



An MSCI Brand

International Corporate Governance Policy

2011 Updates

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Institutional Shareholder Services Inc.

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ISS' International Corporate Governance Policy 2011 Updates

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These policy updates present changes and clarifications to ISS' International benchmark guidelines for 2011. If new issues arise, such as shareholder proposals or regulatory developments, prior to the next formal update, ISS will adopt policies to cover such issues on an as-needed basis. Note that markets covered in this update document exclude the United States, Canada, and Europe. Further note that new policies applicable to Australia and South Africa are effective immediately, as peak proxy season in those markets takes place during the Fall season in the Northern Hemisphere.

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RESEARCH COVERAGE

Corporate Governance Issue: Country of Incorporation vs. Country of Listing—Application of Policy

Current Policy Application: ISS currently applies its benchmark policy based on an issuer's country of incorporation, as generally this approach has been compatible with the appropriate regulatory and operating environment.

Key Change: Apply U.S. policy to issuers that are incorporated outside the United States but file DEF 14As, 10-K annual reports, and 10-Q quarterly reports, and are thus considered domestic issuers by the U.S. Securities and Exchange Commission (SEC).

New Policy Application: In general, country of incorporation will still be the basis for policy application. However, ISS will generally apply its U.S. policies to the extent possible with respect to issuers that file DEF 14As, 10-K annual reports, and 10-Q quarterly reports, and are thus considered domestic issuers by the U.S. Securities and Exchange Commission (SEC).

Rationale for Update: In recent years, certain companies that are listed on a U.S. exchange have "redomesticated," i.e., re-incorporated outside the United States. As a result, many of these issuers have found themselves subject to a combination of governance regulations and best practice standards that may not be entirely compatible with ISS' policy approach based exclusively on country of incorporation. The intent of this policy change is to apply policies that are more compatible with standards applicable in an issuer's market of operation. While incorporated outside the United States, issuers that are listed on a U.S. exchange are considered U.S. domestic issuers by the SEC. In our [2010-2011 Policy Survey](#), 85 percent of institutional investors surveyed were in favor of this change. The adoption of this policy will result in the transfer of approximately 74 companies to be evaluated generally under ISS' U.S. policies. In the future, we will continue to look at potential transfers of companies that are incorporated in one jurisdiction but listed elsewhere.



BOARD

Corporate Governance Issue:

Election of Directors/Board Independence (South Africa)

Current Recommendation:

Vote FOR the reelection of directors unless:

- Adequate disclosure has not been provided in a timely manner;
- There are clear concerns over questionable finances or restatements;
- There have been questionable transactions with conflicts of interest;
- There are any records of abuses against minority shareholder interests;
- The board fails to meet minimum governance standards;
- There are specific concerns about the individual nominee, such as criminal wrongdoing or breach of fiduciary responsibilities;
- Repeated absences (less than 75 percent attendance) at board meetings have not been explained;
- Elections are bundled;
- The director is an executive who serves on one of the key board committees (audit, compensation, nominations).

Key Changes: Include other governance issues such as combined chair/CEO roles without adequate explanation, the appointment of the former CEO as chair, and poor independence levels on boards or committees.

New Recommendation:

Vote FOR the reelection of directors unless:

- Adequate disclosure has not been provided in a timely manner;
- There are clear concerns over questionable finances or restatements;
- There have been questionable transactions with conflicts of interest;
- There are any records of abuses against minority shareholder interests;
- The board fails to meet minimum governance standards;
- There are specific concerns about the individual nominee, such as criminal wrongdoing or breach of fiduciary responsibilities;
- Repeated absences (less than 75 percent attendance) at board meetings have not been explained;
- Elections are bundled;
- The director is an executive who serves on one of the key board committees (audit, compensation, nominations);
- The director combines the roles of chair and CEO and the company has not provided an adequate explanation;
- The director is the former CEO who has been appointed as chair;
- The director is a non-independent NED who serves on the audit committee;
- The director is a non-independent NED who serves on the compensation or nomination committee and there is not a majority of independent NEDs on the committee. However, such a consideration should take into account the potential implications for the board's black economic empowerment (BEE) credentials;
- The director is a non-independent NED and the majority of NEDs on the board are not independent. However, such a consideration should take into account the potential implications for the board's black economic empowerment (BEE) credentials;
- Under extraordinary circumstances, there is evidence of egregious actions related to the director's service on other boards that raise substantial doubts about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

Notes:

- The definition of NED independence as proposed in the King III report should be used in those areas where it is stricter than ISS' international director classification criteria. For example, the shareholding level which compromises independence is set at 5 percent in King III, compared to 10 percent in ISS' policy. In addition, under King III, the receipt of any performance-related compensation compromises NED independence.
- ISS has a preference for a compensation committee to be wholly independent. However, to be consistent with King III, we accept a majority of independent NEDs on this committee.

Rationale for Update: The King III report, the latest version of South Africa's best practice code, was published in September 2009 and was effective for financial years beginning March 2010. King III has strengthened some of the recommendations of its predecessor (King II).

The proposed changes bring the international policy as applied to South Africa into line with key King III recommendations and other updates to ISS' policy. Similar features are also highlighted in the governance policies of South African institutional investors. In light of this, it is an appropriate time to take into account issues such as NED independence for the purpose of ISS' vote recommendations. It is also appropriate to update the South Africa policy to include the option of voting against directors due to serious problems at other companies, as per ISS' policy in other markets.



Corporate Governance Issue: Election of Directors/Director Independence (Japan)

Current Recommendation:

Vote AGAINST the top executive at listed subsidiary companies that have publicly traded parent companies, where the board after the shareholder meeting does not include at least two independent directors based on ISS' independence criteria for Japan.

For companies with a three committee structure, vote AGAINST outside director nominees who are regarded as non-independent.

ISS does not have a specific policy for director nominees appointed as "independent outsiders" because of problems associated with obtaining independence designation information.

Key Changes: Apply a majority independent board standard at companies with a three-committee structure when determining whether to recommend against affiliated directors; modify the definition of listed subsidiaries by replacing "publicly traded companies" with "controlling shareholders" when determining whether to recommend against the top executive.

New Recommendation:

Vote AGAINST the top executive at listed companies that have controlling shareholders, where the board after the shareholder meeting does not include at least two independent directors based on ISS' independence criteria for Japan.

For companies with a three-committee structure, vote AGAINST outside director nominees who are regarded as non-independent. However, if a majority of the directors on the board after the shareholder meeting are independent outsiders, vote FOR the appointment of affiliated outsiders.

Rationale for Update: By taking a holistic approach, the updated policy is expected to encourage companies to build a better board with participation from outsiders who have knowledge of the company through business relationships, while the policy requires an overall board independence level to ensure the interests of independent shareholders are protected. With respect to the change in definition of listed subsidiaries, the current policy is only applicable to listed subsidiaries which have publicly traded parents. However, regardless of whether or not controlling shareholders are publicly traded companies, the protection of minority shareholders of controlled companies is critically important. The policy update is intended to better reflect this concept. On balance, these policy updates are generally in line with feedback received from investors.



Corporate Governance Issue:
Election of Audit Committee Members (South Africa)

Current Recommendation: ISS does not currently have a policy regarding the election of audit committee members in the South African market.

Key Change: Address a new feature of South African annual general meetings ("AGMs") following recent legal changes. In line with the Companies Act 2008, consider the election of audit committees (or, where appropriate, individual audit committee members) primarily in the context of the independence of the committee.

New Recommendation:

Vote FOR the reelection of the audit committee and/or audit committee members unless:

- The committee includes one or more non-independent NEDs;
- The audit committee member is a non-independent NED;
- Members of the committee do not meet the further minimum requirements for audit committee membership to be outlined by the South African government;
- There are serious concerns about the accounts presented, the audit procedures used, or some other feature for which the audit committee has responsibility.

Rationale for Update:

The Companies Act 2008 includes a requirement that audit committees be elected by shareholders at each AGM, and that such committees include independent NEDs only. Although the Act has yet to be formally implemented, some companies are already proposing AGM resolutions to satisfy the new requirement.



COMPENSATION

Corporate Governance Issue: Termination Benefits (Australia)

Current Recommendation: The current policy is that resolutions asking shareholders to approve "termination payments" in excess of the statutory maximum will not generally be supported by ISS unless there is clear evidence that such a payment would benefit shareholders. This policy has not been included in the written policy document, given such resolutions have been historically extremely rare.

Key Change: Codify existing practice on such resolutions into a formal ISS policy, given the expectation of more resolutions seeking prior approval of termination payments.

New Recommendation: Vote AGAINST resolutions seeking approval of termination payments for executives in excess of the statutory maximum (i.e., 12 months' base pay), except where there is clear evidence that the termination payment would provide a benefit to shareholders.

In cases where approval is sought for termination benefits under any equity plan, vote FOR the provision of termination benefits under the plan in excess of 12 months' base salary, if the approval is for three years or less and no vesting is permitted without satisfaction of sufficiently demanding performance hurdles.

Rationale for Update: The policy update incorporates the current application of the policy regarding resolutions seeking approval of termination benefits. Legislative changes to the maximum amount payable for a "termination payment" mean resolutions seeking to approve termination benefits will become more common. Amendments to the Australian Corporations Act in November 2009 capped allowable (i.e., without shareholder approval) "termination benefits" at 12 months' base pay. Formerly the Corporations Act only required shareholder approval where the termination payment was in excess of seven times total compensation (what constituted compensation was not defined under the former law). Companies are able to seek approval of such payments in advance.

Equity plans: The policy supports allowing termination benefits to be delivered under equity plans if the approval of the provision of benefits under the plan is for three years or less and allows vesting only if sufficiently demanding performance hurdles are met. Under the legislation it is not clear if allowing executives to retain previously granted equity incentives that vest post-cessation subject to the original performance hurdles is permitted. The policy approach is designed to ensure that unvested equity incentives may be retained post-cessation, such that boards can allow "good leavers" (those retiring or departing due to restructuring whose performance has been reasonable) to retain equity grants subject to performance hurdles.

Even in this case, no vesting would occur unless a suitably demanding performance hurdle (i.e., one that complies with ISS' policy) is met. It is consistent with client opposition to windfall gains for executives on termination regardless of performance, but supportive of allowing executives to retain incentives subject to performance hurdles on cessation, to encourage management to focus on long-term company performance. It also follows extensive discussions with directors who consider allowing boards to permit retention of unvested equity incentives (subject always to performance) as making discussions over executive succession easier.

Restricting any approval to allow termination benefits under an equity plan to three years allows shareholders to continually review the board's treatment of executive departures and revise voting decisions when companies seek to refresh termination benefit approvals.



Corporate Governance Issue: Retirement Bonuses for Directors and Statutory Auditors, and Deep Discount Stock Option (Japan)

Current Recommendation:

Vote AGAINST retirement bonuses if recipients include outsiders, or recipients include those who can be held responsible for a corporate scandal or poor financial performance that has led to shareholder value destruction.

For special payments in connection with the abolition of retirement bonus system, ISS applies the same policy as for retirement bonus payments.

As one of the conditions for support of deep discount options, ISS evaluates the vesting period. Vote AGAINST deep discount options if the exercise period starts before retirement. (However, if specific performance hurdles are clearly specified, this policy may not apply.)

Key Changes: Add bonus amount disclosure as a condition for support and remove the requirement that recipients of deep-discount options be able to exercise options only after retirement. With respect to the latter, the new policy will emphasize that ISS prefers disclosed performance conditions in order to support deep discount options. In the absence of such conditions, require recipients to exercise options at least after three years from grant.

New Recommendation:

Vote AGAINST retirement bonuses if the recipients include outsiders, or include those who can be held responsible for corporate scandal or poor financial performance which has led to shareholder value destruction. (However, in rare occasions, ISS may support payment to outsiders on a case-by-case basis, if the individual amount is disclosed and the amount is not excessive.) In addition, ISS opposes the payments if neither the individual payments nor the aggregate amount of the payments is disclosed.

Vote AGAINST special payments in connection with abolition of retirement bonus system if the recipients include outsiders, or include those who can be held responsible for corporate scandal or poor financial performance which has led to shareholder value destruction. (However, in rare occasions, ISS may support payment to outsiders on a CASE-BY-CASE basis, if the individual amount is disclosed and the amount is not excessive.) In addition, vote AGAINST the payments if neither the individual payments nor the aggregate amount of the payments is disclosed.

Among other conditions, vote AGAINST deep discount options if disclosed performance conditions are not attached. In the absence of such conditions, a vesting period of at least three years will be required to support such options.

Rationale for Update: Retirement bonuses and related special payments are determined based on board tenure, not on recipients' contribution to shareholder value creation. Due to pressure from shareholders, an increasing number of companies have abolished the system, but the practice is still widespread. Rather than opposing all retirement bonuses, it is reasonable to at least require the amounts to be disclosed at the time shareholders vote on the payments, and this will send the message that shareholders want companies to shift away from seniority-based pay practices. Although abolishing

the practice of paying retirement bonuses is a positive step, asking shareholders to approve the payout of funds accrued in the system, while not disclosing the amounts in question, remains a problematic practice.

Regarding ISS' current approach to deep-discount options, it was customary for Japanese companies to propose the grant of such options (which are equivalent to shares of restricted stock) in place of retirement bonuses whose payment was abolished. However, now that it has become more common for companies to propose deep discount options as part of regular compensation packages, the updated policy better reflects the status quo. In addition, the central issue of Japanese compensation is the lack of a link to shareholder value, and Japanese managers' holdings in their companies are usually limited. In light of this, the increased use of options as part of regular compensation packages is recommended. The updated policy sends the message that Japanese managers' interests should be more aligned with those of shareholders, by encouraging companies to give deep-discount options as part of regular compensation packages for managers, but with a vesting period that encourages long-term alignment.

On balance, these policy updates are generally in line with feedback received from investors.



Corporate Governance Issue: Advisory Votes on Compensation Policy/Compensation Report (South Africa)

Current Recommendation: Vote compensation items on a CASE-BY-CASE basis.

Key Change: Highlights the ISS Global Principles on Executive Compensation and identifies those issues which are likely to lead to a recommendation against compensation-related items. This is particularly relevant as more South African companies put compensation policy resolutions to an advisory vote.

New Recommendation:

ISS Global Principles on Executive Compensation

The assessment of compensation should follow the ISS Global Principles on Executive Compensation, which underlie market-specific policies in all markets:

- Provide shareholders with clear, comprehensive compensation disclosures;
- Maintain appropriate pay-for-performance alignment with emphasis on long-term shareholder value;
- Avoid arrangements that risk "pay for failure;"
- Maintain an independent and effective compensation committee;
- Avoid inappropriate pay to non-executive directors.

Approve Compensation Policy/Compensation Report

ISS will evaluate management proposals seeking ratification of a company's compensation policy on a CASE-BY-CASE basis. In support of King III, ISS believes that seeking annual shareholder approval for a compensation policy is a positive corporate governance provision.

When judging compensation policies or reports, ISS will generally recommend a vote AGAINST if the level of disclosure of the policy and/or its application is below what is required to make an informed judgment on the policy.

In the event of satisfactory disclosure, ISS will recommend a vote FOR the approval of the executive compensation policy unless two or more of the following issues apply (it may be appropriate to vote AGAINST on one issue if it has been identified as particularly serious):

- Large increases in fixed compensation have been implemented and have not been adequately explained.
- The company has made bonus payments but these have not been clearly linked to performance (including guaranteed bonuses or transaction bonuses).
- The company operates long-term incentive schemes (including matching shares) which do not have performance conditions attached for all or a substantial proportion of awards.
- The vesting period for long-term incentive schemes is set at less than three years.
- Long-term schemes include an element of retesting.
- Options can be granted at a discount to market value.
- The potential dilution under share incentive schemes is deemed excessive, and there are no mitigating circumstances (e.g., stringent performance measures)
- Executive directors have service contracts with notice periods which exceed one year.
- The company has made ex-gratia payments or one-off special awards to executives during the year which have not been adequately explained.
- Discretion has been used during the year in a manner not considered consistent with shareholder interests.
- The policy or the application of the policy is in any way not considered aligned with shareholder interests.

In circumstances where a company has demonstrated a significant shift in the right direction, it may be appropriate for ISS to support the compensation policy resolution, notwithstanding the presence of some historical issues of concern.

Failure to propose a resolution on executive compensation for shareholder approval may, over time, lead to an adverse vote recommendation on another AGM item, for example, the reelection of the chairman of the compensation committee.

Approve Share Incentive Scheme

ISS will evaluate management proposals seeking approval for a share incentive scheme on a CASE-BY-CASE basis.

When judging such items, ISS will generally recommend a vote AGAINST if the level of disclosure on the proposal is below what is required to make an informed judgment on the scheme.

In the event of satisfactory disclosure, ISS will recommend a vote FOR the proposal unless ONE or more of the following apply:

- Performance conditions do not apply, have not been disclosed, or are not considered sufficiently challenging or relevant.
- Performance conditions can be retested.
- Performance is measured over a period shorter than three years.
- The plan allows for option repricing or issue of options at a discount or backdating of options.
- The potential dilution is deemed excessive, and there are no mitigating circumstances (e.g., stringent performance measures).
- The scheme provides for potentially excessive individual reward or has no caps on individual participation.
- NEDs can participate in the scheme.
- The scheme is in any way not considered aligned with shareholder interests.

Proposals to amend a scheme will involve an assessment of the nature of the amendment.

Rationale for Update: The new policy will clarify ISS' approach to assessing compensation-related items in South Africa. This is particularly relevant given that the King III report includes a recommendation that companies provide shareholders with a non-binding vote at the AGM on the executive compensation policy. It is expected that more companies will put these types of resolution forward for a shareholder vote; a number of such resolutions have already been included in AGM agendas in 2010.

Using the ISS Global Principles on Executive Compensation as a starting point, and taking into account best practice guidance outlined in King III and some common concerns of shareholders, the intention is to focus on disclosure and also highlight those issues which are likely to trigger negative vote recommendations.



CAPITAL MEASURES & AUDITORS

Corporate Governance Issue: Share Issuance Authorities (South Africa)

Current Recommendation:

Placing Shares under Control of Directors

Vote FOR a general authority to place authorized but unissued shares under the control of the directors unless:

- The authority is over a number of shares equivalent to more than 20 percent of the current issued share capital.
- The authority would allow shares to be used for share incentive scheme purposes and the underlying scheme(s) raises concerns.

Authorities to Issue Shares for Cash

Vote FOR a general authority to issue shares for cash, unless the authority is over a number of shares equivalent to more than 20 percent of the current issued share capital.

Key Changes: Reduce the acceptable limit on share issuances from 20 to 10 percent of issued share capital; add a provision that ISS may recommend a vote against if there is evidence of past abuse of these authorities.

New Recommendation:

Placing Shares under Control of Directors

Vote FOR a general authority to place authorized but unissued shares under the control of the directors unless:

- The authority is over a number of shares equivalent to more than 10 percent of the current issued share capital.
- The authority would allow shares to be used for share incentive scheme purposes and the underlying scheme(s) raises concerns.
- The company used the authority during the previous year in a manner deemed not to be in shareholders' best interests.

Authorities to Issue Shares for Cash

Vote FOR a general authority to issue shares for cash unless:

- The authority is over a number of shares equivalent to more than 10 percent of the current issued share capital.
- The company used the authority during the previous year in a manner deemed not to be in shareholders' interests.

Rationale for Update: Resolutions of this nature – seeking general authorities to issue shares – are common at South African AGMs. Many local institutional investors regularly vote against these authorities on account of concerns over potential dilution, and resolutions are regularly not carried (particularly those requiring 75 percent support). The preference among local institutions is for companies to seek specific authorities for issues of new shares, allowing shareholders the ability to assess the potential dilution in the context of the business case for the specific issue.

The proposed updates to ISS' policy strike a balance between (a) continuing to allow companies to have a degree of flexibility to issue shares and (b) moving to a position more closely in line with local shareholder expectations.

An additional provision to the policy has been added to capture concerns over those circumstances where a company may have used general authorities during the year in a manner not considered in shareholders' interests.

