DOUGLAS K. CHIA
ASSISTANT GENERAL COUNSEL
CORPORATE SECRETARY

ONE JOHNSON & JOHNSON PLAZA
NEW BRUNSWICK, NJ 08933-0026
(732) 524-3292
FAX: (732) 524-2185
EMAIL: DCHIA@ITS.JNJ.COM

November 7, 2011

VIA E-MAIL
Institutional Shareholder Services
Global Policy Board
policy@issgovernance.com

RE: 2012 Draft Policies for Comment
Evaluation of Executive Pay (Management Say-on-Pay) (US and Canada)

Members of the Global Policy Board:

Thank you for the opportunity to comment on the Institutional Shareholder Services (ISS) 2012 Draft Policies. We commend ISS for continuing to provide opportunities for the issuer community to participate in the proxy voting policy formulation process. Our comments on the 2012 Draft Policies concern the "relative alignment" and "absolute alignment" included in the draft "Evaluation of Executive Pay (Management Say-on-Pay)" policy.

1. **Relative Alignment**

The ISS draft policy states:

> ***1. Relative Alignment –*** *Two factors are analyzed to determine the pay-performance alignment within a group of companies similar to the company in market cap, revenue (or assets), and industry*[(1)]*:*
>
> - *The degree of alignment between the company's TSR rank and the CEO's total pay rank within the peer group, as measured over one-year and three-year periods (weighted 40/60, to put more emphasis on the longer term);*
> - *The multiple of the CEO's total pay relative to the peer group median, which may identify cases where a high performing company may nevertheless be overpaying.*
>
> [(1)] *The peer group is generally comprised of 14-24 companies that are selected on the basis of market cap, revenue (or assets for financial firms), and GICS industry group, via a process designed to select peers that are closest to the subject company in terms of revenue/assets and industry and also within a market cap range that is reflective of the company's life cycle maturity phase*

We have two primary concerns:

(a) ***Peer Group Selection***. As we have discussed in the past, **we believe the use of GICS codes to select peer groups is not in the best interests of investors trying to understand relative performance**. The GICS codes were not created for this purpose and, to our knowledge, are not typically used by issuers, investors and consultants in executive compensation analysis. Granted, there have been times that ISS has departed from the strict use of GICS codes to select customized peer groups, including for Johnson & Johnson, a practice that we encouraged. However, doing so raises another issue for ISS to resolve that relates to the disclosure contained in ISS proxy reports. As you are aware, ISS has changed the peer group that it has applied to Johnson & Johnson numerous times in recent years. As an issuer, we understand the need for peer groups to change from time-to-time to adapt to changes in the marketplace. As such, **we suggest that ISS follow the following best practices that many large issuers follow when disclosing peer groups: (i) explain the quantitative and qualitative selection criteria, (ii) show the issuer's positioning within the peer group based on the quantitative criteria, (iii) show how each company in the peer group meets each qualitative criterion, and (iv) disclose the changes that were made to the peer group from the previous year and the reasons why those changes were made**. We believe following these best practices will not be unduly burdensome for ISS to implement and will enhance the disclosure about peer groups in ISS proxy reports. Clients will benefit from this enhanced disclosure and issuers will gain better insight into how ISS analyzes peer groups.

(b) ***TSR Rank vs. CEO Compensation Rank***. We are concerned that relying on straight comparisons of TSR rank to CEO compensation rank without accounting for other relevant facts and circumstances could lead to inaccurate analyses of pay versus performance. **Using this method alone, it is likely that CEOs who are (i) at the larger companies within the TSR comparison group, (ii) longer in tenure (either at the company or in the CEO position) than others in the TSR comparison group, and (iii) at companies that have defined benefits plans, will more often than not end up at the top of the compensation rank, regardless of TSR rank**, especially in industries with many medium-sized companies, but very few large companies.

2. **Absolute Alignment**

We are concerned that **ISS's continued comparison of actual TSR performance to the present value of long-term incentives on the date of grant (rather than using the actual pay an employee receives from the long-term incentives) artificially creates the appearance of a pay-for-performance disconnect**. Continuing to use these misaligned comparisons will be misleading to investors.

The ISS draft policy states:

2. ***Absolute Alignment** – this factor measures long-term alignment between pay and company performance, as:*

    - *Alignment between the trend in the CEO's pay and the company's TSRs over the prior five fiscal years – i.e., the difference between the slope of annual pay changes and the slope of annualized TSR changes during the prior 5-year period.*

In the past, the ISS has compared the present value of long-term incentives on the date of grant to actual TSR performance. There is no new definition of CEO pay in the draft policy. Thus, we can only assume that the ISS's definition of CEO pay has not changed.

We believe actual performance should be compared to actual pay – not to pay opportunity.

- TSR for a year is the actual return an investor who held the stock for the entire year (and reinvested the dividends) receives.
- The actual pay an employee receives from the long-term incentives depends on the performance of the company. The actual pay received from long-term incentives is largely dependent on the actual performance of the stock.
- The present value of long-term incentives on the date of grant measures the pay opportunity granted to an employee. The present value of long-term incentives on the date of grant is not the actual pay that a CEO, or any other employee, receives.

If the ISS continues to compare CEO pay using the present value of long-term incentives on the date of grant to actual TSR performance, one should expect low, or no, correlation. If the actual CEO pay is compared to actual TSR performance, one would see high correlation because of the use of stock-based long-term incentives.

We provide a simple hypothetical with good and poor TSR performance to illustrate this point:

- On January 1st, Executive X has options with a total intrinsic value of $10 million.
- On February 1st, Executive X exercises options for a pre-tax gain of $3 million.
- On March 1st, Executive X receives an option grant with a present value on the date of grant of $2 million.
- *Scenario 1 (Good TSR Performance):* TSR for the year is **positive** and on December 31st, Executive X has options with a total intrinsic value of $15 million.

- *Scenario 2 (Poor TSR Performance):* TSR for the year is **negative** and on December 31st, Executive X has options with a total intrinsic value of $5 million.

If ISS were to compare CEO pay using the present value of long-term incentives on the date of grant to actual TSR performance, the present value on the date of grant of $2 million would be compared to both Scenario 1's positive TSR and Scenario 2's negative TSR. This would imply a pay-for-performance disconnect, while ignoring what actually happened.

If actual pay is compared to actual performance, pay and performance are aligned. In Scenario 1 above, TSR is positive and the CEO's actual long-term incentive gains for the year totaled $8 million: $3 million of realized pre-tax gain from the options exercised on February 1st plus $5 million of unrealized gain from the increase in the total intrinsic value of his options from January 1st to December 31st ($10 to $15 million). In Scenario 2 above, TSR is negative and the CEO's actual long-term incentive gains for the year totaled ($2 million): $3 million of realized pre-tax gain from the options exercised on February 1st plus ($5 million) of unrealized losses from the decrease in the total intrinsic value of his options from January 1st to December 31st ($10 to $5 million).

* * * * *

Thank you again for soliciting comments on your 2012 policies. We hope they are helpful. Do not hesitate to call upon us should you wish to engage in further discussion about pay-for-performance analysis or other proxy voting policies for the upcoming annual meeting season.

Best regards,

Douglas K. Chia

cc: Martha Carter
Patrick McGurn
Carol Bowie
Kathryn Cohen
Marc Goldstein