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U.S. Corporate Governance Policy

2011 Updates

November 19, 2010

Institutional Shareholder Services Inc.

ISS' U.S. Corporate Governance Policy
2011 Updates

Effective for Meetings on or after Feb. 1, 2011
Updated Nov. 19, 2010

Table of Contents

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INTRODUCTION

Each year, ISS undertakes an extensive process to update the policies that inform its benchmark proxy voting recommendations. Our commitment is to make this process open and transparent, so that all members of the financial community – including our institutional investor clients and corporate issuers – understand the foundations of our benchmark policies and proxy voting recommendations. Our objective in this process is to address critical emerging corporate governance issues in a way that informs and enhances dialogue among investors, boards, and companies.

Our broad-based policy formulation process collects feedback from a diverse range of market participants through multiple channels: an annual Policy Survey of both institutional investors and corporate issuers, roundtables with industry groups, and ongoing feedback throughout the year. ISS' Policy Board uses this input in forming draft policy updates, the most significant of which are published for an open review and comment period.

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 us-research@issgovernance.com.

These policy changes will be effective for meetings on or after Feb. 1, 2011.

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:
Voting on Director Nominees in Uncontested Elections

Director Attendance

Current Recommendation: Vote AGAINST or WITHHOLD from individual directors who attend less than 75 percent of the board and committee meetings without a valid excuse, such as illness, service to the nation, work on behalf of the company, or funeral obligations. If the company provides meaningful public or private disclosure explaining the director's absences, evaluate the information on a CASE-BY-CASE basis taking into account the following factors:

- Degree to which absences were due to an unavoidable conflict;
- Pattern of absenteeism; and
- Other extraordinary circumstances underlying the director's absence.

Key Changes: Removing the private disclosure option for explaining absences; articulating the reasons that are acceptable; and clarifying the policy application when the attendance disclosure does not conform with SEC requirements.

New Recommendation: Generally vote AGAINST or WITHHOLD from individual directors who attend less than 75 percent of the board and committee meetings (with the exception of new nominees). Acceptable reasons for director(s) absences are generally limited to the following:

- Medical issues/illness;
- Family emergencies; and
- If the director's total service was three meetings or fewer and the director missed only one meeting.

These reasons for director(s) absences will only be considered by ISS if disclosed in the proxy or another SEC filing. If the disclosure is insufficient to determine whether a director attended at least 75 percent of board and committee meetings in aggregate, vote AGAINST/WITHHOLD from the director.

Rationale for Update: The policy update aligns the application of the policy with best governance and public disclosure practices and is generally supported by the feedback received from ISS' comment period. Directors who do not attend their board and committee meetings cannot be effective representatives of shareholders. Anyone who accepts a nomination to serve as director should be prepared to make attendance at meetings a top priority. Customarily, boards set schedules for routine board and committee meetings at least a year in advance. Moreover, attending at least 75 percent of the meetings is not an unreasonable standard for directors to meet, as it still allows sufficient leeway for meetings missed due to legitimate reasons. Issuers are encouraged to proactively provide additional explanatory disclosure on poor attendance for the benefit of shareholders in the proxy or another SEC filing.

The SEC requires the following attendance disclosures in the proxy:

- the total number of meetings of the board (including regularly scheduled and special meetings) which were held during the last full fiscal year; and
- name of each incumbent director who during the last full fiscal year attended fewer than 75 percent of the aggregate of the total number of meetings of the board (held during the period for which he or she has been a

director) and the total number of meetings held by all committees of the board on which he or she served (during the periods served).

As such, the updated policy further clarifies that insufficient disclosure to determine whether a director attended at least 75 percent of board and committee meetings in aggregate will lead to an adverse recommendation on the director.

Responsiveness to Majority-Supported Shareholder Proposals

Current Recommendation: Vote WITHHOLD/AGAINST the entire board of directors (except new nominees, who should be considered on a CASE-by-CASE basis), if:

- The board failed to act on a shareholder proposal that received approval by a majority of the shares outstanding the previous year; or
- The board failed to act on a shareholder proposal that received approval of the majority of shares cast for the previous two consecutive years.

Key Change: With respect to a shareholder proposal that received approval of the majority of shares cast for the previous two consecutive years, apply the policy if a proposal receives a majority of shares cast in two voting opportunities within the last three years.

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

- The board failed to act on a shareholder proposal that received approval by a majority of the shares outstanding the previous year; or
- The board failed to act on a shareholder proposal that received approval of the majority of shares cast in the last year and one of the two previous years.

Rationale for Update: A series of successful shareholder proposals on topics of paramount importance to shareholders can be interrupted, generally through an exclusion allowed by the SEC. The policy change is to focus on the vote results from consecutive voting opportunities. Therefore, if a shareholder proposal is absent from the ballot in one year, it does not necessarily preclude application of this policy.

Corporate Governance Issue:
Cumulative Voting

Current Recommendation: Generally vote AGAINST proposals to eliminate cumulative voting.

Generally vote FOR shareholder proposals to restore or provide for cumulative voting unless:

- The company has proxy access or a similar structure[1] to allow shareholders to nominate directors to the company's ballot; and
- The company has adopted a majority vote standard, with a carve-out for plurality voting in situations where there are more nominees than seats, and a director resignation policy to address failed elections.

Vote FOR proposals for cumulative voting at controlled companies (insider voting power > 50%).

Key Change: Removing the "similar structure" language.

New Recommendation:

Generally vote AGAINST proposals to eliminate cumulative voting.

Generally vote FOR shareholder proposals to restore or provide for cumulative voting unless:

- The company has proxy access, thereby allowing shareholders to nominate directors to the company's ballot; and
- The company has adopted a majority vote standard, with a carve-out for plurality voting in situations where there are more nominees than seats, and a director resignation policy to address failed elections.

Vote FOR proposals for cumulative voting at controlled companies (insider voting power > 50%).

Rationale for Update: The "similar structure" language is unnecessary because of (1) the absence of companies taking this approach and (2) the presence of proxy access rules in certain states and the strong probability of federal proxy access rules in the future (mandated by The Dodd-Frank Wall Street Reform and Consumer Protection Act, but currently delayed due to a court challenge.)

[1] Similar structure" would be a structure that allows shareholders to nominate candidates who the company will include on the management ballot IN ADDITION TO management's nominees, and their bios are included in management's proxy.

SHAREHOLDER RIGHTS & DEFENSES

Corporate Governance Issue:
Net Operating Loss (NOL) Protective Amendments

Current Recommendation: For management proposals to adopt a protective amendment for the stated purpose of protecting a company's net operating losses ("NOLs"), the following factors should be considered on a CASE-BY-CASE basis:

- The ownership threshold (NOL protective amendments generally prohibit stock ownership transfers that would result in a new 5-percent holder or increase the stock ownership percentage of an existing 5-percent holder);
- The value of the NOLs;
- Shareholder protection mechanisms (sunset provision or commitment to cause expiration of the protective amendment upon exhaustion or expiration of the NOL);
- The company's existing governance structure including: board independence, existing takeover defenses, track record of responsiveness to shareholders, and any other problematic governance concerns; and
- Any other factors that may be applicable.

Key Change: Specifying and emphasizing that the protective amendment should last no longer than three years.

New Recommendation: Vote AGAINST proposals to adopt a protective amendment for the stated purpose of protecting a company's net operating losses ("NOLs") if the effective term of the protective amendment would exceed the shorter of three years and the exhaustion of the NOL.

Vote CASE-BY-CASE, considering the following factors, for management proposals to adopt an NOL protective amendment that would remain in effect for the shorter of three years (or less) and the exhaustion of the NOL:

- The ownership threshold (NOL protective amendments generally prohibit stock ownership transfers that would result in a new 5-percent holder or increase the stock ownership percentage of an existing 5-percent holder);
- The value of the NOLs;
- Shareholder protection mechanisms (sunset provision or commitment to cause expiration of the protective amendment upon exhaustion or expiration of the NOL);
- The company's existing governance structure including: board independence, existing takeover defenses, track record of responsiveness to shareholders, and any other problematic governance concerns; and
- Any other factors that may be applicable.

Rationale for Update: The recent difficult market conditions continue to result in widespread losses in certain industries. This has resulted in previously profitable companies adopting NOL protective amendments and/or poison pills to protect their NOL tax assets, which may be lost upon an acquisition of 5 percent of a company's shares. As a result, last year, ISS created a policy to address the NOL protective amendments. Given the low ownership thresholds involved, shareholders want to ensure that such an amendment does not remain in effect permanently, thus, the duration of the amendment is a primary consideration. The policy has been revised to emphasize the primacy of this factor.

Corporate Governance Issue:
Poison Pills- Management Proposals to Ratify a Pill to Preserve Net Operating Losses (NOLs)

Current Recommendation: Vote CASE-BY-CASE on management proposals for poison pill ratification. For management proposals to adopt a poison pill for the stated purpose of preserving a company's net operating losses ("NOLs"), the following factors are considered on a CASE-BY-CASE basis:

- The ownership threshold to transfer (NOL pills generally have a trigger slightly below 5 percent);
- The value of the NOLs;
- The term;
- Shareholder protection mechanisms (sunset provision, or commitment to cause expiration of the pill upon exhaustion or expiration of NOLs);
- The company's existing governance structure including: board independence, existing takeover defenses, track record of responsiveness to shareholders, and any other problematic governance concerns; and
- Any other factors that may be applicable.

Key Change: Specifying and emphasizing that the term of the NOL pill should be no longer than three years.

New Recommendation: Vote AGAINST proposals to adopt a poison pill for the stated purpose of protecting a company's net operating losses ("NOLs") if the term of the pill would exceed the shorter of three years and the exhaustion of the NOL.

Vote CASE-BY-CASE on management proposals for poison pill ratification, considering the following factors, if the term of the pill would be the shorter of three years (or less) and the exhaustion of the NOL:

- The ownership threshold to transfer (NOL pills generally have a trigger slightly below 5 percent);
- The value of the NOLs;
- Shareholder protection mechanisms (sunset provision, or commitment to cause expiration of the pill upon exhaustion or expiration of NOLs);
- The company's existing governance structure including: board independence, existing takeover defenses, track record of responsiveness to shareholders, and any other problematic governance concerns; and
- Any other factors that may be applicable.

Rationale for Update: Similar to the NOL protective amendments, the term of the pill is a primary consideration in determining the vote on an NOL.

Corporate Governance Issue:
Shareholder Ability to Act by Written Consent

Current Recommendation: Vote AGAINST management and shareholder proposals to restrict or prohibit shareholders' ability to act by written consent.

Generally vote FOR management and shareholder proposals that provide shareholders with the ability to act by written consent taking into account the following factors:

- Shareholders' current right to act by written consent;
- Consent threshold;
- The inclusion of exclusionary or prohibitive language;
- Investor ownership structure; and
- Shareholder support of, and management's response to, previous shareholder proposals.

Key Change: Consider as an additional factor the company's overall governance practices and takeover defenses.

New Recommendation:

Generally vote AGAINST management and shareholder proposals to restrict or prohibit shareholders' ability to act by written consent.

Generally vote FOR management and shareholder proposals that provide shareholders with the ability to act by written consent, taking into account the following factors:

- Shareholders' current right to act by written consent;
- The consent threshold;
- The inclusion of exclusionary or prohibitive language;
- Investor ownership structure; and
- Shareholder support of, and management's response to, previous shareholder proposals.

Vote CASE-BY-CASE on shareholder proposals if, in addition to the considerations above, the company has the following governance and antitakeover provisions:

- An unfettered[2] right for shareholders to call special meetings at a 10 percent threshold;
- A majority vote standard in uncontested director elections;
- No non-shareholder-approved pill; and
- An annually elected board.

Rationale for Update:
After a long hiatus, shareholder proposals requesting shareholder's ability to act by written consent are resurging. However, the corporate governance landscape has changed tremendously. ISS acknowledges that a meaningful right to act by written consent is a fundamental shareholder right that enables shareholders to take action between annual meetings. However, the potential risk of abuse associated with the right to act by written consent such as bypassing procedural protections, particularly in a hostile situation, may outweigh its benefits to all shareholders in certain circumstances. Due to alternative mechanisms that have evolved for shareholders to express concern (e.g., a majority vote standard, the right to call a special meeting) and an evolving governance landscape, ISS will be taking a more holistic evaluation of a company's overall governance practices and takeover defenses when evaluating these proposals.

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[2] "Unfettered" means no restrictions on agenda items, no restrictions on the number of shareholders who can group together to reach the 10 percent threshold, and only reasonable limits on when a meeting can be called: no greater than 30 days after the last annual meeting and no greater than 90 prior to the next annual meeting.

CAPITAL/RESTRUCTURING

Corporate Governance Issue:
Common Stock Authorization

Current Recommendation: Vote CASE-BY-CASE on proposals to increase the number of shares of common stock authorized for issuance. Take into account company-specific factors which include, at a minimum, the following:

- Past Board Performance:
  - The company's use of authorized shares during the last three years;
  - One- and three-year total shareholder return; and
  - The board's governance structure and practices;
- The Current Request:
  - Disclosure in the proxy statement of the specific reasons for the proposed increase;
  - The dilutive impact of the request as determined through an allowable cap generated by ISS' quantitative model, which examines the company's need for shares and its three-year total shareholder return; and
  - Risks to shareholders of not approving the request.

Vote AGAINST proposals at companies with more than one class of common stock to increase the number of authorized shares of the class that has superior voting rights.

Key Changes: Amending the method of determining allowable increases; emphasizing that disclosure of risks of non-approval should appear in the proxy statement; and adding a provision to vote against authorized capital increases when there is also a reverse stock split on the ballot and the authorized shares would not be proportionally reduced.

New Recommendation: Vote FOR proposals to increase the number of authorized common shares where the primary purpose of the increase is to issue shares in connection with a transaction on the same ballot that warrants support.

Vote AGAINST proposals at companies with more than one class of common stock to increase the number of authorized shares of the class of common stock that has superior voting rights.

Vote AGAINST proposals to increase the number of authorized common shares if a vote for a reverse stock split on the same ballot is warranted despite the fact that the authorized shares would not be reduced proportionally.

Vote CASE-BY-CASE on all other proposals to increase the number of shares of common stock authorized for issuance. Take into account company-specific factors that include, at a minimum, the following:

- Past Board Performance:
  - The company's use of authorized shares during the last three years

- The Current Request:
  - Disclosure in the proxy statement of the specific purposes of the proposed increase;
  - Disclosure in the proxy statement of specific and severe risks to shareholders of not approving the request; and
  - The dilutive impact of the request as determined by an allowable increase calculated by ISS (typically 100 percent of existing authorized shares) that reflects the company's need for shares and total shareholder returns.

Rationale for Update: Our clients have indicated to us the primacy of disclosure when considering these ballot items. They want to know both the uses of the capital requested and the risks of non-approval. We are also changing the calculation methodology on these requests, with a strong preference for share requests of 100 percent or less of existing authorized capital. The new methodology will be outlined in an FAQ. Lastly, we have seen an increase in the number of dual requests on the same ballot: an increase in common stock coupled with a reverse stock split in which the shares are not being proportionately reduced. Although the reverse stock split may be needed due to imminent delisting, there is no reason to effectively approve two increases in common stock on the same ballot.

Corporate Governance Issue:
Preferred Stock Authorization

Current Recommendation: Vote CASE-BY-CASE on proposals to increase the number of shares of preferred stock authorized for issuance. Take into account company-specific factors that include, at a minimum, the following:

- Past Board Performance:
  - The company's use of authorized preferred shares during the last three years;
  - One- and three-year total shareholder return; and
  - The board's governance structure and practices;
- The Current Request:
  - Disclosure in the proxy statement of specific reasons for the proposed increase;
  - In cases where the company has existing authorized preferred stock, the dilutive impact of the request as determined through an allowable cap generated by ISS' quantitative model, which examines the company's need for shares and three-year total shareholder return; and
  - Whether the shares requested are blank check preferred shares, and whether they are declawed.

Vote AGAINST proposals at companies with more than one class or series of preferred stock to increase the number of authorized shares of the class or series that has superior voting rights.

Key Changes: Amending the method of determining allowable increases; emphasizing that disclosure of risks of non-approval should appear in the proxy statements.

New Recommendation: Vote FOR proposals to increase the number of authorized preferred shares where the primary purpose of the increase is to issue shares in connection with a transaction on the same ballot that warrants support.

Vote AGAINST proposals at companies with more than one class or series of preferred stock to increase the number of authorized shares of the class or series of preferred stock that has superior voting rights.

Vote CASE-BY-CASE on all other proposals to increase the number of shares of preferred stock authorized for issuance. Take into account company-specific factors that include, at a minimum, the following:

- Past Board Performance:
  - The company's use of authorized preferred shares during the last three years;
- The Current Request:
  - Disclosure in the proxy statement of the specific purposes for the proposed increase;

- Disclosure in the proxy statement of specific and severe risks to shareholders of not approving the request;
- In cases where the company has existing authorized preferred stock, the dilutive impact of the request as determined by an allowable increase calculated by ISS (typically 100 percent of existing authorized shares) that reflects the company's need for shares and total shareholder returns; and
- Whether the shares requested are blank check preferred shares that can be used for antitakeover purposes.

Rationale for Update: Similar to the increase in common stock policy, we are stressing the importance of disclosure in the proxy regarding both the specific purposes of the requested shares and the risk of non-approval of the item. The calculation methodology is also being changed as with the common stock authorization policy.

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Corporate Governance Issue: Reverse Stock Splits

Current Recommendation: Vote FOR management proposals to implement a reverse stock split when the number of authorized shares will be proportionately reduced.

Vote FOR management proposals to implement a reverse stock split to avoid delisting.

Vote CASE-BY-CASE on proposals to implement a reverse stock split that do not proportionately reduce the number of shares authorized for issue based on the allowable increased calculated using the Capital Structure model.

Key Changes: Ensuring that the risk is real as opposed to a vague potential risk in the future if a company undertakes a reverse stock split without a proportional reduction in authorized shares and justifies the action by citing the risk of delisting; using the new Capital Authorization policies to calculate allowable increases when the authorized shares are not proportionately reduced.

New Recommendation: Vote FOR management proposals to implement a reverse stock split when the number of authorized shares will be proportionately reduced.

Vote AGAINST proposals when there is not a proportionate reduction of authorized shares, unless:

- A stock exchange has provided notice to the company of a potential delisting; or
- The effective increase in authorized shares is equal to or less than the allowable increase calculated in accordance with ISS' Increase in Authorized Common Stock policy.

Rationale for update: Delisting is most imminent after a listing exchange has notified the company of its potential delisting. Shareholders should only vote for non-proportionate reverse stock splits in the most dire of situations; requiring disclosure in the proxy statement of external evidence of a potential delisting serves to separate the true emergencies from vague threats. The change in the calculation of the allowable increase is linked to our revisions of the capital authorization policies above.

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COMPENSATION

Corporate Governance Issue:
Equity Compensation Plans: Burn Rate

Current Recommendation: Generally vote AGAINST equity plans for companies whose average three-year burn rates exceeds the greater of: (1) the mean plus one standard deviation of the company's GICS group segmented by Russell 3000 index and non-Russell 3000 index (per the following Burn Rate Table); and (2) two percent of weighted common shares outstanding. The three-year burn rate policy does not apply to non-employee director plans unless outside directors receive a significant portion of shares each year.

The annual burn rate is calculated as follows:

Annual Burn rate = (# of options granted + # of full value shares awarded * Multiplier) / Weighted Average common shares outstanding

However, vote FOR equity plans if the company fails this burn rate test but the company commits in a public filing to a three-year average burn rate equal to its GICS group burn rate mean plus one standard deviation (or 2 percent, whichever is greater), assuming all other conditions for voting FOR the plan have been met.

If a company fails to fulfill its burn rate commitment, vote AGAINST or WITHHOLD from the compensation committee.

For the Dec. 1, 2009 and future quarterly data downloads, ISS will use the 200-day volatility for the shareholder value transfer and burn rate policies. We will also use the 200-day average stock price for the shareholder value transfer policy.

Key Change: Minimizing the year-to-year changes possible in the allowable caps.

New Recommendation: Generally vote AGAINST equity plans for companies whose average three-year burn rates exceeds the greater of: (1) the mean (μ) plus one standard deviation (σ) of the company's GICS group segmented by Russell 3000 index and non-Russell 3000 index (per the Burn Rate Table published in December); and (2) two percent of weighted common shares outstanding. In addition, year-over-year burn-rate cap changes will be limited to a maximum of two (2) percentage points (plus or minus) the prior year's burn-rate cap.

If a company fails to fulfill a burn rate commitment, vote AGAINST or WITHHOLD from the compensation committee.

Rationale for Update: The burn rate policy is designed to identify the companies that use an excessive amount of shareholders' equity to reward employees, since excessive cost may not be captured in the case of, for example, frequent small requests and a high exercise rate. Limiting the positive or negative year-over-year change in burn-rate caps will compensate for outlier companies within any individual GICS group and the impact of recent market volatility that may result in extraordinary changes in annual burn-rate caps not actually reflective of average usage.

N.B.: The updated burn rate table will be included in the 2011 Summary Guidelines, to be released in December 2010.

Corporate Governance Issue:
Frequency of Advisory Vote on Executive Compensation (Management "Say on Pay")

Current Recommendation: None. This is a new proxy item required under The Dodd-Frank Wall Street Reform and Consumer Protection Act.

Key Change: Adopting a policy for this new proxy item.

New Recommendation: Vote FOR annual advisory votes on compensation, which provide the most consistent and clear communication channel for shareholder concerns about companies' executive pay programs.

Rationale for Update: The Dodd-Frank Act, in addition to requiring advisory votes on compensation (aka management "say on pay" or MSOP), requires that each proxy for the first annual or other meeting of the shareholders (that includes required SEC compensation disclosures) occurring after Jan. 21, 2011, include an advisory voting item to determine whether, going forward, the "say on pay" vote by shareholders to approve compensation should occur every one, two, or three years.

In line with overall client feedback, ISS is adopting a new policy to recommend a vote FOR annual advisory votes on compensation. The MSOP is at its essence a communication vehicle, and communication is most useful when it is received in a consistent and timely manner. ISS supports an annual MSOP vote for many of the same reasons it supports annual director elections rather than a classified board structure: because this provides the highest level of accountability and direct communication by enabling the MSOP vote to correspond to the majority of the information presented in the accompanying proxy statement for the applicable shareholders' meeting. Having MSOP votes every two or three years, covering all actions occurring between the votes, would make it difficult to create the meaningful and coherent communication that the votes are intended to provide. Under triennial elections, for example, a company would not know whether the shareholder vote references the compensation year being discussed or a previous year, making it more difficult to understand the implications of the vote.

Corporate Governance Issue:
Problematic Pay Practices

Current Recommendation:

Evaluate executive pay and practices on a CASE-BY-CASE basis.

If the company maintains problematic pay practices, generally vote:

- AGAINST management "say on pay" (MSOP) proposals;
- 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; and/or
- AGAINST an equity-based incentive plan proposal if excessive non-performance-based equity awards are the major contributor to a pay-for-performance misalignment.

ISS recognizes that companies adopt a variety of pay arrangements that may be acceptable in their particular industries, or unique for a particular situation, and all companies are reviewed on a case-by-case basis. However, based on input from client surveys and roundtables, ISS has identified certain adverse practices that are particularly contrary to a performance-based pay philosophy. Vote recommendations are generally based on the preponderance of problematic elements; however, certain adverse practices carry more weight on a stand-alone basis in the evaluation. While not exhaustive, this is the list of the practices that carry greatest weight in this consideration and may result in negative recommendations on a stand-alone basis:

- Multi-year guarantees for salary increases, non-performance based bonuses, and equity compensation;
- Including additional years of unworked service that result in significant additional benefits, without sufficient justification, or including long-term equity awards in the pension calculation;
- Perquisites for former and/or retired executives, and extraordinary relocation benefits (including home buyouts) for current executives;
- Change-in-control payments exceeding three times base salary and target bonus; change-in-control payments without job loss or substantial diminution of duties ("Single Triggers"); new or materially amended agreements that provide for "modified single triggers" (under which an executive may voluntarily leave for any reason and still receive the change-in-control severance package); new or materially amended agreements that provide for an excise tax gross-up (including "modified gross-ups");
- Tax Reimbursements related to executive perquisites or other payments such as personal use of corporate aircraft, executive life insurance, bonus, etc; (see also excise tax gross-ups above)
- Dividends or dividend equivalents paid on unvested performance shares or units;
- Executives using company stock in hedging activities, such as "cashless" collars, forward sales, equity swaps, or other similar arrangements; or
- Repricing or replacing of underwater stock options/stock appreciation rights without prior shareholder approval (including cash buyouts and voluntary surrender/subsequent regrant of underwater options).

Key Change: Revise the list of egregious practices that, by themselves, are sufficiently problematic to warrant withhold or against votes in most circumstances.

New Recommendation:

Evaluate executive pay and practices on a CASE-BY-CASE basis.

If the company maintains problematic pay practices, generally vote:

- AGAINST management "say on pay" (MSOP) proposals;
- 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;
    - When no MSOP item is on the ballot; or
    - When the board has failed to respond to concerns raised in prior MSOP evaluations; and/or
- AGAINST an equity incentive plan proposal if excessive non-performance-based equity awards are the major contributors to a pay-for-performance misalignment.

Pay elements that are not directly based on performance are generally evaluated on a CASE-BY-CASE basis considering the context of a company's overall pay program and demonstrated pay-for-performance philosophy. Please refer to ISS' Compensation FAQ document for detail on specific pay practices that have been identified as potentially problematic and may lead to negative recommendations if they are deemed to be inappropriate or unjustified relative to executive pay best practices. The list below highlights the problematic practices that carry significant weight in this overall consideration and may result in adverse vote recommendations:

- Repricing or replacing of underwater stock options/SARS without prior shareholder approval (including cash buyouts and voluntary surrender of underwater options);
- Excessive perquisites or tax gross-ups, including any gross-up related to a secular trust or restricted stock vesting;
- New or extended agreements that provide for:
  - CIC payments exceeding 3 times base salary and average/target/most recent bonus;
  - CIC severance payments without involuntary job loss or substantial diminution of duties ("single" or "modified single" triggers);
  - CIC payments with excise tax gross-ups (including "modified" gross-ups).

Rationale for Update: The key change to this policy is to revise the list of egregious practices that, by themselves, are sufficiently problematic to warrant withhold or against votes in most circumstances. The policy remains case-by-case, and these, along with other problematic practices, may ultimately result in negative vote recommendations based on consideration of a company's overall pay program and past practices. However, the items highlighted above identify those practices considered most egregious under the Problematic Pay Practices section of ISS' executive compensation policy. These include the repricing/exchange of stock options without shareholder approval; paying excessive perquisites or tax gross-ups (including any gross-ups related to secular trusts or restricted share vesting), and entering into a new agreement or arrangement (including by extending the term of a current agreement) that provides for one of the listed problematic CIC features, in accordance with ISS' policy aimed at curtailing the perpetuation of such features. While amended CIC agreements or arrangements that contain pre-existing problematic features will generally be evaluated on a more holistic basis (with regard to a company's overall program), amended auto-renewing ("evergreen") agreements may receive particular scrutiny.

Corporate Governance Issue:
Problematic Pay Practices- Commitments

Current Practice: When ISS has identified a problematic pay practice, we have generally accepted a commitment by the company that it will eliminate such practice going forward, thus precluding a negative vote recommendation from ISS.

Key Changes: Effective immediately, ISS will no longer consider prospective commitments with respect to problematic pay practices in the current recommendation. Companies are encouraged to adopt forward-looking policies to address problematic pay practices, which will be considered in future reviews of the company's program. Note that ISS will continue to evaluate compensation practices on a holistic basis relative to a company's overall program and the compensation committee's track record of responsible stewardship. We have minimized the list of practices that carry significant weight in such evaluations (see policy above).

New Practice: ISS is no longer accepting future commitments on problematic pay practices as a way of preventing or reversing a negative vote recommendation.

Rationale for Update: Clients understand ISS' policies, including those targeting problematic pay practices. The policies are also transparent to issuers, who at this point should have sufficient awareness of actions that will or may result in negative recommendations, so they can be avoided if desired. Consideration of prospective commitments to eliminate a problematic practice was intended to provide a transitional mechanism, to give issuers time to understand evolving policy guidelines, not as a permanent "cure" system that provides limited benefit to shareholders and calls into question the board's process for adopting improved compensation practices (since such commitments are often made within a minimal time frame after the ISS report is published, in order to reverse a negative recommendation).

Shareholders are better served by boards that spend appropriate time deliberating the benefits of progressive changes, rather than making reactive changes in order to obtain a favorable recommendation from ISS.

Therefore, prospective commitments to eliminate or curtail the following will no longer be considered in ISS' evaluations:

- Excise tax gross-up, single trigger, and modified single trigger provisions in future new or materially amended employment agreements;
- Excessive perquisites, including home loss buyouts and other perquisites compensation to NEOs deemed excessive;
- Tax gross-ups on perquisites, such as for life insurance, personal use of corporate aircraft, home security, and certain relocation benefits, as well as gross-ups for Grantor Trusts and restricted stock vesting;
- Guaranteed multi-year incentive awards;
- Dividend payments on unvested performance shares;

Exceptions to this change will include the following:

1) Pay-for-performance and burn-rate commitments, since ISS' burn-rate caps and total shareholder return benchmarks that apply to each compensation year are not disclosed until late in the year, after a company may have made grants/awards that ultimately trigger ISS' policy; and

2) Plan language related to certain equity grant practices (e.g., liberal CIC definition), which may be modified under a straightforward procedure so that a plan that is then more beneficial to shareholders may receive a favorable recommendation from ISS.

N.B.: This update is effective immediately for all proxy analyses prepared from the date of release of these Policy Updates onward.

Corporate Governance Issue:
Voting on Golden Parachutes in an Acquisition, Merger, Consolidation, or Proposed Sale

Current Recommendation: None. This is a new proxy item required under The Dodd-Frank Wall Street Reform and Consumer Protection Act.

Key Change: Adopting a policy for this new proxy item.

New Recommendation: Vote CASE-BY-CASE on proposals to approve the company's golden parachute compensation, consistent with ISS' policies on problematic pay practices related to severance packages. Features that may lead to a vote AGAINST include:

- Recently adopted or materially amended agreements that include excise tax gross-up provisions (since prior annual meeting);
- Recently adopted or materially amended agreements that include modified single triggers (since prior annual meeting);
- Single trigger payments that will happen immediately upon a change in control, including cash payment and such items as the acceleration of performance-based equity despite the failure to achieve performance measures;
- Single-trigger vesting of equity based on a definition of change in control that requires only shareholder approval of the transaction (rather than consummation);
- Potentially excessive severance payments;
- Recent amendments or other changes that may make packages so attractive as to influence merger agreements that may not be in the best interests of shareholders;
- In the case of a substantial gross-up from pre-existing/grandfathered contract: the element that triggered the gross-up (i.e., option mega-grants at low point in stock price, unusual or outsized payments in cash or equity made or negotiated prior to the merger); or
- The company's assertion that a proposed transaction is conditioned on shareholder approval of the golden parachute advisory vote. ISS would view this as problematic from a corporate governance perspective.

In cases where the golden parachute vote is incorporated into a company's separate advisory vote on compensation ("management "say on pay"), ISS will evaluate the "say on pay" proposal in accordance with these guidelines, which may give higher weight to that component of the overall evaluation.

Rationale for Update: ISS' policy on change in control packages has evolved over the past several years in response to survey responses and changes in common practice. ISS' policy, informed by shareholder input, has focused particularly on severance packages that provide inappropriate windfalls and cover certain tax liabilities of executives. This update applies these standing policies to the newly required proposals regarding specific advisory votes on "golden parachute" arrangements for Named Executive Officers (NEOs).

SOCIAL/ENVIRONMENTAL ISSUES

Corporate Governance Issue:
Environmental, Social, and Governance (ESG) Compensation-Related Proposals

Current Recommendation: Generally vote AGAINST proposals to link, or report on linking, executive compensation to environmental and social criteria (such as corporate downsizings, customer or employee satisfaction, community involvement, human rights, environmental performance, or predatory lending) as the practice of linking executive compensation and such criteria is currently the exception rather than the norm and there appears to be a lack of widely accepted standards regarding the implementation of effective linkages between executive compensation and corporate non-financial performance. However, the following factors will be considered:

- Whether the company has significant and persistent controversies or violations regarding social and/or environmental issues;
- Whether the company has management systems and oversight mechanisms in place regarding its social and environmental performance;
- The degree to which industry peers have incorporated similar non-financial performance criteria in their executive compensation practices; and
- The company's current level of disclosure regarding its environmental and social performance.

Generally vote AGAINST proposals calling for an analysis of the pay disparity between corporate executives and other non-executive employees. The value of the information sought by such proposals is unclear.

Key Change: Removing the policy language that indicates the linkage is an exception.

New Recommendation: Generally vote AGAINST proposals to link, or report on linking, executive compensation to environmental and social criteria such as corporate downsizings, customer or employee satisfaction, community involvement, human rights, environmental performance, or predatory lending. However, the following factors will be considered:

- Whether the company has significant and persistent controversies or violations regarding social and/or environmental issues;
- Whether the company has management systems and oversight mechanisms in place regarding its social and environmental performance;
- The degree to which industry peers have incorporated similar non-financial performance criteria in their executive compensation practices; and
- The company's current level of disclosure regarding its environmental and social performance.

Generally vote AGAINST proposals calling for an analysis of the pay disparity between corporate executives and other non-executive employees. The value of the information sought by such proposals is unclear.

Rationale for Update: Because the issue appears to be moving into the mainstream, as highlighted by an increase in discussions and resolutions, policy language that did not reflect the evolving discourse in the link between environmental and social criteria and executive compensation is being removed.