U.S. Corporate Governance Policy

2013 Updates

November 16, 2012

Institutional Shareholder Services Inc.
ISS' U.S. Corporate Governance Policy
2013 Updates

Effective for Meetings on or after Feb. 1, 2013
Updated Nov. 16, 2012

Table of Contents

INTRODUCTION ................................................................................................................................................................... 3

BOARD................................................................................................................................................................................. 4

Voting on Director Nominees in Uncontested Elections....................................................................................................... 4

Board Responsiveness – Governance Failures .......................................................................................................................... 4
Board Responsiveness – Majority Supported Shareholder Proposals ...................................................................................... 5
Director Competence - Attendance at Board and Committee Meetings ................................................................................. 6
Director Competence - Overboarded Directors ...................................................................................................................... 8

Categorization of Directors.................................................................................................................................................. 8

2013 ISS Categorization of Directors..................................................................................................................................... 10

COMPENSATION ................................................................................................................................................................ 13

Pay-for-Performance Evaluation ........................................................................................................................................... 13

Voting on Golden Parachutes in an Acquisition, Merger, Consolidation, or Proposed Sale ................................................ 15

SOCIAL/ENVIRONMENTAL ISSUES ..................................................................................................................................... 18

Global Approach................................................................................................................................................................ 18
Environmental, Social, and Governance (ESG) Compensation-Related Proposals .............................................................. 19

Lobbying............................................................................................................................................................................ 20

DISCLOSURE/DISCLAIMER ................................................................................................................................................. 21
INTRODUCTION

Each year, ISS’ Global Policy Board conducts a robust and transparent global policy formulation process which culminates in benchmark guidelines to be used in its proxy voting research for the upcoming year. To that end, ISS is pleased to announce its 2013 Global Policy Updates.

The complete set of ISS Global Benchmark Policy Guidelines consider market-specific recommended best practices, transparency, and disclosure when addressing issues such as board structure, director accountability, corporate governance standards, executive compensation, shareholder rights, corporate transactions, and social/environmental issues. The updates contained in this document reflect changes to regional proxy voting policies. These changes are based on significant engagement and outreach with multiple constituents in the corporate governance community, along with a thorough analysis of regional regulatory changes, best practices, voting trends, and academic research.

The 2013 policy updates are grouped by region, including separate documents that specifically address US, Europe, Canada, and International policy changes. Highlights and key changes for the upcoming year include:

- Pay for Performance Evaluation, including peer groups and realizable pay (US)
- Board Responsiveness to Majority Supported Proposals (US)
- Pledging of Company Stock (US)
- Pay for Performance Evaluation, including quantitative and qualitative factors (Canada)
- Voto di Lista (Italy)
- Overboarded Directors (Hong Kong and Singapore)
- Board Tenure (Hong Kong and Singapore)
- Director Nominee Disclosure (Global)

In addition to creating the updates to ISS’ Global Policies, the ISS Research team collaborates with over 400 custom clients to ensure that their voting policies reflect their voting philosophy and are updated to take into account trends, practices, and regulatory changes in each market in which they invest.

The full text of the updates, along with detailed results from the Policy Survey, as well as comments received during the open comment period, are all available on ISS' Web site under the Policy Gateway.

The ISS 2013 Global Policy Updates will be effective for meetings on or after February 1, 2013. ISS will release revised Frequently Asked Questions (FAQ) documents in December 2012 that provide additional guidance related to some of the new policies.

This document presents the changes being made to ISS’ Benchmark U.S. Corporate Governance Policies. If you have any questions, please contact the Research Helpdesk at 301-556-0576 or usresearch@issgovernance.com.
BOARD

Corporate Governance Issue:
Voting on Director Nominees in Uncontested Elections

Board Responsiveness – Governance Failures

Current Recommendation: Under extraordinary circumstances, vote AGAINST or WITHHOLD from directors individually, committee members, or the entire board, due to:

- Material failures of governance, stewardship, risk oversight, or fiduciary responsibilities at the company;
- Failure to replace management as appropriate; or
- Egregious actions related to a director’s service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

Key Change: Indicating by footnote that hedging of company stock and significant pledging of company stock by directors and/or executives are considered failures of risk oversight.

New Recommendation: Under extraordinary circumstances, vote AGAINST or WITHHOLD from directors individually, committee members, or the entire board, due to:

- Material failures of governance, stewardship, risk oversight, or fiduciary responsibilities at the company;
- Failure to replace management as appropriate; or
- Egregious actions related to a director’s service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

Rationale for Update:

Hedging is a strategy to offset or reduce the risk of price fluctuations for an asset or equity. Stock-based compensation or open market purchases of company stock should serve to align executives’ or directors’ interests with shareholders. Therefore, hedging of company stock through covered call, collar, or other derivative transactions sever the ultimate alignment with shareholders’ interests. Any amount of hedging will be considered a problematic practice warranting a negative voting recommendation.

Pledging of company stock at any amount as collateral for a loan is not a responsible use of equity. Pledging of company stock as collateral for a loan may have detrimental impact on shareholders if the officer or director is forced to sell company stock, for example, to meet a margin call. The forced sale of significant company stock may negatively impact the company's stock price, and may also violate company insider trading policies. In addition, pledging of shares may be utilized as part of hedging or monetization strategies that would potentially immunize an executive against economic exposure to the company’s stock, even while maintaining voting rights. In ISS’ 2012-2013 policy survey, 49 percent and 45 percent of institutional and issuer respondents, respectively, indicated that any pledging of shares by executives or directors is significantly problematic. Only 13 percent and 20 percent of institutional investors and issuers, respectively, responded that pledging is not a concern for them. Therefore, both investors and issuers view pledging of company shares as a problematic practice.

In determining vote recommendations for election of directors of companies who currently have executives or directors with pledged company stock, the following factors will be considered:

- Presence in the company’s proxy statement of an antipledging policy that prohibits future pledging activity;

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2 Examples of failure of risk oversight include, but are not limited to: bribery; large or serial fines or sanctions from regulatory bodies; significant adverse legal judgments or settlements; hedging of company stock; or significant pledging of company stock.
• Magnitude of aggregate pledged shares in terms of total common shares outstanding or market value or trading volume;
• Disclosure of progress or lack thereof in reducing the magnitude of aggregate pledged shares over time;
• Disclosure in the proxy statement that shares subject to stock ownership and holding requirements do not include pledged company stock; and
• Any other relevant factors.

Board Responsiveness – Majority Supported Shareholder Proposals

Current Recommendation: 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;
• 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.

Key Changes:

• Start using a majority of shares cast in one year as the trigger to evaluate a company’s response to majority supported shareholder proposals;
• Include the flexibility to recommend against members of the board as deemed appropriate, not necessarily the full board; and
• Include more guidance on the case-by-case examination of the sufficiency of a company’s action in response to a majority-supported shareholder proposal.

Transition Rule: The one-year votes cast requirement will commence with shareholder proposals appearing on companies’ ballots in 2013.

New Recommendation: Vote AGAINST or WITHHOLD from individual directors, committee members, or the entire board of directors as appropriate if:

• For 2013, the board failed to act on a shareholder proposal that received the support of a majority of the shares outstanding the previous year;
• For 2013, 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.
• For 2014, the board failed to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year.

2 Responding to the shareholder proposal will generally mean either full implementation of the proposal or, if the matter requires a vote by shareholders, a management proposal on the next annual ballot to implement the proposal. Responses that involve less than full implementation will be considered on a case-by-case basis, taking into account:

• The subject matter of the proposal;
• The level of support and opposition provided to the resolution in past meetings;
• Disclosed outreach efforts by the board to shareholders in the wake of the vote;
• Actions taken by the board in response to its engagement with shareholders;
• The continuation of the underlying issue as a voting item on the ballot (as either shareholder or management proposals); and
• Other factors as appropriate.

ISS will be releasing an FAQ document in December 2012 for further guidance related to the new policy.
Rationale for Update: The marketplace has been evolving in the matter of board responsiveness to majority-supported shareholder proposals, in both institutional investors’ expectations and in the actual responsiveness by issuers. ISS’ 2012-2013 Policy Survey results show that 86 percent of the institutional investor respondents expect that the board should implement a shareholder proposal that receives support from a majority of shares cast in the previous year. Almost half (47 percent) of issuer respondents agreed with that view as well. Issuers have been increasingly responding to shareholder proposals that received only one year of a majority of votes cast: in 2010, 37 percent of the proposals that received only one year of a majority of votes cast in 2009 were implemented (an additional 18 percent received a partial response); whereas in 2012 thus far, 50 percent have been implemented (an additional 6 percent have been partially implemented).

In response to comments received concerning this new policy, ISS will commence the application of this new policy of one year of share cast standard on proposals appearing on companies’ ballots in 2013 (and thus look for the companies’ responses in 2014). It will not be applied on proposals that received only one year of shares cast in 2012. The current policy of two years of cast or one year of shares outstanding will apply to those proposals for the ISS vote recommendations to be made in 2013.

Director Competence - Attendance at Board and Committee Meetings

Current Recommendation: Vote AGAINST or WITHHOLD from the entire board of directors (except new nominees, who should be considered CASE-BY-CASE) if:

- The company’s proxy indicates that not all directors attended 75 percent of the aggregate board and committee meetings, but fails to provide the required disclosure of the names of the director(s) involved.

Generally vote AGAINST or WITHHOLD from individual directors who:

- Attend less than 75 percent of the board and committee meetings (with the exception of new nominees).

Acceptable reasons for director absences are generally limited to the following:

- Medical issues/illness;
- Family emergencies; and
- Missing only one meeting.

These reasons for directors’ absences will only be considered by ISS if disclosed in the proxy or another SEC filing. If the disclosure is insufficient to determine whether a director attended at least 75 percent of board and committee meetings in aggregate, vote AGAINST or WITHHOLD from the director.

Key Changes: Inclusion of the term “period of service”; rearrangement of the policy from group vs. individual withhold recommendations to distinct policies for poor attendance vs. unclear/insufficient attendance disclosure.

New Recommendation:

- Generally vote AGAINST or WITHHOLD from directors (except new nominees, who should be considered CASE-BY-CASE) who attend less than 75 percent of the aggregate of their board and committee meetings for the period for which they served, unless an acceptable reason for absences is disclosed in the proxy or another SEC filing.

Acceptable reasons for director absences are generally limited to the following:

- Medical issues/illness;

For new nominees only, schedule conflicts due to commitments made prior to their appointment to the board are considered if disclosed in the proxy or another SEC filing.
o Family emergencies; and
o Missing only one meeting (when the total of all meetings is three or fewer).

- If the proxy disclosure is unclear and insufficient to determine whether a director attended at least 75 percent of the aggregate of his/her board and committee meetings during his/her period of service, vote AGAINST or WITHHOLD from the director(s) in question.

Rationale for Update:
Investors expect directors to attend their board and committee meetings; poor attendance is a primary reason directors receive majority withhold or against votes.

For exchange-listed companies, the SEC requires the following disclosure:
Item 407(b) Board meetings and committees; annual meeting attendance. (1) State the total number of meetings of the board of directors (including regularly scheduled and special meetings) which were held during the last full fiscal year. Name each incumbent director who during the last full fiscal year attended fewer than 75 percent of the aggregate of:

i. The total number of meetings of the board of directors (held during the period for which he has been a director); and
ii. The total number of meetings held by all committees of the board on which he served (during the periods that he served).

Institutional investors expect the same disclosure from all companies. Note that disclosure is only required if any director did not meet the threshold; if all nominees met the threshold, no disclosure is needed. The disclosure requirements are clear, and the director attendance record should be a straightforward and simple disclosure in the proxy. Although the SEC disclosure rules have not changed, over recent years the incidences of unclear attendance disclosures have been increasing.

Examples of deviations from the required disclosure include, but are not limited to:

- Not naming the director(s) who failed to meet the threshold attendance;
- Using a threshold of less than 75 percent;
- Using a threshold greater than 75 percent and reporting that a director did not achieve that threshold;
- Excluding special meetings from total meetings;
- Reporting attendance separately for regular vs. special meetings;
- Boosting the attendance records by including actions by written consents in total meetings;
- Reporting average attendance instead of threshold attainment;
- Reporting aggregate board and aggregate committee attendance instead of the overall aggregate; and
- For directors who served for only part of a year, reporting attendance based on the full fiscal year rather than the period served.

Given the importance institutional investors place on director attendance, company disclosures in this area should be clear as to whether a director attended 75 percent of the total of his or her board and committee meetings for the period served. The updated policy takes a stronger approach by recommending a withhold or against vote on any director whose attendance is questionable due to unclear and insufficient attendance disclosure.

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5 http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=ddff06bb856f3e795de4ae8e3255c8eb6&rgn=div8&view=text&node=17:2.0.1.11.5.31.7&dfto=17
Director Competence - Overboarded Directors

**Current Recommendation:** Vote AGAINST or WITHHOLD from individual directors who:

- Sit on more than six public company boards; or
- Are CEOs of public companies who sit on the boards of more than two public companies besides their own—withhold only at their outside boards.

**Key Change:** Previously, a parent company and any subsidiary company owned at least 20 percent by the parent were counted as a single board under the overboarded policy. All subsidiary boards will now be counted as separate boards.

**New Recommendation:** Vote AGAINST or WITHHOLD from individual directors who:

- Sit on more than six public company boards; or
- Are CEOs of public companies who sit on the boards of more than two public companies besides their own—withhold only at their outside boards.

**Rationale for Update:** Currently, as described in our 2012 Audit/Board FAQs, when ISS is counting the boards for the overboarded policy, the following rules apply:

We include: publicly traded companies (including non-U.S. companies) and mutual fund families. Disclosure permitting, we do not include: subsidiaries or the parent of the company (where ownership by the parent is 20 percent or more), non-profit organizations, universities, advisory boards, and private companies. Mutual funds are rolled up to mutual fund families, with one family counting as one board. Also, if service on another board is a required duty of the officer (e.g., as part of a joint marketing agreement), that board will not be counted.

In our update for 2013, ISS is no longer going to count publicly traded subsidiaries owned 20 percent or more by the parent as one board with the parent company. Rather, all subsidiaries with publicly traded stock will be counted as boards in their own rights. (Subsidiaries that only issue debt will not count.) Mutual funds will continue to be rolled up to the mutual fund families, and non-profit organizations, universities, advisory boards, and private companies will continue not to be counted.

The policy application change, as reflected in the new footnote, is that although all of a CEO’s subsidiary boards will be counted as separate boards, ISS will not recommend a withhold vote from the CEO of a parent company board or any of the controlled (>50 percent ownership) subsidiaries of that parent, but will do so at subsidiaries that are less than 50 percent controlled and boards outside the parent/subsidiary relationships. Our Frequently Asked Questions document to be released in December 2012 will be updated accordingly.

This counting of all subsidiary boards as separate boards is in accordance with the investor sentiment expressed in our 2012-2013 Policy Survey and is a major step in the harmonization of ISS policies applied around the globe on overboarded directors.

Corporate Governance Issue:

**Categorization of Directors**

**Current Categorization:**

1. **Inside Director (I)**
   1.1. Employee of the company or one of its affiliates.
   1.2. Among the five most highly paid individuals (excluding interim CEO).

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^6 A CEO's “own board” includes boards of controlled subsidiaries and affiliates.
1.3. Listed as an officer as defined under Section 16 of the Securities and Exchange Act of 1934 ("Section 16 officer").
1.4. Current interim CEO.
1.5. Beneficial owner of more than 50 percent of the company's voting power (this may be aggregated if voting power is distributed among more than one member of a defined group).

Key Changes:

- Moving the consideration of director compensation to Affiliated Outside Director from Inside Director;
- Expanding interim CEO to include other interim officers;
- Including non-executive directors named in the Summary Compensation Table due to the material nature of their compensation in the definition of Insider Director.

New Categorization:

1. **Inside Director (I)**
   1.1. Current employee or current officer of the company or one of its affiliates.
   1.2. Beneficial owner of more than 50 percent of the company's voting power (this may be aggregated if voting power is distributed among more than one member of a group).
   1.3. Director named in the Summary Compensation Table (excluding former interim officers).

Rationale for Update: ISS is starting to simplify the categories of directors, starting with the definition of Inside Director. Directors will be considered Inside Directors if they are currently employed or are officers of the company, or, if they control 50 percent of the voting power of the company.

Also, although only Named Executive Officers are normally included in the Summary Compensation Table, sometimes companies will include non-executive directors in the table because of the material nature of their compensation. (For example, see page 36 of Ashford Hospitality Trust's 2012 proxy: [http://www.sec.gov/Archives/edgar/data/1232582/0001193132512157030/d328182ddef14a.htm#tx328182_42](http://www.sec.gov/Archives/edgar/data/1232582/0001193132512157030/d328182ddef14a.htm#tx328182_42))

Any director thus named in the Summary Compensation Table will be categorized as an Inside Director.

As any person who served in the CEO or CFO position for any part of the fiscal year is required to be included in the Summary Compensation Table, directors who served a portion of the year as an interim officer (but are no longer in that position) are carved-out. Although it is a more common occurrence that an independent director steps into the role of CEO on an interim basis while the board is searching/deciding on a new CEO, there have been instances where board members have stepped into other officer positions on an interim basis, such as CFO. Directors serving as interim officers are considered Inside Directors while serving in that capacity, and are generally considered Independent Outside Directors immediately upon their stepping out of that position, unless the length of service and terms of their agreements indicate their position may not have been truly interim (see item 2.4 in the table).

Director compensation will continue to be an item for examination as a potential impediment on director independence, but it will be under the Affiliated Outside Director category (item 2.18: Any material relationship with the company.)

Please see the new Categorization of Directors table for 2013 below:
# 2013 ISS Categorization of Directors

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<tbody>
<tr>
<td>1</td>
<td><strong>Inside Director (I)</strong></td>
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<td></td>
<td>1.1. Current employee or current officer(^i) of the company or one of its affiliates(^ii).</td>
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<td></td>
<td>1.2. Beneficial owner of more than 50 percent of the company’s voting power (this may be aggregated if voting power is distributed among more than one member of a group).</td>
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<td></td>
<td>1.3. Director named in the Summary Compensation Table (excluding former interim officers).</td>
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<td></td>
<td><strong>Affiliated Outside Director (AO)</strong></td>
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<td><strong>Board Attestation</strong></td>
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<td>2.1. Board attestation that an outside director is not independent.</td>
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<td><strong>Former CEO/Interim Officer</strong></td>
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<td>2.2. Former CEO of the company (^iii/iv).</td>
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<td>2.3. Former CEO of an acquired company within the past five years(^iv).</td>
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<td>2.4. Former interim officer if the service was longer than 18 months. If the service was between 12 and 18 months an assessment of the interim officer’s employment agreement will be made(^v).</td>
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<td></td>
<td><strong>Non-CEO Executives</strong></td>
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<td>2.5. Former officer(^i) of the company, an affiliate (^ii) or an acquired firm within the past five years.</td>
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<td>2.6. Officer(^i) of a former parent or predecessor firm at the time the company was sold or split off from the parent/predecessor within the past five years.</td>
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<td>2.7. Officer(^i), former officer, or general or limited partner of a joint venture or partnership with the company.</td>
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<td><strong>Family Members</strong></td>
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<td></td>
<td>2.8. Immediate family member(^vi) of a current or former officer(^i) of the company or its affiliates(^ii) within the last five years.</td>
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<td>2.9. Immediate family member(^vi) of a current employee of company or its affiliates(^ii) where additional factors raise concern (which may include, but are not limited to, the following: a director related to numerous employees; the company or its affiliates employ relatives of numerous board members; or a non-Section 16 officer in a key strategic role).</td>
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<td><strong>Transactional, Professional, Financial, and Charitable Relationships</strong></td>
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<td>2.10. Currently provides (or an immediate family member(^vi) provides) professional services(^vii) to the company, to an affiliate(^ii) of the company or an individual officer of the company or one of its affiliates in excess of $10,000 per year.</td>
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<td>2.11. Is (or an immediate family member(^vi) is) a partner in, or a controlling shareholder or an employee of, an organization which provides professional services(^vii) to the company, to an affiliate(^ii) of the company, or an individual officer of the company or one of its affiliates in excess of $10,000 per year.</td>
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<td>2.12. Has (or an immediate family member(^vi) has) any material transactional relationship(^viii) with the company or its affiliates(^ii) (excluding investments in the company through a private placement).</td>
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<td>2.13. Is (or an immediate family member(^vi) is) a partner in, or a controlling shareholder or an executive officer of, an organization which has any material transactional relationship(^viii) with the company or its affiliates(^ii) (excluding investments in the company through a private placement).</td>
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<td>2.14. Is (or an immediate family member(^vi) is) a trustee, director, or employee of a charitable or non-profit organization that receives material grants or endowments(^viii) from the company or its affiliates(^ii).</td>
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<td><strong>Other Relationships</strong></td>
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<td>2.15. Party to a voting agreement(^ix) to vote in line with management on proposals being brought to shareholder vote.</td>
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<td>2.16. Has (or an immediate family member(^vi) has) an interlocking relationship as defined by the SEC involving members of the board of directors or its Compensation Committee(^x).</td>
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<td>2.17. Founder(^xi) of the company but not currently an employee.</td>
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<td>2.18. Any material(^xi) relationship with the company.</td>
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<td><strong>Independent Outside Director (IO)</strong></td>
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<td>3.1. No material(^xi) connection to the company other than a board seat.</td>
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Footnotes:

i The definition of officer will generally follow that of a “Section 16 officer” (officers subject to Section 16 of the Securities and Exchange Act of 1934) and includes the chief executive, operating, financial, legal, technology, and accounting officers of a company (including the president, treasurer, secretary, controller, or any vice president in charge of a principal business unit, division, or policy function). Current interim officers are included in this category. For private companies, the equivalent positions are applicable. A non-employee director serving as an officer due to statutory requirements (e.g. corporate secretary) will be classified as an Affiliated Outsider under 2.18: “Any material relationship with the company.” However, if the company provides explicit disclosure that the director is not receiving additional compensation in excess of $10,000 per year for serving in that capacity, then the director will be classified as an Independent Outsider.

ii “Affiliate” includes a subsidiary, sibling company, or parent company. ISS uses 50 percent control ownership by the parent company as the standard for applying its affiliate designation.

iii Includes any former CEO of the company prior to the company’s initial public offering (IPO).

iv When there is a former CEO of a special purpose acquisition company (SPAC) serving on the board of an acquired company, ISS will generally classify such directors as independent unless determined otherwise taking into account the following factors: the applicable listing standards determination of such director’s independence; any operating ties to the firm; and the existence of any other conflicting relationships or related party transactions.

v ISS will look at the terms of the interim officer’s employment contract to determine if it contains severance pay, long-term health and pension benefits, or other such standard provisions typically contained in contracts of permanent, non-temporary CEOs. ISS will also consider if a formal search process was under way for a full-time officer at the time.

vi “Immediate family member” follows the SEC’s definition of such and covers spouses, parents, children, step-parents, step-children, siblings, in-laws, and any person (other than a tenant or employee) sharing the household of any director, nominee for director, executive officer, or significant shareholder of the company.

vii Professional services can be characterized as advisory in nature, generally involve access to sensitive company information or to strategic decision-making, and typically have a commission- or fee-based payment structure. Professional services generally include, but are not limited to the following: investment banking/financial advisory services; commercial banking (beyond deposit services); investment services; insurance services; accounting/audit services; consulting services; marketing services; legal services; property management services; realtor services; lobbying services; executive search services; and IT consulting services. The following would generally be considered transactional relationships and not professional services: deposit services; IT tech support services; educational services; and construction services. The case of participation in a banking syndicate by a non-lead bank should be considered a transactional (and hence subject to the associated materiality test) rather than a professional relationship. “Of Counsel” relationships are only considered immaterial if the individual does not receive any form of compensation (in excess of $10,000 per year) from, or is a retired partner of, the firm providing the professional service. The case of a company providing a professional service to one of its directors or to an entity with which one of its directors is affiliated, will be considered a transactional rather than a professional relationship. Insurance services and marketing services are assumed to be professional services unless the company explains why such services are not advisory.

viii A material transactional relationship, including grants to non-profit organizations, exists if the company makes annual payments to, or receives annual payments from, another entity exceeding the greater of $200,000 or 5 percent of the recipient’s gross revenues, in the case of a company which follows NASDAQ listing standards; or the greater of $1,000,000 or 2 percent of the recipient’s gross revenues, in the case of a company which follows NYSE/Amex listing standards. In the case of a
company which follows neither of the preceding standards, ISS will apply the NASDAQ-based materiality test. (The recipient is the party receiving the financial proceeds from the transaction).

ix Dissident directors who are parties to a voting agreement pursuant to a settlement arrangement, will generally be classified as independent unless determined otherwise taking into account the following factors: the terms of the agreement; the duration of the standstill provision in the agreement; the limitations and requirements of actions that are agreed upon; if the dissident director nominee(s) is subject to the standstill; and if there any conflicting relationships or related party transactions.

x Interlocks include: executive officers serving as directors on each other’s compensation or similar committees (or, in the absence of such a committee, on the board); or executive officers sitting on each other’s boards and at least one serves on the other’s compensation or similar committees (or, in the absence of such a committee, on the board).

xi The operating involvement of the founder with the company will be considered. Little to no operating involvement ever may cause ISS to deem the founder as an independent outsider.

xii For purposes of ISS’s director independence classification, “material” will be defined as a standard of relationship (financial, personal or otherwise) that a reasonable person might conclude could potentially influence one’s objectivity in the boardroom in a manner that would have a meaningful impact on an individual’s ability to satisfy requisite fiduciary standards on behalf of shareholders.
COMPENSATION

Corporate Governance Issue:
Executive Pay Evaluation: Advisory Votes on Executive Compensation – Management Proposals

Pay-for-Performance Evaluation

Current Methodology: ISS annually conducts a pay-for-performance analysis to identify strong or satisfactory alignment between pay and performance over a sustained period. With respect to companies in the Russell 3000 index, this analysis considers the following:

1. Peer Group\(^7\) Alignment:
   - The degree of alignment between the company’s TSR rank and the CEO’s total pay rank within a peer group, as measured over one-year and three-year periods (weighted 40/60);
   - The multiple of the CEO’s total pay relative to the peer group median.

2. Absolute Alignment: The absolute alignment between the trend in CEO pay and company TSR over the prior five fiscal years – *i.e.*, the difference between the trend in annual pay changes and the trend in annualized TSR during the period.

If the above analysis demonstrates significant unsatisfactory long-term pay-for-performance alignment or, in the case of non-Russell 3000 index companies, misaligned pay and performance are otherwise suggested, analyze the following qualitative factors to determine how various pay elements may work to encourage or to undermine long-term value creation and alignment with shareholder interests:

- The ratio of performance- to time-based equity awards;
- The ratio of performance-based compensation to overall compensation;
- The completeness of disclosure and rigor of performance goals;
- The company’s peer group benchmarking practices;
- Actual results of financial/operational metrics, such as growth in revenue, profit, cash flow, etc., both absolute and relative to peers;
- Special circumstances related to, for example, a new CEO in the prior fiscal year or anomalous equity grant practices (*e.g.*, biennial awards); and
- Any other factors deemed relevant.

Key Changes:

- Use company’s selected peers as an input to its peer group methodology, while maintaining an approach that includes company size and market capitalization constraints.
- Potentially incorporate a comparison of realizable pay to grant date pay as part of the qualitative evaluation of pay-for-performance alignment when relevant to the analysis in large cap companies.

\(^7\) The peer group is generally comprised of 14-24 companies that are selected using 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, and where the subject company is close to median in revenue/asset size. The relative alignment evaluation will consider the company’s rank for both pay and TSR within the peer group (for one- and three-year periods) and the CEO’s pay relative to the median pay level in the peer group.
New Methodology: ISS annually conducts a pay-for-performance analysis to identify strong or satisfactory alignment between pay and performance over a sustained period. With respect to companies in the Russell 3000 index, this analysis considers the following:

1. Peer Group Alignment:
   - The degree of alignment between the company’s TSR rank and the CEO’s total pay rank within a peer group, as measured over one-year and three-year periods (weighted 40/60);
   - The multiple of the CEO’s total pay relative to the peer group median.

2. Absolute Alignment – the absolute alignment between the trend in CEO pay and company TSR over the prior five fiscal years – i.e., the difference between the trend in annual pay changes and the trend in annualized TSR during the period.

If the above analysis demonstrates significant unsatisfactory long-term pay-for-performance alignment or, in the case of non-Russell 3000 index companies, misaligned pay and performance are otherwise suggested, our analysis may include any of the following qualitative factors, if they are relevant to the analysis to determine how various pay elements may work to encourage or to undermine long-term value creation and alignment with shareholder interests:

- The ratio of performance- to time-based equity awards;
- The overall ratio of performance-based compensation;
- The completeness of disclosure and rigor of performance goals;
- The company's peer group benchmarking practices;
- Actual results of financial/operational metrics, such as growth in revenue, profit, cash flow, etc., both absolute and relative to peers;
- Special circumstances related to, for example, a new CEO in the prior FY or anomalous equity grant practices (e.g., bi-annual awards);
- Realizable pay compared to grant pay; and
- Any other factors deemed relevant.

Rationale for Update:

The 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 new 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 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 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.

The revisions take into account feedback from both investors and issuers based on ISS' 2012-2013 policy survey and in-person and telephonic roundtable discussions.

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8 The revised peer group is generally comprised of 14-24 companies that are selected using market cap, revenue (or assets for certain financial firms), GICS industry group and company's selected peers' GICS industry group with size constraints, 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 bucket that is reflective of the company’s.
Peer Group Methodology

The following outcomes are observed between the new and current peer group methodology:

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<thead>
<tr>
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<th>New Methodology</th>
<th>Current Methodology</th>
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<tbody>
<tr>
<td>GICS precision – 8-digit</td>
<td>The average company has more than 80% of peer selections drawn from the company's 8-digit GICS group or the 8-digit GICS groups of self-selected peers</td>
<td>Only 40% of peers are drawn from the company's 8-digit GICS group or the 8-digit GICS groups of self-selected peers</td>
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<td>No peer groups have members based on 2-digit GICS</td>
<td>12% of peer groups have members based on 2-digit GICS</td>
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<td>GICS precision – 2-digit</td>
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<td>Similarity with company's selected peers</td>
<td>42% of companies have a potential ISS peer group that overlaps at least 50% of their own</td>
<td>20% of companies have a potential ISS peer group that overlaps at least 50% of their own</td>
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<td>On average, an ISS peer group contains 44% of company's chosen peers</td>
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<td>Size comparison</td>
<td>Over 90% of peer groups maintain the subject company within 20% of the peer group median size by revenue.</td>
<td>82% of peer groups maintain the subject company within 20% of the peer group median size by revenue.</td>
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Realizable pay

Realizable pay is being added to the research report 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. Stock options or stock appreciation rights (SARs) will be re-valued using the remaining term and updated assumptions, as of the performance period, using a Black-Scholes option pricing model. Realizable pay consideration may mitigate or exacerbate CEO’s pay-for-performance concerns.

Corporate Governance Issue:
Voting on Golden Parachutes in an Acquisition, Merger, Consolidation, or Proposed Sale

Current Recommendation: Vote CASE-BY-CASE on proposals to approve the company's golden parachute compensation, consistent with ISS' policies on problematic pay practices related to severance packages. Features that may lead to a vote AGAINST include:

- Recently adopted or materially amended agreements that include excise tax gross-up provisions (since prior annual meeting);
- Recently adopted or materially amended agreements that include modified single triggers (since prior annual meeting);
- Single trigger payments that will happen immediately upon a change in control, including cash payment and such items as the acceleration of performance-based equity despite the failure to achieve performance measures;
2013 U.S. Corporate Governance Policy Updates

• Single-trigger vesting of equity based on a definition of change in control that requires only shareholder approval of the transaction (rather than consummation);
• Potentially excessive severance payments;
• Recent amendments or other changes that may make packages so attractive as to influence merger agreements that may not be in the best interests of shareholders;
• In the case of a substantial gross-up from pre-existing/grandfathered contract: the element that triggered the gross-up (i.e., option mega-grants at low point in stock price, unusual or outsized payments in cash or equity made or negotiated prior to the merger); or
• The company’s assertion that a proposed transaction is conditioned on shareholder approval of the golden parachute advisory vote. ISS would view this as problematic from a corporate governance perspective.

In cases where the golden parachute vote is incorporated into a company’s separate advisory vote on compensation (management say-on-pay), ISS will evaluate the say-on-pay proposal in accordance with these guidelines, which may give higher weight to that component of the overall evaluation.

Key Changes:

• Include existing change-in-control arrangements maintained with named executive officers rather than focusing only on new or extended arrangements
• Place further scrutiny on multiple legacy problematic features in change in control agreements.

New Recommendation: Vote CASE-BY-CASE on say on Golden Parachute proposals, including consideration of existing change-in-control arrangements maintained with named executive officers rather than focusing primarily on new or extended arrangements.

Features that may result in an AGAINST recommendation include one or more of the following, depending on the number, magnitude, and/or timing of issue(s):

• Single- or modified-single-trigger cash severance;
• Single-trigger acceleration of unvested equity awards;
• Excessive cash severance (>3x base salary and bonus);
• Excise tax gross-ups triggered and payable (as opposed to a provision to provide excise tax gross-ups);
• Excessive golden parachute payments (on an absolute basis or as a percentage of transaction equity value); or
• Recent amendments that incorporate any problematic features (such as those above) or recent actions (such as extraordinary equity grants) that may make packages so attractive as to influence merger agreements that may not be in the best interests of shareholders; or
• The company’s assertion that a proposed transaction is conditioned on shareholder approval of the golden parachute advisory vote.

Recent amendment(s) that incorporate problematic features will tend to carry more weight on the overall analysis. However, the presence of multiple legacy problematic features will also be closely scrutinized.

In cases where the golden parachute vote is incorporated into a company’s advisory vote on compensation (management say-on-pay), ISS will evaluate the say-on-pay proposal in accordance with these guidelines, which may give higher weight to that component of the overall evaluation.

Rationale for Update:
The Dodd-Frank Act requires companies to hold separate shareholder votes on potential “golden parachute” payments when they seek shareholder approval for mergers, sales, and certain other transactions. Since the SEC mandate on golden parachute proposals did not take effect until April 25, 2011, most proposals were submitted after July 2011. Covering meeting dates from Jan. 1, 2012, to Oct. 4, 2012, the average support on Golden Parachute proposals across ISS’ coverage universe was approximately 81 percent, while support for the underlying transactions averaged above 95 percent of votes
cast. Compared to the 2012 average vote on management say-on-pay proposals of 91 percent, the lower level of support on golden parachute proposals stands out.

According to the results of ISS’ 2012-2013 ISS Policy Survey, 74 percent of investor respondents believe that excessive golden parachute payments are problematic when shareholders consider them in evaluating both the management say-on-pay and say on golden parachute agenda items. More than a majority of ISS’ institutional investor clients suggest that payments resulting from problematic severance features, such as single triggered equity, excise tax gross-ups, and modified single triggered cash severance, are objectionable regardless of the timing of the arrangement.

ISS’ 2011 and 2010 policy survey results also indicated that the majority of investor respondents do not favor single trigger equity vesting upon a change in control.
SOCIAL/ENVIRONMENTAL ISSUES

Corporate Governance Issue:
Global Approach

Current Recommendation: When evaluating social and environmental shareholder proposals, ISS considers the following factors:

- Whether adoption of the proposal is likely to enhance or protect shareholder value;
- Whether the information requested concerns business issues that relate to a meaningful percentage of the company's business as measured by sales, assets, and earnings;
- The degree to which the company's stated position on the issues raised in the proposal could affect its reputation or sales, or leave it vulnerable to a boycott or selective purchasing;
- Whether the issues presented are more appropriately/effectively dealt with through governmental or company-specific action;
- Whether the company has already responded in some appropriate manner to the request embodied in the proposal;
- Whether the company's analysis and voting recommendation to shareholders are persuasive;
- What other companies have done in response to the issue addressed in the proposal;
- Whether the proposal itself is well framed and the cost of preparing the report is reasonable;
- Whether implementation of the proposal's request would achieve the proposal's objectives;
- Whether the subject of the proposal is best left to the discretion of the board;
- Whether the requested information is available to shareholders either from the company or from a publicly available source; and
- Whether providing this information would reveal proprietary or confidential information that would place the company at a competitive disadvantage.

Key Change: Establish overarching principles for social and environmental proposals for all markets.

New Recommendation: Issues covered under the policy include a wide range of topics, including consumer and product safety, environment and energy, labor standards and human rights, workplace and board diversity, and corporate political issues. While a variety of factors goes into each analysis, the overall principle guiding all vote recommendations focuses on how the proposal may enhance or protect shareholder value in either the short term or long term.

Generally vote CASE-BY-CASE, taking into consideration whether implementation of the proposal is likely to enhance or protect shareholder value, and in addition the following will also be considered:

- If the issues presented in the proposal are more appropriately or effectively dealt with through legislation or government regulation;
- If the company has already responded in an appropriate and sufficient manner to the issue(s) raised in the proposal;
- Whether the proposal's request is unduly burdensome (scope, timeframe, or cost) or overly prescriptive;
- The company's approach compared with any industry standard practices for addressing the issue(s) raised by the proposal;
- If the proposal requests increased disclosure or greater transparency, whether or not reasonable and sufficient information is currently available to shareholders from the company or from other publicly available sources; and
- If the proposal requests increased disclosure or greater transparency, whether or not implementation would reveal proprietary or confidential information that could place the company at a competitive disadvantage.
Rationale for Update: This policy update codifies the overarching principles that are applied to all markets, globally, and clarifies the factors that ISS considers in its case-by-case evaluation of environmental and social shareholder proposals. In markets where shareholder proposals on specific environment and social issues are routinely or frequently observed on company ballots, ISS has more nuanced policies that stem from these principles to address those issues.

Corporate Governance Issue:
Environmental, Social, and Governance (ESG) Compensation-Related Proposals

Current Recommendation: Generally 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. However, the following factors will be considered:

- Whether the company has significant and persistent controversies or violations regarding social and/or environmental issues;
- Whether the company has management systems and oversight mechanisms in place regarding its social and environmental performance;
- The degree to which industry peers have incorporated similar non-financial performance criteria in their executive compensation practices; and
- The company’s current level of disclosure regarding its environmental and social performance.

Generally vote AGAINST proposals calling for an analysis of the pay disparity between corporate executives and other non-executive employees. The value of the information sought by such proposals is unclear.

Key Changes:

- Modification of the general position of the policy from "Generally vote AGAINST" to "Vote CASE-BY-CASE";
- Replacement of the listing of specific social and environmental criteria with a general reference of sustainability criteria. That sustainability refers to environmental and social issues is noted in case the reader is unfamiliar with the term sustainability in this context; and
- In the first bullet point, "significant and persistent" has been changed to "significant and/or persistent."

New Recommendation: Vote CASE-BY-CASE on proposals to link, or report on linking, executive compensation to sustainability (environmental and social) criteria. The following factors will be considered:

- Whether the company has significant and/or persistent controversies or regulatory violations regarding social and/or environmental issues;
- Whether the company has management systems and oversight mechanisms in place regarding its social and environmental performance;
- The degree to which industry peers have incorporated similar non-financial performance criteria in their executive compensation practices; and
- The company’s current level of disclosure regarding its environmental and social performance.

Generally vote AGAINST proposals calling for an analysis of the pay disparity between corporate executives and other non-executive employees. The value of the information sought by such proposals is unclear.

Rationale for update: The incorporation of sustainability-related (environmental and social) non-financial performance metrics into executive compensation is becoming commonplace in certain industry sectors, specifically the extractive industry sectors, and is increasingly addressed in international investor initiatives, such as the UN Principles for Responsible Investment (UNPRI), that a growing number of institutional investors participate in.
The results of ISS’ 2012-2013 Policy Survey support a more flexible approach to proposals requesting the incorporation of sustainability metrics in corporate executive compensation plans. Just under a third of responders agreed that the use of relevant non-financial metrics in executive compensation would be beneficial for shareholders and just over another third agreed that a case-by-case approach is appropriate for determining if the use of such metrics would benefit shareholders where a company has experienced significant, related problems.

Corporate Governance Issue:
Lobbying

Current Recommendation: Vote CASE-BY-CASE on proposals requesting information on a company’s lobbying activities, including direct lobbying as well as grassroots lobbying activities, considering:

- The company’s current disclosure of relevant policies and oversight mechanisms;
- Recent significant controversies, fines, or litigation related to the company’s public policy activities; and
- The impact that the policy issues may have on the company’s business operations.

Key Changes:

- Adding lobbying policies and procedures: current policy only notes lobbying activities;
- Adding indirect lobbying: current policy only notes direct lobbying and grassroots lobbying;
- Changing the reference to the company’s public policy activities in the second bullet to lobbying–related activities; and
- Clarifying that the third bullet addresses situations where a proposal cites specific public policy issues and not how a company may be affected by public policy issues generally.

New Recommendation: Vote CASE-BY-CASE on proposals requesting information on a company’s lobbying (including direct, indirect, and grassroots lobbying) activities, policies, or procedures, considering:

- The company’s current disclosure of relevant policies and oversight mechanisms;
- Recent significant controversies, fines, or litigation regarding the company’s lobbying-related activities; and
- The impact that the public policy issues in question may have on the company’s business operations, if specific public policy issues are addressed.

Rationale for Update: The changes to the general policy position will clarify the scope (all types of lobbying) and focus (lobbying policies and procedures, as well as lobbying activities) of the policy. The additional changes to the bullets will replace legacy policy language with clearer and more specific terminology.
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