HUGESSEN
CONSULTING

Memo

To: Institutional Shareholder Services Canada

From: Hugessen Consulting Inc

Date: October 31, 2012

Subject: Proposed Pay-for -Performance Methodology

Hugessen is a leading provider of independent executive compensation consulting advice to the boards and compensation committees of many large issuers in Canada and the United States. The proposed updates to ISS' 2013 proxy voting guidelines, issued October 16, 2012, have important ramifications for our clients and we are pleased to have the opportunity to provide our views.

We have reviewed the proposed updates to ISS' guidelines and wish to provide our comments on the proposed pay-for-performance methodology being considered for the Canadian marketplace. We support ISS' efforts to respond to concerns expressed by issuers and other market participants regarding its current pay-for-performance policy and believe that there are aspects of the proposed methodology that improve upon the existing approach, for example, the longer time frame used to assess the alignment of CEO compensation with company performance; however, we have several concerns with the proposed approach and methodology which we outline below with suggested alternatives.

This letter sets out three main areas that we believe need to be addressed: peer group challenges, engagement process and realizable versus grant date pay. Additionally, we have provided specific comments on ISS' qualitative analysis.

We also recommend that the improvements currently being considered for the pay-for-performance evaluation in the US be applied to Canada as well. Specifically, the inclusion of a company's proxy-disclosed peer groups for the quantitative tests and incorporation of an assessment of realizable pay as part of the qualitative analysis.

We note that, in our view, the draft guidelines do not provide sufficient detail to understand and comment in detail on the proposed methodologies. We encourage ISS to publish a more detailed document on the tests and guidelines, and seek a second round of comments.

Peer Group Challenges

Determining responsible and meaningful peer groups presents a significant challenge for the Boards of many Canadian issuers. Canada is a much smaller market than the United States, with many industries comprised of only a few players. We caution that ISS' desire to have at least 11 companies will cause challenges and in many situations will result in a peer group being less relevant. A second consequence of our smaller market is that a thoughtful process for determining peer groups to assess the competitive market for talent can lead to a significantly different result than a similar process to determine peer groups for assessing performance. Developing a reasonably large and stable reference group for assessing pay levels in many cases requires going beyond similar size, industry and nationality characteristics. The end result will vary by issuer, but may include a combination of:

- Organizations from multiple industries but with similar scope and complexity;
- Multiple peer groups, which may include a group of US peers, recognizing shortcomings in any one peer group;
- Including significantly larger or smaller organizations, while applying tools or judgment to recognize the size difference
    - Considerable use of informed judgment, considering the limitations of relevant data

In assessing relative performance (total shareholder return), industry and investment characteristics are of paramount importance. To this end, a performance peer group may sometimes include much larger or smaller organizations and/or non-Canadian companies. Often, there are trade-offs in terms of using a small, best-suited sample versus a larger sample including less relevant companies. Furthermore, there is judgment in terms of the ultimate suitability of relative total shareholder return given comparability challenges that may exist.

We would recommend that, as a starting point, ISS use issuers proxy-disclosed peer groups, including when different groups are used by the issuer for pay and performance. If ISS comes to the conclusion that an issuer's disclosed peer group(s) are deficient for a proper pay-for-performance analysis, then it can always revert to using its own custom-developed peer groups. ISS should then disclose an explanation for why it believes such an issuer's own peer group(s) are deficient.

Engagement

We view, on the whole, that Canadian boards have been very sensitive and responsive to shareholder issues. Significant improvements to governance structure and shareholder pay alignment have occurred as part of an ongoing dialogue between the issuers and shareholders (e.g., the engagement initiatives of the Canadian Coalition for Good Governance). Moreover, this process has aided in a common and accurate understanding of issues and information. We encourage ISS to engage in active dialogue with issuers as we believe that this is an effective way to promote change in areas of concern.

Most importantly, we stress the importance of providing issuers with the opportunity to review and comment on a draft ISS report before the report's final release. This will help to address issues concerning errors in content and/or analysis as well as lead to a more constructive relationship between ISS and issuers

Use of Grant Date Value

When valuing equity compensation, the proposed methodology looks only at intended grant date value. While the guideline recognizes that there are issues with this approach, the proposal does not attempt to overcome these limitations. We suggest that realizable or realized value, reflecting actual compensation over time, should be incorporated into the pay-for-performance assessment in some fashion.

If it is viewed that calculating realized and realizable pay is too cumbersome an analysis to complete for the full peer group (used in the Relative Degree of Misalignment test), it should at a minimum, be used for the "Pay-TSR Alignment" test. We believe that the change in realized and realizable pay (i.e. cash received annually (including any gains on option exercise and maturation of RSUs/PSUs) plus unrealized change in the value of outstanding equity) over five years provides a more accurate picture against which to compare the trend in a company's total shareholder return.

We note the change under consideration in the US, which would compare the realizable pay to grant date pay as part of the qualitative analysis. This represents an improvement that should be applied to Canada as well.

Qualitative Analysis

In addition to the factors listed in the proposal's qualitative evaluation component, we believe that ISS' analysts should consider that compensation committees own evaluation of pay-performance alignment. If a thoughtful analysis is disclosed in the proxy, the results of such an analysis should be considered. Moreover, consideration should be given to the realized and realizable equity position versus the grant date used in the quantitative test.

Finally, given the importance placed on total shareholder return, we recommend a deeper assessment of the suitability of this measure's ability to properly reflect performance over the periods in question. To this end, any disclosure by the issuer relating to the suitability of total shareholder return should be taken under consideration. We caution that the share price condition at the start of the measurement period impacts the measurement of total shareholder return over the period and may result in an inflated or deflated result. In addition, an issuer's total shareholder return may have more or less sensitivity to exogenous variables (e.g., industry conditions). Accordingly, we recommend that longer term views of relative total shareholder return should also be considered (e.g., five plus years).

We appreciate the opportunity to comment on the proposed guideline and would very much welcome the opportunity to discuss further.

HUGESSEN CONSULTING INC.