RiskMetrics Issues Policy Updates for 2009 Proxy Season

RiskMetrics Group, the East Coast-based risk management and corporate governance services provider ("RMG"), recently updated its U.S. corporate governance policies for the upcoming 2009 proxy season. This update, which continues an annual tradition started by Institutional Investor Services ("ISS"), which was acquired by RMG in 2007, covers the corporate governance and executive compensation policies that are used by RMG to determine its voting recommendations for its proxy advisory clients.

As in past years, this year's updates include changes affecting various governance and compensation issues, as well as revisions to the formula RMG uses to evaluate equity-based compensation plan proposals. (The policy updates in the compensation area are summarized in the shaded box below.)

The updated policies are effective for annual shareholder meetings held after February 1, 2009.

Significance of Policies

As an advisor to the institutional investor community for many years, ISS established itself as a bellwether for the key shareholder issues each proxy season. For several years, ISS (and now RMG) has regularly published and annually updated its standards on good corporate governance. These standards, which are contained in a series of policy statements, are used by RMG to formulate the voting recommendations on annual shareholders meeting proposals that it provides to its clients, as well as to analyze companies' corporate governance practices.

While most technology and life sciences companies focus on the policy updates that affect their corporate governance structure and executive compensation programs, the updates actually encompass a broader range of shareholder issues, including auditing practices and a number of corporate responsibility matters (such as energy efficiency, internet privacy, operations in high-risk markets, and product safety).

This article summarizes the policy updates that affect executive and equity compensation matters.

Impact of Economic Crisis

The ongoing economic crisis has not only roiled the markets and undermined investor confidence, from RMG's standpoint it has also brought into question all executive compensation practices, including practices that were considered acceptable in the past. Thus, companies should recognize that "everything is on the table" in 2009 and that their pay policies and practices will be evaluated

Summary of RMG's Compensation-Related Policy Updates

Impact of Economic Downturn – RMG plans to evaluate all pay policies from the standpoint of whether they create and sustain long-term shareholder value. Most importantly, the economic crisis will not be considered sufficient justification for an option repricings or exchange, or the resetting of incentive plan performance goals. Voting recommendations will continue to be made on to promote pay for performance.

Pay for Performance – Companies in industry sectors that have suffered a widespread financial decline will not be considered

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to have a "pay for performance" disconnect even though CEO pay has increased while one- and three-year TSR has declined as long they are not in the bottom half of their industry group (based on their GICS codes).

Poor Pay Practices – RMG has expanded its list of "poor pay practices" to include tax gross-ups or "modified single-trigger" provisions in severance or change-in-control arrangements, accelerated vesting of equity awards upon a change-in-control transaction that isn't completed, tax reimbursements on executive perquisites, and payment of dividends and dividend equivalents on unearned performance share awards.

Good Pay Practices – RMG has updated its list of "good pay practices" to enhance the examples of shareholder-friendly employment agreements, severance and change-in-control arrangements, SERPs, and deferred compensation. The examples also cover good disclosure practices, including a detailed explanation and rationale regarding compensation amounts, pay strategy, the pay mix, performance-based compensation metrics and targets, competition, and the pay for performance linkage.

Burn Rate Limits – RMG has updated its annual "burn rate" limits (the number of shares that can be granted as options and other equity awards) by approximately 10%, on average, but with wide variance across industries. Its 2009 guidelines for applying a premium to full value share awards is the same as for 2008.

Stock Option Overhang – In response to the unprecedented volatility in the stock market, RMG will use a 400-day, rather than a 200-day, sampling period for calculating stock price volatility in its shareholder value transfer formula for the next four quarterly data downloads.

Section 162(m) Compliance – RMG will vote against plan amendments intended to ensure compliance with the "performance-based compensation" exception of Section 162(m), the $1 million deduction limit, unless the board compensation committee does not consist solely of "independent" directors (which RMG defines as a director with no material connection to the company other than his or her board seat).

from the perspective of whether they are aimed at creating and sustaining long-term shareholder value.

This reorientation will be seen in the following policy shifts:

Shareholder Proposals

RMG is re-evaluating its policies on compensation-related shareholder proposals. For example, even though RMG previously did not support shareholder proposals on "clawbacks" of incentive pay where a company had previously instituted a corresponding policy, it may now do so if that policy does not meet "best practices." In addition, the evaluation of shareholder proposals seeking to impose holding requirements for executives who receive stock-based incentives will, similarly, be considered in light of events that call into question whether certain incentives encourage undue risk-taking.

Repricing or Exchange of Stock Options and Resetting of Performance Goals

RMG does not view the deterioration of the stock market, in and of itself, as a sufficient justification for companies to reprice their stock options (or conduct an option exchange) or for compensation committees to reset the performance objectives or targets under performance-based compensation plans. Instead, it intends to continue to apply its voting recommendation policies as appropriate to encourage the strongest possible link between executive pay and performance.

Compensation Peer Groups

In response to both institutional investor and issuer feedback, RMG has revised its methodology for constructing peer groups used to show the pay of the chief executive officers of companies in the Russell 3000 relative to their peers. Specifically:

- Company size will be a key determinant in peer group construction. It will use size parameters ranging from 0.5X to 2X times the company's size. This will generally be measured by revenue (assets in the case of financial services companies) or, as appropriate, market capitalization
- Peer groups will no longer be required to contain 12 companies, since that may lead to inclusion of too many firms that are dissimilar to a company. Instead, the chief executive officer compensation peer group will have a minimum of eight companies
- In the case of extremely large companies, a wider industry sector or a market index may be used to create a peer group of reasonably similar companies.

In 2009, RMG plans to add to its research reports a comparison of chief executive officer compensation under both its peer group methodology (as described above) and the peer group selected by the company. While it does not appear that these reviews will have any practical impact on RMG's current analyses, it remains to be seen whether (and how) its institutional clients will make use of this information.

Pay for Performance

Generally, RMG will recommend a vote "against" a compensation plan and/or a "withhold vote" from the members of a compensation committee if:

- There is a pay for performance disconnect between the chief executive officer's pay and the company's stock performance;
- The main source of the pay increase (over half) is equity-based; and
- The chief executive officer is a participant (or proposed participant) in the compensation plan.

For these purposes, a "pay for performance disconnect" is defined as an increase in the chief executive officer's total compensation where the company's one-year and three-year total shareholder return ("TSR") are in the bottom half of its industry group (based on the company's four-digit global industry classification standard ("GICS") code). Previously, a disconnect was deemed to exist where the chief executive officer's pay had increased when one-year and three-year TSR were both negative (as measured on an absolute basis). The move to a relative approach was based both on institutional client feedback and recognition of the ongoing financial crisis.

Under this policy, RMG first identifies companies that are in the bottom half of each four-digit GICS code group for the one- and three-year fiscal periods where there has been an increase in the total direct compensation of the chief executive officer. The chief executive officer's total direct compensation is the sum of base salary, bonus, non-equity incentives, the full grant date value of stock options and other stock awards, the target value of performance shares or units, any change in pension value and nonqualified deferred compensation earnings, and all other compensation (with the exception of equity awards, these are essentially the same items reported in the company's Summary Compensation Table).

RMG then examines the company's Compensation Discussion and Analysis ("CD&A") to understand the source of the compensation increase (for example, is the increase attributable to performance-based compensation, such as performance-based stock or time-based restricted stock?). In RMG's view, the CD&A should provide "enlightening and meaningful" disclosure with respect to the compensation committee's decisions on the chief executive officer's pay and the underlying rationale for the pay increase despite poor stock performance. This analysis will be conducted on a case-by-case basis that will involve a detailed examination of the company's CD&A.

Newly-appointed chief executive officers that have not been with the company for the prior two completed fiscal years are exempt from the policy.

To potentially mitigate the "against" or "withhold vote" recommendations, RMG will consider whether a company has evidenced a commitment to "pay for performance" principles by:

- stating that the compensation committee has reviewed all components of the chief executive officer's compensation,
- providing a tally sheet under various termination of employment scenarios,
- disclosing the performance measures and goals for all performance-based compensation,
- committing to grant at least 50% of its equity awards (measured by number of shares) where the grant or vesting is tied to pre-established performance conditions, and
- committing that the compensation committee has the sole authority to hire or fire compensation consultants.

To ensure full transparency to shareholders, RMG requires that this commitment must be publicly disclosed.

Observations

This updated policy should provide relief for companies that are in industry sectors that have experienced a widespread financial decline. Not only does the policy only apply to companies that are part of the Russell 3000, we understand that relative stock price performance will be measured against only those companies in the applicable four-digit GICS code group that are included in the Russell 3000. For most companies, the challenge here will be to track their status themselves without having to pay RMG for the information. This may require using various third-party sources to access the TSR information for the other companies in their industry sector.

Further, the potential lag in the assessment of short-term and long-term TSR will continue to lead to surprising results. For example, a company that increases its chief executive officer's compensation at the beginning of the year for prior year performance (based, in part, on its immediate one-year and three-year TSR) and then experiences a dramatic downturn in its stock price that drops it into the bottom half of its four-digit GICS code group, may find itself to have violated the "pay-for-performance" policy (even though the compensation decision was actually made at a time when it was near the top of the industry group). Similarly, a company that makes one-time retention awards or increases the size of its annual equity awards in response to "underwater" stock options resulting from the recent market turmoil may experience similar problems. In these situations, the company's CD&A will play a critical role in determining how the policy will be applied.

RMG will now provide an analysis of the pay of a company's chief executive officer relative to the company's actual peer group (in addition to the four-digit GICS code group). Consequently, where the total direct compensation of a company's chief executive officer is high relative to their peers (or if the company's peer group is comprised of companies that are larger than it is), this will be readily apparent. Also, where a company uses survey data to assist in setting its chief executive officer's pay, but doesn't disclose this fact, then its explanation of pay positioning won't necessarily match RMG's analysis.

Finally, as companies continue shift their long-term equity programs to full-value share awards, we may see more instances where individual companies fail this pay-for-performance test (because their chief executive officer has received a pay increase, over half of which is attributable to equity) unless they use reasonable exchange ratios (for example, the ratios applied in RMG's burn rate table below) when making restricted

stock or performance share awards Otherwise, the mere shift (without a corresponding adjustment to the size of these full value awards) may have the unforeseen effect of creating what RMG would consider a pay "disconnect" even though the move from stock options to other award types may be intended to better align the interests of executives and shareholders.

Poor Pay Practices

For the past four years, RMG has been identifying what it considers to be "poor pay practices," the presence of which may result in a "withhold vote" recommendation from directors (particularly, the chief executive officer and the compensation committee members) who are up for reelection, or "against" an equity-based compensation plan that is viewed as facilitating such practices. As a practical matter, companies are evaluated on a case-by-case basis, so the existence of what it considers to be an egregious pay practice will not automatically led to a negative vote recommendation. However, companies that have experienced difficulties with RMG need to be sensitive to its position on these pay practices to minimize potential future problems.

The following list (which is non-exclusive) reflects examples of poor compensation practices that RMG has identified as potentially warranting a "withhold vote" or an "against" recommendation:

- "Egregious" employment contracts (that is, contracts containing multi-year guarantees for salary increases, bonuses, and equity compensation);
- Excessive perquisites, such as overly generous cost and/or reimbursement of taxes for personal use of corporate aircraft, personal security systems maintenance and/or installation, car allowances, and/or other excessive arrangements relative to base salary;
- "Abnormally large" bonus payouts without a justifiable performance linkage or proper disclosure, including arrangements where performance metrics have been changed, canceled, or replaced during the performance period without an adequate explanation of the action and the link to performance;
- "Egregious" pension or supplemental executive retirement plan ("SERP") payouts, including arrangements that include additional years of service not worked that result in significant payouts or include performance-based equity awards in the pension calculation;
- A new chief executive officer with an overly generous new hire package, including a package with excessive "make whole" provisions or any of the other poor pay practices reflected described here;
- Excessive severance and/or change-in-control provisions (for example, the inclusion of payments with a multiplier in excess of 3X cash compensation (base salary and, possibly, annual bonus), severance paid for a "performance-related" termination (that is, due to the executive's failure to perform job functions at the appropriate level), "single trigger" change-in-control payments (for example, payments that are awarded without the loss of a job or a substantial diminution of job duties), and perquisites for former executives, such as car allowances, personal use of corporate aircraft, or other inappropriate arrangements)
- Poor disclosure practices, including:
  - An unclear explanation of how the CEO is involved in the compensation-setting process;
  - A failure to discuss the performance targets and award methodology for annual and long-term incentive awards where the performance period has been completed; and
  - A failure to disclose and explain a company's methodology for benchmarking practices and/or its compensation peer group;
- Internal pay disparity, as reflected by an excessive differential between the chief executive officer's total pay and that of the next highest paid named

executive officer (interestingly, what constitutes an "excessive" differential is not defined);

- Stock option backdating (which is covered in a separate RMG policy); and
- Other excessive compensation payouts or poor pay practices at the company.

Changes for 2009

Based on its recent experience in evaluating executive compensation programs, as well as the enhanced executive compensation disclosure, market "best practices," and feedback from its institutional clients, RMG has made the following enhancements to its poor pay practices list:

- The practice with respect to excessive severance and/or change-in-control arrangements now covers any new or materially amended arrangements that include provisions for the payment of excise tax gross-ups (including modified gross-ups), as well as modified "single-trigger" arrangements (which allow an executive to receive severance payments upon his or her voluntary resignation during a window period following the change in control of the company);
- The practice with respect to excessive severance and/or change-in-control arrangements now covers situations where a company's definition of a "change-in-control" in individual employment agreements or equity-based compensation plans could result in payments to an executive without an actual change in control occurring (see below);
- The practice with respect to excessive perquisites now covers income tax reimbursements paid by a company in connection with any executive perquisites or other payments; and
- A new practice for the payment of dividends or dividend equivalents on unearned performance share awards.

Observations

Companies should review their existing executive compensation arrangements in light of the changes to this poor pay practice list. For example, companies with severance arrangements that contain a modified "single-trigger" provision or allow accelerated vesting of outstanding equity awards even where a proposed change-in-control transaction is not consummated may want to re-evaluate the merits of such provisions.

In addition, RMG's more strident position on tax reimbursements and gross-up payments may provide the impetus for eliminating or phasing out these provisions in any new or materially modified employment agreements or other arrangements. Note, however, that employment agreements with an automatic renewal provision or agreements that have been amended to comply with new laws or regulations (for example, Section 409A of the Internal Revenue Code) are not considered to be "materially modified" for this purposes. Consequently, existing agreements that contain a tax gross-up provision (for example, triggered upon a change-in-control of the company that activates Section 280G) need not be revised at this time solely to comply with RMG's policy.

Another area that will warrant attention involves short-term incentive and performance share plans. Since the payment of bonuses or shares where performance metrics have been changed, canceled, or replaced during the performance period without adequate explanation of the action and the link to performance is considered a poor pay practice, companies with plans that have been rendered moot as a result of the ongoing financial crisis will need to carefully consider the implications of any decisions to waive plan provisions or pay bonuses outside the plan.

Good Pay Practices

In addition to what it doesn't like, RMG also identifies the types of compensation practices that it believes companies should use in their executive compensation

programs (although, in reality, these "good" practices tend to be framed in the negative – essentially telling a company what it shouldn't do). These practices reflect its overarching belief that executive pay should be fair, competitive, reasonable, and appropriate, as well as fundamentally performance-based.

To that end, RMG has identified the following updated examples of best pay practices:

- **Employment agreements**: These should be limited to new executives and have a fixed duration (for example, three years). They should not have an automatic renewal feature and should have a specified termination date.
- **Severance agreements**: These should not be so appealing that they serve as an incentive for the executive to be terminated. The severance formula should be reasonable and not overly-generous (for example, severance multiples should not exceed 3X, and should use pro-rated target/average historical bonus and not the maximum bonus amount), and a failure to renew an employment agreement, termination under questionable circumstances, or termination for poor performance should not constitute "good reason" for termination with severance payments.
- **Change-in-control payments**: These should only be made when there is a significant change in a company's ownership structure, and when there is a loss of employment or a substantial change in job duties associated with the change in company ownership structure (a "double trigger" arrangement). Further, these payments should exclude excise tax gross-ups and should not provide for accelerated vesting of equity awards except under a "double trigger" scenario. Similarly, change-in-control provisions in equity-based compensation plans should be double-triggered. A change in control event should not result in an acceleration of vesting of all unvested stock options or removal of vesting and/or performance requirements on restricted stock or performance shares, unless there is a loss of employment or substantial change in job duties.
- **Supplemental executive retirement plans**: Provisions that can increase the SERP value significantly or even exponentially, such as additional years of credited service or the inclusion of variable pay (for example, bonuses and equity awards) in the benefits calculation formula should be avoided. Similarly, pension formulas should not make use of extraordinary annual bonuses paid close to retirement years and should be based on an average, not the maximum, level of compensation earned.
- **Deferred compensation**: Above-market returns or guaranteed minimum returns should not be applied on deferred compensation.
- **Disclosure practices**: The CD&A should be written in plain English, with as little technical language as possible. The CD&A also should be formatted using section headers, bulleted lists, tables, and charts where possible to ease reader comprehension. Ultimately, the CD&A should provide a detailed explanation and rationale regarding compensation amounts, pay strategy, the pay mix, performance-based compensation metrics and targets, challenges, competition and pay for performance linkage, etc. presented in a narrative fashion.
- **Responsible use of company stock**: Companies should adopt policies that prohibit their executives from speculating in their stock or using company stock in hedging activities, such as "cashless" collars, forward sales, equity swaps or other similar arrangements, as such arrangements undermine the ultimate alignment with long-term shareholders' interests. In addition, these policies should prohibit or discourage the use of company stock as collateral for margin loans, to avoid any potential sudden stock sales (required upon margin calls) that could have a negative impact on the company's stock price.

- **Long-term focus (including hold-until-retirement policies)**: Executive compensation programs should be designed to support companies' long-term strategic objectives. A short-term focus on performance does not necessarily create sustainable shareholder value. Instead, long-term goals may be sacrificed to achieve short-term expectations. Compensation programs embedding a long-term focus with respect to company goals better align with the long-term interests of shareholders. Granting stock options and restricted stock awards to executives that vest in five years do not necessarily provide a long-term focus, as executives can sell the company shares once they vest. However, requiring senior executives to hold company stock until they retire can encourage a long-term focus on company performance.

Observations

The expansion of this list of good pay practices reflects the impact of the enhanced executive compensation disclosure, particularly the CD&A, that is now required of all public companies. As RMG continues to analyze the wealth of information that is now available, it is finding it easier to compare and contrast executive pay practices among companies and industry sectors and develop a refined understanding of what companies are capable of doing. In addition, the emphasis on a long-term focus for executive compensation programs is likely a reflection of the current economic crisis and the concern that some programs may place an undue emphasis on short-term results that create unacceptable levels of organizational risk.

Burn Rate Tables

Each year, RMG updates its "burn rate" tables and limits for the upcoming proxy season. "Burn rate" is measured using the total number of equity awards (stock and options) granted in a given year and is expressed as a percentage of weighted average common shares outstanding. These tables set the acceptable burn rate levels (based on one standard deviation above the industry mean) using the four-digit GICS codes.

Currently, RMG will recommend a vote "against" an equity-based compensation plan proposal if the company's average three-year burn rate exceeds one standard deviation higher than the industry mean (based on the applicable GICS category), and is greater than 2%. If a company grants both full value awards and stock options, ISS applies a "multiplier" to the full value awards for the past three fiscal years to equate them economically with stock options. A company that would otherwise fail the burn rate test may still avoid an "against" recommendation if it publicly commits to stay within its applicable burn rate limit for the next three years.

Changes for 2009

RMG has updated its burn rate tables for 2009 as reflected in the table on page 9.

In the case of companies that grant full value awards, RMG applies a premium on these awards for the past three fiscal years (see the burn rate multiplier table on page 10).

Observations

RMG's burn rate limits went up by approximately 10%, on average, but with wide variance across industries. The guidelines for applying the premium on full value shares for 2009 are the same as in 2008.

As discussed further below, for the next four quarterly data downloads, RMG intends to measure stock price volatility (using RMG's calculated, rather than the company's reported, volatility) over 400, rather than 200, days for purposes of converting full-value awards to stock option equivalents, as well as for its shareholder value transfer ("SVT") analysis. As this will likely reduce stock price volatilities for companies in most technology industries, full-value awards may become more expensive in the burn rate analysis.

RiskMetrics Issues Policy Updates for 2009 Proxy Season (continued)

RiskMetrics 2009 Burn Rate Table

		Russell 3000				Non-Russell 3000			
GICS	Description	Mean	Standard Deviation	Mean + SDEV	Change from 2008	Mean	Standard Deviation	Mean + SDEV	Change from 2008
1010	Energy	1.75%	1.35%	3.09%	0.0%	2.41%	2.75%	5.15%	16.3%
1510	Materials	1.22%	0.91%	2.14%	10.9%	2.17%	1.63%	3.80%	-15.4%
2010	Capital Goods	1.69%	1.83%	3.52%	38.0%	2.71%	2.44%	5.15%	17.3%
2020	Commercial Services & Supplies	2.21%	1.79%	4.01%	-1.0%	2.50%	2.19%	4.69%	10.9%
2030	Transportation	1.82%	1.36%	3.18%	13.6%	1.86%	1.59%	3.45%	-15.9%
2510	Automobiles & Components	1.86%	1.19%	3.05%	2.0%	1.86%	1.19%	3.05%	-19.3%
2520	Consumer Durables & Apparel	2.06%	1.38%	3.44%	3.3%	2.33%	2.46%	4.79%	18.6%
2530	Consumer Services	2.11%	1.21%	3.32%	-0.3%	2.75%	2.39%	5.14%	20.9%
2540	Media	1.87%	1.38%	3.25%	-0.6%	3.16%	2.98%	6.13%	3.4%
2550	Retailing	1.84%	1.27%	3.12%	7.6%	2.79%	1.83%	4.62%	-20.3%
3010, 3020, 3030	Consumer Staples	1.77%	1.35%	3.12%	6.8%	2.39%	2.06%	4.45%	15.6%
3510	Health Care Equipment & Services	2.72%	1.67%	4.39%	-3.9%	3.63%	3.01%	6.64%	3.8%
3520	Pharmaceuticals & Biotechnology	3.40%	2.36%	5.76%	16.1%	4.98%	4.49%	9.46%	8.9%
4010	Banks	1.20%	0.97%	2.18%	1.4%	1.40%	1.50%	2.89%	32.0%
4020	Diversified Financials	2.94%	2.62%	5.56%	23.0%	5.12%	5.93%	11.05%	13.8%
4030	Insurance	1.23%	0.98%	2.22%	3.7%	2.49%	2.22%	4.71%	8.3%
4040	Real Estate	1.07%	0.99%	2.05%	10.8%	1.33%	1.52%	2.85%	41.1%
4510	Software & Services	4.05%	2.72%	6.76%	10.6%	5.57%	4.56%	10.12%	9.2%
4520	Technology Hardware & Equipment	3.24%	2.29%	5.52%	15.0%	3.54%	2.76%	6.30%	8.1%
4530	Semiconductors & Semiconductor Equipment	3.69%	2.02%	5.72%	2.3%	4.95%	2.84%	7.79%	14.4%
5010	Telecommunication Services	2.16%	1.57%	3.74%	33.6%	2.92%	3.00%	5.92%	16.1%
5510	Utilities	0.81%	0.83%	1.64%	34.4%	0.87%	1.00%	1.86%	48.8%

Change to Definition of Change in Control

As has long been the case, RMG evaluates equity-based compensation plans on a case-by-case basis. Typically, it will recommend a vote "against" an equity compensation plan if any of the following factors apply:

- The total cost of all of the company's equity compensation plans is considered "unreasonable" (that is, under RMG's SVT analysis, the plan's cost exceeds the company's allowable cap). Unlike its burn rate information, which is published by industry group, RMG treats these "allowable cap" figures, which can vary significantly for companies in the same industry, as proprietary;
- The plan expressly permits the repricing (or other exchange) of stock options or stock appreciation rights without prior shareholder approval;
- For Russell 3000 companies, the chief executive officer may participate in the proposed plan and there is a disconnect between his or her pay and the company's performance where over 50% of the year-over-year increase is attributed to equity awards (see above);
- The company's three year burn rate exceeds the greater of 2% and the mean plus one standard deviation of its industry group; or
- The plan is a vehicle for "poor pay practices."

Beginning in 2009, RMG is adding a new factor that will trigger an "against" recommendation. If a plan provides for accelerated vesting of equity awards in the event of a change in control of the company even though an actual change in control may not occur, it will recommend a vote "against" the plan. For example, a provision that calls for accelerated vesting of outstanding equity awards upon shareholder approval of a transaction or the announcement of a tender offer, rather than the actual consummation of the transaction, will result in an "against" recommendation.

Volatility Assumptions in Equity Plan Proposals

Currently, under RMG's SVT and burn rate policies, stock price volatility is calculated using historic daily price movements equivalent to the standard deviation of a company's stock price over a 200-day sampling period.

Annual Stock Price Volatility	Multiplier
54.6% and higher	1 full-value award will count as 1.5 option shares
36.1% or higher and less than 54.6%	1 full-value award will count as 2.0 option shares
24.9% or higher and less than 36.1%	1 full-value award will count as 2.5 option shares
16.5% or higher and less than 24.9%	1 full-value award will count as 3.0 option shares
7.9% or higher and less than 16.5%	1 full-value award will count as 3.5 option shares
Less than 7.9%	1 full-value award will count as 4.0 option shares

For the next four quarterly data downloads (that is, December 1, 2008, March 1, 2009, June 1, 2009, and September 1, 2009), RMG will use a 400-day volatility sampling period for its SVT and burn rate polices. It intends to revert to the 200-day volatility sampling period beginning with the December 1, 2009 data download and for all subsequent quarterly data downloads.

This temporary change is being made in response to the recent unprecedented volatility levels in the stock market to minimize the possibility of unintended consequences such as a company's stock option valuations approaching the valuations for full value shares. By doubling the sampling period for the next four quarters, RMG is hoping to reduce the impact of the recent (and ongoing) market volatility, and, thus, provide a more representative assessment of a company's stock valuation.

Observations

The use of the 400-day volatility sampling period should reduce the value of outstanding stock options in the SVT analysis, but may also provide that full-value share awards are more expensive in the burn rate analysis. Presumably, RMG will return to the 200-day sample period when it next updates its policies In November 2009, although it has indicated that such a decision will be based on market conditions at that time.

Proposals to Maintain Tax Deductibility of Incentive Compensation Plans

Currently, RMG will recommend a "for" vote in the case of a company proposal that simply seeks to amend a shareholder-approved incentive compensation plan to:

- include administrative features;
- place a cap on the amount that any individual participant may receive during a single year; or

- add performance goals (unless clearly inappropriate) to comply with the requirements of the "performance-based" compensation exception of Section 162(m) of the Internal Revenue Code. Further, RMG will recommend a "for" vote in the case of a cash or cash and stock bonus plan that is submitted to shareholders for the purpose of qualifying the plan under the "performance-based" compensation exception of Section 162(m) as long as no increase in shares is requested.

Where a company seeks to amend an existing compensation plan to increase the number of shares reserved and to qualify for favorable tax treatment under Section 162(m), the proposal (and the plan) will be considered on a case-by-case basis using a proprietary, quantitative model developed by RMG.

RMG's new policy position is to recommend a vote "against" any of the foregoing proposals where the compensation committee of the company's board of directors does not fully consist of "independent" directors under its definition of director independence (that is, the director has no material connection to the company other than his or her board seat). This position is intended to further RMG's objective of ensuring that the oversight of corporate incentive compensation plans is conducted through fully independent "outside" advisors.

Implications of Updated Policies

RMG maintains the premier presence in the proxy voting area, and, for many companies, its policies are very influential with their investors. Typically, companies with strong institutional shareholder bases design their executive compensation programs with an eye towards the policies and try to avoid "against" or "withhold vote" recommendations when possible.

However, while the policies offer insight into RMG's position on current executive pay issues, they are not always an accurate forecast of its ultimate analysis or vote recommendations for an individual company. As in the past, the specific issues that may be raised will depend largely on the orientation and experience of the analyst reviewing the company's disclosures, as well as the totality of its corporate governance and executive compensation picture.

Further, although this year's turbulent market events have created significant challenges for compensation committees in making year-end pay decisions, they do not appear to have significantly influenced the policy updates. While this may reflect a tacit acknowledgement by RMG that the current environment presents a series of issues that are not easily translated into formal policies, it is more likely an attempt to retain flexibility in the face of the complex and novel compensation-related issues that may present themselves over the next year.

Consequently, companies with unusual compensation structures or that find themselves making decisions that may deviate from their previously-disclosed program should treat their CD&A as an opportunity to explain and justify their compensation policies (and related decisions) to ensure that RMG has access to appropriate information with which to formulate its 2009 voting recommendations. As a practical matter, this means that most companies will want to familiarize themselves with RMG policy guidelines to ensure that they do not encounter any insurmountable obstacles in adopting any new equity-based compensation plans or re-electing their board of directors. ■

To obtain a copy of the RMG "US Corporate Governance Policy 2009 Updates," please click here »

About Compensia

Compensia, Inc. is a management consulting firm that provides executive compensation advisory services to Compensation Committees and senior management.

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