



ISS GOVERNANCE SERVICES

2008 DRAFT POLICY UPDATES

REQUEST FOR COMMENTS

As part of its transparent and proactive approach to formulating its proxy voting policies, ISS Governance Services engages in extensive outreach activities in an effort to collect feedback from multiple constituencies and markets. As investors and issuers engage more actively on governance issues, it's vital to understand the perspectives of a broad range of market participants.

ISS Governance Services' Global Policy Board invites you to share your thoughts on ten important corporate governance issues, which represent some of our policy changes under consideration for 2008. We believe that additional market feedback on these topics will benefit our policy formulation process.

Comments are requested for the following policies:

Audit

Aggressive Accounting Practices (U.S.)

Board

Cumulative Voting (U.S.)
Director Attendance (Japan)
Independent Chair (U.S.)

Compensation

Non-Employee Director Limit on Equity Plan Participation (Canada)
Stock Options for Non-Executive Directors (Belgium and the Netherlands)
Poor Pay Practices (U.S.)
Stock Option Overhang in ISS Governance Services' Binomial Option Pricing ("SVT") Model (U.S.)
Say on Pay - Principles for Evaluating Remuneration (U.S. and International)

Social

Product Safety (U.S.)

To provide feedback, and to learn more about how your comments will be used in the policy formulation process, please visit ISS Governance Services' Policy Gateway at www.riskmetrics.com/issgovernance/policy. You can also e-mail your comments to policy@riskmetrics.com. The comment period will remain open for three weeks, from October 12 through November 1. Responses will remain confidential - should ISS Governance Services make any external reference to any comments, no potentially identifying information will be included.

On behalf of the ISS Governance Services Global Policy Board, I would like to thank you for your participation in the policy review and comment period and for your support in our continued outreach efforts as we formulate our 2008 voting guidelines.

Martha L. Carter, Ph.D.
Chair, ISS Governance Services Global Policy Board

Aggressive Accounting Practices (U.S.)

I. Background and Overview

Five years after the passage of the Sarbanes-Oxley Act of 2002, accounting issues continue to figure prominently in the investment landscape. The Act's landmark provisions in Section 302 (Corporate Responsibility for Financial Reports) and Section 404 (Management Assessment of Internal Controls) have redefined corporate governance with respect to accounting issues.

In ISS Governance Services' 2007 Policy Survey, we asked our clients to comment on types of information that they felt would be useful additions to proxy research reports. Over 83% of respondents felt that information on accounting practices would be useful.

Given the importance of and focus on accounting practices and their governance implications, we are reassessing our accounting and auditing policies. We are considering expanding current policies to articulate problematic areas in accounting practices that would have voting implications on the ratification of the auditor and the election of the audit committee.

II. Review of Current Policy

Under ISS Governance Services' current auditor ratification policy, we generally recommend supporting proposals to ratify the auditor unless there are factors that would impair the auditor's independent judgment, such as excessive audit fees, financial interests, or other associations with the company.

Similarly, voting recommendations on the entire audit committee are generally favorable. Cases where the recommendations might be unfavorable include non-independence, inappropriate actions, indemnification agreements that run counter to shareholders' interests, options backdating problems, or other actions taken by the board that raise concern.

III. Under Consideration for 2008

We are proposing the addition of an aggressive accounting practices policy that would evaluate troubling audit and accounting practices and could result in withhold recommendations on the audit committee or recommendations against the ratification of the auditor.

Practices that would be of concern and could result in unfavorable vote recommendations would include, but are not limited to:

- misapplication of GAAP or fraud
- troubling related party transactions
- troubling off balance sheet transactions
- policies that flatter metrics used to value the business, such as techniques designed to boost reported earnings
- excessive use of pro forma or non-GAAP metrics
- other practices that would interfere with the auditor's ability to exercise independent judgment

IV. Intent and Impact

The proposed policy amendments seek to identify potential areas of concern in corporate issuers' accounting practices. These practices would be evaluated on a case-by-case basis and could result in negative voting recommendations.

V. Request for Comment

- What specific accounting activities do you view as indicative of poor accounting practices?
- Should the implementation of aggressive accounting practices result in withhold votes for Audit Committee members and/ or votes against auditor ratification?
- What time frame would be relevant for the problematic practices, e.g. a 24 month lookback?
- Please feel free to add any additional information or comments that you would like us to consider for this policy.

Cumulative Voting (U.S.)

I. Background and Overview

Cumulative voting allows shareholders to amass, or cumulate, their votes for one or more directors on the ballot. Each shareholder is entitled to a number of votes equal to the number of shares held multiplied by the number of directors to be elected, then he or she may cast these votes for one nominee or may distribute them among multiple nominees at his or her discretion. Cumulative voting supports the interest of minority shareholders in contested elections; by concentrating their votes, they can elect a dissident nominee to the board. According to our database, about 290 companies in the U.S. allow for cumulative voting.

Conversely, what works for minority shareholders also works for the management nominees. Depending on the company's charter/bylaws, proxies tendered by the shareholders that vote for the director nominees can be re-allocated by the company. Some proxies state that the persons named in the company's proxy card will allocate the votes to elect the largest number of management nominees as possible. Therefore, cumulative voting is not always seen as a positive standard.

ISS Governance Services currently examines specific governance factors, which collectively could represent a meaningful alternative to cumulative voting. Conceptually, if the company showed evidence of board independence, impartiality in the nominating process, and accountability to shareholders, this would likely be sufficient to offset the need for cumulative voting. With the introduction of proxy access and majority voting to address the voting process and help ensure board accountability to shareholders, we are reevaluating the alternative structure that is outlined in our current voting policy.

II. Review of Current Policy

ISS Governance Services' current policy on cumulative voting proposals is:

- Generally recommend against proposals to eliminate cumulative voting.
- Generally recommend for proposals to restore or provide for cumulative voting unless the company meets *all* of the following criteria:
 - Majority vote standard in director elections, including a carve-out for plurality voting in contested situations;
 - Annually elected board;
 - Two-thirds of the board composed of independent directors;
 - Nominating committee composed solely of independent directors;
 - Confidential voting; however, there may be a provision for suspending confidential voting during proxy contests;
 - Ability of shareholders to call special meetings or act by written consent with 90 days' notice;
 - Absence of superior voting rights for one or more classes of stock;
 - Board does not have the right to change the size of the board beyond a stated range that has been approved by shareholders;
 - The company has not under-performed both its industry peers and index on both a one-year and three-year total shareholder returns basis*, unless there has been a change in the CEO position within the last three years; and
 - No director received a WITHHOLD vote level of 35% or more of the votes cast in the previous election.

*Starting in 2007, the industry peer group used for this evaluation changed from the 4-digit GICS group to the average of the 12 companies in the same 6-digit GICS group that are closest in revenue to the company. To fail, the company must under-perform its index and industry group on all 4 measures (1 and 3 year on industry peers and index).

III. Under Consideration for 2008

ISS Governance Services proposes changes to the existing policy that would reflect the recent evolution in director election reforms - majority voting and proxy access.

In this policy revision, we would generally recommend voting against proposals to eliminate cumulative voting, and for proposals to restore or provide for cumulative voting, unless the company has proxy access and majority voting, or a similar structure to allow for accountability in director elections.

IV. Request for Comment

- Do you support cumulative voting?
- Do you consider proxy access, or equivalent shareholder access to the proxy, to be a viable alternative to cumulative voting proposals?
- Does the presence of a majority vote standard create a sufficiently accountable board that would render cumulative voting unnecessary?
- Should ISS Governance Services continue to look at the list of other governance features that we are currently analyzing for these proposals?
- Please feel free to add any additional information or comments that you would like us to consider for this policy.

Director Attendance (Japan)

I. Background and Overview

Under the new Corporate Law which took effect in 2006, Japanese companies must now disclose the participation of outside directors and statutory auditors at meetings of the board of directors (and in the case of statutory auditors, meetings of the board of statutory auditors as well). Most companies interpret this as a call to disclose the number of meetings attended. Meanwhile, as the number of outsiders in Japan continues to increase, we are seeing some cases of low attendance rates, apparently caused by scheduling conflicts.

II. Review of Current Policy

ISS Governance Services does not currently use attendance at board or committee meetings as a factor in deciding whether to recommend votes for the reelection of incumbent directors or statutory auditors in Japan. Until recently, attendance was not disclosed, and at the same time, most directors have traditionally been insiders, and there were relatively few cases of "over-boarding" or other scheduling conflicts preventing directors from attending meetings.

III. Under Consideration for 2008

We are considering adopting the same policy used at U.S. companies: namely, opposing the reelection of directors who fail to attend at least 75 percent of board meetings, unless the company discloses a legitimate reason for the poor attendance. The same policy should be applied to statutory auditors, because they will not be able to properly fulfill their oversight function if they fail to attend meetings of the board of directors and board of statutory auditors. Attendance via webcast or teleconference will be deemed equivalent to attendance in person.

Note that the attendance rates of insiders are still not disclosed in Japan, and so this policy will be applied to the outsiders only. Nevertheless, we would like to call upon companies to proactively disclose the attendance rates of insiders as well.

IV. Intent and Impact

Outside directors and statutory auditors are elected by shareholders to oversee management and ensure that executives are acting in shareholders' interest. However, their ability to do so is limited if they fail to attend the board meetings where important management decisions are made. This is true in every country, but in Japan there is an additional factor at work. Many companies are only now appointing outside directors for the first time, not necessarily because management is convinced of the desirability of doing so, but because shareholders are calling for such appointments - and in some cases, because companies believe their poison pill plans are more likely to be approved if they appoint outsiders to the board. In such cases, shareholders need to be on guard to ensure that the outsiders are not mere figureheads, but are actually playing a meaningful role. Moreover, the limited number of outsiders at most companies means that the absence of one director (or statutory auditor) from a board meeting will have a greater impact than would be the case if a majority of the board were outsiders. It should also be noted that the frequency of board meetings varies significantly among Japanese companies, but that boards tend to meet more often than boards in the U.S. Many boards meet once or even twice a month.

Directors at Japanese companies serve for terms of one year or two years, while statutory auditors serve for four years. Terms may be staggered or aligned. Directors and statutory auditors are elected by majority vote, and the vote options are therefore FOR, AGAINST or ABSTAIN. "Withhold" is not an option in Japan.

Our experience since the new law took effect is that most directors and auditors attend at least 75 percent of meetings, and we therefore expect relatively few AGAINST recommendations as a result of this policy change. However, it should be noted that most directors and many statutory auditors were insiders, for whom attendance figures are not disclosed and other directors and auditors had poor attendance, but were not up for reelection, either because they were in the middle of a term, or because they were stepping down from their posts.

V. Request for Comment

ISS Governance Services is seeking feedback and comments on director attendance and the extent to which it should be used as a factor in director and statutory auditor elections. Please provide comments on the following questions:

- Should ISS Governance Services recommend votes against the reelection of incumbent directors and statutory auditors in Japan due to poor attendance (less than 75% of meetings)? Alternatively, in consideration of the greater number of board meetings in Japan, should ISS Governance Services recommend votes against the reelection of incumbent directors and statutory auditors who attend less than 50% of meetings?
- There may be some cases where an individual has a legitimate reason, such as hospitalization, for not attending meetings; but where this reason is not disclosed in the proxy materials – for example, because the company wants to preserve the individual’s privacy concerning a medical condition. More typically, however, the reason will not be disclosed simply because disclosure is not legally required. The extreme concentration of shareholder meetings and the limited time between release of proxy materials and voting deadlines makes it impossible to contact companies to inquire as to the reason(s) for poor attendance; and there is no guarantee that a company would disclose the reason even if we were able to inquire. Should ISS Governance Services put the burden of disclosure on the company, and assume that if no mitigating factors are disclosed, poor attendance is due to an excessively busy schedule?
- A small number of companies do not clearly disclose attendance figures, but state only that the directors and auditors attended “most meetings” or “as many meetings as possible,” or simply state that the directors or auditors took part in the debate, without indicating how often they attended meetings. In such cases, should ISS Governance Services oppose the reelection of the outsiders as a way to protest the substandard disclosure practices?
- Should poor attendance by the outside directors be taken into account when voting on other agenda items, such as director compensation proposals or takeover defense proposals?
- Please feel free to add any additional information or comments that you would like us to consider for this policy.

Independent Chair (U.S.)

I. Background and Overview

For several years there has been ongoing discussion over the merits of a separate and independent board chair versus a combined or non-independent chairman/CEO structure. While the latter has been a prevalent practice among US companies for many years, some investors argue that the combined role limits accountability and is indicative of poor governance structure.

This lack of a consensus opinion on the matter has led to myriad different structures, including: separate and independent chair/CEO, combined chair/CEO, combined chair/CEO with an independent lead director, and combined chair/CEO with a presiding director. Each structure has its advocates and opponents; however, from a governance perspective, it appears that the majority of investors prefer an independent chair or an independent lead director with a well-defined role in managing the board.

II. Review of Current Policy

ISS Governance Services' current policy is to generally recommend *FOR* shareholder proposals requiring the position of chairman be filled by an independent director, unless there are compelling reasons to recommend against the proposal, such as a counterbalancing governance structure. This should include all of the following:

- Designated lead director, elected by and from the independent board members with clearly delineated duties. (The role may alternatively reside with a presiding director, vice chairman or rotating lead director). At a minimum these duties should include:
 - presiding at all meetings of the board at which the chairman is not present, including executive sessions of the independent directors
 - serving as liaison between the chairman and the independent directors;
 - approving information sent to the board;
 - approving meeting agendas for the board;
 - approving meeting schedules to assure that there is sufficient time for discussion of all agenda items;
 - having the authority to call meetings of the independent directors;
 - being available for consultation and direct communication, if requested by major shareholders.
- Two-thirds independent board;
- All independent key committees;
- Established governance guidelines;
- The company should not have underperformed both its peers and index on the basis of both one-year and three-year total shareholder returns, unless there has been a change in the Chairman/CEO position within that time; and
- The company does not have any problematic governance issues.

ISS Governance Services' 2007 Policy Survey indicated that nearly one-half of institutional shareholders believe that an independent lead director makes a combined CEO/chair acceptable. However, 36 percent of the shareholders believe that a combination is generally not acceptable. While it appears that shareholders typically support a lead director structure, a significant minority opposed the combination of chair/CEO roles in our survey.

III. Under Consideration for 2008

ISS Governance Services is seeking input on the lead director structure that would act as a counterbalance to a combined chair/CEO and is considering the following changes to our existing

policy. If the company has an independent lead director elected by and from the independent board members, the proposed policy would require that:

- the duties of the lead director would be consistent with a framework that encourages board accountability and embodies sound governance principles consistent with our current policy;
- the company disclose a comparison between the duties of its independent lead director and non-independent chairman, and;
- the company disclose an explanation/reasons for not appointing an independent chair and instead maintaining both a non-independent chair and an independent lead director.

IV. Intent and Impact

The intent of modifying the current policy is to gain more insight from the company on the duties of the lead director, its rationale for maintaining a combined chair/CEO structure, and any associated benefits to shareholders of not appointing an independent chair.

ISS Governance Services supported 90 percent of independent chair/separation proposals in 2005, which fell to 70 percent in 2006 to 46 percent through August 2007. The decline in ISS support for these proposals is partly due to an increase in companies appointing a lead director with the delineated duties. The disclosure requirements under the proposed policy, in addition to the other factors in the counterbalancing structure, could impact the frequency of supporting these proposals.

V. Request for comment

We are seeking feedback on the following questions with respect to the proposed policy:

- What specific governance policies or procedures are important for a company to implement that may counterbalance a combined chair/CEO role.
- Under which circumstances would a chair/CEO combination not be acceptable? (i.e. poor performance, poor compensation practices, ignoring majority supported shareholder proposals, adopting a pill without shareholder vote, other.)
- In your opinion, what are the distinct differences between the role of a chairperson and the role of a lead director?
- In your opinion, what are the potential benefits of a combined chair/CEO role?
- Please feel free to add any additional information or comments that you would like us to consider for this policy.

Non-Employee Director Limit On Equity Plan Participation (Canada)

I. Background and Overview

For several years ISS Governance Services Canada has followed a policy of recommending a vote against discretionary non-employee director participation in employee equity plans. The basis for this opposition has been the potential for self-dealing on the part of non-employee directors when they may grant themselves options without restriction under employee plans. The conflict of interest inherent in this type of plan participation may also extend to the 'back scratching mindset' whereby the non-employee and employee directors make decisions that will benefit one another. This conflict may increase where directors sit on more than one board together.

A number of institutional investors in Canada are opposed to grants of options to outside directors under any circumstances, largely because of the potential for many kinds of abuses like those leading to questionable accounting and options backdating. The Canadian Coalition for Good Governance Guidelines for Building High Performance Boards states, "Stock options are an inappropriate form of compensation for the directors of large and established corporations."

Due to the prevalence of options in the compensation plans of mid- to small-cap issuers in Canada, we have not opposed the use of options for outside directors per se, but have tried to address concerns by ensuring a reasonable limit on grants to the independent non-employee directors, who are charged with overseeing not only a company's compensation program but its corporate governance and sustainability.

Recent trends in director compensation have been to move away from stock options at the larger index companies in Canada, in favor of higher cash retainers and meeting fees, and adopting policies of paying up to half of the cash fees in the form of deferred share units or restricted share units. At several mid- to small-size issuers, director compensation has, in some cases, moved from entirely stock option grants to a mix of options and restricted stock or to grants of restricted stock completely.

The replacement of stock options with other forms of equity grants such as restricted stock, while mitigating the potential for abuses like options backdating, does not address the concern over discretionary director grants. For this reason, we believe all equity grants to non-employee directors that are not in lieu of a cash fee, should be reasonably limited. Again, we have not opposed any particular type of equity award for non-employee directors but have insisted on a reasonable limit to mitigate the potential for self-dealing and compromised independence.

According to the 2006 Spencer Stuart Canadian Board Index report, which covered trends in pay practices at the 100 largest publicly traded Canadian companies, the total average annual compensation for a non-employee director increased 15% over the previous year to \$118,026. Of this amount, the cash/equity split was \$71,784 and \$46,242. When taken alone the average director compensation for the largest 44 companies with revenues over \$5 billion was \$143,808 (cash/equity of \$84,933/\$58,875), and the average among the smallest 56 companies with revenues between \$1 billion and \$5 billion was \$96,913 (cash/equity of \$60,362/\$36,551). Interestingly, the Board Index report divulges that the average compensation of the firms that pay any equity to directors is more than double the average compensation at firms that pay only in cash (\$144,747 vs. \$70,910).

II. Review of Current Policy

ISS Governance Services Canada has established an acceptable range for director participation in equity-based compensation plans of 0.25% to 1% of the outstanding shares. A company is expected to fall within this range based on its size and stage of development, so that larger more mature companies would be limited to something closer to 0.25% and smaller companies with less cash and

much lower share prices would fall at the 1% end of the range, thus having a larger pool of options or equity awards from which to draw. This range was initially established based on an underlying policy that an upper limit of \$1 million worth of stock acquired by means of option grants for each director over the life of a typical 10-year plan seemed reasonable to prevent misalignment of purpose.

Over the course of the past two proxy seasons two developments in particular have prompted review of our policy approach. First, director compensation has increased for many reasons, not the least of which is the increased responsibility now attributed to more rigorous regulatory and corporate governance requirements. The second is that, with the continued reliance on director stock options at mid- to smaller-cap companies and a heightened awareness of corporate governance best practice expectations, public issuers are asking what limit is acceptable within our range of 0.25% to 1% of the outstanding shares. This question is particularly relevant if 1% would result in millions of dollars worth of stock for a non-employee director over the life of the compensation plan, which ISS Governance Services would view as excessive based on our underlying limit of \$1 million per director.

III. Under Consideration for 2008

ISS Governance Services Canada is proposing to assess non-employee director awards based on the same binomial compensation model award value that is used to evaluate the cost of the compensation plan. This would be consistent with our methodology for establishing the value of awards for employee participants and the plan.

The proposed maximum for director equity grants (including options) would then factor in the following:

- the difference between options and full value awards (restricted stock);
- a discount for performance awards;
- share price volatility and other criteria factored into a Black-Scholes type evaluation.

We believe it is then appropriate using this award value, to establish an annual maximum for non-employee director participation in conjunction with our reserve limit of 0.25% to 1% of the outstanding shares.

Using the binomial equity award value, we propose to establish a maximum non-employee director participation limit of the lesser of: (i) a reserve of 1% of the shares outstanding or (ii) an annual equity award value of the \$100,000 per director. Equity award refers to options, restricted stock, performance share grants or any other equity grant made under an employee equity compensation plan, other than equity granted or taken in lieu of cash fees.

We would generally recommend against an equity compensation plan proposal that provides that non-employee director participation in equity awards under the plan is discretionary or exceeds this limit.

IV. Request for Comment

ISS Governance Services Canada is seeking feedback and comments on acceptable equity-based compensation for non-employee directors. Specifically, we ask for your comments on the following questions:

- Is it appropriate to limit non-employee director participation in equity compensation plans?
- Should ISS Governance Services value non-employee director equity awards using the binomial compensation model award values established to determine the overall cost of the plan?

- Should all forms of equity-based compensation that are not in lieu of cash fees payable to non-employee directors be subject to limit? If not, what are the exceptions?
- Are stock options ever appropriate for non-employee directors?
- Based on Canadian market practices, is \$100,000 per director per year an appropriate absolute maximum for the value of equity compensation, not paid or taken in lieu of cash fees, among TSX listed issuers? If not, what is?

Stock Options to Non-Executive Directors (Belgium and the Netherlands)

I. Background and Overview

Granting options to non-executive directors is currently an accepted practice in the U.S. and Canada. However, in the U.K., Australia and some Continental European countries, such as Belgium and the Netherlands, local codes of best practice recommend against the granting of stock options to non-executive directors. French law even takes this a step further by limiting the grant of options strictly to corporate officers or employees.

As indicated below, the codes advocate the principle that option grants do not necessarily align non-executive directors' interests with those of shareholders, as stock options arguably confer potential upside to directors but none of the downside that shareholders face. In addition, such exposure to a company's financial performance may make non-executives either less or more risk averse from a strategic point of view, taking the focus away from oversight of management processes and accountability.

The Netherlands (Tabaksblat Code): *"The remuneration of a supervisory board member should not be dependent on the results of the company". "A supervisory board member shall not be granted any shares and/or rights to shares by way of remuneration" and "Any shares held by a supervisory board member in the company on whose board he sits are long-term investments".*

Belgium (Lippens Code): *"Non-executive directors should not be entitled to performance-related remuneration such as bonuses, stock related long-term incentive schemes, fringe benefits or pension benefits."*

France (Bouton Code): *"Directors who are neither corporate officers nor employees are barred by law from receiving options."*

Given the current opposition in Belgium and the Netherlands to granting options to non-executive directors, ISS Governance Services is considering modifying its policies to recommend against proposals on Belgian or Dutch agendas (new plans or modifications) that allow such grants.

II. Review of Current Policies

In most markets, stock option plans featuring potential grants to non-executive directors are generally considered acceptable. In the U.K., ISS Governance Services' policy is in line with local best practice, as articulated by the National Association of Pension Funds (NAPF) on the basis of the Combined Code. According to the ABI (Associations of British Insurers)/NAPF guidelines on executives' remuneration, "participation in share incentive schemes should be restricted to bona fide employees and executive directors." A similar policy applies in Australia, where stock options for non-executives are not accepted either.

III. Under Consideration for 2008

In international markets where local codes of best practice oppose the practice, ISS Governance Services would adopt a policy of recommending against new plans that include option grants to non-executives as well as recommending against modifications to such plans.

IV. Request for comment

ISS Governance Services is seeking feedback and comments on specific areas of its proxy voting policy as we finalize policies on stock option grants to non-executive directors for 2008. Specifically, we ask for your comment in the following areas:

- If local codes of best practice recommend against granting options to non-executive directors, should ISS Governance Services recommend against any plan that does allow such grants?
- Are there reasons that could lead to a favorable recommendation for plan proposals that include stock options to non-executive directors, even in markets where local best practice codes disfavor them?
- In the Netherlands, where the Tabaksblat Code opposes stock option grants for non-executive directors, would the existence of option grants to non-executives be sufficient reason to oppose an entire remuneration policy or an unrelated change to the policy?
- Please feel free to add any additional information or comments that you would like us to consider for this policy.

Poor Pay Practices (U.S.)

I. Background and Overview

Executive compensation levels have continued to rise in recent years and have been the subject of intense scrutiny. Outsized pay packages that are not tied to performance, golden parachutes and generous perquisites, including tax gross-ups, have been a focus of attention by the media and the investing public at large.

The SEC's updated disclosure rules significantly enhanced the executive compensation information available to shareholders. The new disclosures provide increased transparency and give investors more comprehensive information and insight into specific pay practices, including perquisites, deferred compensation earnings, supplemental executive retirement plans (SERPS), and potential payouts triggered in various termination scenarios, including those related to a change in control. The new disclosures enable shareholders to better understand all pay elements and ascertain their appropriateness from a pay-for-performance perspective.

II. Review of Current Policy

ISS Governance Services instituted a formal Poor Pay Practices policy in 2006 and extensively updated the policy for 2007. ISS Governance Services believes that executive pay programs should be fair, reasonable and appropriate, and that pay for performance should be a central tenet in executive compensation philosophy. The current Poor Pay Practices Policy provides for withhold recommendations for Compensation Committee and/or the CEO on a case-by-case basis where egregious pay practices are identified and may indicate withhold recommendations for the entire board if the whole board was involved in and contributed to the egregious compensation problems.

ISS Governance Services recognizes that companies adopt a variety of pay practices that may be acceptable in their respective industries or unique for a particular situation. We believe that the following, while not exhaustive, are examples of poor compensation practices that may warrant withhold recommendations:

- Egregious employment contracts, such as those containing multi-year guarantees for bonuses and grants;
- Excessive perks that dominate compensation, such as tax gross-ups for personal use of corporate aircraft;
- Huge bonus payouts without justifiable performance linkage or proper disclosure;
- Performance metrics that are changed, canceled or replaced during the performance period without adequate explanation of the action and the link to performance;
- Egregious pension/SERP (supplemental executive retirement plan) payouts, which may include additional years of service not worked or inclusion of performance-based equity awards in the pension calculation;
- New CEO with overly generous new hire package, with excessive "make whole" provisions or any of the poor pay practices listed in this policy;
- Excessive severance provisions, including excessive change in control payments;
- Change in control payouts without loss of job or substantial diminution of job duties;
- Internal pay disparity;
- Options backdating (covered in a separate policy); and
- Other excessive compensation payouts or poor pay practices at the company.

III. Under Consideration for 2008

ISS Governance Services is considering updating the current policy to provide additional examples of poor compensation practices based on lessons learned and feedback from the first year of new disclosures. Results from the 2007 Policy Survey provide continued support for many of the provisions

of the current policy and bolster support for the proposed revisions. For example, 65.7% of survey respondents viewed perquisites, such as car allowances and office space for former executives, to be problematic. The following are proposed as new items or material amendments to the current policy:

- Include the following on the list of undesirable practices:
 - Perquisites for former executives, such as car allowances, personal use of corporate aircraft or other inappropriate arrangements.
 - Poor disclosure practices, such as
 - Unclear explanation of how the CEO is involved in the pay-setting process
 - Retrospective performance targets and methodology not disclosed
 - Methodology for benchmarking practices and/or peer group constituents not disclosed or explained.
- Consider withhold recommendations for the compensation committee in cases where issues that received cautionary language persist. In these instances, the company has been warned about a poor pay practice and has had sufficient opportunity to review their practices and make appropriate adjustments.

IV. Request for Comment

ISS Governance Services is seeking feedback on these potential updates to the Poor Pay Practices policy. Specifically:

- Should ISS Governance Services consider poor disclosure, per se, as sufficient reason to recommend withholding votes from directors?
- If a company has received cautionary language in the past and has not remedied its problematic practices, what voting action is appropriate?
- Please provide any feedback you would like regarding how the poor pay practices policy was implemented in the 2007 season.
- Please feel free to add any additional information or comments that you would like us to consider for this policy.

Stock Option Overhang Cost in ISS Governance Services' Binomial Option Pricing ("SVT") Model

I. Background and Overview

ISS Governance Services evaluates equity-based compensation plans using a cost-based analysis. The potential cost of an equity plan is expressed in terms of shareholder value transfer (SVT), which is measured using a binomial model that assesses the amount of shareholders' equity that will flow out of the company to participants as options are exercised and/or restrictions on awards lapse.

When analyzing the potential cost of a new plan or an amendment to add shares to an existing plan, ISS Governance Services estimates the potential total cost of a company's equity compensation program, including: (1) new shares being reserved, (2) shares available under all existing equity compensation plans, and (3) shares subject to outstanding awards (or "overhang"). Note that, for purposes of the binomial model, new shares, available shares, and shares underlying outstanding grants are referred to as A, B, and C shares, respectively, in our analyses. SVT is expressed in dollar terms and as a percentage of the company's market value. As part of the evaluation protocol for determining a recommendation on a plan proposal, the total potential cost (SVT) of all a company's equity-based incentive plans is compared to a company-specific cap that is both industry - and performance-based.

A company's SVT is fueled by three elements - its current share request, plus the number of shares previously reserved under its equity plans that have not yet been granted, plus the number of shares that have been granted and not yet exercised or (in the case of full-value awards) vested.

II. Review of the Current Policy

The current approach provides an unbiased dollar cost estimate of a company's equity compensation program. If the potential cost of the equity compensation program exceeds the company-specific allowable cap, we generally recommend a vote AGAINST the equity plan proposal because it is too costly for shareholders.

Companies with sustained positive stock performance may exhibit high SVT costs attributable to overhang if optionees hold their options for prolonged periods. Such a combination likely reflects employees' confidence in their company's future prospects. However, we may recommend a vote against a new share request due to excessive cost that is driven primarily by overhang. Although positive stock performance will typically result in a higher allowable cap for a company, the high cost of overhang may still represent a significant component of SVT. In addition, although most full-value awards (such as time-based restricted shares) fully vest after no more than three or five years, most stock options are granted with 10-year terms, and thus may impact overhang for a longer period than full-value awards if not exercised within five years after they are granted.

III. Under Consideration for 2008

A question in our 2007 Policy Survey asked institutional clients under what circumstances they would support an equity plan whose cost exceeds the industry allowable cap. Approximately 60 percent indicated they would support equity plan proposals with excessive cost if the company had a significant portion of vested, in-the-money options in its overhang and employees had been holding onto their vested equity over a significant time period. We propose to add a case-by-case policy to the current approach in situations where a company keeps its employees and the employees keep the options. Such a case may represent successful retention of employees, who have a positive outlook on the future performance of the company. Our new approach would entail an evaluation of companies with excessive SVT cost. For these companies, we would examine the company's: (1) performance, (2) overhang, (3) dilution attributable to equity compensation, and (4) overall compensation practices. For companies with excessive SVT cost, we would consider, on a case-by-case basis, a carve-out of a portion of cost attributable to overhang, considering the following criteria:

(1) Stock performance: A company with sustained positive stock performance will merit greater scrutiny. Five-year total shareholder return (TSR), year over year performance, and peer performance could play a significant role in this determination.

(2) Overhang and exercise behavior: We would assess whether optionees have held in-the-money options for a prolonged period (thus reflecting their confidence in the prospects of the company). Note that this factor would require detailed disclosure regarding a company's overhang, such as tranches of all outstanding grants with corresponding exercise prices, vesting provisions, terms, forfeiture rates, and their distribution with respect to the employee base.

(3) New share request: We would evaluate the new share request and calculate the expected duration of the request in addition to the shares currently available under the equity compensation program, based on the company's three-year average burn rate (or a burn-rate commitment that the company makes for future years). For example, an expected duration in excess of five years could be considered problematic.

(4) Overall compensation practices: An evaluation of overall practices could include: (1) stock option repricing provisions, (2) liberal share recycling provisions, (3) evergreen provisions, (4) high concentration ratios (of grants to top executives), or (5) additional practices outlined in ISS Governance Unit's current poor pay practices policy.

IV. Request for Comment

We are seeking feedback regarding the potential introduction of an additional case-by-case approach in the evaluation of high overhang for equity plan proposals. Specifically, we ask the following questions:

- As described above, should ISS Governance Services consider carving out a portion of SVT as part of our evaluation of companies with good stock performance that exhibit high SVT due to outstanding option grants held for a long period by their employees?
- What is an appropriate option-holding period to consider (e.g. 5 years, 6 years)?
- For new share requests and shares currently available, would you consider an expected duration (based on current burn rate) in excess of five years to be problematic?
- In applying a case-by-case approach, would you agree with the consideration and evaluation of additional factors, such as overall use of equity and other compensation practices? Are there other factors that ISS Governance Services should consider in evaluating companies with high overhang?

Say On Pay - Principles for Evaluating Remuneration

I. Background and Overview

High levels of investor concern about spiraling executive pay have prompted a number of developments this decade, including the implementation of shareholder votes on pay programs in a growing number of markets. These include the U.K., Australia, the Netherlands, Sweden, and Norway. Several companies in Denmark also now put executive remuneration programs to an up-or-down shareholder vote, and Spain may join this list beginning in 2008.

The probability that shareholders of U.S. companies will see similar resolutions in the near future has also increased recently. Legislation has been introduced in the U.S. Senate, raising the possibility that these resolutions will be required of all U.S. public companies. TIAA-CREF has already included a say-on-pay vote in its proxy statement, and AFLAC (and likely additional companies) will do so beginning in 2009. A shareholder proposal seeking advisory votes on executive pay at U.S. companies was introduced in 2006 and has received substantial support (over 42%) so far in 2007. ISS Governance Services supported these resolutions, and hence, the attached request for comments does not request feedback on the "say on pay" proposals of the last two years.

Our focus for this comment request is on a framework for assessing the stewardship of a compensation program. Given the growing momentum for annual "say on pay" management resolutions in the U.S., ISS Governance Services has frequently been asked how it would evaluate remuneration plans if and when they appear on U.S. proxy ballots. To answer this question, we turned to our global colleagues in markets where a vote on remuneration already exists. We found several core principles in common across all markets, as well as market specific differences. The attached request solicits comments on the core principles for evaluating a compensation program, as well as on key factors that should be evaluated in the U.S. market.

II. Review of Current Policy

Vote recommendations for annual "say-on-pay" resolutions put forward by management are made on a case-by-case basis by ISS Governance Services in each market where such proposals routinely appear on proxy ballots. As noted, these currently include the U.K., Australia, the Netherlands, Sweden, Norway, and some companies in Denmark.

Evaluations take into account specific proposal wording, local market regulations and prevailing practices, and local governance and best practice codes. The key factors influencing evaluations generally fall into the following categories:

1. Pay in relation to performance, usually based on the design of programs and actual grants (e.g., the use of rigorous performance hurdles);
2. Equity-based awards, which should not exceed levels recommended under local best practice codes;
3. "Pay for failure" arrangements, such as long-term contracts that could lead to multiple-year severance packages;
4. The quality of pay disclosures (e.g., specifying incentive goals that generated past-year rewards and/or forward-looking targets); and
5. In some markets, aspects of non-executive directors' pay (e.g., codes in several markets discourage stock-based grants to non-executive directors)

Voting recommendations typically look to the preponderance of evidence - i.e. an "against" recommendation may result when a preponderance of negative features outweighs the positive features presented in a remuneration report.

III. Under Consideration for 2008

ISS Governance Services proposes to create a framework of universal principles for annual say-on-pay resolutions, which will apply to a range of proposal language, disclosure regimes, local best practices, and operational considerations. In turn, these principles would form the core of a voting policy on “say on pay” in the U.S. market.

The proposed principles are both broad and simply expressed, reflecting a review of current best practice codes and guidance that has been issued by several large institutional investors, as well as corporate focused organizations such as the National Association of Corporate Directors, the Business Roundtable, and the Aspen Institute’s recently released guiding principles for long-term value creation.

1. Maintain appropriate pay-for-performance alignment, with emphasis on long-term shareholder value.

This principle encompasses overall executive pay practices, which must be designed to attract, retain, and appropriately motivate the key employees who drive shareholder value creation over the long term. It may take into consideration market-based best practices and linkage between pay and performance, which may be measured in both absolute and relative terms. It may involve assessment of fixed pay and incentives (including appropriateness of performance goals relative to award size), pensions, perquisites, and internal pay equity. Evaluating the pay-performance relationship may focus on plan design, on plan implementation, and/or on actual payouts versus performance.

2. Avoid arrangements that risk “pay for failure.”

This principle addresses the use and appropriateness of long or indefinite contracts, excessive severance packages, and guaranteed compensation.

3. Maintain an independent and effective compensation committee.

This principle promotes oversight of executive pay programs by directors with appropriate skills, knowledge, and experience as well as access to independent expertise and advice.

4. Optimize equity program costs and alignment with shareholder interests.

This principle recognizes that excessive stock-based compensation cost, particularly without long-term equity retention by executives, is generally not in shareholders’ best interests.

5. Provide shareholders with clear, informative compensation disclosures.

This principle underscores the importance of comprehensive and timely disclosures that enable shareholders to evaluate executive pay practices fully and fairly.

6. Avoid inappropriate pay to non-executive directors.

This principle recognizes the interests of shareholders in ensuring that compensation to outside directors does not compromise their independence and ability to make appropriate judgments in overseeing managers’ pay and performance. At the market level, it may incorporate a variety of generally accepted best practices.

Additionally, given the strong prospect that “say on pay” votes will arise in the U.S. within the next year or so, we seek to identify specific criteria that may shape case-by-case evaluations of such proposals in the U.S.

IV. Request for Comment

ISS Governance Services is seeking feedback and comments on both aspects of the proposed policy evolution (global principles and U.S. considerations). Specifically, we request the following:

- Are the six proposed global principles appropriate as universal values that should underlie an evaluation of executive compensation programs from a shareholder’s perspective, across global markets? Are there additional principles that should be included?
- Should “say on pay” evaluations focus only on program characteristics and design, or should the outcome of those programs (as measured by actual pay levels) be considered also?
- With regard to U.S. companies, the following list of potential factors that might be taken into account in evaluating say-on-pay resolutions. We seek comments on each factor as a consideration in analyzing compensation disclosures and practices:
 1. Balance of fixed versus performance-driven pay;
 2. Alignment of performance metrics and business strategy;
 3. Appropriateness of target awards in relation to performance goals;
 4. Appropriateness of peer groups used to set target pay or award opportunities;
 5. Poor pay practices such as excessive perks, excessive severance payouts, and excessive burn rates;
 6. Disconnect between company performance and executive pay trends (performance down: pay up);
 7. Inadequate information and board rationale about how pay is set and relevant; goals (e.g., including specific goals for prior fiscal year award payouts); and
 8. Large disparity between CEO and next highest NEO’s total pay.
- Are there additional factors that should be considered for “say on pay” evaluations?

Product Safety (U.S.)

I. Background and Overview

The recent wave of recalls and warnings from products produced in China has ignited concerns about the complex risks associated with safety of products, including the potential management of certain global supply chains. Companies operating in the global economy are increasingly called upon to assume greater responsibility for social and environmental compliance in their supply chain operation, in particular as it relates to toxic chemicals risks in the workplace and/or consumer human exposure to toxic chemicals in products.

ISS Governance Services' 2007 Policy Survey revealed that 62% of respondents felt it was important for U.S. companies to report to shareholders on the environmental and social practices of the supply chain as a part of routine filings and disclosure. Over 78% of respondents felt that workplace safety performance was an important disclosure criterion.

Toxic chemical and product safety concerns may pose substantial challenges to both manufacturing and retail companies. In the short term, companies may face supply shortages; in the long term, companies may be challenged by persistent supply-chain disruptions and legislative, legal, and reputational risk. As a result, long-term institutional investors may face significant risk exposure at companies that fail to properly manage product safety in their supply chain.

II. Review of Current Policy

ISS Governance Services evaluates a number of shareholder proposals each season on the issue of toxic chemicals. Proponents have in past years focused on the phase-out of certain high profile chemicals by eliminating (or evaluating the feasibility of eliminating): persistent and bioaccumulative toxic (PBT) chemicals, brominated flame retardants (BFRs) and polyvinyl chloride (PVC) plastics, bisphenol-A, lead, and mercury, and requested for the use of safer materials. Further, these proposals have also asked for what new initiatives management can or will take to respond to these toxic chemical public policy challenges (beyond those initiatives or actions already required by law).

ISS Governance Services will continue to recommend on a case-by-case basis when shareholder proponents request that a company evaluate and disclose the potential financial and legal risks associated with utilizing certain chemicals, weighing issues such as: current regulations, recent significant controversy/litigation/fines stemming from toxic chemicals, and the current level of disclosure by the company on this topic. ISS Governance Services will not be supportive of resolutions requiring that a company reformulate its products.

III. Under Consideration for 2007

ISS Governance Services' existing policy is to generally support resolutions requesting that a company disclose its policies related to toxic materials, unless substantial information is already provided by the company. This existing policy works appropriately for manufacturers but falls short of addressing companies further down the supply chain, notably retailers. Consistent with the mounting concerns over product recalls and our client survey results, the intent of ISS Governance Services' proposed product safety policy is to expand the scope of the current toxic chemicals policies to be more applicable to issues related to product safety and global supply chain management.

IV. Intent and Impact

If the policies were to be modified for the 2008 proxy season, companies beyond manufacturers would be evaluated individually and relative to industry peers to determine if their policies and disclosure provide shareholders with the necessary information to consider the company's management of the potential risks associated with toxic chemical and/or product safety.

V. Request for Comment

ISS Governance Services is seeking feedback to assist in evaluating how institutional investors may utilize corporate disclosure of policies, initiatives and oversight mechanisms relating to toxic chemicals and product safety in their investment risk. Specifically, we would like to hear thoughts on which industries are most impacted, and what standards (if any) should be applied universally. In addition, please provide comments on issues that we have not addressed that you think are important in balancing costs and operational considerations when evaluating the impact of toxic chemicals and/or product safety in the supply chain.

- Do you believe ISS Governance Services should expand its existing toxic chemical and product safety policies to address supply chain management?
- Regarding toxic chemical and/or product safety supply chain reporting, should a company's policies and disclosure be evaluated relative to industry norms or the industry "best in class"?
- Does a recent recall/controversy at a targeted company affect your viewpoint?
- Are there any universal criteria that should be required aspects of disclosure when considering toxic chemical and/or product safety?
- Should the financial impact of supply chain disruptions as a result of toxic chemical and/or product safety issues be generally considered as material risk and reported as such in a company's filings?

Please feel free to add any additional information or comments that you would like us to consider for this policy.