U.S. Corporate Governance Policy

2012 Updates

November 17, 2011

Institutional Shareholder Services Inc.

ISS' U.S. Corporate Governance Policy
2012 Updates

Effective for Meetings on or after Feb. 1, 2012
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INTRODUCTION

The primary purpose of a public corporation is to create sustainable value for its shareowners. To that end, ISS designs its proxy voting guidelines to enhance shareholders' long-term economic interests. ISS' Benchmark proxy voting guidelines serve as a tool to assist institutional investors in meeting their fiduciary requirements with respect to voting by promoting shareholder value creation and risk mitigation at their portfolio firms.

ISS reviews and updates its proxy voting guidelines each year, taking into account emerging issues and trends, the evolution of market standards, regulatory changes, and feedback provided by ISS' institutional clients.

ISS' robust and transparent policy formulation process includes an exhaustive review of relevant empirical studies and other factual data, an annual policy survey of institutional clients and corporate issuers, policy roundtables with a wide range of industry constituents, and an open comment period on draft policy changes. ISS also conducts internal research to validate assumptions and policy positions.

The Benchmark Policy Guidelines consider market-specific recommended best practices, transparency, and disclosure when addressing issues such as board structure, director accountability, corporate governance standards, executive compensation, shareholder rights, corporate transactions, and social/environmental issues.

ISS' policy guidelines require the consideration of company-specific circumstances. When issuing a vote recommendation on a proposal, ISS considers historical operating and investment performance, company disclosure (and proponent/dissident disclosure, if applicable), the company's governance structure and historical practices, and its industry.

In applying these policies, ISS often engages with public issuers, shareholders, activists, and other stakeholders to seek additional information and to gain insight and context in order to provide our clients with informed vote recommendations. This engagement process enhances dialogue and promotes a higher level of understanding between investors and the companies in which they invest.

In formulating proxy voting policies, ISS assesses the potential costs and benefits of the adoption or rejection of the underlying ballot items. Where the economic impact of a ballot item is not apparent and may involve trade-offs, the guidelines direct analysts to consider the economic consequences as well as potential risks to shareholders of approval.

This document presents the changes being made to ISS' Benchmark U.S. Corporate Governance Policies. The document, along with other policy documents, is available on our Web site under the Policy Gateway. If you have any questions, please contact Research Central at 301-556-0576 or usresearch@issgovernance.com.

These policy changes will be effective for meetings on or after Feb. 1, 2012.

BOARD

Corporate Governance Issue: Proxy Access

Current Recommendation: Vote CASE-BY-CASE on shareholder proposals asking for open or proxy access, taking into account:

- The ownership threshold proposed in the resolution;
- The proponent's rationale for the proposal at the targeted company in terms of board and director conduct.

Key Changes: Refining the factors to be examined in the evaluation; broadening the policy to apply to management proposals as well.

New Recommendation: ISS supports proxy access as an important shareholder right, one that is complementary to other best-practice corporate governance features. However, in the absence of a uniform standard, proposals to enact proxy access may vary widely; as such, ISS is not setting forth specific parameters at this time and will take a case-by-case approach in evaluating these proposals.

Vote CASE-BY-CASE on proposals to enact proxy access, taking into account, among other factors:

- Company-specific factors; and
- Proposal-specific factors, including:
  - The ownership thresholds proposed in the resolution (*i.e.*, percentage and duration);
  - The maximum proportion of directors that shareholders may nominate each year; and
  - The method of determining which nominations should appear on the ballot if multiple shareholders submit nominations.

Rationale for Update: On Sept. 20, 2011, the Securities and Exchange Commission's amendment to Rule 14a-8 took effect, providing that companies may not exclude from their proxy materials shareholder proposals for proxy access procedures. The Commission lifted the stay on the amendment to Rule 14a-8 in conjunction with its decision not to appeal a decision by the D.C. Circuit Court striking down the commission's mandatory proxy access rule, Rule 14a-11. In the wake of the commission's decision, several investors have indicated their intent to bring proxy access shareholder proposals in the coming months.

ISS' existing CASE-BY-CASE policy on proxy access shareholder proposals did not incorporate certain expected core features of such proposals and overemphasized the proponent's rationale, given ISS' support in principle for these proposals. The existing policy also did not address management proposals, which may appear in 2012 as well. While the revised policy for 2012 remains CASE-BY-CASE, ISS expands and refines the factors that will be examined in the evaluation and broadens the policy to apply to management proposals as well. Although the enumerated factors are likely to be among the core features of proxy access bylaw proposals, the list is not intended to be exhaustive in ISS' evaluations. For instance, ISS is removing rationale as an enumerated factor, but rationale will remain one of the numerous "other factors" that ISS may consider when evaluating proxy access bylaw proposals.

Based on ISS' 2011-2012 comment period, institutional investors generally support the updated policy. However, issuers and issuer-related organizations wanted more specificity in the policy and sought further guidance. ISS notes that the access debate is fluid and likely to gain more attention in 2012. We anticipate that there will be a variety of access proposals in 2012 with different ownership thresholds (percent and duration) and potentially binding proposals.

Corporate Governance Issue:
Voting on Director Nominees in Uncontested Elections

Board Accountability – Governance Failures

Current Recommendation: Under extraordinary circumstances, vote AGAINST or WITHHOLD from directors individually, committee members, or the entire board, due to:

- Material failures of governance, stewardship, or fiduciary responsibilities at the company;
- Failure to replace management as appropriate; or
- Egregious actions related to the director(s)' service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

Key Change: Adding an explicit reference to risk oversight.

New Recommendation: Under extraordinary circumstances, vote AGAINST or WITHHOLD from individual directors, members of a committee, or the entire board, due to:

- Material failures of governance, stewardship, risk oversight, or fiduciary responsibilities at the company;
- Failure to replace management as appropriate; or
- Egregious actions related to a director's service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

Rationale for Update: This policy update clarifies ISS' existing policy by highlighting the significance of risk oversight within the broader concept of directors' fiduciary responsibilities. The intention of this update is not to penalize boards for taking prudent business risks or for exhibiting reasonable risk appetite, but is instead intended to address situations where there has been a material failure in a board's role in overseeing the company's risk management practices.

Over the past few years, the market has seen a multitude of well-publicized failures of board risk oversight. These failures are not limited to the financial sector, as evidenced by the events leading up to the Deepwater Horizon oil spill of 2010, or the scandals surrounding News Corporation's U.K. operations in 2011. The importance of proper risk oversight has been further highlighted by a number of national and international codes of best practice, including, but not necessarily limited to, the International Corporate Governance Network's TCRO guidelines, and the Council of Institutional Investors' Corporate Governance Policies.

Board Responsiveness – Response to Frequency of Advisory Vote on Pay Results

Current Recommendation: None.

Key Changes: Adopt a policy to determine whether to vote against or withhold from directors if the board implements a say-on-pay schedule that is less frequent than the frequency most recently preferred by shareholders.

New Recommendation: Vote AGAINST or WITHHOLD from the entire board of directors (except new nominees, who should be considered CASE-BY-CASE) if:

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

Vote CASE-BY-CASE on the entire board if:

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

Rationale for Update: Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC not only required U.S. corporate issuers to present shareholders with an advisory say-on-pay (MSOP) vote but also required them to provide shareholders with an advisory vote to select the preferred frequency of MSOP votes at the first annual shareholder meeting occurring on or after Jan. 21, 2011, and at least every six years thereafter. The resolution allowed shareholders to vote for a frequency of every year, every two years, or every three years.

While the MSOP frequency vote is non-binding on the board, it is a means for shareholders to express their preference. Majority support for a particular frequency should be viewed as a mandate to a board. Boards should be responsive and implement the option preferred by shareholders, regardless of whether it is the same option as recommended by the board. The majority of the investors who responded during ISS' 2011-2012 Comment Period endorsed this position.

In a situation where voters have more than two choices, the possibility exists that no choice will receive a majority vote, and the preference of shareholders may be unclear. Therefore, if a board implements an option that is less frequent than the one receiving a plurality, but not a majority, of votes cast, ISS will consider additional factors, including the board's rationale for implementing a less frequently recurring say-on-pay vote, the company's ownership structure, any compensation concerns, and the say-on-pay support level from the prior year.

Implementation of a more frequent say-on-pay vote than the one that received a majority or plurality of shareholder vote is not considered problematic, as it is in line with good corporate governance. The more often a board brings its executive compensation to a shareholder vote, a greater opportunity is given to shareholders to voice any concerns.

BOARD and COMPENSATION

Corporate Governance Issues:
Voting on Director Nominees in Uncontested Elections and Executive Pay Evaluation

Board Response to High Levels of MSOP Opposition

Current Recommendations: Under Election of Directors: Vote AGAINST/WITHHOLD on compensation committee members (or in rare cases where the full board is deemed responsible, all directors including the CEO) in egregious situations or when no MSOP item is on the ballot or when the board has failed to respond to concerns raised in prior MSOP evaluations

Under Compensation: MSOP Evaluation– Board Communications and Responsiveness: Vote CASE-BY-CASE on board's responsiveness to investors' input and engagement on compensation issues, for example:

- Failure to respond to majority supported shareholder proposals on executive pay topics; or
- Failure to respond to concerns raised in connection with significant opposition to prior year's MSOP.

Key Changes: Highlighting the types of disclosure that shareholders will examine in determining whether a company has sufficiently addressed shareholders' concerns with respect to the compensation issues raised in the prior year.

New Recommendation: Vote CASE-BY-CASE on Compensation Committee members (or, in exceptional cases, the full board) and the Management Say-on-Pay proposal if the company's previous say-on-pay proposal received the support of less than 70 percent of votes cast, taking into account:

- The company's response, including:
  - Disclosure of engagement efforts with major institutional investors regarding the issues that contributed to the low level of support;
  - Specific actions taken to address the issues that contributed to the low level of support;
  - Other recent compensation actions taken by the company;
- Whether the issues raised are recurring or isolated;
- The company's ownership structure; and
- Whether the support level was less than 50 percent, which would warrant the highest degree of responsiveness.

Rationale for Update: The Dodd-Frank Act requires issuers to address, in the CD&A, whether and how their compensation policies and decisions have taken into account the results of the most recent say-on-pay vote. Based on ISS' 2011-2012 Policy Survey results, 72 percent of investor respondents indicate that an explicit response from the board regarding improvement to pay practices should be made at opposition levels of “more than 30 percent.” Investors' feedback during ISS' 2011-2012 comment period indicated general support for the proposed thresholds for closer scrutiny. At companies that fail to receive a meaningful level of support on their say-on-pay proposals, shareholders will seek substantive and meaningful disclosure in determining whether the company has taken sufficient actions to address the compensation issues that contributed to the low level of support. Companies should discuss their outreach efforts to major institutional investors and provide the specific actions that they have taken to address the compensation issues that resulted in a significant opposition votes. These specific actions should ideally be new rather than a reiteration of existing practices. Companies should refrain from providing boilerplate disclosure, as it does not enable shareholders to gauge the level of effort taken by the company. Placement of such information should be readily identifiable.

COMPENSATION

Corporate Governance Issue:
Executive Pay Evaluation: Advisory Votes on Executive Compensation – Management Proposals

Pay-for-Performance Evaluation

Current Methodology: Evaluate the alignment of the CEO's pay with performance over time, focusing particularly on companies that have underperformed their peers over a sustained period. From a shareholders' perspective, performance is predominantly gauged by the company's stock performance over time. Even when financial or operational measures are utilized in incentive awards, the achievement related to these measures should ultimately translate into superior shareholder returns in the long-term.

Focus on companies with sustained underperformance relative to peers, considering the following key factors:

- Whether a company's one-year and three-year total shareholder returns (TSR) are in the bottom half of its industry group *(i.e.*, four-digit GICS – Global Industry Classification Group); and
- Whether the total compensation of a CEO who has served at least two consecutive fiscal years is aligned with the company's total shareholder return over time, including both recent and long-term periods.

If a company falls in the bottom half of its four-digit GICS, further analysis of the CD&A is required to better understand the various pay elements and whether they create or reinforce shareholder alignment. Also assess the CEO's pay relative to the company's TSR over a time horizon of at least five years. The most recent year-over-year increase or decrease in pay remains a key consideration, but there will be additional emphasis on the long-term trend of CEO total compensation relative to shareholder return. Also consider the mix of performance-based compensation relative to total compensation. In general, standard stock options or time-vested restricted stock are not considered to be performance-based. If a company provides performance-based incentives to its executives, the company is highly encouraged to provide the complete disclosure of the performance measure and goals (hurdle rate) so that shareholders can assess the rigor of the performance program. The use of non-GAAP financial metrics also makes it very challenging for shareholders to ascertain the rigor of the program as shareholders often cannot tell the type of adjustments being made and if the adjustments were made consistently. Complete and transparent disclosure helps shareholders to better understand the company's pay-for-performance linkage.

Key Change: Refining the methodology of determining pay-for-performance alignment.

New Methodology: ISS annually conducts a pay-for-performance analysis to identify strong or satisfactory alignment between pay and performance over a sustained period. With respect to companies in the Russell 3000 index, this analysis considers the following:

1. Peer Group[1] Alignment:

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[1] The peer group is generally comprised of 14-24 companies that are selected using market cap, revenue (or assets for financial firms), and GICS industry group, via a process designed to select peers that are closest to the subject company, and where the subject company is close to median in revenue/asset size. The relative alignment evaluation will consider the company's rank for both pay and TSR within the peer group (for one- and three-year periods) and the CEO's pay relative to the median pay level in the peer group.

- The degree of alignment between the company's TSR rank and the CEO's total pay rank within a peer group, as measured over one-year and three-year periods (weighted 40/60);
- The multiple of the CEO's total pay relative to the peer group median.

2. Absolute Alignment: The absolute alignment between the trend in CEO pay and company TSR over the prior five fiscal years – *i.e.*, the difference between the trend in annual pay changes and the trend in annualized TSR during the period.

If the above analysis demonstrates significant unsatisfactory long-term pay-for-performance alignment or, in the case of non-Russell 3000 index companies, misaligned pay and performance are otherwise suggested, analyze the following qualitative factors to determine how various pay elements may work to encourage or to undermine long-term value creation and alignment with shareholder interests:

- The ratio of performance- to time-based equity awards;
- The ratio of performance-based compensation to overall compensation;
- The completeness of disclosure and rigor of performance goals;
- The company's peer group benchmarking practices;
- Actual results of financial/operational metrics, such as growth in revenue, profit, cash flow, etc., both absolute and relative to peers;
- Special circumstances related to, for example, a new CEO in the prior fiscal year or anomalous equity grant practices (*e.g.*, biennial awards); and
- Any other factors deemed relevant.

Rationale for Update: The advent of near universal say-on-pay has underscored the importance of a balanced evaluation of executive pay practices. At the same time, 94 percent of institutional respondents to ISS' 2009-2010 Policy Survey indicated that pay-for-performance is a critical or important consideration in their vote determinations. This year, another overwhelming majority of institutional respondents to ISS' 2011-2012 Policy Survey indicated two factors as relevant to evaluating pay-for-performance alignment: pay relative to peers is considered very relevant by 62 percent and somewhat relevant by 32 percent; and 88 percent believe pay increases that are disproportionate to the company's performance trend are very relevant to this evaluation (plus 11 percent who consider it somewhat relevant). Among issuers, 86 percent responded that pay versus peers is an appropriate factor, while 97 percent said pay increases in light of company performance should be a consideration. In addition, both clients and issuers have indicated through roundtables and during ISS' 2011-2012 Comment Period that pay-performance alignment should be viewed in a long-term context rather than the most recent year.

In light of this guidance, ISS is revising its approach to identifying pay-for-performance alignment in order to better address market needs. The new approach will identify strong as well as weak pay-for-performance alignment over a sustained period, thus giving clients a more robust view of the relationship between executive pay and performance at portfolio companies.

In cases where alignment appears to be weak, further in-depth analysis will determine causal or mitigating factors, such as the mix of performance- and non-performance-based pay, biennial grant practices, impact of a newly hired CEO, and rigor of performance programs. For example, 81 percent of investor respondents to ISS' 2010-2011 Policy Survey said that the way a company's short-term and long-term incentive metrics relate to the company's business strategy is among their most important considerations in evaluating executive pay. If long-term alignment of TSR performance and CEO pay opportunities is weak, investors expect current pay and pay opportunities to be strongly performance-based.

Although ISS' current pay-for-performance evaluation is also case-by-case and ultimately qualitative, the current screen does not identify companies with strong pay-for-performance alignment and also does not address companies that deliver high pay and pay opportunities in contrast to mediocre long-term performance (*e.g.*, TSRs that marginally exceed the peer group median).

Note also that the longer-term emphasis of the new methodology largely alleviates concern about the impact of CEO turnover. Thus, except in extenuating circumstances, a "new" CEO will not exempt the company from consideration under the analysis as the compensation committee is also accountable when a company is compelled to significantly "overpay" for new leadership due to prior poor performance.

Corporate Governance Issue:
Incentive Bonus Plans and Tax Deductibility Proposals (OBRA-Related Compensation Proposals)

Post- IPO companies

Current Recommendation: Vote FOR proposals that simply amend shareholder-approved compensation plans to include administrative features or place a cap on the annual grants any one participant may receive to comply with the provisions of Section 162(m) of the Internal Revenue Code.

Vote FOR proposals to add performance goals to existing compensation plans to comply with the provisions of Section 162(m) unless they are clearly inappropriate.

Votes to amend existing plans to increase shares reserved and to qualify for favorable tax treatment under the provisions of Section 162(m) are considered CASE-BY-CASE using a proprietary, quantitative model developed by ISS.

Generally vote FOR cash or cash and stock bonus plans that are submitted to shareholders for the purpose of exempting compensation from taxes under the provisions of Section 162(m) if no increase in shares is requested.

Vote AGAINST proposals if the compensation committee does not fully consist of independent outsiders, as defined in ISS' classification of director independence, or if the plan contains excessive problematic provisions.

Key Change: The first time that a company presents an equity plan on its ballot for 162(m) shareholder approval, the plan will be given a full equity plan evaluation.

New Recommendation: Generally vote FOR proposals to approve or amend executive incentive bonus plans if the proposal:

- Is only to include administrative features;
- Places a cap on the annual grants any one participant may receive to comply with the provisions of Section 162(m);
- Adds performance goals to existing compensation plans to comply with the provisions of Section 162(m) unless they are clearly inappropriate; or
- Covers cash or cash and stock bonus plans that are submitted to shareholders for the purpose of exempting compensation from taxes under the provisions of Section 162(m) if no increase in shares is requested.

Vote AGAINST such proposals if:

- The compensation committee does not fully consist of independent outsiders, per ISS' director classification; or
- The plan contains excessive problematic provisions.

Vote CASE-BY CASE on such proposals if:

- In addition to seeking 162(m) tax treatment, the amendment may cause the transfer of additional shareholder value to employees (*e.g.*, by requesting additional shares, extending the option term, or expanding the pool of plan participants). Evaluate the Shareholder Value Transfer in comparison with the company's allowable cap; or
- A company is presenting the plan to shareholders for Section 162(m) favorable tax treatment for the first time after the company's initial public offering (IPO). Perform a full equity plan analysis, including consideration of total shareholder value transfer, burn rate (if applicable), repricing, and liberal change in control. Other factors such as pay-for-performance or problematic pay practices as related to Management Say-on-Pay may be considered if appropriate.

Rationale for Update: While shareholders would benefit from the tax deduction that newly public companies would receive for Section 162(m), they are not provided an opportunity to fully evaluate such companies' equity plans. The updated policy enables shareholders to identify whether any problematic features exist under the proposed plan such that approval solely for Section 162(m) for the first time would not benefit shareholders. Eighty percent of investor survey respondents in the 2011-2012 Policy Survey results supported this position.

While ISS anticipates continuing to support the vast majority of Section 162(m) proposals that do not seek additional shares, our ultimate recommendation is based on evaluation of all aspects of the plan to ensure that any adverse provisions would not have a more detrimental potential impact on shareholders than a potential loss of tax deductions related to named executive officer grants.

The policy change aligns with the recently proposed Treasury rule related to Section 162(m) of the Internal Revenue Code, which would require newly public companies to obtain shareholder approval before awarding certain performance-based restricted stock units to named executive officers before the end of their standard transition period in order for them to qualify as performance-based compensation. This change is expected to increase the number of post-IPO plans being presented for shareholder approval.

SHAREHOLDER RIGHTS & DEFENSES

Corporate Governance Issue: Exclusive Venue Management Proposals

Current Recommendation: The current approach was adopted after publication of our 2011 policy documents.

Vote AGAINST exclusive venue proposals unless the company has in place the following best-practices governance features:

- An annually elected board;
- A majority vote standard in uncontested elections of directors;
- A meaningful special meeting right (generally a 10 percent demand level without onerous restrictions on topics and timing); and
- The absence of a poison pill, unless the pill was approved by shareholders.

Key Changes: Moving to a CASE-BY-CASE policy; adding a company's litigation history to the list of factors to be examined; and removing a meaningful special meeting right from list of governance factors to be examined.

New Recommendation: Vote CASE-BY-CASE on exclusive venue proposals, taking into account:

- Whether the company has been materially harmed by shareholder litigation outside its jurisdiction of incorporation, based on disclosure in the company's proxy statement; and
- Whether the company has the following good governance features:
  - An annually elected board;
  - A majority vote standard in uncontested director elections; and
  - The absence of a poison pill, unless the pill was approved by shareholders.

Rationale for Update: Exclusive venue management proposals were new for the 2011 proxy season, as issuers began seeking shareholder approval of exclusive venue charter provisions in 2011 after a court opinion suggested that unilaterally adopted exclusive venue bylaw provisions might not be enforceable. Investors' awareness of and opinions on exclusive venue provisions are still emerging, but some large investors remain wary of these provisions. In ISS' 2011-2012 Policy Survey, institutional investors indicated that they would be likely to evaluate factors other than governance, including the company's litigation history, in evaluating exclusive venue management proposals and the quality of the state's corporate law. Furthermore, ISS held a policy roundtable discussion on this topic in November with seven institutional investors. Based on that discussion, there was no uniform approach when voting on these proposals. Some investors generally voted against these proposals while others typically supported them.

Based on feedback from institutional investors, ISS determined that the CASE-BY-CASE policy reflects a reasonable approach taking into account factors that are relevant for investors to consider.

ISS has removed the examination of the company's special meeting right from the policy, as this governance feature is less relevant to exclusive venue than it is to other proposals (such as those seeking to provide shareholders with the right to act by written consent). All of the exclusive venue proposals to date have sought to make Delaware the exclusive forum for resolution of shareholder disputes. If proposals to make other jurisdictions the exclusive venue arise in 2012, ISS may examine that jurisdiction's statutes, case law, and judiciary as part of its evaluation.

CAPITAL/RESTRUCTURING

Corporate Governance Issue:
Dual-Class Structure

Current Recommendation:

Vote AGAINST proposals to create a new class of common stock with superior voting rights.

Vote FOR proposals to create a new class of nonvoting or subvoting common stock if:

- It is intended for financing purposes with minimal dilution to current shareholders;
- It is not designed to preserve the voting power of an insider or significant holder.

Key Changes: Consolidate the factors into one policy on the formation of a dual-class capital structure regardless of voting rights. Add the issuer's rationale, economic condition, and the expected duration of the new class as factors.

New Recommendation: Generally vote AGAINST proposals to create a new class of common stock unless:

- The company discloses a compelling rationale for the dual-class capital structure, such as:
  - The company's auditor has concluded that there is substantial doubt about the company's ability to continue as a going concern; or
  - The new class of shares will be transitory;
- The new class is intended for financing purposes with minimal or no dilution to current shareholders in both the short term and long term; and
- The new class is not designed to preserve or increase the voting power of an insider or significant shareholder.

Rationale for Update: Most investors take a limited view toward dual-class capital structures because of the structure's inherent negative impact on shareholder rights. This policy update better aligns ISS' policy with investors' views. Only in the most compelling of circumstances—generally occurring when a company is on the brink of liquidation or dissolution—will ISS support the creation of a dual-class capital structure.

SOCIAL/ENVIRONMENTAL ISSUES

Corporate Governance Issue: Hydraulic Fracturing

Current Recommendation: No existing policy; currently the General Environmental Proposals and Community Impact Assessments policy is applied.

Key Change: An issue-specific policy is being created for this topic.

New Recommendation: Generally vote FOR proposals requesting greater disclosure of a company's (natural gas) hydraulic fracturing operations, including measures the company has taken to manage and mitigate the potential community and environmental impacts of those operations, considering:

- The company's current level of disclosure of relevant policies and oversight mechanisms;
- The company's current level of such disclosure relative to its industry peers;
- Potential relevant local, state, or national regulatory developments; and
- Controversies, fines, or litigation related to the company's hydraulic fracturing operations.

Rationale for Update: Hydraulic fracturing, also known as fracking, is a natural gas extraction technique that involves the high-pressure injection of water, sand, and chemicals into a gas-bearing shale rock formation. The pressure creates or exposes fissures, which then are kept open by the sand that remains after the water and chemicals are removed, allowing the formerly inaccessible natural gas to flow to the well for extraction.

The public profile of the issue has only increased since fracking-related shareholder proposals were first introduced in 2010; it is frequently the subject of media coverage – national coverage as well as regional media coverage where hydraulic fracturing operations are conducted. The issue has found similar traction among investors and companies as reflected in the relatively high number of hydraulic fracturing proposals that are withdrawn and the relatively high levels of shareholder support these proposals receive when they come to a vote.

During ISS' 2011-2012 Comment Period, a majority of institutional investors supported the updated policy. Given developments regarding the public profile of the issue and the traction these proposals have found with investors, as well as for purposes of clarity, a specific policy on hydraulic fracturing-related proposals is warranted.

Corporate Governance Issue: Recycling

Current Recommendation: Vote CASE-BY-CASE on proposals to adopt a comprehensive recycling strategy, taking into account:

- The nature of the company's business;
- The extent that peer companies are recycling;
- The timetable prescribed by the proposal and the costs and methods of implementation; and
- Whether the company has a poor environmental track record, such as violations of applicable regulations.

Key Changes: The policy is being broadened to take into account proposals that seek information on a company's existing recycling programs and to explicitly include a company's current level of disclosure of such programs when determining a proposal voting recommendation.

New Recommendation: Vote CASE-BY-CASE on proposals to report on an existing recycling program, or adopt a new recycling program, taking into account:

- The nature of the company's business;
- The current level of disclosure of the company's existing related programs;
- The timetable prescribed by the proposal and the costs and methods of program implementation;
- The ability of the company to address the issues raised in the proposal; and
- The company's recycling programs compared with the similar programs of its industry peers.

Rationale for Update: New proposals during 2011 revisited the issue of corporate recycling. The new proposals asked for reports on corporate recycling strategies as well as for the adoption of strategies. The proposals focused on beverage container recycling at Starbucks and McDonald's (the McDonald's proposal also asked for disclosure on the company's use of polystyrene containers) and on electronics recycling at Target.

Corporate Governance Issue:
Political Spending

Current Recommendation: Vote CASE-BY-CASE on proposals to improve the disclosure of a company's political contributions and trade association spending considering:

- Recent significant controversy or litigation related to the company's political contributions or governmental affairs; and
- The public availability of a company policy on political contributions and trade association spending including information on the types of organizations supported, the business rationale for supporting these organizations, and the oversight and compliance procedures related to such expenditures of corporate assets.

Key Changes: Change the policy from CASE-BY-CASE to generally vote FOR; disclosure of oversight mechanisms is being explicitly included as a point of consideration.

New Recommendation: Generally vote FOR proposals requesting greater disclosure of a company's political contributions and trade association spending policies and activities. However, the following will be considered:

- The company's current disclosure of policies and oversight mechanisms related to its direct political contributions and payments to trade associations or other groups that may be used for political purposes, including information on the types of organizations supported and the business rationale for supporting these organizations; and
- Recent significant controversies, fines, or litigation related to the company's political contributions or political activities.

Rationale for Update: The issue of corporate political spending continues to evolve as shareholders' appetite grows for more disclosure of corporate policies and practices. This demand for greater transparency appears to be a result of the increasing traction of the multiyear shareholder campaign on corporate political contribution disclosure and the 2010 *Citizens United* decision by the U.S. Supreme Court, as well as other factors.

Furthermore, recent incidents where companies have received negative media attention as a result of their political activities (support for California's Proposition 23 in 2010 and contributions associated with the 2010 Minnesota gubernatorial race) further demonstrate the risks and consequences of corporate missteps regarding this issue.

For 2012, in line with overall institutional investor feedback, ISS is changing its policy from CASE-BY-CASE to generally vote FOR these proposals. Disclosure of oversight mechanisms is explicitly included as a point of consideration under the revised policy. A majority of investor respondents to ISS' 2011-2012 Policy Survey consider both the various types of contributions of corporate funds for political purposes (including direct contributions, contributions to trade associations, or payments made for grassroots lobbying) and political spending-related disclosure, policies, and practices as either "critical" or "important" to their organization. This view was reflected in a policy roundtable discussion that ISS held with institutional investors and issuers in October; and the consensus view was in favor of ISS' updated policy. Moreover, based on ISS' 2011-2012 Comment Period, institutional investors were generally in favor of the updated policy.

Corporate Governance Issue: Lobbying Activities

Current Recommendation: Vote CASE-BY-CASE on proposals requesting information on a company's lobbying initiatives, considering:

- Significant controversies, fines, or litigation surrounding a company's public policy activities;
- The company's current level of disclosure on lobbying strategy; and
- The impact that the policy issue may have on the company's business operations.

Key Changes: Clarifying that the policy applies to proposals seeking information on the company's lobbying activities generally and not only to those seeking information on its initiatives, and clarifying that it applies to proposals addressing broader efforts to inform/sway public opinion as well as formalized, political lobbying activities.

New Recommendation: Vote CASE-BY-CASE on proposals requesting information on a company's lobbying activities, including direct lobbying as well as grassroots lobbying activities, considering:

- The company's current disclosure of relevant policies and oversight mechanisms;
- Recent significant controversies, fines, or litigation related to the company's public policy activities; and
- The impact that the policy issues may have on the company's business operations.

Rationale for Update: Beginning in 2010 and continuing into 2011, the number of shareholder proposals addressing corporate lobbying activities increased. Related to the increase in lobbying proposal activity, corporate grassroots lobbying efforts became a particular focus for shareholder proponents – in apparent conjunction with increased proponent/investor interest in corporate political contributions disclosure. As a result of these two developments, the Lobbying Activities policy is being updated to ensure that the policy language is clear and is applicable to this new focus on corporate grassroots lobbying activities.

Corporate Governance Issue:
Workplace Safety

Current Recommendation: None

Key Change: Adopt a new policy for this emerging issue.

New Recommendation: Vote CASE-BY CASE on requests for workplace safety reports, including reports on accident risk reduction efforts, taking into account:

- The current level of company disclosure of its workplace health and safety performance data, health and safety management policies, initiatives, and oversight mechanisms;
- The nature of the company's business, specifically regarding company and employee exposure to health and safety risks;
- Recent significant controversies, fines, or violations related to workplace health and safety; and
- The company's workplace health and safety performance relative to industry peers.

Rationale for Update: In light of recent fatal accidents at oil refineries (Tesoro – Anacortes refinery, April 2010; and BP – Texas City refinery, March 2005) and the 2010 BP Deepwater Horizon incident in the Gulf of Mexico, shareholders have sought greater transparency and accountability regarding workplace safety by filing resolutions at seven corporations, four of which came to a vote at 2011 annual meetings.

ISS expects to see similar proposals in the future, not only at companies in the oil and gas industry, but also possibly at companies in other industries as well.

Corporate Governance Issue:
Water Issues

Current Recommendation: No existing policy; currently the General Environmental Proposals and Community Impact Assessments policy is applied.

Key Changes: An issue-specific policy is being created for this topic.

New Recommendation: Vote CASE-BY-CASE on proposals requesting a company report on, or to adopt a new policy on, water-related risks and concerns, taking into account:

- The company's current disclosure of relevant policies, initiatives, oversight mechanisms, and water usage metrics;
- Whether or not the company's existing water-related policies and practices are consistent with relevant internationally recognized standards and national/local regulations;
- The potential financial impact or risk to the company associated with water-related concerns or issues; and
- Recent, significant company controversies, fines, or litigation regarding water use by the company and its suppliers.

Rationale for Update: Proposals regarding water-related risks, often noting environmental and human-rights concerns, are being more frequently submitted by shareholder proponents. In 2011, there were several new proposals filed targeting water use and water-related risk at companies, including those in the utilities sector. It is likely that these types of proposals will be filed more often over the next few years for the reasons discussed below.

Water risks assumed a higher profile when the Carbon Disclosure Project (CDP) released its first Water Disclosure Global Report in 2010, which surveyed 302 of the world's largest companies in the FTSE Global Equity Index Series. The survey asked targeted companies to provide information on water management and governance, risks and opportunities, as well as water accounting. The results in the report showed that many largest companies are responding to water-related issues and including it on their corporate agendas.

In addition, the SEC has issued new guidance on the disclosure of climate-related risks, which includes water as a business risk. In January 2010, the Securities and Exchange Commission (SEC) issued new interpretative guidance clarifying the disclosure requirements public companies must meet regarding the climate-related risks and opportunities that they face, and specifically cited water's business risk. According to the SEC, "Changes in the availability or quality of water, or other natural resources on which the registrant's business depends, or damage to facilities or decreased efficiency of equipment can have material effects on companies."

Lastly, in July 2010, the United Nations General Assembly explicitly recognized the human right to water and sanitation. Furthermore, it acknowledged that clean drinking water and sanitation are essential to the realization of all human rights.

MUTUAL FUNDS

Corporate Governance Issue:
Authorizing the Board to Hire and Terminate Subadvisers without Shareholder Approval

Current Recommendation: Vote AGAINST proposals authorizing the board to hire/terminate subadvisers without shareholder approval.

Key Change: Clarify that the policy applies only if the investment advisor employs only one subadviser.

New Recommendation: Vote AGAINST proposals authorizing the board to hire or terminate subadvisers without shareholder approval if the investment adviser currently employs only one subadviser.

Rationale for Update: Many mutual fund investment advisers use subadvisers in an attempt to increase shareholder returns. Subadvisers often have expertise in a particular investment method or industry that the fund's investment adviser may not possess. Subadvisers have become standard in the industry, and in many cases, have proven their worth.

Fund families that utilize more than one subadviser are typically known as multimanaged funds and are said to have a multimanager structure in place. Shareholder approval is required in order to engage a subadviser. The costs associated with obtaining shareholder approval of multiple subadvisory agreements can be exceedingly high for multimanaged funds. As a result, the SEC exempted multimanaged funds from having to seek shareholder approval to hire or terminate subadvisers. However, before receiving the exemption, funds are required to ask shareholders to approve the exemption.

ISS will not support funds seeking the SEC exemption that currently engage only one subadviser; however, it will support funds seeking the exemption that currently engage more than one subadviser. A fund that currently utilizes more than one subadviser is justified in receiving the SEC exemption due to the excessive costs involved in approving multiple subadvisory agreements.

Corporate Governance Issue:
Business Development Companies–Authorization to Sell Shares of Common Stock at a Price below Net Asset Value

Current Recommendation: No current policy published.

Key Change: Codify ISS' approach on these proposals.

New Recommendation: Vote FOR proposals authorizing the board to issue shares below Net Asset Value (NAV) if:

- The proposal to allow share issuances below NAV has an expiration date that is less than one year from the date shareholders approve the underlying proposal, as required under the Investment Company Act of 1940;
- A majority of the independent directors who have no financial interest in the sale have made a determination as to whether such sale would be in the best interests of the company and its shareholders prior to selling shares below NAV; and
- The company has demonstrated responsible past use of share issuances by either:
    - Outperforming peers in its 8-digit GICS group as measured by one- and three-year median TSRs; or

- Providing disclosure that its past share issuances were priced at levels that resulted in only small or moderate discounts to NAV and economic dilution to existing non-participating shareholders.

Rationale for Update:

A Business Development Company (BDC) is a publicly offered and exchange-traded closed-end fund that typically invests in smaller, middle-market, private, or financially troubled companies. BDCs were created by Congress in 1980 with the intent of providing venture capital through a publicly listed vehicle for companies to whom such access was otherwise limited. BDCs may be internally or externally managed and are considered a hybrid between an operating company and a closed-end fund.

BDCs are subject to specialized SEC regulation as set forth in the Investment Company Act of 1940. This act requires BDCs to obtain shareholder approval to issue equity at a discount to NAV and the approval must be granted at a meeting held within one year immediately prior to such sales. However, the restrictions do not quantify the magnitude of the discount to NAV or speak to the economic impact on existing shareholders of issuing shares below NAV. Rather, the 1940 Act (Section 61(a)) limits the total voting dilution that would result from the exercise of all outstanding warrants, options, and rights at the time of issuance to no more than 25 percent.

The policy is thus designed to prevent open-ended authorizations to issue stock at a discount, and to ensure that the discounts are not excessive. When determining whether the company has used shares responsibly in the past, either a demonstrated history or outperformance of peers will be the factors. The median TSRs will be calculated quarterly, and the BDC's company's performance will be compared as of the closest quarter prior to the meeting.

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