Kelly Crean
Governance, Shareowner,
and Equity Team Leader

3560 Lenox Road, Suite 2400
Atlanta, GA 30326
+1 404 442 3504
kelly.crean@mercer.com
www.mercer.com

ISS Policy Committee

November 5, 2011

Subject: **Mercer Commentary on ISS' Proposed Pay for Performance Policy Update**

Mercer has reviewed ISS's proposed new methodology for assessing pay-for-performance alignment; this letter presents our views and comments. In a separate letter, we have commented on how management's response to its say-on-pay (MSOP) vote should affect ISS's director election recommendations.

ISS Commentary Request -- Pay-for-Performance

Mercer has reviewed ISS's proposed policy changes for its methodology assessing a company's pay-for-performance alignment. We believe the proposed two-pronged initial screen reflects a significant improvement over the current approach. However, we have identified a number of items that we recommend be addressed in the final policy guidelines, a supplemental Q&A document, or both.

We have the following responses to ISS's request for comments on this topic.

1. Do the factors utilized in ISS' proposed pay-for-performance evaluation approach align with those your organization believes should be considered?

We support replacing the current initial screen, which looks only at relative TSR ranking against companies with the same GICS code(s), with a two-pronged initial screen. We believe combining (1) relative TSR and CEO pay ranking against a targeted group of peer companies and (2) the relationship between absolute TSR and CEO pay over a five-year period provides shareholders with more complete information. However, we have a number of suggested enhancements and clarifications:

- We believe TSR should not be the sole performance factor in ISS's quantitative analysis. With the current level of uncertainty in the market (and stock price volatility), and differing company risk profiles and business environments, we believe any pay-for-performance review should also include a focus on core business fundamentals and that ISS should develop a list of four to six additional financial measures which are important to investors.

- A critical aspect of any pay-for-performance review is to ensure pay comparisons to an appropriate group of competitor organizations. Peer group development requires more analysis than simply comparing revenue size, market capitalization and GICS codes. While we understand that ISS intends to apply a standard methodology in selecting peer companies, the proposed methodology may not accurately reflect a company's actual competitors for talent, performance, and investor dollars. As such, we believe that ISS should also analyze pay and performance relative to the company's chosen peer group. This will provide investors with a better understanding of how the company's compensation committee evaluated pay-for-performance when determining the CEO's pay package.

- If the proposed policy will be extended to Canadian companies, we suggest allowing for the inclusion of US companies in the peer group assessment (currently only Canadian companies are used). Many Canadian companies have significant operations within the US and compete with US companies for talent. Under the historical ISS approach, only Canadian companies were utilized for the peer assessment – which lead to challenges in identifying an appropriate number of comparable, like-sized companies

- We recommend that the "absolute" component of the CEO pay analysis include an analysis of the impact of stock price changes on outstanding equity awards. For example, if stock price declines, options may become underwater and equity compensation may lose a portion of its value – which demonstrates pay-for-performance alignment. A key issue which ISS omits under its current analysis is the difference between grant-date value and the actual realized value of incentive awards (especially for stock options and performance shares).

- Neither the current or proposed approaches adequately address the performance year to which an equity grant relates. For example, in some cases, Q1 grants should be applied to prior year compensation decisions, even though they are required to be disclosed as current year grants under the SEC rules.

- Under the supplemental qualitative measures assessment, we disagree with the decision to classify time-based stock options as non-performance-based pay. Given that stock option value tracks most closely with change in stock price, ISS should include all (or at least a portion) of stock options as performance-based pay when reviewing the mix of pay.

- We recommend that ISS change its requirement that a majority of the *number* of shares granted be performance-based to a majority of share *value*, taking into account the maximum number of performance shares that can be earned if performance objectives are met. We believe this would be a more accurate snapshot of pay mix.

- We recommend that the final guidelines confirm the relative weighting of the absolute and relative components of the pay-for-performance test. The proposed policy guidelines state the two "*may* be equally weighted."

- We encourage ISS to minimize the use of market capitalization in determining peer group composition. Based on recent market fluctuations (and high stock price volatility), market capitalization data will be significantly impacted by the timing of the ISS analysis.

2. Does the proposed new approach give adequate consideration to long-term alignment?

As noted above, we recommend that long-term alignment include other performance metrics within the five-year absolute snapshot. We also think that, under the supplemental qualitative portion of the review, ISS should take into account vesting schedules, holding period requirements, ownership levels and requirements, and deferred payments. These design features foster longer-term alignment with investors.

3. Will the proposed new approach be beneficial to your organization in identifying companies with strong pay-for-performance alignment?

See our suggestions above.

4. What additional factors, if any, should ISS consider and display to improve investors' ability to evaluate companies' long-term pay-performance alignment?

The following is a list of additional factors we recommend ISS consider and display:

- As discussed in "1" above, we strongly urge ISS to provide an assessment of relative pay-for-performance against the company's chosen peer group. Doing this will provide investors with a better understanding of how the company's compensation committee evaluated pay-for-performance when determining the CEO's pay package.

- We recommend that ISS disclose the following items in its report:
  - Differences in valuation between the compensation data disclosed in the summary compensation table and the values used by ISS for its analysis
  - Input assumptions to the binomial model and any adjustments related to multi-year compensation or deferred payments
  - For the relative pay review, the list of peer companies, CEO total compensation values, TSR results, and the company's rank when compared to the peer companies
  - For the absolute five-year review, total compensation values and the change in TSR
  - Benchmark scoring guidelines (i.e., what score was needed to achieve a weak, satisfactory, and strong ranking) for both the relative and absolute tests and a clear rationale for why a company was placed within one of the three ratings assignments of weak, satisfactory, or strong alignment
- We believe a strong track record of pay-for-performance alignment should mitigate the existence of a perceived problematic pay practice when ISS develops its voting recommendations for say-on-pay proposals. Currently, a single problematic pay practice can lead to a negative recommendation.

Additional Questions for Clarification

Before finalizing the proposed updates, we ask ISS to clarify the answers to the following questions:

- Will companies with newly-hired CEOs continue to be exempt from the pay-for-performance test?
- Will ISS apply the further qualitative analysis only to companies that fall within the "weak alignment" category?
- Will ISS provide further guidance as to how the "other compensation" values impact the pay assessment? Companies could be inadvertently penalized by changes in pension values or other compensation that are more reflective of tenure than pay-for-performance disconnect.

- Given the timing of the disclosure of CEO pay in peer company proxy statements and annual proxy meeting dates, does ISS intend to use the most recent fiscal year data in its evaluation of 2012 proxies (i.e., 2011 compensation data for 2012 reports)? In our experience, a review of most companies will show that there can be a meaningful number of companies with later proxy filings than the ISS publication data. As a result, TSR data in the analysis would be applied to prior year compensation data for some companies in the peer group. This pay and TSR review is further compounded by the use of quarter ending TSR data rather than company FYE TSR. ISS should provide information on how this issue will be addressed in the proposed policy change.

- Since most proxy statements are released at varying times (and typically 45 to 60 days in advance of an annual meeting), will ISS be able to quickly update its compensation database?
- Will a company's fiscal year end versus the fiscal year end of similar companies affect the selection of the peer group?

Thank you for allowing Mercer the opportunity to review and respond to your proposed proxy voting guidelines. Mercer is a leading global provider of consulting, outsourcing and investment services, with more than 25,000 clients worldwide and approximately 10,000 in the United States. Mercer consultants help clients maximize the effectiveness of their compensation and benefit programs and optimize workforce performance by providing human resources and related financial advice, products, and services, including compensation consulting services, to corporations, boards of directors, and board compensation committees concerning the compensation of executives and directors. Mercer provides executive compensation consulting services to companies around the globe, including U.S. publicly-traded companies.

Should you have additional questions for us, please contact Kelly Crean, Leader of Mercer's Governance, Shareowner, and Equity Team at 404 442 3504.

Respectfully,

Kelly Crean
GSE Leader