



An MSCI Brand

International Corporate Governance Policy

2012 Updates

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Institutional Shareholder Services Inc.

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ISS' International Corporate Governance Policy 2012 Updates

Effective for Meetings on or after Feb. 1, 2012
Updated Nov. 17, 2011

These policy updates present changes and clarifications to ISS' International benchmark guidelines for 2012. If new issues arise, such as shareholder proposals or regulatory developments, prior to the next formal update, ISS will adopt policies to cover such issues on an as-needed basis. Note that markets covered in this update document exclude the United States, Canada, and Europe.

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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 International 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 usresearch@issgovernance.com.

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



BOARD

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 Independence (Philippines)

Current Recommendation: Where independent directors represent less than one-third of the board, vote AGAINST the following directors:

- An executive director who is neither the CEO nor a member of the founding family; or
- One non-executive non-independent director who represents a substantial shareholder where the number of seats held by the representatives is disproportionate to its holdings in the company.

Key Changes: The updated policy reflects the New Corporate Governance Guidelines of the Philippine Stock Exchange which state that boards must now have at least three independent directors or at least 30 percent of the board must be independent, whichever is higher. Also, the updated policy removes the exemption for a member of the founding family.

New Recommendation: Where independent directors represent less than the higher of three independent directors or 30 percent of the board, vote AGAINST the following directors:

- An executive director with exception of the CEO; or
- One non-executive non-independent director who represents a substantial shareholder where the number of seats held by the representatives is disproportionate to its holdings in the company

Rationale for Update: Given the updates to corporate governance practices in the Philippines, companies are now held to a higher standard of board independence (whereas before the requirement was the lesser of two independent directors or 20 percent of the board). The exemption for founding family members was removed to provide flexibility to hold such directors accountable for low level of board independence.



Board Independence (Brazil)

Current Recommendation: Vote AGAINST proposals to elect directors if the post-election board is not at least 20-percent independent. This policy applies to companies that belong to the Novo Mercado and Nivel 2 listing segments.

Key Changes: Raise the required minimum level of board independence for Novo Mercado companies from 20 percent to 30 percent.

New Recommendation: Vote AGAINST proposals to elect directors if the post-election board is not at least 30-percent independent. This policy applies to Novo Mercado companies.

Vote AGAINST proposals to elect directors if the post-election board is not at least 20-percent independent. This policy applies to Nivel 2 companies.

Rationale for Update: The new policy would be more aligned with the concept of proportional board representation and in line with institutional investor views. The average free float among the Novo Mercado companies is 46.5 percent (minimum required is 25 percent). The average board independence of the Novo Mercado companies stands at 34.12 percent. A number of companies currently in, or transitioning to, the Novo Mercado have increased the proportion of independent directors on their boards, with some companies even modifying their bylaws to specify that their boards must be majority-independent. Moreover, the Brazilian Institute of Corporate Governance's (IBGC) best practices code, last edited in 2009, recommends that boards be at least majority independent.

In late 2010, The Sao Paulo Stock Exchange (BM&FBovespa) attempted to increase the minimum board independence threshold for the Novo Mercado and Nivel2 to 30 percent from 20 percent, and to establish a 20-percent minimum for Nivel1 companies. However, issuers belonging to these voluntary corporate governance differentiated segments voted against this proposal. The Novo Mercado has accounted for nearly 90 percent of all IPOs in Brazil over the past three years.

Note that the current Novo Mercado regulations technically allow issuers to "round down" the number of required independent directors if the board is close to 20-percent independent. Thus, many companies with six or seven-member

boards have only one independent director. However, as currently applied, ISS' updated policy will not "round down" the number of independent directors when determining the level of board independence.

According to ISS' 2011-2012 Policy Survey, 38 percent of institutional investors supported an increased board independence threshold of 30 percent for the Novo Mercado, while another 46 percent favored even higher thresholds. Furthermore, during ISS' 2011-2012 Comment Period, no institutional investors opposed raising the required minimum level of board independence for Novo Mercado companies from 20 percent to 30 percent.



Committee Independence (Hong Kong)

Current Recommendation: Where independent directors represent at least one-third of the board, vote FOR election of a board-nominated candidate unless:

- He or she is classified by the company as independent, but fails to meet the ISS criteria for independence;
- He or she has been a partner of the company's auditor within the last three years, and is on the audit committee of the company; or
- He or she has attended less than 75 percent of board meetings over the most recent two years, without a satisfactory explanation.

Where independent directors represent less than one-third of the board, generally vote AGAINST the election of a candidate if:

- He or she is classified by the company as independent, but fails to meet the ISS criteria for independence;
- He or she is an executive director. If more than one executive director is up for election, ISS will recommend against only one (typically, the director with the worst attendance record). Executives do not need to sit on the board for directors to access their expertise. Executives can be invited to board meetings to make presentations and answer questions.
- He or she is a representative of a substantial shareholder on a board where the reason independent directors constitute less than one-third of the board is because of a preponderance of executive directors and representatives of one substantial shareholder. In these cases, ISS will recommend against only one representative of the substantial shareholder (typically, the director with the worst attendance record);
- He or she has been a partner of the company's auditor within the last three years, and is on the audit committee of the company; or
- He or she has attended less than 75 percent of board meetings over the most recent two years, without a satisfactory explanation.

In making these recommendations, ISS will not recommend against the election of the CEO or a company founder who is integral to the company.

Key Changes: Include additional factors regarding committee independence when recommending against director elections.

New Recommendation: Generally vote FOR director nominees to the board. Vote AGAINST any nominee who:

- Is classified by the company as independent, but fails to meet the ISS criteria for independence;
- Has been a partner of the company's auditor within the last three years, and serves on the audit committee;
- Had attended less than 75 percent of board meetings over the most recent two years, without a satisfactory explanation;
- Is an executive director serving on the remuneration committee or nomination committee, and the committee is not majority independent; or
- Is an executive director serving on the audit committee.

If the board is composed of less than one-third independent directors, additional criteria apply. In such cases, vote AGAINST any nominee who:

- Is an executive director. If more than one executive director is up for election, vote against only one – generally the director with the worst attendance record;
- Serves as a representative of one substantial shareholder; and the board is less than one-third independent because of a preponderance of executive directors and representatives of the substantial shareholder. Vote against only one representative of the substantial shareholder – generally the director with the worst attendance record.

Vote FOR the election of a CEO or company founder who is integral to the company.

Rationale for Update: Hong Kong issuers have begun to establish remuneration and nomination committees, which are covered by best practice recommendations stated in the market's Code of Corporate Governance. The code calls for these committees to be composed of a majority of independent non-executive directors. Audit committees, though, are required under the listing rules. These requirements are that the audit committee must comprise a minimum of three members, at least one of whom is an independent non-executive director with appropriate professional qualifications or accounting or related financial management expertise as required under rule 3.10(2). The majority of the audit committee members must be independent non-executive directors of the listed issuer. The audit committee must be chaired by an independent non-executive director. According to ISS' 2011-2012 Policy Survey, a substantial majority (72 percent) of investor respondents indicated that it is not appropriate for an executive director to serve on audit, remuneration, or nominating committees.



Board Responsiveness, Board Independence, and Director Independence (Japan)

Current Recommendation: ISS has two policies for director elections in Japan: one for companies with a statutory auditor board structure, and the other for companies with a U.S.-type three committee structure. Regardless of governance structure, vote FOR the election of directors, except for:

- An outside director nominee who attended less than 75 percent of board meetings during the year under review¹;
- A top executive² who is judged to be responsible for clear mismanagement or shareholder-unfriendly behavior; or

¹ The attendance of inside directors is not disclosed in Japan.

² In most cases, the top executive will be the "shacho" (president). However, there are companies where the ultimate decision-making authority rests with the "kaicho" (executive chairman) or "daihyo torishimariyaku" (representative director).

- A top executive at a company that has a controlling shareholder, where the board after the shareholder meeting does not include at least two independent directors based on ISS independence criteria for Japan.

In addition, at companies with a U.S.-type three committee structure, vote FOR the election of directors, unless:

- The outside director nominee is regarded as non-independent based on ISS independence criteria for Japan, and the board after the shareholder meeting is not majority independent; or
- The director nominee who sits on the nomination committee is an insider or non-independent outsider, and the board after the shareholder meeting does not include at least two independent directors based on ISS independence criteria for Japan.

Independence criteria for Japan

Outside director candidates falling into any of the following categories will be regarded as non-independent:

- Individuals who work or worked at major shareholders of the company in question;
- Individuals who work or worked at main lenders to the company in question;
- Individuals who work or worked at business partners of the company in question;
- Individuals who are former partners of the company's audit firm;
- Individuals who offer or offered professional services such as legal advice, financial advice, tax advice, or consulting services to the company in question;
- Individuals who have a relative working at the company.

Key Changes:

- Adopt new policy provisions to :
 - Vote AGAINST a top executive if a board ignores a shareholder proposal that receives support from a majority of votes cast.
 - Vote AGAINST a company's top executive if the board does not include at least one outside director. There will be a moratorium on negative recommendations under this policy until 2013.
- Add a new category to independence criteria for Japan, and classify individuals who work or worked at the company's lead underwriter(s) as non-independent.
- Update the category of business partners under the independence criteria for Japan and classify individuals who work or worked at business partners of the company in question as independent if the transaction value is disclosed and not material from the recipient's perspective. "Material" will be defined with reference to ISS international voting guidelines.

New Recommendation: ISS has two policies for director elections in Japan: one for companies with a statutory auditor board structure, and the other for companies with a U.S.-type three committee structure. Regardless of governance structure, vote FOR the election of directors, except for:

- An outside director nominee who attended less than 75 percent of board meetings during the year under review³;
- A top executive⁴ who is judged to be responsible for clear mismanagement or shareholder-unfriendly behavior;

³ The attendance of inside directors is not disclosed in Japan.

⁴ In most cases, the top executive will be the "shacho" (president). However, there are companies where the ultimate decision-making authority rests with the "kaicho" (executive chairman) or "daihyo torishimariyaku" (representative director).

- A top executive who is responsible for not implementing a shareholder proposal which has received a majority of votes cast, or not putting a similar proposal on the ballot as a management proposal the following year (with a management recommendation of FOR), when that proposal is deemed to be in the interest of independent shareholders; or
- A top executive at a company that has a controlling shareholder, where the board after the shareholder meeting does not include at least two independent directors based on ISS independence criteria for Japan; or
- A top executive at any company, where the board after the shareholder meeting does not include at least one outside director (regardless of independence)⁵.

In addition, at companies with a U.S.-type three committee structure, vote FOR the election of directors, unless:

- The outside director nominee is regarded as non-independent based on ISS independence criteria for Japan, and the board after the shareholder meeting is not majority independent; or
- The director nominee who sits on the nomination committee is an insider or non-independent outsider, and the board after the shareholder meeting does not include at least two independent directors based on ISS independence criteria for Japan.

Independence criteria for Japan

Outside director candidates falling into any of the following categories will be regarded as non-independent:

- Individuals who work or worked at major shareholders of the company in question;
- Individuals who work or worked at main lenders to the company in question;
- Individuals who work or worked at the lead underwriter(s) of the company in question;
- Individuals who work or worked at business partners of the company in question and the transaction value is material from the recipient's perspective or is not disclosed;
- Individuals who are former partners of the company's audit firm;
- Individuals who offer or offered professional services such as legal advice, financial advice, tax advice, or consulting services to the company in question; or
- Individuals who have a relative working at the company.

Rationale for Update:

Board Responsiveness: Although the number of shareholder proposals is still small in Japan, some of those proposals are receiving support from nearly 50 percent of votes cast (for example, proposals for disclosure of individual compensation levels). In advance of a shareholder proposal potentially receiving a majority of votes cast, ISS adopts the new policy to address board responsiveness to majority-supported shareholder proposals in line with best governance practices. Most shareholder proposals in Japan are for amendments to the articles of incorporation. These proposals are binding, provided they receive the legally-required two-thirds majority. However, in light of the high levels of ownership in Japan by founders, parent companies, lenders, and business partners, the support of even a simple majority for a shareholder proposal should be considered a mandate to take action. In some cases, the board will be able to take the underlying action even if the articles are not amended, while in other cases, the action cannot be taken unless the articles are amended, in which case the board should submit the amendment as a management resolution the following year. At the same time, because of the high levels of insider ownership, it is possible that a shareholder proposal which benefits a controlling shareholder at the expense of minority shareholders could win majority support, in which case the board should not be punished for failure to take action.

⁵ This new provision of the policy will be fully implemented at all Japanese companies beginning in 2013.

Board Independence: Japanese corporate governance has long been criticized for a lack of outside oversight, let alone independence. It was customary for Japanese boards to be composed entirely of insiders. However, the situation has changed over the years, and in 2010, for the first time, more than half of Japanese companies (50.4 percent, based on ISS data) had at least one outside director. As of June 2011, the number increased slightly to 51.5 percent. Moreover, Japan's Ministry of Justice is considering requiring all Japanese listed companies to appoint at least one outside director to the board. If such a requirement is enacted, it will take effect within a few years (but not before 2013 at the earliest).

Given that a majority of Japanese boards already have at least one outsider, and in light of regulatory developments reflecting the changing public awareness toward the importance of board independence, having outsiders on the board should no longer be viewed as an alien concept among the Japanese business community, corporations, and institutional shareholders alike. Furthermore, in light of a global comparison of board independence which shows that Japanese boards lag far behind their foreign counterparts, and in light of recent corporate scandals (Olympus and Daio Paper) in which the board's role has been called into question, the argument for increasing board independence and oversight is now stronger than ever. Because most Japanese companies have no nominating committee, and new directors are selected by senior management, a vote against the top executive is the most effective way to communicate dissatisfaction with the composition of the board.

Although the new policy provision is being announced with the other 2012 policy updates, it will not be reflected in ISS vote recommendations until 2013. According to ISS' 2011-2012 Policy Survey, institutional investors expressed split views on taking into account the overall board independence level when voting on CEOs. Where boards are composed entirely of insiders, 45 percent of investor respondents indicated that they would not vote against reelection of CEOs across the board. However, 34 percent indicated that they were willing to vote against CEOs, with the remaining 21 percent citing "it depends." Based on these mixed views in addition to discussions held with Japanese investors, ISS determined that a one-year moratorium is a reasonable approach to give companies sufficient time to recruit qualified outside director candidates.

In 2012, ISS will give warnings to companies with all-insider boards, while engaging with market participants on this issue at every opportunity.

Director Independence: In regard to individuals affiliated with a company's lead underwriter, lead underwriters in Japan play a role akin to management consulting service providers. Because they have strong and ongoing relationships with management, directors coming from a company's lead underwriter should be treated as non-independent directors. With respect to directors involved in transactional relationships with the company, given that the number of companies disclosing the size of business transactions is increasing, ISS is adopting a materiality standard in line with ISS' international voting guidelines when determining independence.



COMPENSATION

Corporate Governance Issue: Voting on Proposals To Increase Director Compensation Ceilings (Japan)

Current Recommendation: Vote FOR proposals seeking to increase director/statutory auditor fees, unless:

- There are serious concerns about corporate malfeasance; or
- The company has suffered from prolonged poor financial and stock performance.

Key Changes: Revise the current policy by taking into account a company's disclosure on reasons for increasing director fees, whether director fees are performance-based, and company performance in cases where director compensation is not performance-based.

New Recommendation: Vote FOR proposals seeking to increase director fees, if:

- The specific reason(s) for the increase are explained; or
- The company is introducing or increasing a ceiling for performance-based compensation.

Vote CASE-BY-CASE on proposals seeking to increase director fees, taking into account the company's stock price performance and capital efficiency if:

- The proposals are intended to increase fixed cash compensation or do not specify whether it is fixed or performance-based compensation which will be increased.

Generally vote AGAINST proposals seeking to increase director fees if there are serious concerns about corporate malfeasance.

Rationale for Update: Based on best practices, director pay (in Japan, directors are mostly executives) should be tied to company performance. The updated policy will align the interests of directors with those of shareholders. In cases where the proposals are seeking an increase in non-performance based director pay or it is unclear whether director pay is performance-based, capital efficiency and share price will be examined to determine whether management has conducted business from shareholders' perspective. Furthermore, during ISS' 2011-2012 Comment Period, respondents generally noted that linking executive compensation to shareholder value creation is important.



Corporate Governance Issue: Voting on Proposals To Approve Stock Option Plans (Japan)

Current Recommendation: Vote FOR approval of stock option plans, unless:

- Total dilution from proposed plan(s) and previous option plans exceeds 5 percent for mature companies, or 10 percent for growth companies; or;
- Recipients include individuals who are not in a position to affect the company's stock price, including employees of business partners or unspecified "collaborators;" or
- The maximum number of options that can be issued per year is not disclosed; or
- The exercise period starts within one year from grant and the exercise price will be set at a premium of less than 5 percent to fair market price. (However, if specific performance hurdles are specified, this policy may not apply.)

Key Changes: Remove the last bullet point in the current policy.

New Recommendation: Vote FOR approval of stock option plans, unless:

- Total dilution from proposed plan(s) and previous option plans exceeds 5 percent for mature companies, or 10 percent for growth companies; or
- Recipients include individuals who are not in a position to affect the company's stock price, including employees of business partners or unspecified "collaborators;" or
- The maximum number of options that can be issued per year is not disclosed.

Rationale for Update: Stock options need to have a vesting period of at least two years in order for recipients to receive tax benefits. Therefore, it is unlikely that options will be exercised within a year from the grant date, even if the terms of the plan allow for it. In addition, the use of stock options among Japanese executives is still not prevalent, and it should be encouraged to better align their interests with those of shareholders.



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