specify)

The next set of questions apply to equity compensation plan proposals from U.S. incorporated companies.

15. In cases where the Shareholder Value Transfer cost of an equity plan proposal is excessive relative to peers, to what extent should the following positive factors mitigate the cost to shareholders?

- Above median long-term shareholder return
- Low average burn rate relative to peers
- Double-trigger CIC equity vesting
- Reasonable plan duration based on historical share usage
- Robust vesting requirements (>5 years)

Responses: Not at all, Somewhat, Very much, No opinion

Comment: *ISS is likely trying to determine where its subscribers would differ in their possible vote on equity plans and could end up modifying its equity compensation plan proposal policies depending on the survey results. In all likelihood, we would expect that it would require multiple positive factors coupled with some stipulations from a company in order for ISS to be comfortable overriding a negative vote recommendation as the result of excessive Shareholder Value Transfer.*

16. In cases where the Shareholder Value Transfer cost of an equity plan proposal is not excessive relative to peers, to what extent should the following negative factors weigh against the plan?

- Liberal CIC definition with automatic award vesting
- Excessive potential share dilution relative to peers
- High CEO or NEO "concentration ratio"
- Automatic replenishment ("Evergreen funding")
- Prolonged poor financial performance
- Prolonged poor shareholder returns

Responses: Not at all, Somewhat, Very much, No opinion

Comment: *Perhaps ISS is ready to confront the reality of the situation facing its vote recommendations on equity plan proposals—many proposals that had acceptable levels of dilution but failed another of ISS's policies and therefore earned a negative ISS vote recommendation, e.g., burn rate policy, nevertheless were accepted by shareholders even in light of the negative ISS vote recommendation. So ISS might be trying to get some context around what these shareholders find acceptable and write it into its policies so that its vote recommendations fit better with what its subscribers intend to do. ISS's vote recommendations based on such a modified equity plan proposal policy should be better followed by ISS's subscribers.*

17. Under single-trigger equity vesting, a change of control (CIC) by itself triggers accelerated vesting of all outstanding awards. Under what circumstances is "single-trigger" vesting appropriate?

- Automatic accelerated vesting of outstanding grants upon a CIC
- Accelerated vesting at the board's discretion after a CIC
- Accelerated vesting in certain circumstances after a CIC (e.g., if awards are not converted or replaced by a surviving entity)

Responses: Appropriate, Not appropriate, No opinion

Comment: *This question suggests that ISS will once again be looking at single-trigger CIC protections as it formulates the 2012 policy updates. For the past several years, ISS has looked at single-trigger CIC protections with additional scrutiny and has warned companies that it may change its policy with respect to them, i.e., it could start viewing the inclusion of a single-trigger CIC protection in equity plans as reason alone to recommend against such plans. Certainly if the survey responses from ISS's subscribers seem to support such a position, ISS easily could adopt such a policy update for 2012.*

18. Should equity plans coming to a shareholder vote for the first time after an IPO (in order to qualify for Section 162(m) tax deductibility) be evaluated under the same guidelines as a "standard" equity plan, even if no shares are requested?

- Yes
- No

Comment: *ISS is asking this question to solicit feedback from its subscribers which is similar to several issues which arose during the 2011 proxy season related to post-IPO plan proposals.*

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Conclusion

If you or your company has an opinion on these or any of the other survey questions posed by ISS, you should complete and submit the ISS survey before August 3, 2011 to ensure your point of view is registered with ISS.

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PUB/CA/ISS 2011-12 Policy Survey_20110722