Tips, Tricks, and RiskMetrics' Policy Updates

Relevant to Equity Compensation Plan Proposals

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EXEQUITY

Independent Board and Management Advisors

Introduction

- RiskMetrics Group (RMG) 2010 Policy Updates for Compensation
- Top Tips to Ensure Shareholder Approval of Your Stock Plan Proposals

RiskMetrics Group (RMG) 2010 Policy Updates for Compensation

Changes for Shareholder Value Transfer (SVT) and Burn Rate Policies

- Stock price
  - Will use 200-day average stock price for shareholder meetings on or after February 1, 2010
  - During 2009, used 90-day average stock price
- Volatility
  - Will use 200-day volatility for shareholder meetings on or after February 1, 2010
  - During 2009, used 400-day volatility
- Updated GICS industry group burn rate table for 2010

Implications of Changes for SVT and Burn Rate Policies

- Impact is inversely related to a company's market cap
- Larger the relative market cap, the more positive the impact likely will be
- Across the board, burn rate cap dropped, some by more than half of what they were in 2009
- We looked at 40 random companies—10 each from large, mid, small, and micro cap groups
  - Large cap company stock option valuations drop by about 16% under policy changes (measured as a percent of stock price), compared to only about a 3% drop for micro caps
  - Large caps: Exxon Mobil, Microsoft, Procter & Gamble, Apple, Johnson & Johnson, International Business Machines, JPMorgan Chase, Chevron, AT&T, General Electric
  - Mid caps: TJX Companies, Avon Products, Precision Castparts, Lorillard, H.J. Heinz, Sempra Energy, T. Rowe Price Group, Spectra Energy, Marsh & McLennan, Murphy Oil
  - Small caps: Human Genome Sciences, Tupperware Brands, Solera Holdings, Bally Technologies, E*Trade Financial, MFA Financial, J. Crew Group, 3COM, Highwoods Properties, Revlon
  - Micro caps: Schweitzer-Mauduit International, Veeco Instruments, First Financial Bancorp, Vivus, ArvinMeritor, Dana Holding, Prospect Capital, U.S. Airways, Radian Group, Georgia Gulf

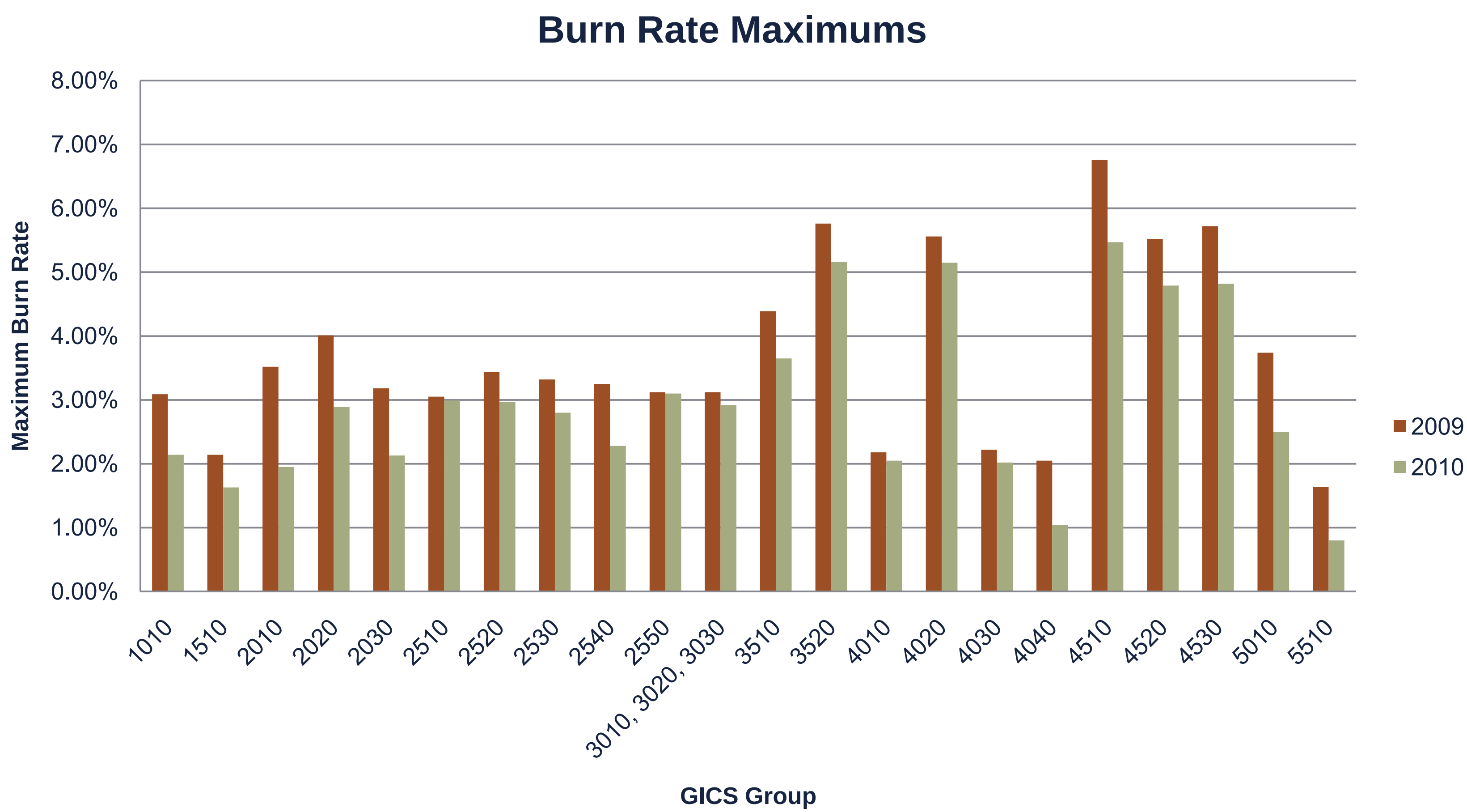
Volatility Under the 2010 Methodology Compared to 2009 Methodology

Overall		2009 Methodology	2010 Methodology	Diff. (+/-)	Diff. (%)
	Lowest	***26.86%***	***18.29%***	***-102.68%***	***-47.48%***
	Average	81.73%	70.12%	-11.61%	-20.36%
	Median	***63.79%***	***51.91%***	***-12.31%***	***-24.09%***
	Highest	216.25%	255.13%	50.87%	28.37%
Large Cap					
	Lowest	***26.86%***	***18.29%***	***-20.69%***	***-43.42%***
	Average	47.06%	33.59%	-13.47%	-30.09%
	Median	***45.42%***	***26.46%***	***-13.38%***	***-30.99%***
	Highest	89.74%	73.46%	-6.27%	-12.73%
Mid Cap					
	Lowest	***29.81%***	***19.26%***	***-21.16%***	***-39.89%***
	Average	49.24%	34.41%	-14.83%	-31.06%
	Median	***46.17%***	***31.75%***	***-14.13%***	***-31.48%***
	Highest	76.12%	60.97%	-10.55%	-19.91%
Small Cap					
	Lowest	***54.12%***	***34.04%***	***-102.68%***	***-47.48%***
	Average	103.41%	90.09%	-13.32%	-14.87%
	Median	***76.81%***	***64.61%***	***-10.08%***	***-14.94%***
	Highest	216.25%	230.19%	50.87%	28.37%
Micro Cap					
	Lowest	***65.09%***	***58.28%***	***-40.97%***	***-28.81%***
	Average	127.22%	122.39%	-4.83%	-5.42%
	Median	***118.32%***	***104.11%***	***-1.58%***	***-2.22%***
	Highest	214.58%	255.13%	40.55%	18.90%

Stock Price Under the 2010 Methodology Compared to 2009 Methodology

Overall		2009 Methodology	2010 Methodology	Difference (+/-)	Difference (%)
	Lowest	***$ 1.5902***	***$ 1.4923***	***$ (32.2477)***	***-47.77%***
	Average	$ 37.5988	$ 32.4056	$ (5.1932)	-16.41%
	Median	***$ 28.1913***	***$ 25.7198***	***$ (3.2106)***	***-12.52%***
	Highest	$ 183.3402	$ 151.0925	$ (0.0979)	-2.07%
Large Cap					
	Lowest	***$ 15.0945***	***$ 13.0935***	***$ (32.2477)***	***-17.59%***
	Average	$ 67.4420	$ 60.4832	$ (6.9588)	-9.24%
	Median	***$ 58.4535***	***$ 54.5339***	***$ (3.9197)***	***-8.02%***
	Highest	$ 183.3402	$ 151.0925	$ (1.0645)	-2.07%
Mid Cap					
	Lowest	***$ 18.9415***	***$ 16.6578***	***$ (13.8998)***	***-16.95%***
	Average	$ 48.1246	$ 42.8499	$ (5.2748)	-11.03%
	Median	***$ 43.3858***	***$ 38.7077***	***$ (4.9110)***	***-10.77%***
	Highest	$ 95.8780	$ 81.9782	$ (2.2243)	-6.35%
Small Cap					
	Lowest	***$ 1.5902***	***$ 1.4923***	***$ (10.2166)***	***-47.77%***
	Average	$ 19.3791	$ 14.8372	$ (4.5419)	-20.16%
	Median	***$ 13.9857***	***$ 8.5934***	***$ (2.8237)***	***-17.52%***
	Highest	$ 40.6015	$ 31.9199	$ (0.0979)	-6.16%
Micro Cap					
	Lowest	***$ 3.6512***	***$ 3.2546***	***$ (16.5530)***	***-44.13%***
	Average	$ 15.4494	$ 11.4523	$ (3.9971)	-25.23%
	Median	***$ 9.2942***	***$ 7.7501***	***$ (2.4978)***	***-27.87%***
	Highest	$ 52.4331	$ 35.8802	$ (0.3966)	-9.60%

RMG Burn Rate Maximums by GICS—2009 vs. 2010



Executive Pay Evaluation Policy

- Consolidates 3 existing policies:
  - Pay-for-Performance
  - Problematic (Poor) Pay Practices
  - Board Responsiveness and Communication on Compensation Issues

- RMG will re-order its Voting Manual into 4 policy sections:
  - Executive Pay Evaluations
  - Equity-Based and Other Incentive Plans
  - Director Compensation
  - Shareholder Proposals

Pay-for-Performance Policy Changes

- RMG will consider the alignment of CEO total direct compensation (TDC) and total shareholder returns (TSR) for a longer period of at least 5 years
- Policy used for determining RMG vote recommendations on:
  - Management Say on Pay (MSOP) proposals
  - Elections of directors
  - Equity plan proposals
- The policy's screening questions:
  - Are a company's 1- and 3-year TSRs **both** below the company's 4-digits GICS industry group medians?
  - Has the CEO served at least 2 consecutive fiscal years at the time of the annual meeting at which the proposal will be voted on?
  - If "yes" to both of the above questions, RMG will:
    - Analyze whether the CEO's TDC is aligned with TSR, both recent and long-term (at least 5 years) [most recent year-over-year increase/decrease in pay remains a key consideration]
    - Review a company's CD&A to better understand the pay elements and whether they create or reinforce shareholder alignment
    - Consider the mix of performance-based compensation relative to TDC

Problematic Pay Practices

- Formerly referred to as "poor" pay practices
- Now, two groups:
  - "Major"—can lead to negative vote recommendations if one exists
  - "Minor"—can lead to negative vote recommendations if more than one exists
- 2010 Policy Updates set out the "Major" Problematic Pay Practices
- 2010 Compensation FAQs set out the "Minor" Problematic Pay Practices
- RMG address some activity in relation to underwater stock options for the first time:
  - Voluntary surrenders of underwater stock options by executive officers
  - Cash buyouts of underwater stock options without shareholder approval
- RMG will utilize MSOP proposals as the initial vehicle to address problematic pay practices. RMG may recommend votes:
  - Against MSOP proposals
  - Against/Withhold from compensation committee members or, in rare cases where full board is deemed responsible for the practice, all directors, or when no MSOP item is on the ballot, or when the board has failed to respond to concerns raised in prior MSOP evaluations
  - Against an equity-based incentive plan proposal if excessive non-performance-based equity awards are the major contributor to a pay-for-performance misalignment

Problematic Pay Practices

"Major"

- Multi-year guarantees for salary increases, non-performance-based bonuses, and equity compensation
- Including additional years of service that result in significant additional benefits, without sufficient justification, or including long-term equity awards in the pension calculation
- Perquisites for former and/or retired executives, and extraordinary relocation benefits (including home buyouts) for current executives
- Change-in-control payments exceeding 3 x times base salary and target bonus
- Change-in-control payments without job loss or substantial diminution of duties ("single triggers")
- New or materially amended agreements that provide for "modified single triggers"
- New or materially amended agreements that provide for an excise tax gross-up (including "modified gross-ups")
- Tax reimbursements related to executive perquisites or other payments such as personal use of corporate aircraft, executive life insurance, bonus, etc.
- Dividends or dividend equivalents paid on unvested performance shares or units
- Executives using company stock in hedging activities, such as "cashless" collars, forward sales, equity swaps, or other similar arrangements
- Repricing or replacing of underwater stock options/stock appreciation rights without prior shareholder approval (including cash buyouts and voluntary surrender/subsequent regrant of underwater options)

"Minor"

- Excessive severance and/or change-in-control provisions
- Payments upon an executive's termination in connection with performance failure
- Liberal change-in-control definition in individual contracts or equity plans which could result in payments to executives without an actual change in control occurring
- Overly generous perquisites, which may include, but are not limited to the following:
  - Personal use of corporate aircraft
  - Personal security systems maintenance and/or installation
  - Car allowances
  - Executive life insurance
- Internal pay disparity-excessive differential between CEO total pay and that of next highest-paid named executive officer
- Voluntary surrender of underwater stock options by executive officers
- May be viewed as an indirect repricing/exchange program especially if those cancelled options are returned to the equity plan, as they can be regranted to executive officers at a lower exercise price, and/or executives subsequently receive unscheduled grants in the future
- Other pay practices deemed problematic but not covered in any of the above categories

2010 Compensation FAQs—Executive Compensation Evaluation

- Not a new policy
- Will first resort to recommending against MSOP proposals unless egregious practices are identified or a company previously received a negative recommendation on an MSOP resolution related to an issue that is still ongoing
- Will evaluate problematic pay practices on a case-by-case basis
- If the initial screening questions under the pay-for-performance analysis require further analysis, RMG will consider:
  - Whether the CEO's pay increased or decreased, and the magnitude of the change
  - The reason for the change in pay with respect to the pay mix
  - The long-term alignment of the CEO's TDC with the company's TSR with particular focus on the most recent 3 years
- Increases in CEOs' TDCs resulting from a change in pension plan assumption generally will not result in an unfavorable vote recommendation
- Companies can make a prospective pay-for-performance commitment, tailored to the specific issues raised in RMG's analysis, and RMG will evaluate such commitments on a case-by-case basis to determine if an exception to the application of the negative vote recommendations will be made

2010 Compensation FAQs—Stock Option Carve-Out Exception

- The Stock Option Carve-Out Exception permits a company to have RMG exclude stock options that have been outstanding for more than 6 years and are in-the-money from the SVT analysis. This was as the policy was understood last year. This policy was introduced as part of the 2009 Policy Updates.
- RMG has thrown several roadblocks up for companies desiring to use this exception, including:
  - Companies must have sustained positive stock price performance
    - Generally means 5-year positive TSR, as well as positive year-over-year performance for the past 5 fiscal years
    - RMG permits negative TSR for first 2 years, so long as final 3 years' TSRs are strongly positive; but, vested stock options that were underwater during a substantial portion of the 5-year period are not eligible for the carve-out
  - Companies must have high overhang cost attributable to such in-the-money stock options
    - Means that outstanding stock options and stock awards should be in the range of 75% to 100% of total overhang
  - Concentration ratio should not be greater than 50%
    - Concentration ratio is the total number of equity grants to the top 5 executives divided by total equity grants to all employees and directors

2010 Compensation FAQs

Option Repricing

- Only deeply underwater stock options should be eligible for exchange or other action
  - Rule of thumb: threshold exercise price should be the higher of the 52-week high or 50% above the current stock price

Burn Rate Commitment

- If a company fails the RMG Burn Rate Policy, it can commit in a public filing on a prospective basis to maintain a gross 3-year average burn rate equal to the higher of 2% of the company's common shares outstanding or the **mean** of its GICS peer group

Pay-for-Performance Timing of Equity Grants

- Companies that grant equity awards at the beginning of the fiscal year based on an analysis of the company's or individual's performance during the prior fiscal year may have an issue under RMG's pay-for-performance analysis unless they provide sufficient information to enable RMG to sufficiently understand and incorporate such grants into its analysis
  - Should provide all necessary information in the proxy

Top Tips to Ensure Shareholder Approval of Your Stock Plan Proposals

#1: Know Your Shareholders

- What are **ownership levels** of your shareholders?
- How many are **retail vs. institutional** shareholders?
- How many of your **institutional** shareholders are **influenced by RMG** proxy vote recommendations?
- How many of your **institutional** shareholders **have their own internal proxy voting guidelines**, i.e., Fidelity, Vanguard Group, State Street, etc.?
- Which relationships are better than others?

#2: Know if RMG Support Is Necessary

- Are a sufficient number of your shareholders (holding a meaningful number of shares) influenced by the RMG proxy vote recommendation?
  - If so, consider finding out what RMG's vote recommendation will likely be
- Knowing RMG's likely vote recommendation is helpful for solicitation efforts, especially if you will not get a positive vote recommendation from RMG

#2: Know if RMG Support Is Necessary

RMG Support Is Not Determinative

	2007	2008	2009 YTD
Total	750	843	767
RMG AGAINST	217	207	198
RMG FOR	533	636	569
FAIL	12	19	1
PASS	640	752	106
Pending/Not Disclosed[1]	95	70	660
Withdrawn	3	2	0
Average Support (F/(F+A+ABS))	81.29%	82.04%	81.62%

Data from ISS voting analytics

[1] Based on reports in 10-Qs of voting results (note: 2009 data is through 7/17/2009; many vote results for 2009 were not known yet at time of material submission)

#3: Know How RMG Would View Your Proposal

- Do you pay for RMG advisory services?
  - RMG ISSue Compass model
  - RMG consulting
  - Third party with experience to help you run the RMG model
- Gain understanding of the RMG tests and how your company would fare under RMG’s 6 critical tests

#3: Know How RMG Would View Your Proposal

RMG's 6 Critical Tests

- **SVT**—Is your company's SVT below your company-specific allowable cap?
- **Burn Rate**—Is your company's burn rate below your company's GICS industry group median plus one standard deviation?
- **Pay for Performance**—Is your company's 1- and 3-year TSR better than its GICS industry group median?
- **Repricing**—Does your plan prohibit repricing without shareholder approval?
- **Poor Pay Practices**—Does your company have any of the identified poor pay practices?
- **Egregious Compensation**—Has your company made any compensation decisions that RMG would say are "egregious?"

#4: Know What Your Shareholders Want

For those shareholders that have their own proxy voting guidelines, what are they looking for?

- Voting power dilution
  - Full dilution
  - Simple dilution
- Burn rate
- Minimum vesting restrictions
- Option repricing provisions
- Stock option reload provisions
- Evergreen provisions

#5: Know How Your Current Equity Plans and Compensation Decisions Fare

- Understand your shareholders' proxy voting guidelines
- Some actions can cause you to lose the ability to get institutional shareholders to support a stock plan proposal
  - *Example*: Including language that permits the repricing of stock options and/or other awards without shareholder approval
- Other actions you can address by committing to take specified future actions and the institutional shareholders will then support your proposal
  - *Example*: For RMG, having a burn rate that exceeds the RMG maximum, but committing to maintain your burn rate at the industry median plus one standard deviation for the next 3 years

#6: Know How Your Company Compares

- Knowing how your company stacks up on a comparative basis can be quite helpful as you craft the messaging around your stock plan proposal request
- Knowing the market index (dilution, burn rate, TSRs, etc.) for your company's Industry Group will enhance your analysis and serve as a guide
- Knowing how your company compares will allow you to anticipate sticking points and enable you to point out key differentiators on some common yardsticks used for comparison

#7: Discussions With a Few Select Large Shareholders

- Discuss policy not soliciting votes—just getting feedback
- Before you even start drafting a plan, take some time to talk with a few of your key shareholders
- You want to find out:
  - What they currently think about your company
  - What their policies are towards stock plan proposals, and if those are likely to change before the next proxy season
  - What new concerns they have about stock plans and their use

#8: Make Sure Your Proposal Is Reasonable

- In the terms included in the plan, the dilution from proposed shares, etc.
- Remember the old saying: *“Pigs get fat, but hogs get slaughtered”*
- What is “reasonable” is, much like beauty, in the eyes of the beholder
- So, know what your shareholders think is reasonable as far as stock plan terms and provisions and try to stick within those boundaries
- Of course, if you have a good, strategic reason to go outside the bounds of what your shareholders consider reasonable, realize that you will most likely need to ensure shareholders fully understand why this is necessary

#9: Comply With the Largest Number of Shareholders' Guidelines Possible

- Draft your stock plan proposal so it complies with the largest number of shareholders' guidelines possible to give the best chance of the plan securing shareholder approval
- Figure out the shareholders whose votes you'll need in order for the proposal to pass
- Review those shareholder proxy voting guidelines and ensure your plan proposal complies
- If a needed shareholder has a policy that you can't or don't see the need to comply with, consider discussing this directly with the shareholder to see if anything can be done

#9: Comply With the Largest Number of Shareholders' Guidelines Possible

Certain Plan Provisions to Consider

- New or amended plan
- Share counting
  - Replenishment
  - Fungible ratio/flexible share pool
- Change of control
  - Vesting acceleration
  - Tax gross-ups
- Buy-out of options
- Option exercise price
- Specified minimum vesting restrictions on full-value awards
  - Exceptions including "in lieu of" salary and 10% pool
- Director awards and discretion
- 162(m) provisions
  - Annual limits
  - Performance criteria
- Tax withholding
- Plan amendments

#10: If You Seek RMG's Support, Make Sure the Proxy Lays Everything Out

- If you seek RMG's support and ran its model, make sure that the proxy proposal lays out all the information on a silver platter that RMG needs to complete its analysis (and that it matches what you used in your modeling)
- By ensuring the proxy proposal sets forth all the information RMG needs for its analysis in a way that is easy for RMG analysts to gather the information, the more likely that the RMG vote recommendation will match your estimate
- Double-checking the numbers used in your RMG modeling against the proxy is a good way to confirm your RMG modeling is still valid and will likely be replicated by RMG analysts

#11: Lay Out a Project Plan With Dates and Responsibilities

- Knowing who on your team will be responsible for the different required actions necessary to take a stock plan proposal to shareholders is a must if you wish to keep your sanity
- Be sure to assign preliminary due dates for the activities—keep in mind that flexibility (other than for required filing dates) is a must
- Some of the best teams have weekly status meetings once the project kicks into high gear to make sure everything is being done on schedule and any hiccups can be quickly addressed

#12: Make Sure You Have Everyone You Need on the Plan Team

Internal Team

- HR
- Legal
- Finance
- Investor Relations
- Corporate Secretary
- Stock plan administrator
- Senior executives

- Compensation Committee

External Team

- Outside Counsel
- Compensation Consultant
- Proxy Solicitor

#13: Use the Project Plan and Keep Key Constituents Apprised of Progress

- Keep everyone on the plan team working on the project plan schedule and keep key constituents apprised of the progress of the plan design, plan drafting, plan proposal drafting, and share modeling
  - Weekly status update meetings for the plan team
  - Convey important developments to senior executives and the Compensation Committee

#14: Realize That Once Your Proxy Is Filed, You'll Still Have a Lot to Do

- The natural reaction is to relax once the proxy is filed, but don't do that
- You will have to monitor what proxy advisory firms recommend regarding the plan
- You may need to schedule conversations with key shareholders to discuss the plan proposal with them and solicit their support
- You will need to be ready to respond to any unforeseen developments, e.g., a change in institutional shareholders' policies that would cause them to vote against the plan

#15: How Do “Other” Proxy Advisory Firm Recommendations Fit In

- You need to figure out how the recommendations from “other” proxy advisory firms (Glass Lewis, ProxyGovernance, Egan Jones, etc.) fit into things
- Are any key shareholders influenced by these “other” proxy advisory firms?
- If so, you need to figure out how they will react to the plan and, if not favorable, be ready to discuss the plan and reasons why it should be supported with your key shareholders that are influenced by these other proxy advisory firms
  - *Example*: A positive vote recommendation from Glass Lewis can blunt a negative recommendation from RMG

#16: Develop a Strategy Plan for Talking to Your Shareholders

- Determine who makes the vote decision—the equity side or compliance side
- Determine the best relationship you have to use in approaching each institution
- Call upon your proxy solicitor to find out if they know of any developments concerning your key shareholders that could impact their vote on the stock plan proposal

#17: Craft Your Shareholder Message

- You need to craft a message to your shareholders as to why they should support the plan—*"Because management is proposing it"* isn't enough today
- Tie back to your understanding of your shareholders
- Be sure to craft a message that hits your shareholders' "hot buttons"
- Look at how you've managed burn rate and dilution, and note any downward trends
- Look at the number of outstanding awards that are "in the money" and have been outstanding for longer than usual, i.e., 6+ years

#18: Determine if the Retail Vote Is Important

- First step is to determine if enough shares are held in retail accounts to warrant an extra effort to get out the retail vote
- If you determine that getting the retail vote is important, then discuss various strategies that can be used to increase the retail vote, including:
  - Calling campaigns
  - Reminder mailings
  - Personal letters from CEO/Chairman explaining why their vote is important and will count

#19: Expect the "Unexpected"

"No battle plan ever survives contact with the enemy"

- That saying is generally applied to wars, but can also be applied to shepherding stock plan proposals through the shareholder approval process
- After the proxy is filed, things may change—at your company, with your shareholders, with their proxy advisory firms, or with the media or others
- Sometimes the changes work to your benefit, e.g., company results that beat expectations
- Sometimes the changes work against you, e.g., a proxy advisory firm changing how it interprets its policies during the proxy season which causes your plan to "fail"
- So, be ready to respond as things develop and the vote comes in
- Remember, it isn't over until the last vote is counted, no matter how certain you or your company is in the outcome

Conclusion

- Taking a stock plan proposal to shareholders for approval is not an easy process
- It takes hard work, planning and diligence in its execution
- But if you have a plan, work it, and are ready to react when changes arise, you will probably come through the process successfully
- Good luck with your stock plan proposals!

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