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U.S. Corporate Governance Policy

2014 Updates

November 21, 2013

Institutional Shareholder Services Inc.

ISS' U.S. Corporate Governance Policy
2014 Updates

Effective for Meetings on or after Feb. 1, 2014
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Table of Contents

SUMMARY OF ISS' POLICY FORMULATION PROCESS

Each year, ISS' Global Policy Board conducts a robust, inclusive, and transparent global policy formulation process that produces the benchmark proxy voting guidelines that will be used during the upcoming year.

The policy review and update process begins with an internal review of emerging issues and notable trends across global markets. Based on data gathered throughout the year (particularly from client and issuer feedback), ISS forms policy committees by governance topics and markets. As part of this process, the policy team examines academic literature, other empirical research, and relevant commentary. ISS also conducts surveys, convenes roundtable discussions, and posts draft policies for review and comment. Based on this broad input, ISS' Global Policy Board reviews and approves final drafts and policy updates for the following proxy year. Annual updated policies are announced in November and apply to meetings held on and after February 1 of the following year.

Also, as part of the process, ISS collaborates with clients with customized approaches to proxy voting. ISS helps these clients develop and implement policies based on their organizations' specific mandates and requirements. In addition to the ISS regional benchmark (standard research) policies, ISS' research analysts apply more than 400 specific policies, including specialty policies for Socially Responsible Investors, Taft-Hartley funds and managers, and Public Employee Pension Funds, as well as hundreds of fully customized policies that reflect clients' unique corporate governance philosophies. The vote recommendations issued under these policies often differ from those issued under the ISS benchmark policies. ISS estimates that the majority of shares that are voted by ISS' clients fall under ISS' custom or specialty recommendations.

Key Strengths of ISS' Policy Formulation Process

Industry-Leading Transparency: ISS promotes openness and transparency in the formulation of its proxy voting policies and the application of these policies in all global markets. A description of the policy formulation and application process, including specific guidelines and Frequently Asked Questions, appear on our website under the Policy Gateway section.

Robust Engagement Process with Industry Participants: Listening to diverse viewpoints is critical to an effective policy formulation and application process. ISS' analysts routinely interact with company representatives, institutional investors, shareholder proposal proponents, and other parties to gain deeper insight into critical issues. This ongoing dialogue enriches our analysis and informs our recommendations to clients.

Global Expertise: ISS ' policy formulation process is rooted in global expertise. ISS' network of global offices provides access to regional and local market experts for the Americas, EMEA (Europe/Middle East/Africa), and Asia-Pacific regions.

This document presents the changes being made to ISS' Benchmark U.S. Corporate Governance Policies. The full text of the updates, detailed results from the Policy Survey, and comments received during the open comment period, are all available on ISS' website under the Policy Gateway.

The ISS 2014 U.S. Policy Updates will be effective for meetings on or after February 1, 2014. In December 2013, ISS will release a complete set of updated policies (in full or summary form). For other updates, please refer to the Executive Summary of Key 2014 Updates and Process.

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

Current Recommendation:

Board Responsiveness

Vote against or withhold from individual directors, committee members, or the entire board of directors as appropriate if:

2.1. For 2013, the board failed to act[1] on a shareholder proposal that received the support of a majority of the shares outstanding the previous year;
2.2. 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;
2.3. 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;
2.4. The board failed to act on takeover offers where the majority of shares are tendered;
2.5. At the previous board election, any director received more than 50 percent withhold/against votes of the shares cast and the company has failed to address the issue(s) that caused the high withhold/against vote; or
2.6. The board implements an advisory vote on executive compensation on a less frequent basis than the frequency that received the majority of votes cast at the most recent shareholder meeting at which shareholders voted on the say-on-pay frequency.

Vote case-by-case on the entire board if:

2.7. The board implements an advisory vote on executive compensation on a less frequent basis than the frequency that received a plurality, but not a majority, of the votes cast at the most recent shareholder meeting at which shareholders voted on the say-on-pay frequency, taking into account:
- The board's rationale for selecting a frequency that is different from the frequency that received a plurality;
- The company's ownership structure and vote results;
- ISS' analysis of whether there are compensation concerns or a history of problematic compensation practices; and
- The previous year's support level on the company's say-on-pay proposal.

[1] 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.

Key Changes:

- Implementing one year of a majority of votes cast as the threshold for the policy application as announced last year;
- Clarifying that the board's rationale is a factor in the case-by-case analysis of less than full implementation of the proposal;
- Changing the "Board Responsiveness" section from "Generally vote Against" to " Case-by-case"; and
- Incorporating the factors for examining responsiveness to majority-supported shareholder proposals into the policy itself rather than as a footnote.

New Recommendation:

Generally vote for director nominees, except under the following circumstances:

Board Responsiveness

Vote case-by-case on individual directors, committee members, or the entire board of directors as appropriate if:

2.1. The board failed to act on a shareholder proposal that received the support of a majority of the shares cast in the previous year. Factors that will be considered are:

- Disclosed outreach efforts by the board to shareholders in the wake of the vote;
- Rationale provided in the proxy statement for the level of implementation;
- The subject matter of the proposal;
- The level of support for and opposition to the resolution in past meetings;
- Actions taken by the board in response to the majority vote and 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;

2.2. The board failed to act on takeover offers where the majority of shares are tendered;

2.3. At the previous board election, any director received more than 50 percent withhold/against votes of the shares cast and the company has failed to address the issue(s) that caused the high withhold/against vote;

2.4. The board implements an advisory vote on executive compensation on a less frequent basis than the frequency that received the majority of votes cast at the most recent shareholder meeting at which shareholders voted on the say-on-pay frequency; or

2.5. The board implements an advisory vote on executive compensation on a less frequent basis than the frequency that received a plurality, but not a majority, of the votes cast at the most recent shareholder meeting at which shareholders voted on the say-on-pay frequency, taking into account:

- The board's rationale for selecting a frequency that is different from the frequency that received a plurality;
- The company's ownership structure and vote results;
- ISS' analysis of whether there are compensation concerns or a history of problematic compensation practices; and
- The previous year's support level on the company's say-on-pay proposal.

Rationale for Update: The marketplace debate continues to evolve with respect to the issue of board responsiveness to majority-supported shareholder proposals with respect to both institutional investors' expectations and issuers' outreach and actions. In 2013, of the 84 shareholder proposals that received support from either a majority of shares outstanding or two years of a majority of votes cast, 73 have been partially or fully implemented by the board to date.

In 2013, ISS made three changes to its policy on board responsiveness to majority - supported shareholder proposals:

- First, starting in 2014, ISS will review the responsiveness of a board to a shareholder proposal that receives one year of a majority of votes cast rather than the previous “triggers” of either two years of a majority of votes cast in a three-year period, or one year of a majority of shares outstanding;
- Second, ISS adopted a case-by-case approach, including a list of factors for analysts to consider, for assessing implementation of majority vote proposals; and
- Finally, ISS provided analysts with broader discretion when determining which directors to hold accountable in the event the level of responsiveness is found to be insufficient.

After soliciting and examining additional feedback from various constituencies via survey, roundtables, and public comment, ISS determined to fully implement the 2013 policy update with a couple of changes. First, ISS’ 2014 policy update clarifies that vote recommendations on director elections with respect to majority-supported shareholder proposals will be made on a fact-specific case-by-case basis. ISS also added “the board's rationale as provided in the proxy statement” as one of the factors in our case-by-case analysis.

These clarifying changes respond to direct feedback received during the policy process. According to ISS' 2013-14 policy survey results, 40 percent of institutional investor respondents indicated that the board should be free to exercise its discretion to respond in a manner that it believes is in the best interest of the company and to disclose the rationale for any actions it takes while 36 percent indicated that the board should implement a specific action to address the shareholder mandate. Comments from our roundtable discussions backed this comply-or-explain approach. Directors and investors generally agreed that boards should either implement a governance action based on a majority supported shareholder proposal or provide a rationale for less than full implementation. Accordingly, directors should communicate how they made the determination that the response they chose is in the best interest 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[2] 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.

Key Changes: Change the calculation of the first peer group alignment measure, the relative degree of alignment (RDA), from a 40/60 weighted average of 1- and 3-year RDA measures to a single, annualized RDA measure for the 3-year measurement period (or shorter period if pay and performance data are not available for all three years).

[2] 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.

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[3] Alignment:
    - The degree of alignment between the company's annualized TSR rank and the CEO's annualized total pay rank within a peer group, each measured over a three-year period.
    - 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[4] compared to grant pay; and
- Any other factors deemed relevant.

Rationale for Update:

A number of reasons are prompting this update:

- Under the revised methodology, ISS will calculate the difference between the company's TSR rank and the CEO's total pay rank within a peer group, as measured over a three-year period (or as many full fiscal years that the company has been publicly traded and disclosed pay data). The current relative degree of alignment (RDA) is the weighted average of two measures: the RDA over a one-year period, and the RDA over a three-year period, weighted 40 percent and 60 percent respectively. Because the most recent year is included in both measures, the result is that this most recent year is the most heavily weighted. Under the new model, each year of TSR will be weighted equally and calculated to produce the annualized TSR for the measurement period, thus providing a smoother performance measure that does not over-emphasize any particular year during the measurement period. Relevant performance and pay in particular years will be addressed during the qualitative phase of ISS' review, as applicable.

- A single measure provides a better view on long-term pay and performance alignment and avoids being overwhelmed by periods of volatility and mean-reversion, especially. The revised formula also better

[3] The 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.

[4] Beginning with Feb. 1, 2014, meetings, ISS research reports will include realizable pay for S&P1500 companies.

addresses companies that have at least two years, but not three years of TSR data available; under the current model, only one year of pay and performance can be assessed in such cases.

- The relative aspect of RDA better matches a single measure. This is best illustrated by an example: a company might experience significant declines in years 1 and 2 of a three-year period, then partially rebound in the final year. This apparent "strong" performance in the final year might be the 100th percentile relative to peers, and thus dominate the longer-term poor performance: even if three-year performance lagged all peers (0th percentile), the weighted arithmetic average performance rank under the current methodology would be at the 40th percentile. The new methodology would better reflect poor overall long-term performance. The same effect would be seen if the reverse is true – two years of high TSR followed by a year of significant decline in TSR.

- Using a single three-year measure also diminishes certain issues relative to the timing of equity awards. Many companies grant equity early in the fiscal year, before the corresponding performance year. A longer-term "average" performance (matched to average pay) helps alleviate any potential timing mismatch.

- A single measure, and its longer term, better aligns with our stated principles of evaluating long-term shareholder performance.

SOCIAL/ENVIRONMENTAL ISSUES

Corporate Governance Issue:
Lobbying

Current 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.

Key Changes: This update modifies the policy's bullet points in order to enhance and better communicate how the proposals are evaluated and the factors that are considered in ISS' analysis. Specifically, the first bullet is updated to reflect that executive level oversight of lobbying activity, in addition to that provided by the board, is considered. A new bullet is added to formally include trade association activity as a relevant factor. The last bullet in the current policy is deleted, as it is no longer relevant to our analysis and represents a legacy policy which was previously added in response to proposals that are no longer submitted.

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 lobbying policies, and management and board oversight;
- The company's disclosure regarding trade associations or other groups that it supports, or is a member of, that engage in lobbying activities; and
- Recent significant controversies, fines, or litigation regarding the company's lobbying-related activities.

Rationale for update: During a review of the policy it was determined that clarification in the language would be beneficial. As a result, the current policy is being amended to better reflect the factors considered in ISS' analysis. In addition, the amendment removes an outdated bullet point that addressed a shareholder resolution that is no longer filed by proponents.

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Corporate Governance Issue:
Human Rights Risk Assessment

Current Recommendation: Case-by-case based on application of Global Approach.

Key Changes: A formal policy is being adopted.

New Recommendation: Vote case-by-case on proposals requesting that a company conduct an assessment of the human rights risks in its operations or in its supply chain, or report on its human rights risk assessment process, considering:

- The degree to which existing relevant policies and practices are disclosed, including information on the implementation of these policies and any related oversight mechanisms;
- The company's industry and whether the company or its suppliers operate in countries or areas where there is a history of human rights concerns;
- Recent, significant controversies, fines, or litigation regarding human rights involving the company or its suppliers, and whether the company has taken remedial steps; and
- Whether the proposal is unduly burdensome or overly prescriptive.

Rationale for update: During the 2013 proxy season, proponents filed new resolutions relating to a company's assessment of its risks related to human rights issues. These resolutions asked for companies to either perform a human rights risk assessment or report on their human rights risk assessment process.

These resolutions differ from the human rights proposals that have been most frequently submitted by shareholder proponents in the past, which have typically sought a report on a company's human rights policies or the amendment of a company's human rights policies to bring them into greater conformity with international human rights standards and conventions.

This addition to the current human rights policy is necessary to provide guidance, given that the existing policy does not address resolutions on human rights beyond policy disclosure or adoption, which require the consideration of different factors.

DISCLOSURE/DISCLAIMER