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October 29, 2014

Mercer Commentary on the Equity Plan Scorecard Proposal

To Whom It May Concern:

Mercer has reviewed the proposed Equity Plan Scorecard (EPSC) policy for the 2015 proxy season and we support the proposed holistic scorecard approach to developing vote recommendations on proposed equity plans. We have long believed that a company's performance and grant practices as well as the plan's overall features should be given weight in evaluating an equity plan proposal. We agree that acceptable compensation and governance practices should allow for an ISS recommendation in favor of a plan even if the plan exceeds the ISS shareholder value transfer (SVT) limitations.

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Mercer's Talent business services include consulting and expertise on rewards, workforce analytics and planning, communication, and mobility as well as a full range of best-in-class information and technology solutions. We have extensive experience designing and implementing executive and director compensation programs and assisting public companies with their executive compensation disclosures.

Based upon our review of the proposed policy, we encourage ISS to ensure the following:

- The EPSC should include clear and transparent disclosure of the scoring mechanics. We recommend that ISS provide detailed commentary and scoring results within its analysis reports. A major concern of our clients is whether the EPSC will allow a company to predict ISS's potential voting recommendation with a high degree of certainty prior to publishing its proxy.

- ISS should reconsider its proposed elimination of the use of prospective burn-rate commitments. We believe this to be an important tool for companies to align their plan with shareholder interests. Additionally, utilizing historical grant practices may provide an inaccurate assessment of how a company intends to use a new equity plan.
- ISS should establish a process that allows companies to review and update their equity plan provisions well in advance of filing their proxy statements – similar to the QuickScore process. The current equity plan data verification process offered by ISS is only available to companies after they file their proxy, and only for two days.

Our other comments, based on our experience designing equity plans and input from our clients, are discussed below.

Requested Feedback

1. Are there certain factors in the proposed scorecard approach that should be more heavily weighted when evaluating equity plan proposals?

   We have identified the following as areas of consideration for the scoring matrix:

   - The three proposed areas of analysis – dilution/SVT, company practice, and plan provisions – are appropriate. However, we encourage ISS to add burn rate as a fourth area of analysis rather than including it in the analysis of grant practices. Combining burn rate with other factors may de-emphasize the importance of maintaining competitive share usage levels.
   - We believe burn rate should have a weighting at least equal to that of the SVT test because it provides a fairer assessment of a company's equity grant practices. Companies that grant stock options and/or awards with longer vesting periods often have a higher dilution level/cost in the ISS model simply because of award features and not actual additional SVT cost. Based on our consulting experience, burn rate is now the primary factor used by many institutional investors in analyzing equity plan proposals.
   - As mentioned above, ISS should reconsider its proposed elimination of prospective burn-rate commitments. We believe the ability to make future burn-rate commitments (and using projected burn rate as opposed to historical grant levels) reflects sound corporate governance.
   - Actual share usage practices should carry a higher weighting than plan design elements. Most plan documents are intended to allow flexibility to address unique competitive needs and grant practices. Actual usage practices are more reflective of company actions and committee oversight than plan document terms.

2. Do you see any unintended consequences from shifting to a scorecard approach?

   It is challenging to comment on unintended consequences without knowing how the EPSC factors will be applied and weighted or seeing a sample scorecard. However, below are potential consequences we foresee based on the preliminary information provided:

   - As described above, we have concerns about burn rate being part of the grant practices analysis as well as the elimination of burn-rate commitments. We believe that this may not provide investors with an accurate assessment of how the proposed plan reserve will be utilized and could de-emphasize the importance of annual burn-rate levels. The elimination of future burn-rate commitments (and their use in the analysis) will also eliminate an effective tool that companies have to address a key shareholder concern.
   - Using only the most recent year CEO grants (and their terms and provisions) as the basis for certain analyses may provide an incorrect assessment of a company's policies and practices. This is especially true for companies with a new CEO or for companies where grant practices are determined on an annual basis. We suggest ISS conduct a multi-year review rather than simply using prior year grants.
   - Depending on how the liberal share counting feature is weighted in the proposed EPSC, eliminating the liberal share counting provisions within the SVT assessment may result in more companies re-establishing this practice. We agree with the prior ISS approach that liberal share counting is not an egregious or poor practice but impacts the cost of the overall plan.
   - Eliminating the carve-out for in-the-money options unfairly penalizes companies that use stock options. The new SVT test may not sufficiently offset this negative impact.
   - We believe this is a good time for ISS to revisit its treatment of stock options as non-performance-based. Based on client feedback and information from ISS at a recent conference, there is considerable pushback against this policy. Even the ISS representative noted that options are "performance-based," although maybe not as "strongly" performance-based as other award types.
   - Long-term cash plans continue to have no impact on the scoring matrix and plan evaluation. While they may be difficult to value under the SVT test, we believe they should factor into a scoring matrix, particularly when determining the percentage of performance-based awards granted to the CEO or other NEOs. It would be inaccurate and misleading to penalize companies for lack of performance-based incentives where cash awards comprise a significant portion of their long-term incentive opportunity. Likewise, companies without a long-term cash plan should be allowed a higher annual equity share usage rate.
   - Under the proposed policy, it appears EPSC components and weightings may differ based on industry or company size. While the scoring within a component may be affected by the various peer companies, it may be confusing if different ranges of scoring outcomes or different sets of scoring components are utilized for each industry or size category.
   - Shifting to a scorecard approach could lead to a lack of transparency in how vote recommendations are determined. We strongly encourage ISS to provide clear and detailed information in the new policy guidelines as well as within its annual company assessments.

- The scorecard approach could increase the probability for factual errors and misinterpretations of company practices and policies. It is critical that companies be given sufficient time to review the scoring inputs that ISS will use.

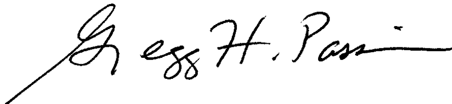
Summary Commentary

We have provided the above information based on our understanding of the initial policy guidelines and the ISS request for general feedback and commentary. Additionally, we have developed the following list of questions that we recommend ISS address in the final policy update and any Q&A documents:

1. Will the underlying scoring mechanics assign specific points or will the elements have interpolated scoring?
2. Will stock options be considered performance-based?
3. Has ISS considered an approach where the ratio of full value shares to options is consistent within the SVT model and the annual burn-rate test? This continues to be a point of confusion for many companies.
4. How will cliff-vesting vs. pro-rata vesting be addressed in the scoring matrix?
5. Will cash-based plans be considered in the scoring? If so, what information is needed?
6. Can companies provide future burn-rate projections/commitments if they vary from historical practices? If so, what information is needed?
7. Will company performance/TSR be factored into the analysis?
8. Will a company's risk-assessment dialogue be addressed in the overall plan assessment?
9. Will a company's say-on-pay results and QuickScore rating impact the EPSC?

Thank you for allowing us the opportunity to provide feedback. Let us know if you have any additional questions or comments.

Regards,



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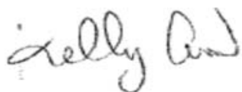

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