ISS Policy Topic 1: Proposed Peer Group Methodology Summary

Policy Update:

The proposed peer group methodology maintains its focus on identifying companies that are reasonably similar to the subject company in terms of industry profile, size, and market capitalization. The proposed methodology incorporates information from companies' self-selected pay benchmarking peer groups in order to identify and prioritize GICS industry groups beyond the subject company's own GICS classification. The methodology draws peers from the subject company's GICS group as well as from GICS groups represented in the company's peer group, while maintaining the approximate proportions of these industries in the final peer group where possible. The proposed methodology additionally focuses initially at an 8-digit GICS resolution to identify peers that are more closely related in terms of industry. Finally, when selecting peers, the methodology prioritizes peers that maintain the company near the median of the peer group, are in the subject company's peer group, and that have chosen the subject company as a peer. Other proposed changes include using slightly relaxed size requirements, especially at very small and very large companies, and using revenue instead of assets for certain financial companies.

ISS Question 1: Are there additional or alternative ways that ISS should use the company's self-selected peer group to inform its peer group construction?

Our first comment is to note that Domtar's 2012 ISS Developed Peer Group and Proxy Peer Group only have 4 companies in common. From that point of view, we welcome the proposed approach. We also note that the ISS Developed Peer Group has companies that are not in the same industry – for example, AK Steel Holding Corp that manufactures stainless steel products is part of our ISS Developed Peer Group. Our view is that the ideal peer group to use for ISS analyses is the Proxy Peer group that we have carefully developed, using companies that we believe most closely resemble our peers in terms of competing for business and talent.

ISS proposal to incorporate the Proxy Peer Group as a natural starting point to create the ISS peer group is positive and will ensure a greater linkage between the two peer groups, which is important, since all of our programs are externally benchmarked to our Proxy Peer Group. Usage of significantly different peers may give different answers on topics like pay for performance, etc which may cause confusion with shareholders.

ISS Question 2: Since company size is highly correlated with levels of executive pay, what is a reasonable size range (revenue / assets) for peer group construction?

Yes we believe that the ½ to 2x revenue is a reasonable range. We don't use assets as a primary metric for peer group development, however, ½ to 2x appears to be a reasonable range for that metric. Anything outside of this band may merit further review to determine appropriateness based on facts / circumstances.

For Domtar, our Proxy Peer group includes one or two cases where revenues for the peer are 4 – 5x of Domtar. However, from a pure business and talent management standpoint, we would absolutely consider them peers, thus their inclusion. In addition, we employee regression analysis as part of our overall compensation methodology to take into account size issues, where warranted.

As such, in our view, as long as there are a reasonable number of peer companies (approx. 12 – 18) in the group, one or two size-related aberrations should not pose a problem.

ISS Question 3: Are there additional factors that investors should consider in peer group construction for pay-for-performance evaluation?

In our view, there are a couple of additional considerations in building an appropriate peer group:

- **Geographic footprint:** **Domtar has an increasingly global footprint and our view is that running global businesses presents challenges not necessarily faced by only-US or only-Canadian based companies. Recognizing the global (or at least North American) business scope versus single country scope is also a worthy consideration.**

- **Volatile Commodity Impact:** **Domtar is subject to significant commodity pricing impact (pulp prices). It would always be a consideration for Domtar to have peers that may have to contend with a similar level of input volatility. Input volatility may manifest in earnings volatility, etc, so having peers that may have similar challenges is useful from a comparability stand-point.**

- **Market Capitalization:** **Another indicator of size, similar to assets / revenue. Depending on the industry, may present challenges in terms of stock price volatility, but may be a good contextual metric to review when building peer groups.**

ISS Policy Topic 2: Realizable pay

Policy Update:

ISS is considering adding realizable pay in the qualitative review of the management say-on-pay for large cap companies. Realizable pay will consist of the sum of relevant cash and equity-based grants and awards made during a specified performance period being measured, based on equity award values for actual earned awards, or target values for ongoing awards, calculated using the stock price at the end of the performance measurement period. Realizable pay consideration may mitigate or exacerbate CEO's pay for performance concerns.

ISS Question 1: How would you define realizable pay?

We note that realized and realizable pay are starting to become top of mind for many companies. We have also had internal discussions around this topic. We have also conducted a "realized pay" analysis to use as an additional data point in reviewing executive compensation versus peers. We have not yet had fulsome dialogue on realizable pay and have not conducted the analysis yet, so it would be a bit premature for us to provide our thoughts on our preferred definition. However, we will offer up a few thoughts / comments as it relates to the calculation.

Above and beyond the change in stock price, how would ISS account for performance based awards? For example, Domtar awards PSUs that are contingent upon TSR and ROIC. As such, a "snapshot in time" analysis of "realizable equity" would need to reasonably take into account the fact that awards will not be realized if certain ROIC and TSR criteria are not met.

Realizable pay calculations also present another challenge – by definition, it is likely forward looking, while any performance analysis is backward looking. From that point of view, a *realized* pay analysis may provide shareholders with a better sense of true pay for performance linkage over a certain period.

We note that ISS' thought is to potentially include realizable pay as a qualitative factor in the CEO pay-for-performance assessment. Including it in the qualitative section may be a reasonable starting point so that companies can really understand how ISS thinks through realizable pay in the context of pay-for-performance.

We also note that ISS is thinking about including a comparison of realizable pay to grant pay in the qualitative assessment. We note that performance does not seem to be incorporated into the

realizable pay to grant pay equation. We understand that embedded in the realizable pay to grant pay calculation is a stock price increase / decrease calculation, but stock price is only one part of the broader performance equation for Domtar. For example, we place significant emphasis on EBITDA and ROIC, which may get lost in a realizable pay to grant pay analysis. Our initial reaction is that any analysis around realizable pay may be more helpful to stakeholders in the context of performance assessment of TSR as well as other key performance indicators, like EBITDA growth, etc.

In conclusion, realized and realizable pay are important emerging topics for compensation professionals as well as committees. As such, we are quite interested in how ISS crafts its policy in this regard.

ISS Question 2: Should stock options be considered based on intrinsic value or Black-Scholes value, and what is the rationale for your choice?

Again, it's a touch premature to provide too many thoughts on "realizable pay" but as it relates to *realized pay* the intrinsic value of a stock option is important, not the fair value. By the same token, for realizable *pay*, using intrinsic value may be a reasonable approach. The rationale for that is based on simplicity for shareholders, as intrinsic value is quite straightforward and intuitive to understand. It is also a fair depiction of "realizable pay" since stock options may be underwater and may not ever provide value to executives.

ISS Question 3: What should be an appropriate measurement period for realizable pay? One year, or three years, or five years or others?

Again, we caveat that it is a touch premature to provide detailed thoughts on the topic of realizable pay since we haven't flushed out the thinking internally. However, at a high level, a 3 – 5 year timeframe may be more appropriate than a 1 year timeframe. This allows multiple equity grants to be factored into any calculation, giving a more accurate depiction of trends, etc. Given that Domtar is in a particularly volatile industry that is highly levered to commodity prices, 3 – 5 years may present a more realistic view as it may incorporate both highs and lows. A 1 year timeframe may provide a distorted answer based on stock price volatility either on the up or downside.

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