

# ISS Governance QuickScore

## *Overview*

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An MSCI Brand

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## Introduction

Institutional Shareholder Services is pleased to introduce ISS Governance QuickScore, a quantitatively-driven data solution designed to identify governance risk within portfolio companies. ISS Governance QuickScore, which will be made available to institutional investors and companies in late February 2013, is the first in a series of ISS QuickScore™ products intended to identify risk within portfolio companies.

ISS Governance QuickScore helps institutional investors identify and monitor potential governance risk in their portfolios and helps companies identify possible investor concerns based on signals of governance risk.

As governance plays a heightened role in investment decision-making, investors are increasingly using data and analytics to support their analysis. The need for quantitative tools to complement qualitative research is emerging as an important trend.

ISS Governance QuickScore is designed to help institutional investors:

- identify and monitor potential governance risk in their portfolios;
- drill down on companies with governance risk;
- identify companies with which to engage on governance issues;
- access detailed data to inform their own investment models; and
- advance compliance on mandates, such as the U.K. Stewardship Code and United Nations' Principles of Responsible Investment

As a governance risk screening tool, the ISS Governance QuickScore methodology contains the following key features:

- **A quantitatively-driven approach**, where governance factor weights are based on the degree of correlation between 40-80 corporate governance attributes and 16 performance and risk factors.
- **Governance attributes**, categorized under four pillars: Board Structure, Shareholder Rights, Compensation/Remuneration, and Audit.
- **Company level deciles scores**, presented as integers running one through 10, and underlying pillar scores that together provide a quick understanding of a company's relative governance risk to an index or region.
- **A regionalized scoring approach**, where questions for a geographic area are tailored to local governance dynamics, with attention to best practices identified for that region.

ISS Governance QuickScore leverages ISS' best-in-class global footprint, which includes local presence and expertise in 25 global markets. Factors used to assess risk-related concerns for a given company are based on the same principles that form the foundation of ISS' benchmark voting policy. Developed through an extensive and transparent process, these policies reflect best practices across global capital markets and factor in the views of both issuers and institutional investors worldwide. The rating factor methodology is closely aligned with ISS' benchmark proxy voting policy to ensure it is up-to-date, relevant, and tailored to address the variations in governance practices across global capital markets. (For more on ISS benchmark policies and their formulation, visit [www.issgovernance.com/policy](http://www.issgovernance.com/policy).)

## Coverage

At launch, ISS Governance QuickScore global coverage includes companies in the MSCI EAFE Index plus extended coverage in North America, totaling 4,100 companies in 25 markets, including the largest 3,000 U.S. companies and the largest 250 Canadian companies by market cap, as well as UK, Europe, Japan and Asia Pacific companies in the MSCI EAFE Index. Additional coverage, including deeper coverage in some developed markets and expansion into emerging markets, is planned for the second half of 2013.

## Methodology

### Governance Factors under Analysis

The methodology is based on best practices across various governance factors. ISS identified 40-80 of the most critical corporate governance factors by which to measure governance-related risk. Each factor falls into one of the below subcategories within each QuickScore pillar, and the number of factors analyzed by region varies. Each factor and the rationale for inclusion, plus factor applicability by market, are discussed in the QuickScore Factor Criteria section of this document.

**Table 1. Listing of Category Pillars and Their Subcategories**

Board Structure	Compensation/Remuneration	Shareholder Rights	Audit Practices
<ul style="list-style-type: none"> <li>Board Composition</li> <li>Composition of Committees</li> <li>Board Practices</li> <li>Board Policies</li> <li>Related Party Transactions</li> </ul>	<ul style="list-style-type: none"> <li>Pay for Performance</li> <li>Non-Performance Based Pay</li> <li>Use of Equity</li> <li>Equity Risk Mitigation</li> <li>Non-Executive Pay</li> <li>Communications and Disclosure</li> <li>Termination</li> <li>Controversies</li> </ul>	<ul style="list-style-type: none"> <li>One Share One Vote</li> <li>Takeover Defenses</li> <li>Voting Issues</li> <li>Voting Formalities</li> <li>Other Shareholder Rights issues</li> </ul>	<ul style="list-style-type: none"> <li>External Auditor</li> <li>Audit and Accounting Controversies</li> <li>Other Audit issues</li> </ul>

The factor coverage takes a regional approach in evaluating and scoring companies, to allow for company comparisons in markets where the corporate governance practices are the most similar. The specific market designations include:

- United States – the top 3,000 by market cap with the largest 500 compared separately from the remaining US coverage
- Japan – all companies in the MSCI EAFE
- Canada – the top 250 companies by market cap

The remaining QuickScore coverage is grouped by region (or common legal tradition, such as Australian and Irish corporate securities regulation having shared roots in British Common Law) and includes the constituents in the MSCI EAFE in these markets:

- Anglo Region – United Kingdom, Australia, Ireland and New Zealand
- Asia Pacific Region – Hong Kong and Singapore
- Western European Region – Belgium, Luxembourg, Netherlands and France
- Nordic Region – Denmark, Finland, Norway and Sweden
- Southern European Region – Italy, Spain, Cyprus and Greece
- Germanic Region – Germany, Austria and Switzerland

### Scoring Process

ISS Governance QuickScore is derived from a quantitatively-driven methodology that looks for correlations between governance factors and key financial metrics, with a secondary policy-based overlay that aligns the qualitative aspect of governance with ISS policy. As a first step, ISS identified the most critical governance factors by which to measure a company and created an answer set where companies meet, exceed, or fall short of market best practices.

For each governance factor, ISS analyzed the correlation with 16 commonly utilized performance and risk factors grouped into 4 measures: Market (2 factors), Profitability (9 factors), Risk (2 factors), and Valuation (3 factors). The target measures selected are listed in the chart below.

Table 2. The 16 Performance Measures

Performance Category	Performance Measure	Description
<b>Market</b>	Industry Adjusted TSR1Y	One year total shareholder return, adjusted by 4-digit GICS groups
	Tobin's Q	Market measure of firm value
<b>Profitability</b>	Cash Flow Return On Investment (CFROI)	Cash flow return on investment
	Dividend Growth 1Y	Dividend growth in one year
	EBITDA Margin	EBITDA margin
	Free Cash Flow to Sales	Free cash flow denominated by sales
	Net Profit Margin	Net profit margin
	Return on Assets (ROA)	Return on assets
	Return on Equity (ROE)	Return on equity
	Return on Invested Capital (ROIC)	Return on invested capital
	SaleGrowth1Y	Sales growth in one year
<b>Risk</b>	Volatility	Daily volatility (std of daily returns within one year)
	Z score	Altman's bankruptcy measure
<b>Valuation</b>	Price to Book Ratio	Price to Book Ratio
	Price to Cash Flow Ratio	Price to Cash Flow Ratio
	Price to Earnings Ratio	Price to Earnings Ratio

Based on quantitative testing and the degree of correlation, ISS assigned weights to the governance factors and performance and risk measures. The higher the correlation, the higher the weights allocated for each of the 40-80 ratings factors.

ISS' governance experts reviewed the output from the quantitative model to reconcile it with corporate governance practices. Based on these observations, the thresholds shifted slightly to maintain or yield stronger correlations. In some cases, minor model adjustments were applied as necessary.

To further test the governance factor scoring framework for U.S. companies, backtesting was conducted for historical governance and performance data from 2007-2012. The Quantitative Analysis team observed consistent and robust correlation between governance and performance and risk factors, especially on volatility, Return on Assets (ROA) and Cash Flow Return on Investment (CFROI).

Other notable observations in this analysis include:

- The scoring model demonstrates robust results on future performance and risk, as it relates to the 16 measures.
- The Compensation and Shareholder Rights pillars emerge with the strongest correlations to the Risk measures.

The ISS Governance QuickScore algorithm derives each pillar raw score based on the weights determined by correlation tests. This process is repeated for the calculation of the raw Total Score.

**Table 3. Hypothetical Example of Raw Scoring, Normalization and Decile Scoring Output**

Rating Category	Raw Points	Governance QuickScore
<b>Board</b>	23.3	8
<b>Audit</b>	56.9	7
<b>Shareholder Rights</b>	28.3	5
<b>Compensation</b>	19.2	10
<b>Total</b>	127.7	8

The 1-10 score is a relative measure based on the raw score calculations of the other companies in the relative index or region. For example, the raw scores for the Top 500 U.S. companies are ranked and grouped into deciles, the first decile (designated with a "1") is indicative of a higher raw score and lower governance risk.

ISS has completed correlation testing in the U.S. and Japan, with additional robust backtesting in the U.S. Additional regions and data are currently being analyzed by the ISS Quantitative Analysis team with a schedule for completion of correlation testing by mid-year 2013. At launch, the Governance QuickScore scoring framework for markets other than the U.S. and Japan are based on the qualitative aspect of governance within the ISS best practices guidelines.

### ISS Governance QuickScore Factor Criteria

The factors analyzed in each of the four pillars, Board Structure, Compensation/Remuneration, Shareholder Rights and Audit, are grouped into subcategories. Governance QuickScore considers factor scores within each subcategory level and provides additional high-level flagging within each pillar, as shown below. The stars and flags represent the company subcategory scores on an absolute basis. As such, the subcategory indicators are not representative of relative scores of company peers.

ISS GOVERNANCE QUICKSCORE DRIVERS

Board	7
Subcategory & Impact:	
 Board Composition	
Composition of Committees	
 Board Practices	
Board Policies	
 Related Party Transactions	

Compensation	6
Subcategory & Impact:	
 Pay for Performance	
 Non-performance Based Pay	
 Use of Equity	
Equity Pay Risk Mitigation	
Non-Executive Pay	
Communication. & Disclosure	
Termination	

Shareholder Rights	4
Subcategory & Impact:	
One Share – One Vote	
 Takeover Defenses	
Voting Issues	
 Voting Formalities	
Other Issues	

Audit	4
Subcategory & Impact:	
External Auditor	
 Audit & Accounting Practices	
Other Issues	

-  Highlights the subcategories that had significantly negative impact on the category score.
  -  Highlights the subcategories that had significantly positive impact on the category score.
- Subcategories without a flag or star had no significant impact on the category score.

There are a total of 181 factors analyzed under Governance QuickScore, with the specific factors under analysis varying by region. The following section details the questions analyzed and rationale for inclusion in the factor methodology. The number associated with each question is the ISS question identification number, and it is highlighted for easy reference throughout the Governance QuickScore documentation and product tools.

## Board Structure Pillar

### Board Composition

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#### 9. How many directors serve on the board?

In general, the investment community expects that boards should not be so large that they become inefficient and hinder decision-making. Generally, boards should not have fewer than 6 members or more than 15 members. A board of between 9 and 12 board members is considered ideal.

Market Applicability: W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

#### 10. What is the independent director composition of the Board?

The proportion of independent directors on a board is viewed by many as critical to firm performance. For instance, a working paper which evaluated the linkage between board composition and company productivity found a positive relationship between the percentage of outsiders on so-called monitoring committees (i.e., audit, compensation, and nominating committees) and the factors associated with the benefits of monitoring. These factors included the firm's outstanding debt and free cash flow (Klein). Another study found a significant correlation between board independence and firm performance as measured by Return on Assets (Elgaied & Rachdi 2008). Other researchers found a positive link between enhanced firm value and boards which have audit committees that are composed of a majority of independent finance-trained directors (Chan & Li 2008).

Market Applicability: U.S., Canada, Japan, W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

#### 203. What is the independent director composition of the Board if the company is majority controlled?

In a number of markets where companies are more often majority controlled, ISS applies different minimum standard of independent representation on the board. ISS accepts that less than 50% of the board is independent.

Market Applicability: W. Europe, S. Europe

#### 11. What is the independent director composition of the Board (shareholder elected board members)?

Best practice suggests that at least half of the shareholder-elected board should be independent of the company, of which at least two members should be independent of major shareholders. In cases where there are employee representatives, ISS' policy calls for at least half the shareholder-elected board members be independent and that at least one-third of the total board (including employee representatives) be independent.

Market Applicability: Nordic

289. Is there an outside director on the Board?

Reflecting an emerging consensus, regulators including the Tokyo Stock Exchange and the Ministry of Justice have been pushing cautiously for market practices and potential rules calling for appointment of at least one outside director. Firms that fail to meet this standard are expected to become outliers in future years.

Market Applicability: Japan

282. What is the outsider director composition of the Board?

In Japan, where appointment of outside directors is not mandatory, a meaningful percentage of outside directors on the board is in the interest of shareholders.

Market Applicability: Japan

13. What proportion of directors sit on the board for an excessive length of time?

Limiting director tenure allows new directors to the board to bring fresh perspectives. A tenure of more than 9 years is considered excessive.

Applicability: Asia Pacific

14. What is the classification of the Chairman of the Board?

An independent Chairman of the Board is broadly considered best practice. As noted in a 2009 policy brief published by Yale University's Millstein Center for Corporate Governance and Performance, the "independent chair curbs conflicts of interest, promotes oversight of risk, manages the relationship between the board and CEO, serves as a conduit for regular communication with shareowners, and is a logical next step in the development of an independent board."

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, S. Europe

15. Are the roles of Chairman and CEO separated?

A growing number of good-governance advocates believe that separating the positions of chairman and CEO improves the board's ability to evaluate the performance of senior officers (including the CEO) and the company.

Market Applicability: W. Europe, Germanic, Anglo, S. Europe,

16. Has the company identified a Senior Independent Director?

A lead independent director provides an important leadership function for a board with a combined CEO/chair structure. An effective lead director's functions may include, but are not limited to, the following: presides at all meetings of the board at which the chairman is not present, including executive sessions of the independent directors; serves as liaison between the chairman and the independent

directors; approves information sent to the board; approves meeting agendas for the board; approves meeting schedules to assure that there is sufficient time for discussion of all agenda items; has the authority to call meetings of the independent directors; and if requested by major shareholders, ensures that he is available for consultation and direct communication.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

17. What is the term of mandate proposed for supervisory board members (at the latest general meeting)?

Term lengths of mandate influence the possibility of shareholders of issuing regular opinions about the composition of the board.

Market Applicability: W. Europe, Germanic, Nordic, S. Europe

205. What percentage of the board consists of family members?

This question elaborates on the general issue of board independence and addresses whether members of the board are related (per the SEC definition of family membership) to any executive officers or significant shareholders of the company.

Market Applicability: U.S.

206. What percentage of the board are former or current employees of the company?

This question provides more detail regarding the level of board independence. This type of affiliation may suggest the ongoing influence of former executives or founders on the board.

Applicability: U.S.

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## Composition of Committees

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19. What percentage of nominating committee members are independent based on ISS standards?

Most nominating committees are responsible for developing a policy on the size and composition of the board and for identifying and approving nominees for vacant positions on the board of directors. The committee should have the benefit of the CEO's involvement in the selection process, but the responsibility for selection of board nominees should be that of independent directors.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

23. What's the classification of the chairman of the nominating committee?

Most nominating committees are responsible for developing a policy on the size and composition of the board and for identifying and approving nominees for vacant positions on the board of directors. The

committee should have the benefit of the CEO's involvement in the selection process, but the responsibility for selection of board nominees should be that of independent directors.

Market Applicability: W. Europe, Germanic, Anglo, W. Europe, Asia Pacific

207. Does the company maintain a formal nominating committee?

Companies should consider setting up a nomination committee responsible for the future composition of the board of directors.

Market Applicability: Anglo, Nordic, S. Europe

21. Are there employee representatives on the nominating committee?

Most nominating committees are responsible for developing a policy on the size and composition of the board and for identifying and approving nominees for vacant positions on the board of directors. The committee should have the benefit of the CEO's involvement in the selection process, but the responsibility for selection of board nominees should be that of independent directors.

Market Applicability: Germanic

208. Are there any board members on the nominating committee?

Nominating committees are formed primarily of shareholder representatives, owing to the very concentrated ownership structure in some Nordic markets. Within this context, having current board members on the committee constitutes a conflict of interest.

Market Applicability: Nordic

210. Are more than one board member who is dependent on major shareholders on the nominating committee?

Nominating committees are formed primarily of shareholder representatives, owing to the very concentrated ownership structure in some Nordic markets. Within this context, having an excessive number of board members on the committee constitutes a conflict of interest.

Market Applicability: Nordic

211. What is the number of nomination committee members?

In parallel to the UK code requirements on remuneration and audit committees, best practice suggests to have a minimum of three non-executive board members sitting on the nomination committee to have a meaningful quorum.

Market Applicability: Anglo

25. What is the independent status of the compensation committee members?

The compensation committee makes recommendations and sets guidelines for the compensation of executives of the company. Best practice dictates the panel should be composed solely of independent directors.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

27. Are there executives on the compensation committee?

The compensation committee makes recommendations and sets guidelines for the compensation of executives of the company. Best practice dictates the panel should be composed solely of independent directors. When executives are member of the compensation committee, there is a conflict of interest.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

28. What's the classification of the chairman of the compensation committee?

The compensation committee makes recommendations and sets guidelines for the compensation of executives of the company. Best practice dictates the panel should be composed solely of independent directors.

Market Applicability: W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

29. Is the Chairman of the board of directors a member of the compensation committee?

The compensation committee makes recommendations and sets guidelines for the compensation of executives of the company. Best practice dictates the panel should be composed solely of independent directors.

Market Applicability: Anglo

212. What is the number of remuneration committee members?

The UK Code recommends that there should be at least 3 non-executive board members sitting on remuneration committees, all of whom should be independent.

Market Applicability: Anglo

31. What is the independent status of the audit committee members?

Like other key board committees, audit panels should ideally be comprised solely of independent non-executives to reduce the risk of conflict of interest with regard to the company's accounts.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

33. Are there executives on the audit committee?

Like other key board committees, audit panels should ideally be comprised solely of independent non-executives to reduce the risk of conflict of interest with regard to the company's accounts.

Market Applicability: W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

34. What's the classification of the chairman of the audit committee?

Like other key board committees, audit panels should ideally be comprised solely of independent non-executives to ensure no possibility of conflict of interest with regard to the company's accounts.

Market Applicability: W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

35. Is the Chairman of the board of directors a member of the audit committee?

Both the UK as well as the Dutch codes of best practice recommend that the chairman of the board should not be a member of the audit committee.

Market Applicability: W. Europe, Anglo

213. What is the number of audit committee members?

The UK Code recommends that there should be at least 3 non-executive board members sitting on audit committees, all of whom should be independent.

Market Applicability: Anglo

283. Does the company adopt a three committee system?

The two-tiered board system includes a secondary board of statutory auditors that lacks voting power on the board of directors. Alternatively, a unitary board requires audit, compensation and nomination committees, each with outside director majorities, with explicit power to oversee these functions.

Market Applicability: Japan

## Board Practices

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36. Do the executives serve on an excessive number of outside boards?

An executive role is a position of great responsibility and time demands. Sitting on multiple outside boards may threaten the ability of the executives to attend to the business of his or her primary employer.

Market Applicability: W. Europe, Germanic, Nordic, S. Europe

37. Does the CEO serve on an excessive number of outside boards? / How many boards does the CEO sit on (U.S. only)?

The Chief Executive role is a position of great responsibility and time demands. Sitting on multiple outside boards may threaten the ability of the CEO to attend to the business of his or her primary employer.

Market Applicability: U.S., W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

38. How many non-executives serve on an excessive number of outside boards? / Other than the CEO if on the board, how many directors serve on an excessive number of outside boards (U.S. only)?

Directors with an excessive number of board seats may not have sufficient time to devote to the needs of individual boards.

Market Applicability: U.S., W. Europe, Germanic, Anglo, Nordic, S. Europe

39. Does the Chairman of the Board serve on an excessive number of outside boards?

As for other non-executives but even more so for the chairman of the board, holding multiple outside board positions may hamper the ability of having sufficient time to devote to the needs of the company.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

42. What is the overall attendance of the members of the Board of Directors?

Directors who do not attend a sufficient number of board meetings are not fulfilling their obligation to represent shareholders and provide oversight and direction to management.

Market Applicability: Asia Pacific

43. What percentage of all meetings was attended by at least 50% of the supervisory board?

Directors who do not attend a sufficient number of board meetings are not fulfilling their obligation to represent shareholders and provide oversight and direction to management. This question was designed as such to account for the specific disclosure in the Germanic markets.

Market Applicability: Germanic

44. What percentage of the directors attended less than 75% of the board meetings?

Directors who do not attend a sufficient number of board meetings are not fulfilling their obligation to represent shareholders and provide oversight and direction to management.

Market Applicability: W. Europe, Anglo, S. Europe, Asia Pacific

45. Did any directors attend less than 75% of the board meetings without a valid excuse?

Directors who do not attend a sufficient number of board meetings are not fulfilling their obligation to represent shareholders and provide oversight and direction to management.

Market Applicability: U.S., Canada

49. How many directors received withhold / against votes of 50% or greater at the last annual meeting?

Significant opposition to a board member typically signifies a lack of accountability, responsiveness, independence, and/or competence on the part of the targeted director, warranting further evaluation.

Market Applicability: U.S., Canada

### Board Policies

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41. Does the company disclose a policy requiring an annual performance evaluation of the board?

Evaluating board performance is a way of measuring effective contribution and commitment of board members to their role, assessing the way the board operates, whether or not important issues are properly prepared as well as key competences on the board.

Market Applicability: Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe

46. Does the company disclose board/governance guidelines?

New York Stock Exchange listed companies are required to publicly disclose board/corporate governance guidelines. Other exchanges, however, do not yet mandate such disclosure.

Market Applicability: U.S.

215. What is the quorum for director meetings?

A quorum ensures that directors meetings can only convene with a minimum number of directors present i.e. eliminating any director resolutions that may be passed in a meeting where less than half of directors are present.

Market Applicability: Canada

100. Does the company allow the Chairman a second or casting vote at director meetings in the event of a tie?

Casting vote is contrary to the tenet of 1 person 1 vote.

Market Applicability: Canada

## Related Party Transactions

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### 50. What percent of the directors were involved in material RPTs?

Related party transactions can lead to conflicts of interest that may compromise independence, particularly in instances where participation or ties to transactions are not fully disclosed.

Market Applicability: U.S., Canada, Asia Pacific

### 51. Do the directors with RPTs sit on key board committees?

The independence of the nomination, audit and compensation committees is vital to their effective oversight of these key board functions. The existence of transactional relationships with the company has the potential to undermine this independence.

Market Applicability: Us, Canada

### 216. Are there material related-party transactions involving the CEO?

The CEO's special role in the company demands special attention to even the appearance of self-dealing.

Market Applicability: U.S., Asia Pacific

## Compensation/Remuneration Pillar

### Pay for Performance

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#### 114. Is there a cap on CEO annual bonus?

Best practices suggest companies disclose bonus caps for CEOs that are tied to a fixed and/or disclosed value such as base salary.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

#### 115. Is there a cap on executives' annual bonus?

Best practices suggest companies disclose bonus caps for executives that are tied to a fixed and/or disclosed value such as base salary.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

#### 116. What percentage of the annual bonus for CEO is or can be deferred?

Deferred compensation is used by companies to reduce long-term risk and better align executive compensation with company performance over the long term. Holdbacks or deferrals on compensation are recommended best practice in many markets, particularly in the wake of the financial crisis and the sharpened focus on tying pay to long-term company performance.

Market Applicability: Canada, W. Europe, Germanic, Anglo, S. Europe

#### 117. What percentage of the annual bonus for Executives is or can be deferred?

Deferred compensation is used by companies to reduce long-term risk and better align executive compensation with company performance over the long term. Holdbacks or deferrals on compensation are recommended best practice in many markets, particularly in the wake of the financial crisis and the sharpened focus on tying pay to long-term company performance.

Market Applicability: W. Europe, Germanic, Anglo, S. Europe

#### 226. What is the degree of alignment between the company's cumulative 3-year pay percentile rank, relative to peers, and its 3-year cumulative TSR rank, relative to peers?

The primary factors identified in the Pay for Performance section are the quantitative measures incorporated in ISS' evaluation of executive compensation for proxy analyses to assess compensation-related risk indicators. For more details on the ISS methodology, see the "Evaluating Pay for Performance Alignment," available at [www.issgovernance.com/policy](http://www.issgovernance.com/policy).

A substantial majority of institutional respondents to ISS' 2011 policy survey confirmed two factors as relevant to evaluating pay-for-performance alignment: pay relative to peers and pay increases that are inconsistent with the company's performance trend. Most issuer respondents also indicated that pay versus peers is an appropriate factor and that pay increases in light of company performance should be a consideration. In addition, both institutions and companies have contended that pay-performance alignment should be viewed in a long-term context.

Market Applicability: U.S., Canada

227. What is the degree of alignment between the company's cumulative 1-year pay percentile rank, relative to peers, and its 1-year cumulative TSR rank, relative to peers?

See above for 226-229.

Market Applicability: U.S., Canada

228. What is the size of the CEO's 1-year cumulative pay, as a multiple of the median pay for company peers?

See above for 226-229.

Market Applicability: U.S., Canada

229. What is the degree of alignment between the company's TSR and change in CEO pay over the past five years?

See above for 226-229.

Market Applicability: U.S., Canada

232. What is the ratio of the CEO's total compensation to the next highest paid executive?

Internal pay parity ratios among executives are an indicator of potential succession-planning challenges within the organization, which may yield high future payouts if the current CEO departs, as well as signaling the potential that pay levels for the CEO are excessive.

Market Applicability: U.S.

233. What is the performance period for the latest active long term incentive plan (or the proposed plan) for executives?

Incentive plans whereby long term incentives are granted based on performance should have a performance period of 24 to 36 months at least in order to comply with the long term nature of such a plan.

Market Applicability: W. Europe, Anglo, S. Europe

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### Non-Performance Based Pay

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156. Are any of the NEOs eligible for multi-year guaranteed bonuses?

Multi-year bonus guarantees are considered problematic under ISS' Problematic Pay Practices policy and sever the pay-for-performance linkage.

Market Applicability: U.S., Canada

154. Does the company provide loans to executives?

In the applicable markets, ISS recommends that loans be made to employees as part of a broad-based, company-wide plan to encourage ownership rather than being given only to executive directors. ISS also calls for loans with interest set at market rates be paid back in full over a reasonable length of time.

Market Applicability: Canada, W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

118. Is part of the bonus granted or to be granted guaranteed?

Guaranteed bonuses to senior executives is a problematic pay practice because it could result in a disconnect between pay and performance and undermines the incentivizing nature of such awards.

Market Applicability: Canada, W. Europe, Germanic, Anglo, S. Europe

159. Did the company grant a one-off reward to any of its executives?

One off rewards are discretionary grants for executives granted for a range of reasons such as transactions, new contracts etc, often outside the scope of the remuneration policy, and not always tied to performance (except if they are conditional to performance conditions).

Market Applicability: Anglo

237. What is the ratio of the CEO's non-performance-based compensation (All Other Compensation) to Base Salary?

High levels of aggregate perks and other payments, such as payments-in-lieu of perks, are aggregated in the All Other Compensation amount. If these are greater than base salary it may reflect a significant additional compensation stream.

Market Applicability: U.S.

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## Use of Equity

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129. Do the company's active equity plans prohibit share recycling for options/SARs?

Companies with liberal share counting provisions receive more utilization for their shares than those without the provision. Liberal use occurs when one or more of the following occur (i) tendered shares in payment of an option are recycled, (ii) withheld for taxes are added back in, (iii) actual stock-settled SARs/shares delivered are the only ones counted against the plan reserve.

Market Applicability: U.S.

138. Do the company's active equity plans prohibit option/ SAR repricing?

This question addresses whether the compensation plan documents expressly permit option repricing without prior shareholder approval. Option repricing occurs when companies adjust outstanding stock options to lower the exercise price. Option exchange occurs when the company cancels underwater options and re-grants new options. Option replacements may be accomplished through option swaps, option re-grants or cash.

Market Applicability: U.S., Canada

238. Does the company's active equity plans prohibit option/ SAR cash buyouts?

Nasdaq and the New York Stock Exchange Euronext state that repricings are subject to shareholder approval unless the (shareholder approved) plan specifically states otherwise. However, the rules on both exchanges leave the door open for companies to exchange underwater stock options for a cash settlement, without seeking shareholder approval of the exchange.

Market Applicability: U.S., Canada

239. Do the company's active equity plans have an evergreen provision?

Best practice dictates that shareholders approve the replenishment of shares available for an equity compensation plan.

Market Applicability: U.S.

240. Do the company's active equity plans have a liberal CIC definition?

While change-in-control agreements have their place in order to insulate executives from loss of employment in conjunction with a change in control, liberal change-in-control agreements may improperly incentivize transactions in order to more quickly realize unvested pay.

Market Applicability: U.S.

139. Has the company repriced options or exchanged them for shares, options or cash without shareholder approval in the last three years?

Per ISS' policy and compensation best practices espoused by investors, repricings should be put to shareholder vote.

Market Applicability: U.S., Canada

137. Has the company backdated options within the past two years?

Granting stock options using hindsight to select favorable grant dates that result in an automatic and immediate in-the-money benefit for optionees does not align with a pay for performance philosophy and fosters an environment of entitlement. Corrective actions taken by the board or compensation committee to address backdating include canceling or repricing backdated options, recouping of option gains on backdated grants, the adoption of a grant policy that prohibits backdating, and the creation of a fixed grant schedule or window period for equity grants going forward.

Market Applicability: Anglo

127. What is the total proportion of all outstanding equity based plans towards the share capital?

Incentive plans where stock options performance shares are granted to executives and employees will lead to a dilution of shareholder interests. Given the incentivizing nature of such instruments, shareholders generally accept such dilution, provided the dilution is limited.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

128. Is there a maximum level of dilution per year?

In line with the question above, dilution due to long term incentives can be capped at a year basis, which is considered good practice.

Market Applicability: W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

130. Does the company grant equity awards at an excessive rate, according to ISS policy?

High rates of equity granting tend to dilute existing shareholders or demand that the company undertake stock repurchase plans to counteract dilution.

Market Applicability: U.S.

136. What are the pricing conditions for stock options granted to executives?

Discounted options represent an immediate financial gain to the beneficiary equal to the market price minus the level of the discount. Investors prefer that options be priced at no less than 100 percent of the shares' fair market value.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

## Equity Risk Mitigation

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155. Did the company disclose a claw back or malus provision?

The presence of claw back provisions may help ensure that real pay is not given for fictitious performance.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe

131. What are the minimum vesting periods mandated in the plan documents for executives' stock options or SARS in the equity plans adopted/amended in the last 3 years?

A minimum vesting period ensures employee retention and alignment with shareholder interest.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

132. What are the minimum vesting periods mandated in the plan documents, adopted/amended in the last three years, for executives' restricted stock?

A minimum vesting period ensures employee retention and alignment with shareholder interest.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

133. What are the vesting periods mandated in the plan documents, adopted/amended in the last three years, for executives' other long-term plan?

A minimum vesting period ensures employee retention and alignment with shareholder interest.

Market Applicability: Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

134. What is the holding period for stock options (for executives)?

Executives should hold a meaningful portion of the shares acquired after exercise. Research points to superior financial performance when officer and director stock ownership falls within a certain range. These are requirements to retain ownership of a portion of shares acquired after the exercising of an option, once specified stock ownership guidelines have been met by the executive and he/she is able to exercise the options. It is generally net of taxes, and may be offered as a percentage of shares acquired. The guidelines can apply to restricted shares as well. The holding requirements of the stock can be for a set number of years following the exercising of the option or through the term of the executive's employment or retirement, or a specified length of time following departure from company (hold until after retirement).

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

135. What is the holding period for restricted shares (for executives)?

See above.

Market Applicability: U.S., W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

145. What proportion of the salary is subject to stock ownership requirements/guidelines for the CEO?

Best practice dictates that executives attain substantive share ownership by a certain time after appointment to better align their interests with those of shareholders.

Market Applicability: U.S., W. Europe, Anglo, S. Europe

142. Is the CEO subject to stock ownership guidelines?

Best practice dictates that executives attain substantive share ownership by a certain time after appointment to better align their interests with those of shareholders.

Market Applicability: Canada

146. What proportion of the salary is subject to stock ownership requirements/guidelines for the other executives?

Best practice dictates that executives attain substantive share ownership by a certain time after appointment to better align their interests with those of shareholders.

Market Applicability: W. Europe, Anglo, S. Europe

140. What is the aggregate level of stock ownership of the officers and directors, as a percentage of shares outstanding?

Best practice dictates that directors maintain a meaningful level of share ownership by a certain time after appointment to better align their interests with those of shareholders.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

143. Are directors subject to stock ownership guidelines?

Best practice dictates that directors maintain a meaningful level of share ownership by a certain time after appointment to better align their interests with those of shareholders.

Market Applicability: U.S., Canada

144. Do all directors with more than one year of service own stock?

Similar to the stock ownership rationale above, all directors should maintain an equity stake in the company.

Market Applicability: U.S., Canada, Asia Pacific

243. Did any executive or director pledge company shares?

The prospect that an executive or director may be forced to sell a substantial amount of shares poses significant risks for other shareholders, who may see the value of their shares decline. In addition, a highly leveraged executive may be incentivized to riskier behavior.

Market Applicability: U.S.

244. Does the company have a policy prohibiting hedging of company shares by employees?

Best practice is to incorporate prohibitions on hedging transactions within companies' insider trading policies. Hedging against losses in company shares breaks the alignment between shareholder and executives that equity grants are intended to build.

Market Applicability: U.S.

## Non-Executive Pay

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### 104. Does the company provide loans to directors?

ISS recommends that loans be made to employees as part of a broad-based, company-wide plan to encourage ownership rather than being given only to non-executive directors. ISS also calls for loans with interest set at market rates be paid back in full over a reasonable length of time.

Market Applicability: Canada, Asia Pacific

### 109. Do directors participate to equity based plans?

Best practice requires non-executive directors not to participate in equity based plans as this puts them at the same level of executives who should be monitored and remunerated by non-executive directors

Market Applicability: Canada, W. Europe, Germanic, Nordic, S. Europe

### 110. Do directors participate to performance related remuneration?

Best practice requires non-executive directors not to participate in performance based remuneration as this puts them at the same level of executives who should be monitored and remunerated by non-executive directors.

Market Applicability: W. Europe, Germanic, Anglo, S. Europe

### 107. What part of the total remuneration received by directors is options-based?

Directors' remuneration should not involve options, which does not align with shareholders interests.

Market Applicability: Canada

## Communications and Disclosure

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### 112. Does the company disclose details of individual executives' remuneration?

Best practice requires companies to disclose complete and individual information on executives' remuneration, especially for the CEO.

Market Applicability: Asia Pacific

### 158. Did the company disclose a performance overview for its long term incentive plans?

As long term performance plans are usually linked to past performance, companies are recommended to disclose an overview of such performance measures over the same period to which the performance plans apply.

Market Applicability: Asia Pacific

### 113. Does the company disclose a performance measure for the short term incentive plan (for executives)?

Poor or missing disclosure of the financial basis for performance metrics make it difficult for investors to judge the quality and/or rigor of these metrics.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

246. What is the level of disclosure on performance measures for the latest active or proposed long term incentive plan?

Poor or missing disclosure of the financial basis for performance metrics make it difficult for investors to judge the quality and/or rigor of these metrics.

Market Applicability: U.S.

121. Does the company disclose a performance measure for matching?

Poor or missing disclosure of the financial basis for performance metrics make it difficult for investors to judge the quality and/or rigor of these metrics.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

122. Does the company disclose a performance measure for stock options plans (for executives)?

Poor or missing disclosure of the financial basis for performance metrics make it difficult for investors to judge the quality and/or rigor of these metrics.

Market Applicability: Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

123. Does the company disclose a performance measure for restricted share plans (for executives)?

Poor or missing disclosure of the financial basis for performance metrics make it difficult for investors to judge the quality and/or rigor of these metrics.

Market Applicability: Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

125. Does the company disclose a performance measure for other long term plans (for executives)?

Poor or missing disclosure of the financial basis for performance metrics make it difficult for investors to judge the quality and/or rigor of these metrics.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

166. Has the company voluntarily adopted a management 'say on pay' advisory vote resolution for the most recent annual meeting or committed to a resolution going forward?

As the MSOP resolution is not mandatory in Canada, ISS will consider whether or not the company has adopted a voluntary say on pay advisory vote for management at the latest annual general meeting, or whether or not the company committed to such resolution going forward.

Market Applicability: Canada

250. What is the level of disclosure on CEO ownership guidelines?

As ownership guidelines in the German region are not common, ISS will only analyze the level of disclosure.

Market Applicability: Germanic

## Termination

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148. What's the trigger under the change-in-control agreements?

A single trigger requires only a change in control and no subsequent termination of employment for the executive to receive their exit pay package. A modified single trigger is similar, but provides a unique window period during which time the executive can leave employment for any reason. In both instances, the executive can unilaterally

decide whether or not to continue employment and may not be sufficiently motivated to stay with the company long term given the prospect of unconditional payment. Moreover, if the board of the new company wishes to retain the services of the executive, they may negotiate any contract under circumstances that give the executive considerable leverage in seeking retention payments or additional compensation.

Market Applicability: U.S., Canada

153. Do equity based plans or long term cash plans vest completely on change in control?

While change-in-control agreements have their place in order to insulate executives from loss of employment in conjunction with a change in control, accelerated vesting of equity grants tends to disconnect pay from performance and may incentivize executives to pursue transactions not in the best interests of shareholders.

Market Applicability: U.S., Canada, Anglo

150. In the event of termination of the contract of executives, does the equity based remuneration vest?

Accelerated vesting of equity grants or even continued vesting after termination of contracts of executives tends to disconnect pay from performance.

Market Applicability: Anglo

161. What is the multiple of salary plus bonus in the severance agreements for the CEO (upon a change-in-control)?

Under ISS' benchmark policy, payments that are in excess of a one time (Netherlands), two times (Canada and Europe) or three times (U.S.) base and bonus multiple are problematic in all instances and considered excessive for all named executive officers. Multiples below mentioned base and bonus are considered acceptable, per ISS' policy.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe

247. What is the basis for the change-in-control or severance payment for the CEO?

Payments based on target or actual bonuses are acceptable. The U.S. Internal Revenue Service (IRS), in defining an excessive "golden parachute" subject to tax consequences, bases the figure on average compensation over the past five years. A payment based on the maximum bonus, or particularly on the "greater of" actual and maximum, is considered excessive.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe

160. What is the multiple of salary plus bonus in the severance agreements for executives excluding the CEO (upon a change-in-control)?

Under ISS' benchmark policy, payments that are in excess of a one time (Netherlands), two times (Canada and Europe) or three times (U.S.) base and bonus multiple are problematic in all instances and considered excessive for all named executive officers. Multiples below mentioned base and bonus are considered acceptable, per ISS' policy.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

248. What is the basis for the change-in-control or severance payment for executives excluding the CEO?

Payments based on target or actual bonuses are acceptable. The U.S. Internal Revenue Service (IRS), in defining an excessive "golden parachute" subject to tax consequences, bases the figure on average compensation over the past five years. A payment based on the maximum bonus, or particularly on the "greater of" actual and maximum, is considered excessive.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

152. How long is the notice period for the CEO if the company terminates the contract?

When a company terminates the contract of the CEO it is in most cases obliged to continue contractual payment until a certain period. Shareholders accept this provided the notice period is limited to 6 months.

Market Applicability: Anglo

162. Does the company provide excise tax gross-ups for change-in-control payments?

An excise tax is an additional tax imposed by the IRS for change-in-control related severance pay that exceeds more than three times an executive's average income--including salary, bonus, and the gains on any equity compensation--over the previous five years. While excise tax-gross-ups became somewhat common during the 1990s, recent shareholder opposition to the practice has led many companies to eliminate the provision, reducing packages to the extent that the excise tax will not be triggered. Executive officers should be responsible for their individual tax liabilities. Common market practice does not justify extraordinary financial burdens to companies and their shareholders. Finally, the excise tax gross-up provision leads to such substantial increases in potential termination payments that the provision may encourage executives to negotiate merger agreements that may not be in the best interests of shareholders. In some instances, the company may commit to lower a severance payment to just below the cap in certain very limited circumstances, but to pay a gross-up if the payment exceeds that level. Creating a very limited circumstance under which gross-ups will not be paid does not address the fundamental problems with these features.

Market Applicability: U.S., Canada

163. What is the length of employment agreement with the CEO?

Best practices dictate that companies should enter into employment contracts under limited circumstances for a short time period (e.g., new executive hires for a three-year contract) for a finite number of executives. The agreements should not have an automatic renewal feature and should have a specified termination date. An auto-renew feature indicates that the agreement can be extended in perpetuity, for all intents and purposes, unless either party provides direction to the contrary pursuant to a defined notice period.

Market Applicability: U.S.

## Controversies

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300. Has ISS' qualitative review identified a pay-for-performance misalignment?

ISS' qualitative analysis of executive compensation identifies pay practices and design features that may strengthen or weaken the linkage between executive pay and company performance. Features and practices to be examined in ISS' qualitative analysis may include (but are not limited to): the rigor of performance conditions on incentive plans, the proportion of performance-based equity pay, whether termination provisions may enable "pay for failure," the presence of retention or other discretionary awards, "realizable" pay relative to granted pay, and other features of the pay design as deemed appropriate to the company's specific circumstances.

Market Applicability: U.S., Canada

301. Has ISS identified a problematic pay practice or policy that raises concerns?

ISS' focus is on specific executive compensation practices that run counter to a pay-for-performance philosophy, including (but not limited to): problematic practices related to non-performance-based compensation elements such as excessive perquisites; incentives that may motivate excessive risk taking; and specific problematic practices such as options backdating.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe

## Shareholder Rights

### One Share One Vote

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54. Does the company have classes of stock with different voting rights?

Dual-class capital structures can serve to entrench certain shareholders and management, insulating them from possible takeovers or other external influence or action. The interests of parties with voting control may not be the same as those of shareholders constituting a majority of the company's outstanding capital. Additionally, research suggests that companies with dual-class capital structures or other antitakeover mechanisms often trade at a discount to similar companies without such structures.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

55. Are there any directors on the board who are not up for election by all classes of common shareholders?

Barring some holders of common stock from voting on directors may serve to entrench board members and perpetuate control by certain blocks or groups.

Market Applicability: U.S., Canada

56. Is there a sunset provision on the company's unequal voting structure?

Some companies with unequal voting structures have set the conditions upon which the unequal voting structure will be terminated and an equal voting structure will take place. Such a condition is called a sunset provision in this regard.

Market Applicability: Canada

57. What is the proportion of multiple voting rights (or voting certificates) relative to the total number of voting rights?

This is the first part of a double materiality test where the impact of the multiple voting rights on the total number of voting rights is measured.

Market Applicability: W. Europe, Germanic, Anglo, Nordic

58. What is the level of free float of the multiple voting rights or voting certificates?

ISS will consider the percentage of free float of the multiple voting rights, or if no information is given. This is the second part of a double materiality test where the level of free float of multiple voting rights is measured.

Market Applicability: W. Europe, Germanic, Anglo, Nordic

59. What percentage of the company's shares is represented by depositary receipts where a foundation votes unexercised proxies?

Depositary receipts have typically been issued by Dutch companies in order to keep minority shareholder from exerting disproportionate influence at general meetings where attendance is often low. Under this system, the underlying shares are nearly all held by a foundation, which is usually independent of the company (Question 62, that has issued the depositary receipts. These instruments are sold on the market. Holders of such instruments are entitled to the same rights as ordinary shareholders, save for voting rights. In order to vote, the holders need to

request a voting proxy from the foundation, or they can exchange their depositary receipts for the underlying shares. Taking these steps can sometimes be restricted either by limitations on the ability to request voting proxies or to exchange depositary receipts for shares.

Market Applicability: W. Europe

60. Has the company indicated to eliminate the system of depositary receipts?

Over the past ten years, Dutch companies have gradually eliminated the system of depositary receipts based on attendance of shareholders at general meetings. In general, if attendance of shareholders in the past three years has reached thresholds of 30% or higher, a number of Dutch companies have committed to eliminating the system.

Market Applicability: W. Europe

61. Are depositary receipt holders restricted in their voting rights?

Traditionally depositary receipts could be exchanged for shares or holders of such depositary receipts could request a voting proxy, but only to a certain limit (usually between 1 and 2% of the share capital). Dutch companies have mostly eliminated these barriers.

Market Applicability: W. Europe

63. What percentage of the company's share capital is made up of non-voting shares?

This is the first part of a double materiality test where the impact of the non-voting shares on the total share capital is measured. The issue of preferential non-voting shares where the lack of voting is compensated by a higher or guaranteed dividend is accepted up to a certain level. However, beyond that level, the influence of shareholders on company decisions can be hampered, especially if the level of free float of the voting rights is limited.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

64. What is the level of free float of voting shares in relation to the non-voting shares?

ISS will measure the level of free float of the voting rights in a system of various share types with at least one of the share types lacking voting rights. This is the second part of a double materiality test where the level of free float of voting rights is measured.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

65. Does the company have an absolute voting right ceiling?

The existence of an absolute voting right ceiling, which caps the vote after a certain threshold has been reached, always creates a voting right distortion for the shareholders whose stake lies above the ceiling. The lower the ceiling, the more shareholders see their voting rights reduced and the larger the voting right distortion.

Market Applicability: W. Europe, Germanic, Nordic, S. Europe

66. Does the company have a relative voting right ceiling?

The existence of a relative voting right ceiling, which caps the vote after a certain threshold has been reached, always creates a voting right distortion for the shareholders whose stake lies above the ceiling. The lower the ceiling, the more shareholders see their voting rights reduced and the larger the voting right distortion.

Market Applicability: W. Europe, Germanic, Nordic, S. Europe

67. Does the company have an ownership ceiling?

A discounted score for the existence of ownership ceilings is meant to reflect the tendency of investors to discount companies featuring ownership ceilings; as such ceilings curb investments and thus limit the voting power shareholders may attain.

Market Applicability: Japan, W. Europe, Germanic, Anglo, Nordic, S. Europe

68. Does the company have ownership ceilings for specific parties?

A discounted score for the existence of ownership ceilings is meant to reflect the tendency of investors to discount companies featuring ownership ceilings, as such ceilings curb investments and thus limit the voting power shareholders may attain, especially if such ceiling applies only to one group of shareholders.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

69. Do shareholders or the State have the priority right?

The investor community generally disapproves special shares that grant disproportionately high voting powers to the state (golden shares) or other specific shareholders (referred to as priority shares).

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

217. Is there a coattail provision attached to the company's unequal voting structure?

Coattail provisions provide protection for minority shareholders when a majority shareholder exists under a dual capital structure.

Market Applicability: Canada

## Takeover Defenses

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72. Does the company have targeted stock placement that can be used as a takeover defense?

At their holders' discretion, financial instruments giving a potential access to the Company's capital may be exercised and may compromise the success of a takeover attempt through the dilution of the percentage of voting rights available on the market. Holders of these instruments may or may not be existing shareholders of the company.

Market Applicability: W. Europe

73. Does the company maintain pre-emptive rights in the event of a takeover bid?

Authorisations given to the management board to increase the share capital do not always preserve pre-emption rights and may even sometimes be allowed during a takeover in certain markets.

Market Applicability: W. Europe, S. Europe

74. Can the company target repurchased shares in the event of a takeover bid?

Shares are usually repurchased either to minimise the dilution of employee share plans, to fund a share exchange for acquisitions or to increase earnings per share (by stabilising the share price). At the same time, a share repurchase could also be used as a takeover defence, which reduces the voting power of the floating capital and increases the relative voting power of the reference or core shareholder(s). This may happen when the company repurchases its own shares during a takeover and when voting rights of repurchased shares are temporarily or permanently (when repurchased shares are destroyed) cancelled. It could also increase the voting power of

friendly parties (existing reference or core shareholders, the “White Knight” defence) when the company resells shares that have been repurchased prior to or even during a takeover.

Market Applicability: W. Europe, Nordic, S. Europe

#### 218. Are there ownership factors that affect the takeover defenses?

Ownership factors such as ceilings preclude the success of a takeover attempt while denying shareholder a takeover premium and potentially entrenching the company’s management.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

#### 219. Are there priority rights that affect the takeover defenses?

Priority rights afford holders the right to decide on key corporate actions such as takeovers that are normally sanctioned by shareholders collectively. Such rights can be vested in specific share types, such as priority shares. These rights may be linked to a specific company structure where certain shareholders hold rights beyond normal voting rights. If such rights are granted to the state, they are called golden shares.

Market Applicability: W. Europe, Germanic, Anglo, Nordic, S. Europe

#### 77. Are all directors elected annually?

Classifying the board makes it more difficult to change control of a company through a proxy contest involving the election of directors. Because only a minority of the directors is elected each year, a dissident will be unable to win control of the board in a single election and would need two years to gain control of the company unless there are vacancies in the other classes. Studies have shown a negative correlation between the existence of a classified board and a firm’s value. In a 2005 study, Bebchuk and Cohen provide suggestive evidence that staggered boards at least partly bring about, not merely reflect, an economically significant reduction in firm value. A 2007 study by Faleye also shows a correlation between the existence of a classified board and a reduction in firm value, and suggests that by insulating management from market discipline, classified boards cause such reduction in firm value through managerial entrenchment and diminished board accountability.

Market Applicability: U.S., Canada, Japan

#### 83. Is the board authorized to issue blank check preferred stock?

Blank check preferred stock can be used for sound corporate purposes such as raising capital or making acquisitions. In these cases, blank check implies flexibility in meeting the company’s broad finance needs. By not establishing the terms of preferred stock at the time the class of stock is created, companies maintain the flexibility to tailor their preferred stock offerings to prevailing market conditions.

Nevertheless, blank check preferred stock is also suited for use as an entrenchment device. Albeit less common today, one powerful takeover defense is the placement of large blocks of corporate securities, or blank check preferred stock, with friendly third parties—the so-called “white knight” rescue. Blank check preferred stock would not be as objectionable to shareholders if a company stated in writing that such shares would be “declawed” and not be used to thwart a potential takeover.

Market Applicability: U.S., Canada

#### 78. Does the company have a poison pill (shareholder rights plan) in effect?

Institutional investors view poison pills as among the most onerous of takeover defenses that may serve to entrench management and have a detrimental impact on their long-term share value. While recognizing that boards have a fiduciary duty to use all available means to protect shareholders’ interests, investors often argue

that, as a best governance principle, boards should seek shareholder ratification of a poison pill (or an amendment thereof) within a reasonable period.

Market Applicability: U.S., Canada, Japan

79. What is the trigger threshold for the poison pill?

Poison pill triggers typically range from 10 to 25 percent, with the overwhelming majority of U.S. companies with pills maintaining a 15 percent trigger.

Market Applicability: U.S.

80. Does the poison pill have a sunset provision?

Poison pills with scheduled dates of termination mean that the decision to maintain the poison pill must be periodically revisited and, ideally, resubmitted for shareholder approval.

Market Applicability: U.S.

81. Does the poison pill have a TIDE provision?

TIDE provisions require the company's independent directors to review the plan every three years to evaluate whether it is still in shareholders' best interest.

Market Applicability: U.S.

82. Does the poison pill have a qualified offer clause?

Well-designed pills provide the company with negotiating power and time to receive the best possible offer for shareholders. Qualified offer clauses empower shareholders to redeem the pill and accept a valid takeover offer.

Market Applicability: U.S.

91. What is the expiration date of the poison pill?

While long-term pills may tend to serve as a device to entrench management, shorter-term pills are more likely to be in response to particular market or company circumstances, and will require, ideally, the board to revisit the decision to institute the rights plan.

Market Applicability: U.S.

220. Is the poison pill designed to preserve tax assets (NOL pill)?

NOL pills are designed to preserve tax assets per IRS rules where these tax-loss assets are forfeited upon change in control, and as such are designed to preserve shareholder value.

Market Applicability: U.S.

222. When was the poison pill implemented or renewed?

A more recently implemented pill deserves additional scrutiny.

Market Applicability: U.S.

223. Does the company's poison pill include a modified slow-hand or dead-hand provision?

“Dead hand” and “slow hand” provisions that prevents the removal of the poison pill is an egregious and unjustifiable violation of shareholders’ rights to accept an attractive takeover offer, even after replacing members of the board.

Market Applicability: U.S.

221. Was the poison pill approved by shareholders?

The Board of Directors should seek shareholder ratification of a poison pill (or an amendment thereof).

Market Applicability: Japan

290. Does the company have a controlling shareholder?

When there is a controlling shareholder, the minority shareholders may face challenges in matters where their interests diverge from those of the majority shareholder.

Market Applicability: Japan

52. Does the company have a majority vote standard in uncontested elections?

A majority vote standard requires that for directors to be elected (or re-elected) to serve on the company's board they must receive support from holders of a majority of shares voted. A plurality standard only requires the most votes, meaning a director nominee in an uncontested election can be elected to the board with, in theory, a single vote.

A majority vote standard, in combination with a plurality standard in elections with more nominees than seats, and a director resignation policy to address post-election results, has emerged in the U.S. in the last few years as a catalyst to make director elections meaningful rather than merely symbolic. One could argue that boards elected under such a majority vote structure are sufficiently accountable to shareholders.

The majority voting election standard (in uncontested elections), coupled with a post-election "director resignation policy" has emerged as the current best practice: shareholders have a clear, legally significant vote, and the board retains the ability to address the situation of "holdover" directors to accommodate both shareholder concerns and the need for stability and continuity of the board.

By adopting both majority voting and a director resignation policy, it is unnecessary to substitute one for the other; the two can co-exist. Majority voting, by itself, does not address the holdover situation if a director fails to get majority support. On the other hand, plurality voting coupled with a director resignation policy lacks teeth: the incumbent director still determines whether to tender his or her resignation. However, if majority voting creates holdover directors, the fate of the director is in the hands of the board.

Market Applicability: U.S., Canada

224. If the company has a majority voting standard, is there a plurality carve-out in the case of contested elections?

The absence of a carve-out for contested elections may serve as a takeover defense, since in a plurality election it is possible that no candidate will receive an absolute majority of votes, which is effectively a result in favor of incumbents.

Market Applicability: U.S.

284. Does the removal of a director require a supermajority vote?

Japanese directors can be removed by a simple majority shareholder vote, unless the articles require a supermajority. The supermajority requirement can serve as a form of management entrenchment.

Market Applicability: Japan

291. Does the company employ a U.S.-type board structure?

A small percentage of Japanese companies have adopted the U.S. style board which contrasts from the traditional board with statutory auditors.

Market Applicability: Japan

## Voting Issues

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89. Does the company require a super-majority vote to approve amendments to the charter and bylaws?

Supermajority provisions violate the principle that a simple majority of voting shares should be all that is necessary to effect change regarding a company and its corporate governance provisions. Requiring more than this may permit management to entrench itself by blocking amendments that are in the best interests of shareholders.

Market Applicability: U.S.

90. Does the company require a super-majority vote to approve mergers/business combinations?

Supermajority provisions violate the principle that a simple majority of voting shares should be all that is necessary to effect a merger. For companies that are controlled, however, supermajority provisions may help ensure that the controlling shareholder cannot unilaterally force a merger despite the opposition of minority shareholders.

Market Applicability: U.S.

285. Does the company have discretion over dividend payments?

According to Japanese corporate law, dividend payment requires shareholder approval, unless the company articles state the board has this authority.

Market Applicability: Japan

286. Are the shareholders allowed to submit dividend proposals?

Investors should not be forbidden from shareholder proposals on dividends, in cases where investors see existing dividend practice as problematic.

Market Applicability: Japan

84. What proportion of shares must be represented at the general meeting to cancel the binding nature of the nomination of supervisory board members (and or executive board members)?

According to the Dutch Code of Corporate Governance (December 2008), the —general meeting of shareholders of a company not having statutory two tier status (structuurregime) may pass a resolution to cancel the binding nature of a nomination for the appointment of a member of the management board or of the supervisory board and/or a resolution to dismiss a member of the management board or of the supervisory board by an absolute majority of the votes cast. It may be provided that this majority should represent a given proportion of the issued capital, which proportion may not exceed one third. If this proportion of the capital is not represented at the meeting, but an absolute majority of the votes cast is in favour of a resolution to cancel the binding nature of a

nomination, or to dismiss a board member, a new meeting may be convened at which the resolution may be passed by an absolute majority of the votes cast, regardless of the proportion of the capital represented at the meeting.

Market Applicability: W. Europe

### 53. Did the company have a slate ballot at its last shareholders' meeting?

Bundled, or slate, director elections provide shareholders with a single vote for or withhold for all of the nominees as a group. A shareholder who wishes to withhold support from a single director does not have the ability to do so when the company bundles director elections as a single ballot item.

Best practice is to provide individual director elections, providing shareholders with the ability to vote on each director separately.

Market Applicability: Canada, W. Europe, Germanic, S. Europe

### 262. What is the number of vacancies on the board?

There are vacancies on the board if the current number of directors is less than the maximum number of directors allowed under the company's bylaws. If there are vacancies on the board and the board has not declared "no vacancy" (subject to provisions of the Australian Corporations Act), it is easier for shareholder nominated candidates to be elected to the board.

Market Applicability: Anglo

## Voting Formalities

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### 97. What is the percentage of share capital needed to convene a special meeting?

Most U.S. state corporation statutes allow shareholders to call a special meeting when they want to take action on certain matters that arise between regularly scheduled annual meetings. Sometimes this right applies only if a shareholder or group of shareholders owns a specified percentage of the outstanding shares (10 percent is a common requirement). The percentage of shareholder votes required to force the company to call the meeting depends on the state statute, as does the company's ability to limit or deny altogether shareholders' right to call a special meeting.

In terms of day-to-day governance, shareholders may lose an important right – the ability to remove directors or initiate a shareholder resolution without having to wait for the next scheduled meeting – if they are unable to call a timely special meeting. Shareholders could also be powerless to respond to a beneficial offer if a bidder cannot call a special meeting. Therefore, the inability to call a special meeting and the resulting insulation of management may result in the decline of corporate performance and shareholder returns.

Market Applicability: U.S., W. Europe, S. Europe

### 98. Can shareholders act by written consent?

Consent solicitations can be advantageous to both shareholders and management in that the process does not involve the expense of holding a physical meeting, and it is easier for shareholders who can simply respond to the proposal by mail. A consent solicitation is similar to a proxy solicitation: consents are mailed to shareholders for their vote and signature and delivered to management. The only procedural difference is that the consent process ends with delivery of the consents. If enough consents are returned, the subject of the consent is deemed ratified. In contrast, a proxy solicitation must end with a meeting because proxy cards merely authorize the indicated "proxy" to cast a vote at a shareholder meeting. A signed consent card is itself the final vote and, as such, does not require a vote by proxy at a shareholder meeting.

Limitations on written consent are clearly contrary to shareholder interests. In terms of day-to-day governance, shareholders may lose an important right – the ability to remove directors or initiate a shareholder resolution without having to wait for the next scheduled meeting – if they are unable to act by written consent. Beneficial tender offers also may be precluded because of a bidder's inability to take action by written consent.

Market Applicability: U.S.

99. Has the board failed to implement a shareholder resolution supported by a majority vote?

Directors should be responsive to the company's owners, particularly in regard to shareholder proposals that receive a majority vote.

Market Applicability: U.S.

225. Are there material restrictions as to timing or topics to be discussed, or ownership levels required to call the meeting?

ISS will inquire as to whether there are material restrictions to the right to call a special meeting of shareholders. Material restrictions include: restrictions that prohibit special meetings more than 90 days away from the prior (or planned future) annual meeting date, restrictions that may be interpreted to preclude director elections or other significant business, and restrictions that effectively raise the ownership threshold required to call the meeting.

Market Applicability: U.S.

101. Is shareholder quorum for shareholders' meetings at least 2 persons representing at least 25% of the outstanding shares?

Shareholder meetings should only convene with a minimum acceptable level of attendance, thereby eliminating any shareholder resolutions that may be passed in a meeting with insufficient shareholder representation.

Market Applicability: Canada

287. Does the company hold shareholder meeting on the June peak date?

Many Japanese companies hold their annual shareholder meeting in the last few days of June, usually with an overwhelming concentration on one or two days. Investors have asked companies not to hold shareholder meetings on this June "peak date"

Market Applicability: Japan

## Other Shareholder Rights Issue

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263. Are there RPTs with significant shareholders?

Related party transactions with a significant shareholder can represent guaranteed business which can help to justify significant investments, but can also "crowd out" transactions with unrelated parties which may be more profitable for the company.

Market Applicability: Asia Pacific

264. Does the company have a frequently updated website?

Outdated financial data or failure to post information related to upcoming meetings disadvantages shareholders, especially those based overseas who cannot easily contact the company by telephone or in person.

Market Applicability: Asia Pacific

## Audit

### External Auditor

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1. Non-Audit fees represent what percentage of total fees?

The practice of auditors providing non-audit services to companies can prove problematic. While large auditors may have effective internal barriers to ensure that there are no conflicts of interest, an auditor's ability to remain objective is questionable when fees paid to the auditor for non-audit services, such as management consulting and special situation audits, exceed the standard annual audit fees. While some compensation for non-audit services is customary, the importance of maintaining the independence of the auditor is paramount, and an ideal gauge for that is the portion non-audit fees comprise of total audit fees.

Market Applicability: U.S., Canada, W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

2. Did the auditor issue an adverse opinion in the past year?

Auditor opinion reports are critical to ensuring a company's financials are presented correctly and free of material misstatements. In the U.S., an adverse auditor opinion is when the auditor believes that no part of the company's financial statements should be relied on. A qualified auditor opinion is when the auditor believes that in general the financial statements can be relied upon with certain exceptions.

Market Applicability: U.S., Canada, Japan, W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

### Audit and Accounting Controversies

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3. Has the company restated financials for any period within the past two fiscal years?

Companies may restate their financials due to misrepresentation or accounting irregularities, for example, or, in other cases, due clerical errors in the production of financial statements or business combinations. GRId will consider the former, focusing on those restatements that pose a material risk to shareholders and/or stakeholders. Restatements can result in significant reputational, legal, and financial risks, as evidenced by the number of U.S. companies that have in recent years been forced to restate their financials as a result of options backdating.

Market Applicability: U.S., Canada

4. Has the company made late financial disclosure filings in the past two fiscal years?

Late financial filings could result in penalties for the issuer and adversely impact the company's reputation and shareholder value.

Market Applicability: U.S., Canada, Japan

5. Has a securities regulator taken enforcement action against the company in the past two fiscal years?

Enforcement actions could result in significant penalties for the issuer and adversely impact the company's reputation and shareholder value.

Market Applicability: U.S., Canada, Japan, W. Europe, Germanic, Anglo, Nordic, S. Europe, Asia Pacific

200. Has a securities regulator taken enforcement action against a director or officer of the company in the past two fiscal years?

Enforcement actions could result in significant penalties for the issuer and adversely impact the company's reputation and shareholder value.

Market Applicability: U.S., Canada

201. Is a director or officer of the company currently under investigation by a regulatory body?

Disclosed investigations indicate the potential for controversy that could result in enforcement actions, significant penalties for the issuer and adversely impact the company's reputation and shareholder value.

Market Applicability: U.S.

8. Has the company disclosed any material weaknesses in its internal controls in the past two fiscal years?

Companies with significant material weaknesses potentially have ineffective internal controls, which may lead to inaccurate financial statements, hampering shareholders' ability to make informed investment decisions, and may lead to a weakening in public confidence and shareholder value.

Market Applicability: U.S., Canada, Japan, Anglo

## Other Audit issues

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6. How many financial experts serve on the audit committee?

Those deemed financial experts must possess accounting and audit skills. Local best practice requirements or rules detailing specific criteria will apply for the relevant jurisdictions. For example, Germany's governance code calls for the chairman of the audit committee to possess — specialist knowledge and experience in the application of accounting principles and internal control processes. The Dutch corporate governance code, meanwhile, is similar but not the same, suggesting at least — one member of the supervisory board shall be a financial expert with relevant knowledge and experience of financial administration and accounting for listed companies or other large legal entities. In some markets the financial expert is also recommended to be independent.

Market Applicability: W. Europe, Germanic, Anglo, S. Europe, Asia Pacific

271. Does the company have a published policy on non-audit work?

The practice of auditors providing non-audit services to companies can prove problematic. While large auditors may have effective internal barriers to ensure that there are no conflicts of interest, an auditor's ability to remain objective is questionable when fees paid to the auditor for non-audit services, such as management consulting and special situation audits, exceed the standard annual audit fees. Companies are required to have established clear guidelines on the provision of such services and to publicly disclose them.

Market Applicability: Asia Pacific

272. How many auditors has the company had in the past 3 years?

Frequent auditor changes may be a sign that auditors have resigned due to discomfort with the company's aggressive or non-standard accounting, or a sign that the company is seeking to avoid a qualified audit opinion by "shopping around" for an auditor willing to endorse the company's accounting.

Market Applicability: Asia Pacific

288. Has the company changed its audit firm without valid reason in the past three fiscal year?

Best practice dictates that a company to provide a valid reason for an auditor change.

Market Applicability: Japan

273. Is the CEO related to the CFO?

A CFO who is related to the CEO may be subject to pressure to falsify or "massage" the financial data to make the company and its management look better. It also suggests that nepotism, rather than merit, is the guiding principle in hiring.

Market Applicability: Asia Pacific

280. Can audit firm be indemnified without shareholder vote?

Some companies allow board to indemnify the audit firm without shareholder vote. Institutional investors typically argue such indemnification should be subject to a shareholder vote and not left solely to board discretion.

Market Applicability: Japan

281. What is the independent statutory auditors composition?

As many Japanese boards lack outside (nonexecutive) directors, the independence on the board of statutory auditors is important.

Market Applicability: Japan

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