November 8, 2012

Global Policy Board
Institutional Shareholder Services Inc.
702 King Farm Boulevard
Suite 400
Rockville, MD 20850

Re: Comments on ISS Proposed 2013 Policy Updates

Dear Members of the Policy Board:

Meridian Compensation Partners, LLC ("Meridian") is pleased to provide the following comments to Institutional Shareholder Services, Inc. (ISS) on its proposed Policy Updates for 2013.

Meridian is one of the largest independent executive compensation consulting firms in North America. We provide trusted counsel to Boards and Management at hundreds of large public and private companies, consulting on executive compensation design issues, corporate governance matters and related disclosures. Our consultants have decades of experience in developing pay solutions that are responsive to shareholders, reflect good governance and align with company performance.

We support ISS's emphasis on performance-based pay and on the need for executive compensation to strongly correlate with company performance. We applaud ISS's approach to regularly examine its policies around pay for performance (as well as other matters), to survey the views of institutional shareholders, issuers, and advisors on significant compensation and governance matters and to solicit comments regarding proposed changes to its policies.

We have comments with regard to ISS's proposed U.S. Policy Updates on the following matters:

- Board response to majority-supported shareholder proposals;
- Development of peer groups under ISS's Pay-for-Performance Policy;
- Inclusion of "realizable pay" as a qualitative factor under ISS's Pay-for-Performance Policy;
- Inclusion of pledging of shares as a problematic pay practice;
- Say on Golden Parachute proposals; and
- Environmental and social non-financial performance compensation-related proposal.

ISS Proposed Policy Update: Board Response to Majority-Supported Shareholder Proposal

ISS Proposed Policy: Under its current policy, ISS recommends a vote AGAINST or WITHHOLD from the entire board of directors (except new nominees, who should be considered CASE-BY-CASE) if:

- The board failed to act on a shareholder proposal that received the support of a majority of the shares **outstanding** the previous year; or

- The board failed to act on a shareholder proposal that received the support of a majority of shares **cast** in the last year **and** one of the two previous years.

Under the proposed policy, ISS would recommend a vote AGAINST or WITHHOLD from the entire board (except new nominees, who would be considered CASE-BY-CASE) if the board failed to act on a shareholder proposal that received the support of a majority of shares **cast** in the previous year.

Meridian Comment: We believe shareholder proposals provide corporate boards and senior management critical information as to issues and topics that are important to shareholders. We also believe that where a shareholder proposal receives significant or majority support, corporate boards have an obligation to seriously evaluate the merits of implementing the proposal, in whole or in part. However, as a general matter, these votes are advisory and non-binding on corporate boards. A majority vote does not impart a fiduciary duty on board members to implement the shareholder-approved proposal. To the contrary, state law recognizes that a director's fiduciary duty is not defined by vote outcomes on shareholder proposals. In fact, a corporate board has the legal obligation ***not*** to implement an approved shareholder proposal if the implementation would not be in the best interests of shareholders.

We recommend that ISS's policy on board responsiveness should be revised to reflect the possibility that the implementation of a majority supported shareholder proposal may, in whole or in part, not always be in the best interests of shareholders. Accordingly, we recommend that ISS make the following two changes to its current policy:

- ISS will determine its vote recommendation CASE-BY-CASE on incumbent directors when a board fails to act on a shareholder proposal that received the support of a majority of shares **cast** in the previous year.
- In making its vote recommendation, ISS will consider the following factors:
  - — Any action taken by the board in lieu of fully implementing the proposal and the disclosed **rationale** for taking such action.
  - — The board's disclosed rationale for not implementing the proposal.
  - — The nature of the shareholder proposal.
  - — The number of times the proposal has received the majority support of shareholders.

ISS Proposed Policy Update: Determination of Peer Group

ISS Proposed Policy: Under its pay-for-performance policy, ISS proposes to modify the method for determining a subject company's peer group by initially drawing potential peers from the 8-digit GICS code of the subject company and from the 8-digit GICS code (or codes) represented in the company's proxy-disclosed peer group (subject to size constraints).

Meridian Comment: In its Policy Update, ISS presents statistics showing that the proposed methodology for developing a peer group yields greater comparability to a subject company's peer group than does the current methodology. Specifically, ISS notes that under its current methodology, 20% of companies have an ISS peer group that overlaps with at least 50% of their respective proxy-disclosed peer companies. In contrast, under it proposed methodology, 42% of companies would have an ISS peer group that overlaps with at least 50% of their respective proxy-disclosed peer companies and that, on average, an ISS peer group would contain 44% of a subject company's proxy-disclosed peer companies.

We believe ISS's proposed revision to its peer group methodology is a step in the right direction. However, the foregoing statistics show that material differences will remain between an ISS peer group and a subject company's peer group. These material differences undermine the transparency of the peer group selection process. In addition, the proposed methodology will likely lead to ISS peer groups including companies that are not comparable to the subject company. To avoid these issues, we recommend ISS consider adopting a peer group selection process largely centered on a subject company's proxy-disclosed custom peer group**,** but subject to ISS's standards for peer company size. In our experience with hundreds of major public companies, we have found board members take the peer group selection process seriously, and in so doing use appropriate criteria such as revenues, assets, market capitalization, industry, competitors for executive talent, relative financial and stock price performance, and other general and industry specific metrics. Accordingly, this process should be given great weight by external parties.

The results of ISS's recent policy survey largely support this approach. Only a minority of investors (15%) and issuers (2.1%) held the view that ISS's quantitative analysis of a subject company's executive compensation should be based solely on an ISS-developed peer group. Nearly 85% of investors and 98% of issuers held the view that this analysis should be based, in whole or in part, on a subject company's peer group. ISS's proposed peer group methodology appears to be a compromise among these views. However, investors and issuers clearly believe there is value in assessing a subject company's executive compensation against a company's proxy-disclosed peer group. The hybrid approach ISS is proposing would not appear to align with the express views of most investors and issuers.

We have the following additional comments on the proposed peer group methodology that we believe should apply whether or not ISS chooses to select peer companies primarily from a subject company's proxy-disclosed peer group:

- **Revenue/Asset Parameters**. We generally agree with ISS's approach to apply size parameters to identify potential peer companies. However, consistent with the approach employed by many compensation committees of large public companies, we recommend ISS expand its existing size parameters of 0.45 to 2.1 times a subject company's revenues (assets in the case of a financial services company) to at least one-third to three times a subject company's revenues (assets in the case of a financial services company). We also recommend that ISS expand its use of asset parameters beyond the financial services industries to other industries that typically use assets as a primary metric in developing peer groups. For example, due to the nature of their capital structure and business operations, companies that primarily operate in the upstream oil sector, typically known as exploration and production companies, generally develop their peer groups based on asset size.

- **Peer Group Median Revenues Relative to Subject Company Revenues**. Under both its current and proposed policies, ISS strives to develop a peer group with median revenues approximately equal to the revenues of the subject company. ISS notes in its policy update that the proposed policy change would result in over 90% of ISS peer groups with median revenues within 20% of the subject company's revenues. This 20% range should be tightened somewhat to no more than 10% to minimize skewing of quantitative results due to the inclusion of outlier peer companies, especially given the fact that ISS does not apply regression analysis to mitigate size differences between peer companies and the subject company.

- **Peer Group Transparency**. Under its proposed policy, ISS will draw potential peer companies initially from a subject company's 8-digit GICS code **and from the 8-digit GICS codes represented in the company's proxy-disclosed peer companies** (emphasis added). The use of multiple GICS codes from which to draw potential peer companies would make it nearly impossible for a subject company to independently replicate its ISS peer group. This will deny companies the important opportunity to evaluate their CEO pay for performance under ISS's quantitative tests. Accordingly, we believe that

ISS should move to a more formulaic process for determining peer groups that each company can use to identify its own peer group as early in the year as possible. Alternatively, ISS could release its peer set for individual issuers well in advance of the full ISS report.

ISS Proposed Policy Update: Expansion of Qualitative Factors

ISS Proposed Policy: If the quantitative tests performed under ISS's Pay-for-Performance Policy find that a significant pay misalignment exists, ISS would then perform a qualitative assessment taking into consideration six qualitative factors to determine whether a subject company's pay practices mitigate or facilitate the misalignment. When the qualitative assessment shows that the misalignment is facilitated by company pay practices, ISS will likely recommend an AGAINST vote on a company's Say on Pay proposal.

ISS proposes to expand this list of qualitative factors to include a comparison of an executive's "realizable pay" and granted pay for large cap companies. "Realizable pay" is determined as follows:

A CEO's 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.

Meridian Comment: We agree with the proposal to expand the list of qualitative measures to include a comparison of realizable pay and granted pay. Realizable pay is a useful way to measure the relationship between a CEO's compensation and company performance as it takes into account post-grant changes in stock price. ISS's proposed definition of realizable pay expressly includes both earned equity awards and the target values of outstanding long-term cash and equity awards. However, it is unclear how ISS's definition would work in application, especially with respect to time-vested stock options and restricted stock. Further, the inclusion of "target values" does not logically relate to realizable pay as it represents a potential payout opportunity that may bear little to no resemblance to actual performance.

We suggest ISS define realizable pay to mean the sum of the following components of pay:

- Annual bonus and non-equity incentive payouts within the last three fiscal years;
- The in-the-money value of any outstanding stock option/SAR awards that were granted within the last three fiscal years; and
- The fair market value of performance shares and any outstanding restricted shares/restricted stock units that vested at any time during the last three fiscal years (fair market value is determined as of the date vested).

The proposed Policy Update limits ISS's consideration of realizable pay to "large cap" companies. Although the term "large cap" is not defined, we infer this to mean component companies of the Standard & Poor's 500 index. However, we believe it would be beneficial to investors and consistent with ISS's application of its quantitative pay-for-performance tests, for ISS to consider realizable pay for all Russell 3000 companies.

We further suggest that realizable pay (in lieu of granted pay) be used to determine a CEO's total pay for purposes of applying the quantitative tests under ISS's Pay-for-Performance Policy. As we have suggested in the past, realizable pay is a more appropriate measure than granted pay for purposes of demonstrating whether a reasonable relationship exists between pay and performance.

ISS Proposed Policy Update: Expansion of Problematic Pay Practices to Include Pledging of Company Shares

ISS Proposed Policy: Currently, ISS does not characterize the pledging of company shares by executive officers and directors as an egregious or problematic pay practice. Under the proposed policy, pledging of company shares would be added to the list of egregious pay practices. This means that the pledging of company shares by officers or directors, standing alone, may warrant an ISS vote recommendation AGAINST a company's Say on Pay proposal.

Meridian Response: We agree with ISS's position that pledging of company shares by officers and directors could prove problematic under certain circumstances. However, we do not believe that pledging of company shares rises to the level of an egregious pay practice which, standing alone, would warrant a vote recommendation by ISS AGAINST a company's Say on Pay proposals. We recommend that pledging of company shares be considered a problematic pay practice that ISS considers as part of its holistic review of a company's executive pay programs. Where NEOs or directors have pledged company shares, we recommend that ISS consider as a mitigating factor the existence of an anti-hedging policy that specifically precludes officers and directors from future pledging of company shares in order to affect an economic hedge.

We also recommend that ISS limit any policy on pledging to shares acquired under a company's equity compensation plans. Given the compensatory nature of these shares, ISS has a reasonable basis to extend its policies on compensation practices to the pledging of such shares. However, no such basis exists with respect to company shares acquired by officers and directors outside of a company's equity plan (e.g., shares purchased on the open market or founder shares held since prior to the date of a company's initial public offering). These shares are not compensatory in nature but represent an officer's or director's private investment decision. Therefore, these shares should not be covered under ISS policies on executive compensation. Moreover, an extension of ISS pay policies to the pledging of such shares could have the undesirable effect of discouraging officers and directors from investing in their **companies'** shares.

ISS Proposed Policy Update: Say on Golden Parachute Proposals

ISS Proposed Policy: ISS is proposing to update its current policy on Say on Golden Parachute proposals to: (i) include existing change-in-control arrangements maintained with named executive officers rather than focusing primarily on new or materially amended agreements; and (ii) place further scrutiny on multiple legacy problematic features in golden parachute agreements.

Meridian Comment: ISS's existing policy on Say on Golden Parachute proposals is defensible and balanced. However, the proposed policy to cover legacy change-in-control agreements (and provisions) is inherently unfair to issuers. Many of these agreements have been in effect for years and may not be modified without the consent of the covered executive. ISS's proposed policy change may have the unintended consequence of forcing companies to provide monetary consideration to an executive in exchange for the executive's consent to modify an existing agreement to comply with the new policy. By changing its policy on Say on Golden Parachute proposals to cover these agreements, ISS is in essence changing the rules in the middle of the game. It is unrealistic to expect companies to unwind these agreements to comply with ISS's new rules. Moreover, shareholders already have an opportunity to express their views on existing golden parachutes through annual Say on Pay voting. Therefore, we are recommending that ISS not revise its current policy on Say on Golden Parachute proposals.

ISS Proposed Policy Update: Environmental and Social Non-Financial Performance Compensation-Related Proposal

Proposed Policy: Under its current policy**,** ISS generally recommends shareholders vote **AGAINST** proposals to link, or report on linking, executive compensation to environmental and social criteria such as corporate downsizings, customer or employee satisfaction, community involvement, human rights, environmental performance or predatory lending. Under the proposed policy, ISS would vote **CASE-BY-CASE** on proposals to link, or report on linking, executive compensation to sustainability (environmental and social) criteria taking into account various subjective factors.

Meridian Comment: We support ISS's current policy with regard to shareholder proposals linking executive compensation to sustainability criteria. Implicit in ISS's current policy is the recognition that the setting of performance metrics should remain the sole province of corporate boards and that shareholders do not have a role in micromanaging pay programs. The power of boards to determine appropriate performance metrics (as well as all other aspects of executive pay) is balanced by shareholders' ability to voice concerns on overall pay policies and practices through say on pay. We believe this represents a reasonable balance between the roles of corporate boards and shareholders on executive pay matters. We do not believe circumstances have changed to alter this balance. Therefore, we recommend that ISS not adopt the proposed changes to its policy on shareholder proposals linking performance metrics with sustainability goals.

Other ISS Policies on Executive Compensation

We have comments on the following additional ISS policies on executive compensation: (i) ISS's engagement with issuers; (ii) ISS's method for valuation of stock option grants; (iii) ISS's qualitative assessment of the "rigor of performance goals" used by an issuer; and (iv) ISS's GRId evaluation of change-in-control severance payments based on salary and target bonus.

- **ISS's Engagement with Issuers**. We support ISS's ongoing efforts to engage issuers on a broad range of proxy matters including executive compensation and to identify opportunities to enhance this engagement. Issuer engagement and input serves to increase the transparency of ISS's proxy voting policies and understanding of those policies by issuers. One area of engagement that clearly could be improved involves ISS's practice of providing advance draft copies of its proxy research reports to companies that are components of the Standard & Poor's 500 index.

  Under current policy, these companies have up to 48 hours to review and provide comments to ISS on factual errors and discrepancies that may be found in their respective proxy research reports. Our clients often raise concerns that the current 48-hour period clearly does not provide them sufficient time to review and analyze their proxy research reports, identify factual errors and discrepancies, and report on these matters to ISS. Based on this feedback, we suggest ISS lengthen the review period to 96 hours from 48 hours. The additional 48 hours should provide companies with more adequate time to review their proxy research reports, including legal, finance and human resource functions involved in proxy preparation and review. It is clearly in the interests of shareholders and issuers that ISS's conclusions and vote recommendations contained in proxy research reports are based on company-specific information that is true and accurate.

  Companies not part of the Standard & Poor's 500 index are currently not given a similar opportunity to review draft copies of their respective proxy research reports. We believe it would be beneficial to issuers and the investing community for ISS to expand its draft review policy to include the component companies of the Russell 3000 index. The Russell 3000 index covers companies that represent approximately 98% of the investable U.S. equity markets. By focusing its quantitative evaluation under its Pay-for-Performance Policy to Russell 3000 companies, ISS has already recognized the importance of these companies. Therefore, expanding the draft review policy to cover these companies is complementary to ISS's existing policies and is consistent with ISS's objectives in developing appropriate vote recommendations on factually accurate company-specific information.

- **Valuation of Stock Option Grants**. Under its current policy, ISS utilizes the Black-Scholes Option Pricing Model to determine the "fair value" of stock options granted to CEOs. This fair value is used, in part, to determine a CEO's total pay for purposes of ISS's Pay-for-Performance evaluation. The Black-Scholes Option Pricing Model requires the input of multiple factors. One factor is the expected life of the stock option. ISS assumes the expected life of an option granted to a CEO will be its full term (typically 10 years). In contrast, some compensation committees review the size of an option grant based on its fair value as determined under applicable accounting standards. These standards require a company to determine and use the estimated expected life of an option grant for determining its fair value. Generally, estimated expected life ranges from 4.5 to 6.5 years. The difference in the expected life assumptions results in the fair value of an option grant generally being substantially greater under the current ISS valuation approach than under the approach typically used by compensation committees. It is important to note that proxy-reported values of stock option grants are also based on the accounting standards valuation approach, as required under the current disclosure rules.

  In determining CEO total pay, we recommend that ISS use the proxy-disclosed fair value of CEO option grants. This would be consistent with the approach taken by most compensation committees of large companies for determining the appropriate size of stock option awards. The transparency of ISS's determination of CEO total pay would also be enhanced by using proxy-disclosed values. Institutional investors and analysts are very familiar with and understand this method of determining option values.

- **Qualitative Measure under Pay-for-Performance Evaluation—Rigor of Performance Goals**. If a company registers a significant pay-for-performance misalignment under ISS's quantitative assessments, the company's pay practices would be subject to evaluation under several qualitative factors. One factor is the "rigor of performance goals." Our clients have found this factor to be ambiguous, which makes compliance problematic. No reasonable standard exists against which to evaluate the "rigor" of a company's performance goals. Performance goals are unique to each company and are based, in part, on proprietary and confidential business strategies and tactics that are not accessible by ISS. Goal setting is a dynamic process and one where informed business judgments need to be made by both senior management and the board on a regular basis. For these reasons, we believe that ISS should completely drop the "rigor of performance goals" qualitative factor. If ISS continues to maintain this qualitative factor, then we recommend ISS provide expansive and detailed guidance as to how it will determine whether a performance goal is "rigorous" or not.

- **Change-in-Control Severance Payments Based on Salary and Target Bonus**. Question #C7.5 of GRId 2.0 asks for the basis upon which change-in-control severance payments for the CEO are calculated. The range of answers includes salary and target bonus. The rationale for the question expressly states that "payment based on target or actual bonuses is acceptable." However, under ISS's scoring approach, change-in-control severance payments based on salary and target bonus will register a "small level of concern." This concern level results in a red arrow on the abbreviated GRId report appearing in a company's ISS proxy research report. In contrast, the use of actual bonus in the determination of change-in-control severance payments will register a neutral concern.

The GRId scoring for the use of target bonus does not appear to reflect its “acceptable” status expressed by ISS. We recommend that ISS revise the scoring of target bonus to neutral concern from small concern. This would be consistent with the scoring for actual bonus which is also characterized as acceptable by ISS. Further, this would reflect the widespread use of target bonus in determining change-in-control payments. The Meridian 2011-2012 Study of Executive Change-in-Control Arrangements shows that over 50% of major public companies (all of which are component companies of the Standard & Poor’s 500 index) used salary plus target bonus to determine change-in-control severance payments, which results in more appropriate and predictable severance outcomes for executives who are terminated following a change in control of the enterprise.

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As we previously stated, we strongly support ISS’s emphasis on performance-based pay and on the need for executive compensation to correlate with company performance. We also support ISS’s view that boards need to be responsive to shareholder concerns. Although we have recommended certain changes to ISS’s Policy Updates, we believe our changes are consistent with these ISS objectives.

Sincerely,

Meridian Compensation Partners, LLC

Donald G. Kalfen, Partner