

ISS 2007 U.S. Proxy Season Preview and Policy Update

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INSTITUTIONAL SHAREHOLDER SERVICES

Enabling the Business of Corporate Governance

Agenda

Introductory Remarks

Summary of ISS' 2007 Policy Process

Preview of Key Issues for 2007

ISS' 2007 U.S. Benchmark Policy Updates

Question and Answers

Concluding Remarks

What's In

- Intel-style Majority-Vote Standards
- Pay Consultant Conflicts
- Pay for Performance
- Tally Sheets
- Say on Pay
- Annual Elections

What's Out

- Pfizer-style Plurality-plus Standards
- Outside Auditor Conflicts
- Pay for Failure
- Stealth Compensation
- Caps on Pay
- Classified Boards

Policy Formation Process: Timeline for 2006-07

Key Milestones in Process

- ❖ **May 31, 2006:** Global Policy Board Kickoff meeting
- ❖ **June 19:** Policy Consultation Survey launched (institutions)
- ❖ **July 21:** Policy Consultation Survey ends
- ❖ **June – October:** Policy groups and country leads form policy
- ❖ **August and September:** Working groups with outside constituencies
- ❖ **Sept 20– Oct. 13:** Comment period
- ❖ **September:** One-on-one interviews with institutions
- ❖ **Nov 2:** Final Approval of draft templates by Global Policy Board
- ❖ **Nov 17:** *ISS U.S. & International 2007 Policy Updates* released to market
- ❖ **Dec 5:** ISS policy webcast for all clients
- ❖ **Dec (mid):** *ISS U.S. & International 2007 Summary Guidelines* published
- ❖ **Jan 15, 2007:** *ISS 2007 Online Policy Manual* updated
- ❖ **Feb 1: Effective date of new policies**

Process Included Extensive External Outreach

**ISS expanded its market outreach efforts in 2006
to inform 2007 policy updates**

Policy Survey

- Post-season feedback
- Almost 300 client responses across numerous markets

NACD Forums

- Held in Houston and Chicago in September
- Received in-person feedback from over 40 corporate directors

European Roundtable

- Held in Paris for 40 clients in September

Policy Roundtables

- Director election reform
- Compensation
- Corporate responsibility

Comment period

- Open for three-weeks
- 150 individual responses

One-on-one interviews

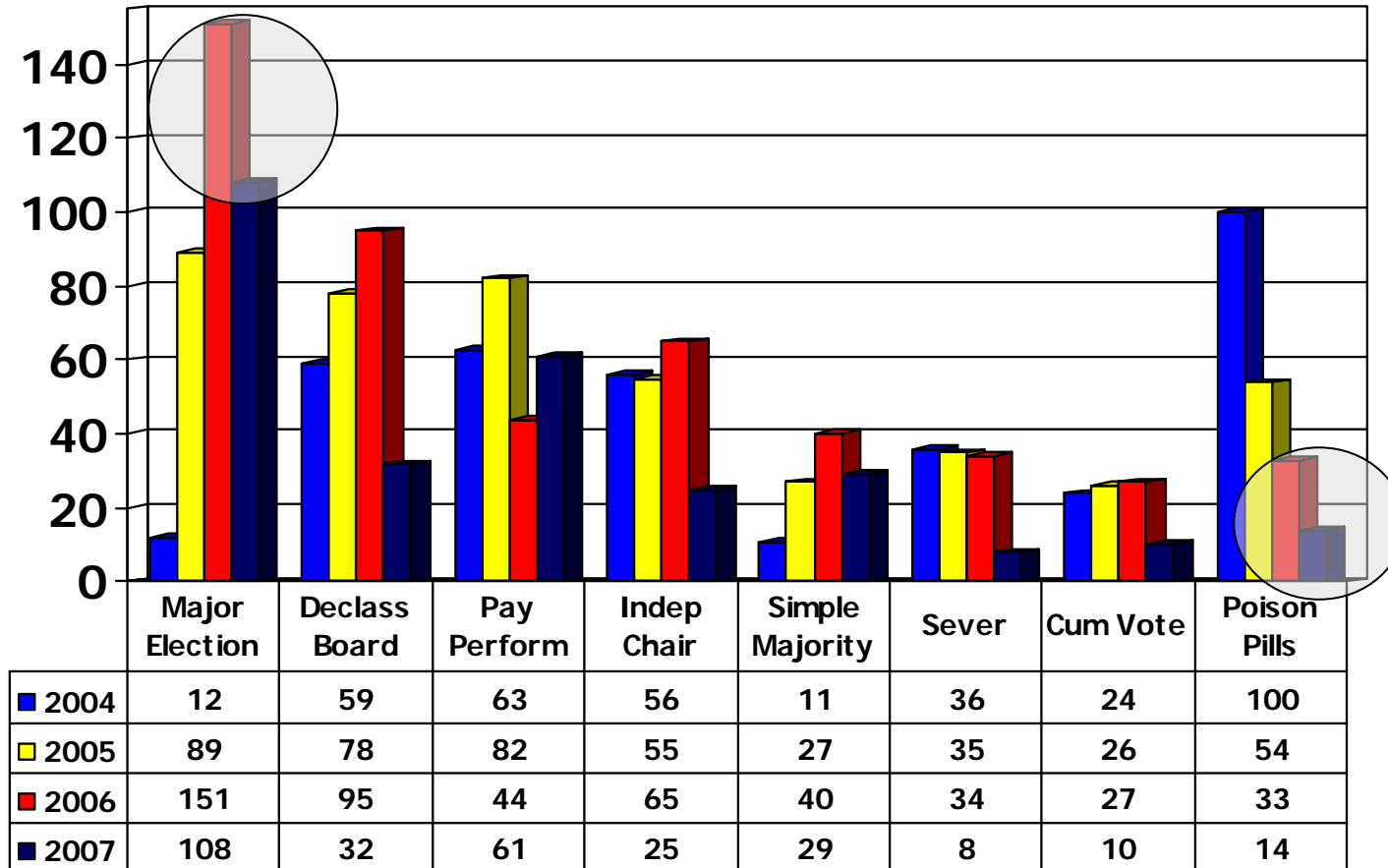
- Numerous discussions with institutions, issuers and industry professionals on specific policies with research staff

Top 7 for '07: Preview of 2007 Proxy Season

Hot Topics

- Majority Threshold Voting takes hold
- Calls for board accountability produce reforms
- Sunlight shines on pay practices
- Spotlight falls on pay panels & comp consultants
- ESG emerges as ERM concern
- Hedge funds lead proxy activism charge
 - Nearly \$2T in assets; 9000+ funds; >50 proxy challenges in 2006
 - Relational Investors LLC @ Home Depot; Breeden Partners LP @ Applebee's Int'l.; Icahn @ Motorola; Pershing Square (Bill Ackman) @ Ceridian
 - Also see Morgan Stanley Investment Management at New York Times
- Major voting process changes on horizon
 - Broker votes out for directors in 2008; share lending/over votes/vote buying
 - E-solicitation rules

What's hot?: shareholder proposals in 2007 (# Submitted)



Board Issues: Preview of 2007 Proxy Season

Investors' Oversight of Directors Grows

- I want my MTV
 - Majority Threshold Voting takes hold
 - Momentum toward majority-plus (Intel model)
 - 2006: >150 proposals; nearing majority support; >35 majority votes on proposals
 - 2007: More proposals?
 - >100 offered to date
 - More binding bylaws hit ballots
 - Charter changes pending @ Aetna, GE and others
 - Reincorporation proposals for MTV-unfriendly domiciles
 - >300 firms take action
 - More than 100 Intel models; many via upgrades
 - Ballot Access—It's Alive! SEC delayed 12/13 vote; then punted
 - Handful of proposals—led by HP

Board Issues: Preview of 2007 Proxy Season

Investors' Oversight of Directors Grows

- Calls for accountability produce reforms
 - Declassified data: Calls grow for annual votes on all directors
 - Staggered board terms fall to minority status (45% of S&P 500) in US
 - 2006: 40 majority votes; 75+ repeals
 - 2007: Continued shareholder pressure and more management proposals
 - Rx expires: More shareholder say on pill popping in US
 - 2006: Boards drop rights plans, provide sunsets or call votes
 - 2007: Shareholder proposals and plan prevalence drop?
 - Keep it simple: Supermajority vote requirements wane
 - 2006: Supermajority vote rules fall in wake of shareholder opposition
 - 2007: More momentum for management proposals
 - New for 2007: Right to call special meetings**

U.S. Board Policy Highlights

Summary of Key Changes

Majority Voting

- Eliminated alternative structure for companies that receive proposal
- New cautionary language for companies with no carve-out
- Cumulative voting policy's countervailing structure to include MV
- **New for CGQ**

Definition of Independence

- Professional Services: new \$10,000 de minimus test
- Relative: Distinguishing between Section 16 Officer and employee

Director Performance Test

- Enhanced methodology to include operating metrics along with share price measurement
- Metrics: 5-year TSR, Sales Growth, EBITDA growth and operating ROIC
- Year 1 cautionary language; Year 2 WITHHOLD

Compensation Issues: Preview of 2007 Proxy Season

Light and Heat on Pay

- Sunlight shines on pay
 - SEC adopts new compensation disclosure rules
 - Addresses *backdating/spring-loading/bullet-dodging* scandal
 - Focus on 4 Stealth P's
 - Pension
 - Parachutes
 - Perks
 - Past pay/Deferred Compensation
 - Hot import: Votes on Tally Sheets
 - 2006: Breakout support for “say on pay” proposals
 - 2007: More proposals (60+); more support likely

Compensation Issues: Preview of 2007 Proxy Season

Light and Heat on Pay

- Spotlight shines on pay panels & consultants
 - Blue chip boards draw fire over pay practices
 - Exxon-Mobil, Pfizer, UnitedHealth, Occidental Petroleum, Home Depot...
 - Growing support for reforms
 - Pay-For-Performance; claw-backs; vote on excessive severance
 - New for 2007: Grant dates; pay consultant fee disclosure; pension reform
 - 18 of top 25 firms agree to boost consultant disclosure
 - GE, Exxon-Mobil, ConocoPhillips...

U.S. Compensation Policy Highlights

Summary of Key Changes

Options Backdating

- New policy with case-by-case analysis
- Withhold from comp committee in certain situations
- **New for CGQ**

Clarification of Poor Pay Policy

- Align with SEC's new disclosure requirements
- Provide better guidance to issuers
- Apply case-by-case withhold on CEOs

Pay-for-Performance Proposals

- New two-step process for evaluating shareholder proposals

Changes to Binomial Model

- Minor modifications to SVT calculation

Audit Issues: Preview of 2007 Proxy Season

SOX and Beyond

- SOX 404 costs continue to draw fire
 - SEC speaks on 12/13
 - Small-caps want exemption
- Restatements soar
 - Backdating and internal controls check drive changes
- Limits on auditor liability
 - Protection from catastrophic consequences?

U.S. Audit Policy Highlights

Summary of Key Changes

Auditor Ratification

- Continue to support on ballot, no longer have cautionary language
- 94% of S&P 500 now putting auditor up to shareholder vote

Auditor Limited Liability Provisions

- Continue case-by-case analysis
- Continue to track information and monitor evolving discussion

Tracking Restatements

- New for CGQ

Corporate Responsibility: Preview of 2007 Proxy Season

ESG and ERM

- Focus on environmental and social issues as risk factors
 - More attention at boardroom level
 - Reputation risk (political donations, human rights/labor practices)
 - Economic impact (global warming, environment)
 - Settlement fever spreads
 - Enterprise Risk Management for issuers and institutional investors

U.S. Corporate Responsibility Policies

Summary of Key Changes

Climate Change

- Issue gains strength for institutional investors
- Industry matters, with a focus on long-term risk
- Quality of disclosure assessed relative to a company's peers

Disclosure of Corporate Lobbying

- Case-by-case approach
- Policy will consider "significant" controversy or litigation surrounding a company's public policy initiatives and the current level of disclosure

**For additional information, go to
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