



An MSCI Brand

2011 Corporate Governance Policy Updates and Process

Executive Summary

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BACKGROUND AND 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' Global Research Policy Board, comprised of our global research heads and subject matter experts, uses this input in forming draft policy updates, the most significant of which are published for an open review and [comment](#) period.

This document summarizes the outreach process and explains the key changes made to ISS' U.S., Canadian, European, and International benchmark corporate governance policies. The full text of the updates, along with detailed results from the Policy Survey and comments received during the open comment period, are all available on our Web site under the [Policy Gateway](#).

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

POLICY FORMULATION PROCESS

The process begins with a review of emerging policy issues and notable trends during proxy seasons worldwide.

Based on information gathered throughout the year (particularly from issuer and client feedback), ISS forms policy committees by governance topics and markets. As part of this process, we examine academic literature, other empirical research, and relevant commentary in the governance field. We also issue surveys, conduct roundtables, and post policy drafts for review. ISS' Global Research Policy Board reviews and approves final drafts and policy updates for the following proxy year. Our annually updated policies are announced in November and apply to meetings held on and after Feb. 1 of the following year.

Our value proposition to our clients extends beyond our regional benchmark policies to our customized approaches to governance. We help our clients develop and implement their own policies based on their specific mandates and requirements. ISS research analysts ultimately apply more than 400 specific policies related to issues coming to a vote at shareholder meetings, including the ISS regional benchmark (standard research) policies, specialty policies such as those for Socially Responsible Investment, Taft-Hartley and Public Pension Funds, as well as hundreds of custom policies that reflect our clients' unique corporate governance philosophies. The vote recommendations issued under these policies often differ from those issued under our benchmark policies. We estimate that the majority of shares that are voted by ISS' clients fall under custom or specialty recommendations.

OUTREACH IN 2010

Policy Survey

In June 2010, ISS launched its policy outreach process with our annual policy survey in order to gain a better understanding of the breadth of financial market views on a range of topics including boards of directors, shareholder rights, and executive

compensation. The survey was sent out to both issuer and investor communities and we received 900 total responses, including 201 institutional investors and nearly 700 corporate issuers.

Policy Roundtables/Client Feedback

In October, ISS held two policy roundtables on topics that pertain to the U.S. market as follows:

October 5: Executive compensation: "say on pay" research content, golden parachute proposals, and "say on pay" frequency votes. Participants included six institutional shareholders and four corporate issuers.

October 25: Two-part roundtable on independent chair and shareholders' ability to act by written consent. Participants included 5 institutional investors, 5 corporate issuers, and one law firm.

In addition, ISS held numerous one-on-one engagements with clients in the United States, Canada, Europe, and Japan throughout the year.

Comment Period

On October 27, ISS released its key draft 2011 proxy voting policies for comment which offered institutional investors, corporate issuers, and industry constituents the opportunity to provide feedback on the draft updates.

The comment period ran through November 11 and solicited feedback on 11 updates to ISS' proxy voting policy guidelines in markets worldwide. Topics covered included "say on pay" frequency and say on golden parachute proposals, independent chair shareholder proposals, director attendance, and authorized capital requests in the United States; dilution/burn rate limits regarding equity-based compensation in Europe; board independence in Canada; pay disclosure/deep-discount options and board independence in Japan; and policy application to domestic issuers incorporated outside the US. ISS received a total of 25 comments (10 from institutional investors and 15 from the corporate community). Overall, the comments were directionally in line with ISS' draft policy updates, with the exception of our contemplated change to our policy on independent chair shareholder proposals (United States) and our policy on compensation policy-annual burn rate (Europe).

The draft policy update regarding independent chair proposals included consideration of compelling company-specific circumstances that challenge the efficacy of appointing an independent chair. The comments suggested that a company's disclosed rationale for maintaining a combined leadership role as mandated by the SEC would not be a meaningful or useful input in determining a vote on these proposals in extenuating circumstances. These comments were consistent with the responses from the investor participants in ISS' October policy roundtable. In fact, many institutional investors stated that ISS should not change its policy and should continue to evaluate these proposals on a case-by-case basis taking into account whether the company has a robust counterbalancing governance structure (including an independent lead director with clearly delineated duties) and any problematic performance, governance or management issues. Based on this feedback, ISS will not be changing its policy on independent chair proposals in 2011.

The draft policy update on the European compensation policy proposed that (1) all companies be limited to an average annual burn-rate of 1 percent (measured as the historical three-year average transfer of equity to employees) and (2) a dilution limit of 10 percent at the time of analysis for all companies – regardless of their developmental stage – provided that a company's equity plans are well-structured. Many of the comments from both issuers and investors indicated that while they agreed with the concept of the proposed policy update, they believed that particular company circumstances may require a more flexible approach. While ISS will not be changing its current policy on either (1) or (2) above, we will revisit this issue in 2011 for consideration in the future development of our compensation policy.

Key Strengths of ISS' Policy Formulation Process

Greater Transparency: ISS is committed to openness and transparency in formulating its proxy voting policies and in applying these policies to more than 35,000 shareholder meetings each year. Our policy formulation and application processes, including specific guidelines and FAQs, are readily available on our Web site under the Policy Gateway section.

Robust Engagement Process with Industry Participants: We believe that listening to multiple views on corporate governance issues is critical for effective policy formulation and application. Moreover, by offering insight into the company perspective, we have encouraged issuers to improve their own governance practices. As part of the research process, ISS' analysts interact with company representatives, institutional shareholders, shareholder proponents, and other parties to gain deeper insight into critical issues. This dialogue helps ensure a full understanding of the facts and enriches our analysis.

Global Expertise: We provide global expertise on a broad range of governance topics and emerging issues, with regional and market experts located in numerous offices worldwide. Our global expertise is utilized throughout our policy formation process covering North America, Europe, Pan-Pacific, and Emerging Markets.

SUMMARY OF POLICY UPDATES

The most material updates to ISS' benchmark proxy voting policies are summarized below. The full updates, covering United States, Canada, Europe, and other International markets, are available through the [ISS Policy Gateway](#).

United States Updates

Frequency of Advisory Vote on Executive Compensation (Management "Say on Pay")

This is a new proxy item required under The Dodd-Frank Wall Street Reform and Consumer Protection Act. 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, which provide the most consistent and clear communication channel for shareholder concerns about companies' executive pay programs.

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.

Voting on Golden Parachutes in an Acquisition, Merger, Consolidation, or Proposed Sale

This is a new proxy item required under The Dodd-Frank Wall Street Reform and Consumer Protection Act. ISS' policy will be to recommend 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 an AGAINST recommendation 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 preexisting/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 (MSOP), 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.

ISS' policy on change in control packages has evolved over the past several years, in response to client feedback 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).

Voting on Director Nominees in Uncontested Elections – Director Attendance

ISS' current policy is to recommend a 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.

The key policy change is to remove 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. In 2011, ISS will generally recommend a vote AGAINST or WITHHOLD from individual directors who attend less than 75 percent of board and applicable 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 less 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, ISS will generally recommend a vote AGAINST or WITHHOLD.

The policy update aligns the application of the policy with best governance and public disclosure practices and is generally supported by the feedback received during 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.

Shareholder Ability to Act by Written Consent

ISS' current policy is to generally recommend a 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.

Based on feedback received from both issuers and institutional investors from ISS' policy roundtable held in October, ISS will consider, as an additional factor, the company's overall governance practices and takeover defenses (with emphasis on shareholders' ability to call special meetings) in evaluating these proposals. In 2011, ISS will continue to generally recommend a vote FOR management and shareholder proposals seeking to provide shareholders with the ability to act by written consent, after taking into account the factors mentioned above. However, ISS will recommend on a CASE-BY-CASE basis (and may recommend AGAINST) if, in addition to the considerations above, the company has the following shareholder rights provisions:

- An unfettered 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.

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 making a more holistic consideration of a company's overall governance practices and takeover defenses when evaluating these proposals.

Canada Policy Updates

Board Independence/Board Committee Structure

ISS' current policy is to generally recommend a WITHHOLD vote from any insider or affiliated outside director (or the whole slate if the slate includes such individual directors) where the board is less than majority independent or the board lacks a separate compensation or nominating committee. This policy currently applies for S&P/TSX Composite companies only. In 2011, ISS will extend this policy to all TSX companies.

The policy update reflects best practice as it relates to board/committee independence. Further, the balance of board influence should reside with independent directors free of any pressures or conflicts which might prevent them from objectively overseeing strategic direction, evaluating management effectiveness, setting appropriate executive compensation, maintaining internal control processes, and ultimately driving long-term shareholder value creation. Canadian best practice as set out in National Policy 58-201 Corporate Governance Guidelines recommends that all company boards should have a majority of independent directors. In addition, National Policy 58-201 recommends that all company boards should appoint a nominating committee and a compensation committee composed entirely of independent directors (Nomination of Directors 3.10; Compensation 3.15). A 2008 review of roughly 532 "core" (those companies having more than 15 institutional holders) TSX reporting issuers revealed that 19 percent of these issuers either did not have majority independent boards or lacked either a compensation or nominating committee. A comparable review based on 2010 proxy season shows that of roughly 575 core TSX reporting issuers, about 29 percent fell short on at least one of these three standards.

The published voting guidelines of public funds and other large institutional investors now indicate that votes should be withheld from directors at any company where the board is less than majority independent. Furthermore, feedback from ISS' policy outreach discussions indicates that an overwhelming majority of ISS' clients support application of this policy to the broader TSX market.

Poison Pills (Shareholder Rights Plans)

ISS' current Canadian policy is to recommend CASE-BY-CASE on management proposals to ratify a shareholder rights plan (poison pill) taking into account whether it conforms with "new generation" rights plans and whether its scope is limited to the following two specific purposes: To give the board more time to find an alternative value enhancing transaction; and to ensure the equal treatment of all shareholders. ISS recommends a vote AGAINST plans that go beyond these purposes. In 2011, ISS will continue to apply its current policy and will add two features of a pill that do not comply with the scope of the "new generation" rights plan mentioned above: (1) *a reference to derivatives contracts within definition of beneficial owner* and/or (2) *a Shareholder Endorsed Insider Bid Provision*. ISS will recommend AGAINST the rights plan if it includes either of these two features.

The extension of beneficial ownership to encompass derivative securities that may result in deemed beneficial ownership of securities that a person has no right to acquire goes beyond the acceptable purpose of a rights plan. Under the provision, the person's deemed ownership extends, as well, to any securities owned by an associate or affiliate of the counterparty and includes any securities owned by any second counterparty (and its associates or affiliates) with whom the first counterparty or any of its associates or affiliates enters into a derivatives contract and any successive counterparties with whom any of the previously described persons or any of their associates or affiliates enters into a derivatives contract. As a result, the receiving party may be deemed to own beneficially securities (defined in the plan as "notional securities") that it

in fact has no right to acquire. If a derivatives contract gives the receiving party a right to acquire the securities to which it relates, the securities would be treated as beneficially owned under the pill provision (standard paragraph (b) or (ii)) that catches any securities as to which a person or its affiliates or associates has the right to become the owner at law or in equity, where such right is exercisable immediately or within 60 days of the date of the determination of beneficial ownership.

Also unacceptable to the purpose of a rights plan is the inclusion of a "Shareholder Endorsed Insider Bid" (SEIB) provision which would allow an "Insider" and parties acting jointly or in concert with an Insider an additional avenue to proceed with a takeover bid without triggering the rights plan, in addition to allowing a permitted bid or proceeding with board approval. The SEIB provision generally permits an insider holding 10 percent of the voting shares to launch a bid by means of a takeover bid circular and requires that more than 50 percent of the common shares held by shareholders other than the insider and its joint actors, have been tendered to the takeover bid at the time of first take up under the bid. The SEIB provision allows insiders the ability to take advantage of a less stringent bid provision that is not offered to other bidders who must make a permitted bid or negotiate with the board for support.

Europe Policy Updates

Compensation Guidelines (Europe)

The key changes to ISS' executive and non-executive director compensation policy applicable in 2011 are to (1) strengthen the power of sanction in case of discretionary payments/pay for failure, (2) establish the link between performance and actual pay, and (3) include reference to market practice and disclosure with respect to severance payment and other compensation practices. These changes are generally in line with investor feedback.

According to our [2010-2011 Policy Survey](#), a substantial majority of both investors and issuers cited performance criteria and the pay-for-performance link as being among the three biggest concerns in evaluating long-term incentive plans. An overwhelming majority of investor respondents indicated that pay-for-performance disconnects (increasing compensation with declining performance) could warrant a negative vote. A majority of investor respondents also cited that disclosure issues (inconsistent and vague disclosure, especially surrounding performance) could warrant a negative vote.

For long-term investors, it is of utmost concern that a company's executive compensation system provides a clear link between pay and sustainable, long-term performance. When determining whether a company's compensation system appropriately links pay to performance, investors will naturally look at both the company's stated compensation principles as well as its application of those principles in the past, in order to assess the likelihood that the company's pay principles will be applied consequently in future years. When a company's disclosure gives the appearance that its compensation practices are not in line with its stated policy, the result is that the credibility of the entire compensation policy is thrown into question. Therefore, if disclosure is such that an investor could reasonably conclude that the company's pay allocations deviate significantly from its stated compensation policy, then ISS may make a negative vote recommendation.

Moreover, the new policy takes into account local best practice or legal requirements that are stricter than ISS' guidelines, and subsequently eliminates reference to market-specific policies. The policy on severance pay agreements still maintains the upper limit of 24 months' pay (both fixed and short-term variable), but otherwise refers to more stringent local provisions, if any, e.g., the Netherlands, or Belgium as of 2011, instead of explicit carve-outs.

Combined Chair/CEO (Europe)

ISS' current policy is to generally recommend a vote AGAINST a combined chair/CEO at core companies in European markets unless the company provides compelling reasons for a combination of the roles, or if there are exceptional circumstances that justify combining the roles.

Considerations should be given to any of the following exceptional circumstances on a CASE-BY-CASE basis if:

- The company substantially demonstrates that the separation of the roles of CEO and chair would have a disproportionately negative effect on the company's economic situation; or
- The company substantially demonstrates that the separation of the roles of CEO and chair would have a negative effect on shareholder value; or
- The company provides assurance that the chair/CEO would only serve in the combined role on an interim basis, with the intent of separating the roles within a given time frame; or
- The company provides other compelling reasons to justify a combined chair/CEO.

In all of the above cases, the company would need to provide for adequate control mechanisms on the board (such as a lead independent director, a high overall level of board independence, and a high level of independence on the board's key committees) in order for ISS to consider a favorable vote recommendation for a combined chair/CEO. This policy is applied to all core companies in European markets that propose the (re)election of a combined chair/CEO to the board, including cases where the chair/CEO is included in an election by slate.

In 2011, ISS' updated policy will remove the exceptional circumstances above with the exception of the "interim situation" presented under the third bullet point above as the only circumstances justifying that the two positions not be split. Specifically, the updated policy will be to recommend AGAINST (re)election of a combined chair/CEO at core companies in European markets. However, when the company provides assurance that the chair/CEO would only serve in the combined role on an interim basis (no more than two years), with the intent of separating the roles within an acceptable time frame, considerations should be given to these exceptional circumstances. In this respect, the vote recommendation would be made on a CASE-BY-CASE basis. As under the current policy, in order for ISS to consider a favorable vote recommendation for a combined chair/CEO serving on an interim basis, the company would need to provide for adequate control mechanisms on the board (such as a lead independent director, a high overall level of board independence, and a high level of independence on the board's key committees). This policy will be applied to all core companies in European markets that propose the (re)election of a combined chair/CEO to the board, including cases where the chair/CEO is included in an election by slate.

This policy amendment more precisely reflects ISS' actual policy application that is based on current market practice and gives special consideration to companies that publicly disclose their intention to make the combined chair/CEO an interim position and to separate the roles within a maximum time frame of two years. Combining the roles of chair and CEO may result in concentration of power and blurs the lines between the duties of the CEO versus the duties of the chair, thus posing a potential risk to shareholders. European markets have further moved toward broad acceptance of the separation of the chair and CEO roles, as reflected by general practice among European public companies, as well as the adoption of best practice recommendations to this end in local corporate governance codes and, therefore, the interim appointment has come to represent the only potentially acceptable explanation for a combination of the roles in Europe. The amended policy would be applied for all European markets.

International Policy Updates

Director Elections-Japan

ISS currently recommends against all outside director nominees at companies (with a three-committee structure) who do not meet our criteria for independence. However, in 2011, if a majority of the directors on the board after the shareholder meeting are independent outsiders, ISS will not recommend votes against the appointment of affiliated outsiders.

When determining whether to recommend against the top executive, ISS' current policy is to recommend against the top executive at listed subsidiary companies that have publicly traded parent companies, where the board after the shareholder meeting does not include at least two independent directors based on ISS' independence criteria for Japan. ISS modified the definition of listed subsidiaries by replacing "publicly traded companies" with "controlling shareholders." Thus, in 2011, ISS will recommend against the top executive at listed companies that have controlling shareholders, where the board after the shareholder meeting does not include at least two independent directors based on ISS' independence criteria for Japan.

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

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

Compensation-Japan

Japan's Financial Instruments and Exchange Act was recently amended to require companies to disclose, in their securities filings, individual director, statutory auditor, and/or officer pay, where total compensation exceeds JPY 100 million (\$1.2 million). Amounts must be disclosed in each pay category – namely cash compensation, performance-based cash compensation, retirement bonuses, and stock options. In addition, compensation policy now needs to be disclosed for all companies, regardless of pay size.

The main concern related to Japanese executive pay is not the amounts, but the lack of connection to shareholder wealth creation. Cash salaries and cash retirement bonuses, neither of which is directly linked to performance, constitute the largest portion of executives' compensation. On the other hand, performance-based pay occupies a relatively small portion of total pay. Furthermore, equity-based incentives, notably stock options, still are not popular among Japanese executives.

For 2011, ISS updated its policy by (1) requiring, as a condition for support, disclosure of the amount of retirement bonuses for directors and/or statutory auditors and special payments in connection with abolition of a company's retirement bonus system and (2) removing the requirement that recipients of deep-discount options be able to exercise those options only after retirement.

With respect to (1), currently, ISS recommends against compensation proposals seeking ratification of retirement bonuses and/or special payments in connection with abolition of a company's retirement bonus system if the recipients include outsiders, or include those who can be held responsible for corporate scandal or poor financial performance which has led to shareholder value destruction (however, in rare occasions, ISS may support a payment to outsiders on a case-by-case basis, if the individual amount is disclosed and the amount is not excessive). Under the new policy in 2011, ISS will also recommend against retirement bonus payments or related special payments if neither the individual payments nor the aggregate amount of the payments is disclosed.

Retirement bonuses and related special payments are determined based on board tenure, not on recipients' contribution to shareholder value creation. Due to pressure from shareholders, an increasing number of companies have abolished the system, but the practice is still widespread. Rather than opposing all retirement bonuses, it is reasonable to at least require the amounts to be disclosed at the time shareholders vote on the payments, and this will send the message that shareholders want companies to shift away from seniority-based pay practices. Although abolishing the practice of paying retirement bonuses is a positive step, asking shareholders to approve the payout of funds accrued in the system, while not disclosing the amounts in question, remains a problematic practice.

With respect to (2), as one of the conditions for supporting the grant of deep discount options, ISS evaluates the vesting period. ISS currently does not support deep discount options if the exercise period starts before the grantee's retirement (however, if specific performance hurdles are clearly specified, this policy may not apply). Under the new policy in 2011, ISS will support deep discount options even absent disclosed performance conditions if the vesting period is at least three years from the grant date.

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

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

Global Update

Country of Incorporation/Country of Listing

ISS has long applied its benchmark policies based on an issuer's country of incorporation. Historically, this approach has ensured that ISS' policy is relevant to and compatible with an issuer's regulatory and operating environment. However, in recent years, certain issuers that are listed on a U.S. exchange have "redomesticated," i.e., reincorporated 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.

While, in general, country of incorporation will still be the basis for policy application, beginning with the 2011 policy update, ISS will generally apply its U.S. policies to the extent possible at issuers that file DEF 14As, 10-K annual, and 10-Q quarterly reports and are thus considered domestic issuers by the U.S. Securities and Exchange Commission (SEC).

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 about 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.