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Client Alert

RiskMetrics Seeks Comments on 2009 Draft Policies

Proposed Compensation-Related U.S. Policy Changes

EXEQUITY

Independent Board and Management Advisors

Exequity, LLP
1870 Winchester Road
Suite 141
Libertyville, IL 60048

Tel (847) 996-3960
Fax (847) 996-3961
www.exqty.com

On October 14, the RiskMetrics Group Policy Board issued its 2009 proposed draft policies for comment. RiskMetrics, through its Governance Services group (formerly Institutional Shareholder Services or ISS), will finalize and implement these policies for the 2009 proxy season. The comment period remains open through October 31 and gives interested parties an opportunity to share their views on these proposed policies with RiskMetrics. These draft policies as well as an online comment process can be accessed at RiskMetrics' web page, www.riskmetrics.com/policy/2009comment.

Overview of 2009 Draft Policies

Several of the proposed draft policies are compensation-related (RiskMetrics is proposing other policy changes as well):

- Peer Group Selection for Executive Compensation Comparisons,
- Poor Pay Practices,
- Pay for Performance, and
- Corporate Social Responsibility Compensation-Related Proposals.

Peer Group Selection for Executive Compensation Comparisons

Under current RiskMetrics' policies, peer groups contain 12 companies based on a company's six-digit Global Industry Classification Standard (GICS) and the fiscal revenue closest to that of the company. If there are less than 12 companies, RiskMetrics broadens out the group by looking to the four-digit GICS group.

RiskMetrics is proposing to modify this policy to maintain homogeneity in terms of the company's size by limiting the revenue range considered to between 0.5 and 2.0 times the company's revenue, and changing the required number of peer companies to a minimum of 8 and a maximum of 12 companies.

RiskMetrics' specific requests for comments on this proposed policy change include:

- Commenters' views on using the proposed approach, to limit the revenue range of companies included in the GICS peer group used for CEO pay comparisons.
- Whether RiskMetrics should continue to provide comparative compensation analysis as part of its standard research reports (for Russell 3000 companies), using a peer group other than the group presented in the company's proxy materials.
- Suggestions for an alternative approach.

Poor Pay Practices

The Poor Pay Practices policy provides for withhold/against vote recommendations for incumbent compensation committee members and/or the CEO on a case-by-case basis, where egregious pay practices are identified. Withhold recommendations may be issued for the entire board if warranted and all members of the board were involved in setting the pay practice.

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The proposal seeks to make the following changes to this policy:

- Expand the list of poor pay practices to include **modified single triggers** that provide an extended window of time (longer than 1 year) during which an executive may voluntarily leave and still receive the change-in-control severance package. As a mitigating factor to avoid a withhold/against vote recommendation, RiskMetrics would consider a company's public commitment not to enter into such modified single-trigger agreements in the future.
- Expand the list of poor pay practices to include **dividends or dividend equivalents on unvested performance shares**. As a mitigating factor against a withhold/against vote recommendation, RiskMetrics would consider a company's public commitment not to pay dividends or dividend equivalents on performance shares until the performance goals have been achieved and the awards earned.
- Cause RiskMetrics to consider recommending a **vote against/withhold** on **compensation committee members** when an **S&P 500 company** enters into a **new or substantially amended** agreement that provides for an **excise tax gross-up**.
- Cause RiskMetrics to **evaluate two perquisites individually**, based on their **value** and **overall utilization** by a company:
    - **Automobile Allowance** – evaluated based on the magnitude of the perk along with any related tax gross-ups, generally resulting in a withhold/against vote recommendation for compensation committee members if such value **exceeds $100,000** on an aggregate basis for the Named Executive Officers (NEOs).
    - **Personal Use of Aircraft** – evaluated based on the magnitude of value, including any related tax gross-ups, generally resulting in a withhold/against vote recommendation for compensation committee members if such value **exceeds $110,000** on an aggregate basis for the NEOs.

RiskMetrics' specific requests for comments on this proposed policy change include:

- Modified Single Trigger
    - Commenters' views on modified single triggers in change-in-control (CIC) packages and whether they would generally vote against agreements that feature them. What factors, if any, would commenters consider in applying a case-by-case evaluation?
    - Under what circumstances, if any, are modified single triggers appropriate?
- Excise Tax Gross-Ups
    - Commenters' views on excise tax gross-up provisions in CIC packages for NEOs.
- Dividends or Dividend Equivalents on Unvested Performance Shares
    - Under what circumstances, if any, are dividends or dividend equivalents on unvested performance shares appropriate?
- Excessive Perquisites
    - Automobile Allowance
        - What threshold, if any, commenters consider appropriate for automobile allowances (including tax gross-ups), e.g., $100,000?
        - What rationale, if any, commenters consider acceptable for auto allowances in excess of $100,000?
    - Personal Use of Aircraft
        - What threshold, if any, commenters consider appropriate for personal aircraft use perquisites, i.e., more or less than $110,000?
        - Commenters' views on companies with long-standing aircraft use in excess of $110,000 and whether that would warrant against votes on directors?

Pay for Performance

The current Pay for Performance policy seeks to identify companies where there has been a disconnect between the company's compensation and performance. To accomplish this, RiskMetrics reviews 1- and 3-year Total Shareholder Return (TSR) to determine if both were negative and if the CEO's compensation increased in the most recent fiscal year. RiskMetrics conducts its analysis on a case-by-case basis and may recommend that shareholders withhold votes from compensation committees and/or vote against equity plan proposals, if it finds evidence of a misalignment of pay and performance.

RiskMetrics is considering replacing the absolute negative 1- and 3-year TSR performance assessment with a relative TSR performance assessment when identifying poor-performing companies. RiskMetrics is considering identifying companies in the bottom quartile of each GICS grouping in assessing relative TSR performance. If a company substantially underperforms its GICS group in terms of 1- and 3-year TSR, RiskMetrics may recommend shareholders withhold or vote against compensation committee members. RiskMetrics may also recommend against equity plan proposals of identified underperforming companies if the CEO's pay increased and more than half of that increase was attributed to equity compensation, and the CEO participates in the proposed plan (generally, this is the same as the current policy for equity proposals).

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RiskMetrics notes that it expects to make fewer withhold/against recommendations on compensation committees in a bear market and more such recommendations in a bull market compared to its current policy approach.

RiskMetrics' specific requests for comments on this proposed policy change include:

- Is relative performance a more useful metric than absolute performance for evaluating whether CEO pay increases are warranted?
- What is the appropriate peer group that should be applied when assessing a company's relative TSR performance, e.g., four-digit vs. six-digit GICS?
- Is the bottom quartile an appropriate measure to identify poor performing companies?

Corporate Social Responsibility Compensation-Related Proposals

RiskMetrics currently does not have a policy on corporate social responsibility (CSR) proposals related to linking executive compensation to non-financial criteria. However, RiskMetrics' current CSR compensation-related proposals policy requires a case-by-case analysis of proposals requesting a review of, or a report on, linking executive compensation to social issues. In considering such proposals, RiskMetrics considers the following factors:

- Relevance of the issue to the company's operations,
- Current company executive compensation practices,
- Industry peer group executive compensation practices,
- Significant company controversies/violations regarding social and environmental performance,
- The company's current level of disclosure regarding social and environmental performance, and
- Independence of the compensation committee.

RiskMetrics is proposing to amend this policy by adding that it will generally recommend against proposals which ask for a linking of executive compensation to non-financial criteria.

RiskMetrics' specific requests for comments on this proposed policy change include:

- Factors commenters would consider in determining whether or not to support proposals that ask a company to report on the possibilities of how it might link executive compensation to non-financial criteria.
- Factors commenters would consider in determining whether or not to support proposals that ask a company to link executive compensation to non-financial criteria.
- What non-financial performance criteria, if any, do commenters believe to be appropriate to include when determining executive compensation?
- Which industry sectors, if any, are more relevant for the inclusion of non-financial performance criteria as a component of executive compensation?

Conclusion

We will submit comments to RiskMetrics on these proposed policy changes from our perspective as compensation consultants. If your company has a point of view on these proposed policies, we encourage you to consider submitting comments as well to ensure that RiskMetrics understands the public company point of view regarding the practices targeted by these proposed policies.

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If you have any questions about this ***Client Alert***, please contact **Ed Hauder** or:

Mike Sorensen	(847) 996-3996	Mike.Sorensen@exqty.com
Perry Papantonis	(908) 849-4858	Perry.Papantonis@exqty.com
Ross Zimmerman	(847) 996-3999	Ross.Zimmerman@exqty.com
Edward Hauder	**(847) 996-3990**	**Edward.Hauder@exqty.com**
Lynn Joy	(847) 996-3963	Lynn.Joy@exqty.com
Jeff Hyman	(203) 856-6739	Jeff.Hyman@exqty.com
Mark Oshima	(949) 936-2558	Mark.Oshima@exqty.com
Bob Reilley	(908) 849-4857	Bob.Reilley@exqty.com

Illinois Office (Headquarters) – 1870 West Winchester Road, Suite 141 ● Libertyville, IL 60048
California Office – 8105 Irvine Center, Suite 900 ● Irvine, CA 92618
Connecticut Office – 108 Pine Ridge Road ● Wilton, CT 06897
New Jersey Office – 3 Werner Way, Suite 300 ● Lebanon, NJ 08833
www.exqty.com