VOLUME 1 ISSUE 17

Meridian Client Update

December 9, 2010

ISS Announces the Results of its 2010-2011 Policy Survey

For the past seven years, ISS has surveyed its institutional clients and issuers on emerging governance issues. Survey results are a critical component of ISS' annual policy formulation process. On October 26, 2010, ISS released the results of its most recent survey that covered responses from 201 institutional clients (two-thirds were U.S. based) and nearly 700 issuers (81% were U.S. based). The following are the key findings on U.S. corporate governance and compensation matters.

Separation of the Roles of Chairman and CEO

A majority of investors support separation of CEO and Chair roles. Three-quarters of investor respondents indicated that an issuer's CEO should ***not*** concurrently serve as the chair of the board. While a majority of issuers disagreed, a substantial minority (41%) concurred that the two roles should be separate.

Meridian Commentary. *The high level of investor support for separation of the roles of Chairman and CEO is not consistent with the observed practice of large public companies. It remains a minority but growing practice to separate the role of Chairman and CEO. The high level of investor support signals that the practice of separating the roles of chair and CEO will likely become more prevalent as investors continue to put pressure on issuers to abide by this emerging "best practice."*

Executive Compensation as a Top Governance Concern

A majority of issuers (65%) cite executive compensation as one of the top three governance topics for the coming year, eclipsed only by "risk oversight" that was cited by 67% of issuers. Executive compensation also rose to the ***top of the list*** for investor respondents, with 60% of respondents identifying compensation as one of the three most important issues.

Meridian Commentary. *The survey asked investors to select the three most important governance concerns from among nine topics. Not surprisingly, a majority of issuers and investors alike identified executive compensation as one of these top governance concerns, which reflects the focus that many constituents are placing on the subject in light of the imminence of mandatory Say on Pay in 2011. The concern about risk oversight by issuers may reflect the perception that risk oversight is a topic directly tied to business strategy and performance, especially following the meltdown in the financial services sector. Additionally, the proxy disclosure enhancements adopted by the SEC in December 2009 have led to more voluntary disclosure by issuers regarding the risks associated with their compensation programs and how the company assesses such risks. In light of this risk assessment process, the high percentage of issuers citing risk oversight as a key governance concern is not unexpected.*

Pay Alignment Important in Evaluating Say on Pay Proposals

A majority of investors and issuers cite pay alignment as most important in evaluating management say on pay proposals. Approximately 80% of investors and issuers cited the "disclosure of short- and long-term incentives and their relation to business strategy" as one of the top three factors in evaluating a management say on pay proposal. The only other factor cited by a majority of investor respondents was non-performance-based pay elements (e.g., perks, tax gross-ups, base pay). For issuers, other commonly mentioned factors include CD&A clarity (48% of issuers) and company peer groups (43% of issuers).

Meridian Commentary. The consistency between issuers and investors in citing disclosure of incentive program design and its relation to business strategy as a primary factor in evaluating say on pay proposals is noteworthy as issuers consider how to effectively communicate to shareholders how executive compensation programs align pay with performance. One notable disconnect exists between issuers' and investors' responses to whether CD&A clarity and completeness constituted an important basis for evaluating a say on pay proposal. While 48% of issuers selected this topic as one of the three most important considerations in evaluating a say on pay proposals, only 10% of investors thought CD&A clarity and completeness is among the top factors in evaluating say on pay proposals.

Acceleration of Vesting of Equity Awards

Generally, investors do not support or broadly support vesting acceleration of equity awards upon a change in control. A minority of investors (13%) support acceleration of vesting of equity awards solely upon a CIC (i.e., single trigger) and 41% of investors support vesting acceleration if the successor company does not assume or substitute the equity awards following a CIC. Slightly more than a majority of investors (55%) support vesting acceleration upon a qualifying termination of employment following a CIC (i.e., double trigger).

Issuers broadly support vesting acceleration upon a double trigger (85%) and if the successor company does not assume or substitute the equity awards following a CIC (72%). However, according to the ISS survey, only 34% of issuers support vesting acceleration upon a single trigger.

Meridian Commentary. The survey results regarding issuers approval of vesting upon a single trigger does not square with current practice. Acceleration of vesting of equity awards solely upon a single trigger remains a dominant practice among issuers. According to a recent Hewitt Associates study, 76% of issuers accelerate stock options upon change in control and 72% of issuers accelerate restricted stock awards upon change in control (i.e. a "single trigger").[1] An emerging trend is to also require a qualifying termination of employment (i.e., a "double trigger"). However, given the low percentage of investors that find a single trigger vesting acceptable indicates that there will be continued pressure on issuers to adopt double trigger vesting for equity awards in the event of a change in control.

Pay Practices that Impact Shareholder Voting

A majority of investors identify certain pay practices that may negatively impact voting on management say on pay resolutions or on compensation committee member elections. The pay practices cited by more than 65% of investors as negatively impacting shareholder voting include uncapped bonuses, mega annual equity grants, standard stock options (i.e., at the money options not subject to performance conditions), other time-based equity awards with no performance linkage and lack of risk mitigation policies. Mega annual grants that provide unlimited upside and no downside risk was the most commonly identified pay practice that would raise concerns sufficient to warrant a shareholder voting response for investors (89%) and issuers (76%) alike.

Meridian Commentary. Given that uncapped bonuses and mega annual equity grants are rare practices, investor concerns about these practices are unlikely to impact shareholder voting at the vast majority of companies. In contrast, however, the issuance of traditional stock options and time-based equity awards such as restricted stock or restricted stock unit awards is a common practice. The high percentage of investors that identified this practice as one that warrants negative votes indicates that there may be increased pressure on companies to move away from granting time-based equity awards in favor of performance-based equity awards.

* * * * *

The ***Client Update*** is prepared by Meridian Compensation Partners' Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

[1] Hewitt Associates. "Executive Change-in-Control Arrangements Among Select Standard & Poor's 500 Companies, 2008-2009."

This report is a publication of Meridian Compensation Partners, LLC, provides general information for reference purposes only, and should not be construed as legal or accounting advice or a legal or accounting opinion on any specific fact or circumstances. The information provided herein should be reviewed with appropriate advisors concerning your own situation and issues.

www.meridiancp.com