



RiskMetrics Group

ISS Governance Services

UK Corporate Governance Policy

2008 Updates

November 19, 2007

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ISS Governance Services UK Corporate Governance Policy 2008 Updates

Effective for Meetings on or after Feb 1, 2008
Updated Nov 19, 2007

The ISS Governance Services (“ISS”) UK Corporate Governance Policy is based exclusively on the Policy and Voting Guidelines published by the National Association of Pension Funds (NAPF). During 2007 the NAPF carried out a full review of its Policy, which resulted in a substantial overhaul of the 2004 publication. At the same time the Financial Reporting Council reviewed the working of the UK Combined Code, on which NAPF Policy is based, and concluded that there was no need for any substantive changes. Thus, despite the NAPF review, there are no material changes to policy for 2008. If new issues arise, such as shareholder proposals or regulatory developments, prior to the next formal update, NAPF/ISS will adopt policies to cover such issues on an as-needed basis.

The NAPF review process involved consultation with leading institutional investors in the UK and with other interested parties including a number of issuers and advisers.

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AUDIT

Corporate Governance Issue: Auditor Re-tendering (re-bidding)

Current Policy Position: Any change of auditors, whether agreed by the board as part of a periodic planned review or for any other reason, should be explained and justified to shareholders.

New Policy Position: The guidelines now refer to the merits of periodic re-tendering (re-bidding). There is no voting sanction recommended where this is not company policy, however.

Rationale for Update: There is a consensus among investors that periodic tendering of the audit service helps to maintain auditor objectivity. Companies are therefore encouraged to consider submitting the audit function to periodic tender and disclose their policy on this matter, including when the audit was last subject to tender. Change of auditors should be explained to shareholders. Where the auditors have resigned, the resignation letter should be posted on the company's website.

Corporate Governance Issue: Auditor Indemnification and Limitation of Liability

Current Policy Position: The 2004 NAPF Policy is silent on the use of indemnification clauses and limited liability provisions in auditor agreements. However, it has long been the position of NAPF members that such practices are not normally acceptable and any resolutions proposing a cap on auditor liability should be opposed.

New Policy Position: Investors should consider voting against resolutions which propose any form of liability limitation other than proportional liability unless there are compelling reasons why an against vote is not appropriate.

Rationale: The NAPF and other institutional investors are willing to support proportional liability, whereby each party is liable for a portion of the loss commensurate with their responsibility for it, in the expectation that this would lead to improved audit quality. It should be noted that the Companies Act of 2006 makes it clear that liability cannot be limited below what the courts deem "fair and reasonable" in all the circumstances - in effect, proportional liability. Under the Act, companies are for the first time allowed to agree with their auditors on a limitation of their liability. Under the Act such arrangements will apply to companies whose financial year begins after April 2008. These agreements will be reached annually, and at public companies each must be approved - either prospectively or in retrospect - by the shareholders. Companies are not obliged to enter into such agreements but we expect that most companies will, and will as a result be required to seek shareholder approval on an annual basis.

BOARD

Corporate Governance Issue: Vote Against the Re-election of the Chairman of the Board

Current Policy Position: 2004 NAPF Policy refers in several places to a vote against the re-election of the chairman of the board as a sanction to be applied where others are not available (e.g., a vote against another director) or have proved ineffective in encouraging improved corporate governance standards.

New Policy Position: References to a vote against the re-election of the Chairman have been removed, except where he/she has direct responsibility for failure to comply with (or explain satisfactorily) the Code. Shareholders are instead advised by NAPF to actively abstain from supporting his/her re-election. The use of "abstain" was encouraged by the FRC in its 2006 update of the Combined Code, where shareholders wish to register concerns about a company's corporate governance policy. ISS/RREV recognises that in several markets an "abstain" vote is not recognised and will therefore amend its recommendation to "Contentious For" or in extreme circumstances "Against" in place of "Abstain".

Rationale for Update: Shareholders should be concerned about the possible consequences of a vote against the Chairman on a governance matter that results in his being forced to step down as a director.

Corporate Governance Issue: Director Independence Compromised by Tenure

Current Policy Position: The NAPF will normally recommend voting against the appointment of an Independent Non-Executive Director for a period in excess of a total of nine years unless the re-election is:

- Justified by the company in the Annual Report;
- Consistent with the broader requirement for the progressive refreshing of the board;
- Consistent with the company successfully addressing any other concerns of the NAPF on issues concerned with board structure or governance.

New Policy Position: Investors should consider positively a company's justification of a director's independence beyond nine years' service, providing that there is a clear and full explanation, which is further supported by:

- General board refreshment and succession planning - this is perhaps the most important consideration;
- Overall corporate governance standards and wider independence on the board;
- Evidence of independence in the director's conduct;
- Confirmation that independence (as distinct from performance) was evaluated.

Rationale for Update: Tenure is an aspect of the Code that has triggered much discussion. The NAPF appreciates that nine years is a milestone, rather than a fixed date after which independence is entirely lost, and before which it is entirely present. A pragmatic approach from companies and investors is therefore required.

As an over-riding principle, the NAPF does not dismiss the possibility that a long serving non-executive director can remain independent. However, independence is likely to diminish with time and the company has a responsibility for explaining why a long-serving non-executive director remains independent.

Just as the company has a responsibility to consider independence carefully in these circumstances, equally shareholders will wish to assess the company's explanation and may take account of some or all of the following factors listed above. The length of service of the executives may also be a factor: should the executives have been *in situ* for a relatively short period, the likelihood of remaining independent from management is stronger.

COMPENSATION

Corporate Governance Issue: Approval of the Remuneration Report

Current Policy Position: Boards are required to propose at each AGM a resolution for shareholders to approve the remuneration report for the financial year being reported. The remuneration report forms part of the annual report but the approval of the remuneration report should be dealt with by a separate resolution. The remuneration report resolution is advisory not mandatory. Whilst the voting result does not, therefore, require the board or company to take any specific action, the NAPF expects the board and remuneration committee to take into account both the voting result and the views of shareholders expressed before, at and after the AGM:

- When applying current remuneration policies and schemes; and
- When developing and implementing remuneration policies and schemes in the future.

New Policy Position: Most, but not all, individual elements of remuneration policy are likely to be insufficient to trigger a voting sanction in isolation, but might warrant such a measure when coupled with other deviations from good practice. It is also important for investors to be aware of recurring trends in remuneration (for example, a basic salary increase in excess of inflation in a particular year may not cause excessive concern whereas a trend of such increases might well). Just as the remuneration committee should adopt a holistic approach when designing and assessing packages, so investors should evaluate remuneration arrangements in their entirety.

Rationale for Update: Several years' experience of applying a vote on the remuneration report has led us to recognize the importance of looking at remuneration policy as a whole rather than individual elements. In addition, ISS Governance Services has developed a global policy on remuneration. This is consistent with NAPF Policy and is reflected in the details of that Policy.

CORPORATE RESPONSIBILITY

Corporate Governance Issue: UN Principles of Responsible Investing

Current Policy Position: None

New Policy Position: The NAPF has endorsed the UN Principles and has stated its intention to develop a more detailed policy on corporate responsibility in 2008.