

RiskMetrics Introduces New Corporate Governance Tool

RiskMetrics Group, Inc. (“RMG”), the prominent risk management and corporate governance services firm, has introduced a new tool to help investors assess corporate governance-related risks, including compensation-oriented risks, at portfolio companies: Governance Risk Indicators, or GRId. Prompted by the belief that lax corporate governance contributed to the recent global economic recession, GRId consists of two major components:

- A comprehensive database of the corporate governance attributes and practices at an array of global companies; and
- A new methodology for measuring the level of risk in four key corporate governance categories:
 - ▶ Audit;
 - ▶ Board Structure;
 - ▶ Compensation; and
 - ▶ Shareholder Rights.

In each area, companies will be assigned a color-coded risk rating each year – high, medium, or low – based on RMG’s perceived level of concern.

GRId replaces RMG’s long-standing process for evaluating the corporate governance practices of 6,400+ U.S. public companies, the Corporate Governance Quotient (“CGQ”) system. The CGQ system has been used since 2002 to rate the corporate governance of companies against their industry peers using RMG’s benchmark proxy voting standards. CGQ scores will be frozen in early March and the program will be formally discontinued in June 2010.

The principal differences between GRId and the CGQ system are (1) GRId contains a more detailed review of a company’s compensation practices; a process that will continue to mirror RMG’s benchmark proxy voting standards that it uses to formulate its voting recommendations for its institutional clients; and (2) GRId assessments in all

categories will be performed on an absolute, rather than a relative, basis.

GRId ratings will be reflected in the research reports that RMG issues in connection with a public company’s annual meeting of shareholders beginning in late March.

GRId Methodology

The GRId methodology involves a set of 60 – 80 questions, tailored to prevailing market “best practices,” which address a company’s existing policies and practices with respect to its audit function, board of directors’ structure, compensation, and shareholder rights. Each of these categories is divided into subcategories, with individual questions focused on specific issues associated with that subcategory.

While RMG has yet to disclose the specific questions that it will use, it is likely that the compensation-related questions will be designed to assess a company’s policies that reflect “poor pay practices” or could potentially encourage excessive risk-taking (such as stock option repricings without shareholder approval, guaranteed bonuses, “mega grants” of stock options, lucrative severance packages, and high pay opportunities relative to industry peers), as well as program features that may mitigate this risk (such as “clawback” policies or stock ownership and holding requirements).

RMG will compile responses in each relevant subcategory to generate an overall rating for each of the four primary categories:

- **Low** – practices that reduce the level of concern;
- **Medium** – practices with no impact on the level of concern; and
- **High** – practices that increase the level of concern.

RMG expects to update the GRId methodology on an annual basis in conjunction with its corporate governance policy update each fall.

RiskMetrics Introduces New Corporate Governance Tool (continued)**Verifying GRId Data**

Given the potential significance of the new ratings, companies will want to verify the data that RMG compiles to ensure that it is accurate and complete. RMG plans to establish a password-protected data verification site in early March 2010 that will be freely available to all of the public companies that it covers. Companies that already have access to RMG's Governance Analytics may use their current password to access the new site; all others should contact RMG at support-corporate@riskmetrics.com or call (301) 556-0570.

You may not have much time to verify the accuracy of your GRId data if time is limited between the GRId rollout and your annual meeting of shareholders. Consequently, you may wish to check your profile as soon as it is posted to ensure that any errors have been identified (and fixed) and a corrected report is issued, and thereafter at least annually.

Potential Implications

- GRId is being touted as a risk assessment tool. In the current highly-sensitized environment for both corporate governance and compensation-related risks, companies will need to be mindful of this analysis as it may have far-reaching implications for how your shareholders – and the general public – view your company's management of governance and compensation-related risks.
- While GRId's ultimate impact will unfold over the next several months, its use of color-coding to present a company's level of compliance will present an appealing (albeit simplistic) way for investors and others to form a general impression of a company's governance practices, which may influence their overall opinion of the company and, more importantly, their voting decisions.
- Further, RMG's use of a single set of "best practices" to determine its ratings will give it additional leverage to influence, if not dictate, the corporate governance practices of U.S. companies. In the past, the CGQ system evaluated a company's policies and practices relative to its peers, which largely precluded adverse consequences for the presence or absence of a policy or practice that reflected the prevailing market. That will no longer be true under GRId, potentially generat-

ing additional pressure on companies to conform to RMG's governance policies even where legitimate reasons to not follow a specific policy may exist.

- On the other hand, the additional transparency offered by the new system should make it easier for companies to identify (and address) problematic governance or compensation policies and practices, and introduce a greater degree of certainty into a process that has been long-criticized for its complexity and opacity. RMG has committed to disclosing the data points that are employed in the GRId system, along with its underlying methodology.
- At this stage, there are several important questions about GRId which remain unanswered. For example, RMG has not yet indicated whether and, if so, how GRId analyses will influence its voting recommendations on director elections and compensation-related shareholder proposals. In addition, RMG has yet to publicly disclose how companies will be able to access their analyses, rather than just the results of these analyses, and how this access will be priced. The answers to these questions will go a long way to helping companies understand the potential implications of the new methodology and its impact on their interactions with RMG.

Visit www.riskmetrics.com/grid-info to view RMG's announcement of GRId, along with more detailed information about the new program.

Need Assistance?

Compensia has had significant experience in helping companies understand and address RiskMetrics' corporate governance and executive compensation policies. If you have any questions on the topics covered in this Thoughtful Pay Alert or would like assistance in assessing how GRId is likely to affect your executive compensation program, please feel free to contact us. ■

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