

Corporate Governance Rating



INSTITUTIONAL SHAREHOLDER SERVICES

Enabling the Business of Corporate Governance

Agenda

- **Overview**

- Process & Output
- Content of the ratings
- Data Examples

Corporate governance has become embedded as part of the regular investment decision-making process and lexicon

Corporate Governance Front and Center

“Corporate Governance looks at the institutional and policy framework for corporations - from their very beginnings, in entrepreneurship, through their governance structures, company law, privatisation, to market exit and insolvency. The integrity of corporations, financial institutions and markets is particularly central to the health of our economies and their stability.”

– OECD¹

“...Those jurisdictions with good corporate governance codes, which are taken seriously, by companies and by shareholders, will be more liquid, and more highly rated than those where shareholders are treated with less deference.”

– Alastair Ross Goobey, Chair, ICGN²

“These corporate scandals have I believe taught us all some basic lessons. One is that money spent on good corporate governance is money well spent.”

–Charlie McCreevy, European Commissioner for Internal Market and Services³

Sources: (1) OECD website; (2) Alastair Goobey, LSE Corporate Governance Conference, 15 March 2005; (3) Charlie McCreevy, Euro Conference, New York, 20 April 2005

ISS has provided leadership in corporate governance for 20 years

ISS Overview

- **Founded in 1985**
 - two decades of experience

- **Recognized industry leader**
 - 1600+ institutional clients worldwide
 - 750 + corporate clients worldwide

- **Demonstrated ability to keep clients ahead of regulatory curve**
 - First to market:
 - outsourced vote agent service (1992)
 - corporate governance ratings (2002)
 - securities class action monitoring (2002)
 - vote disclosure service (2003)
 - fully integrated end-to-end proxy voting solution (2005)
 - corporate facing services (2000)

ISS's market perspective, mission and vision represent the company's commitment to shareholders and companies

ISS Market Perspective, Mission and Vision

Market Perspective

shareholders and companies will increasingly leverage corporate governance to transform the way they interact to manage risk and drive value



ISS Mission

ISS provides corporate governance solutions that enhance the interaction between shareholders and companies to manage risk and drive value



ISS Vision

ISS will be the leading global provider of corporate governance solutions to shareholders and companies

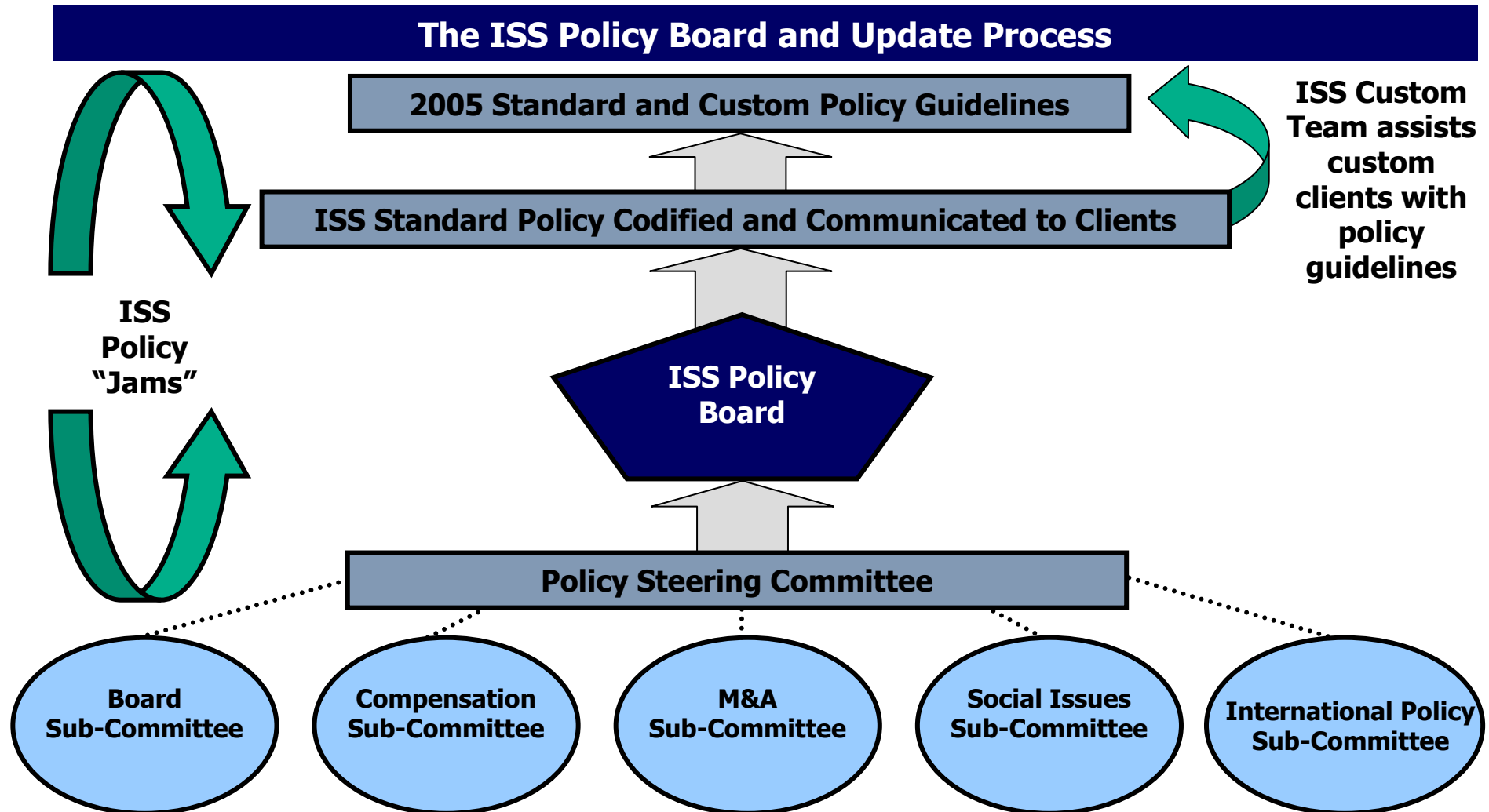
ISS' governance philosophy is intended to maximize value, protection and accountability

ISS Governance Philosophy

- **Enhance Value**
 - Poor governance = Potential Risk
- **Protect Shareholder Rights**
 - Maintain Checks and Balances
- **Promote Accountability**
 - Directors Represent Shareholders

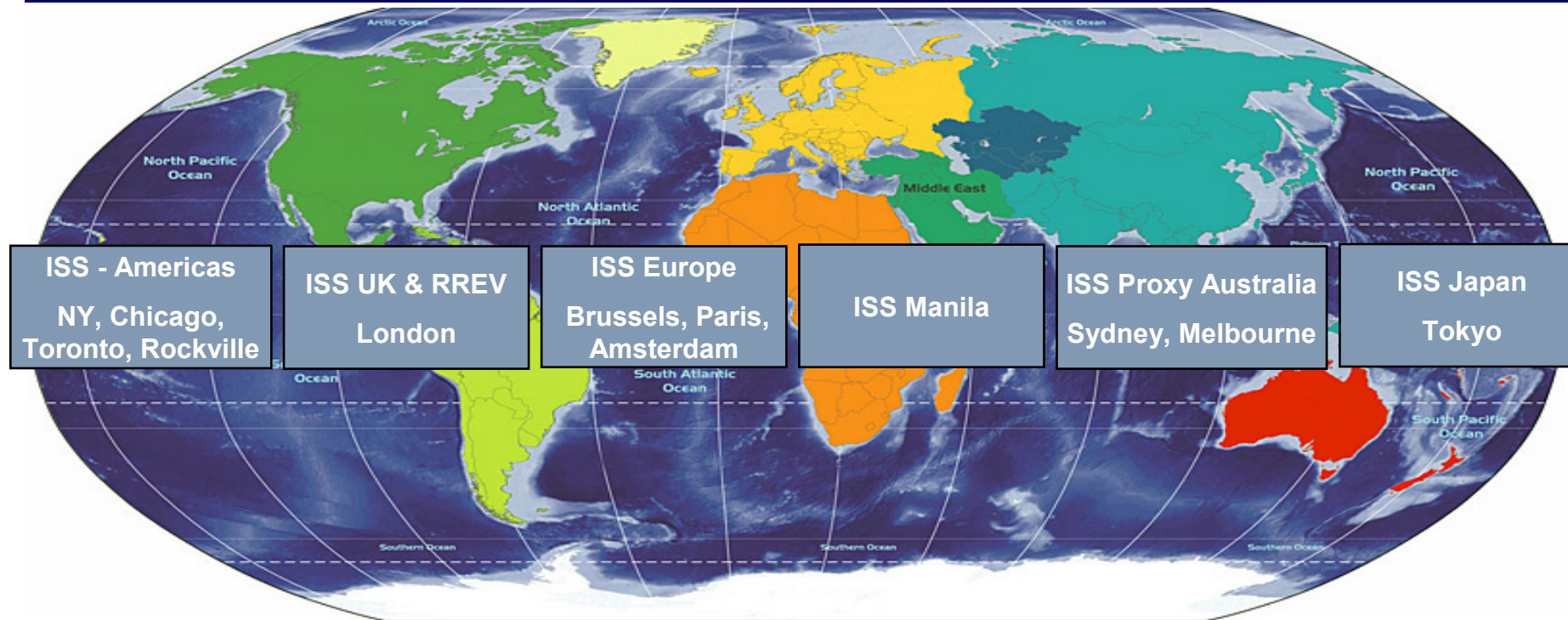
These three principles to enhance value, protect shareholder rights and promote accountability drive ISS policy when making vote recommendations.

ISS policy results from a transparent process that ensures fairness, consistent application, and systematic review of issues



ISS has offices worldwide that support world-class corporate governance expertise and research

ISS Global Procurement and Research Network



ISS' goal is to localize production of research and to provide market-specific research by developing market presence and expertise.

ISS continues to improve research quality, timeliness and breadth of services provided to clients

Increasing Complexity of Corporate Governance

- ISS has covered over **208,607** agenda items through year-end 2004^a, representing **112%** of last year's figure for the same time period
- The company produced **321,533** pieces of research (analyses and custom vote recommendations) during this time, totaling **132%** of last year's research for the same time period
- ISS analysed **1,619** shareholder proposals^b during this time, **111%** of the same period in 2003
- ISS covers all securities traded on all major exchanges worldwide (**almost 300,000**) and 100% of the securities in every client's portfolio.

^A Figures between 1/1 and 12/31/04. 46,422 items for U.S. meetings, 162,185 non-U.S (46,102 U.S. and 140,129 non-U.S. for same time period in 2003).

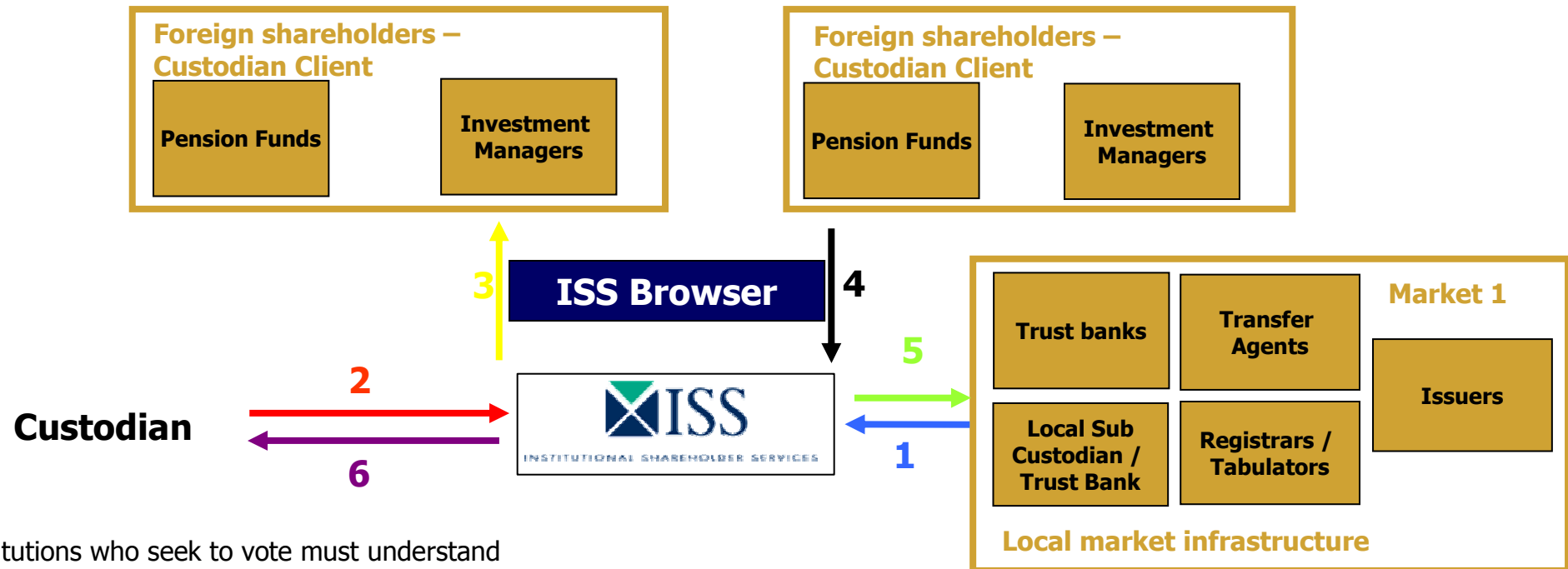
^B Figures between 1/1 and 12/31/04. 728 proposals at 7,850 meetings in U.S., 891 proposals at 22,021 non-U.S. meetings (729 proposals at 7,850 U.S. meetings and 725 proposals at 18,863 non-U.S. meetings for the same period in 2003).

ISS continues to lead the market in providing services to facilitate proxy distribution and vote execution

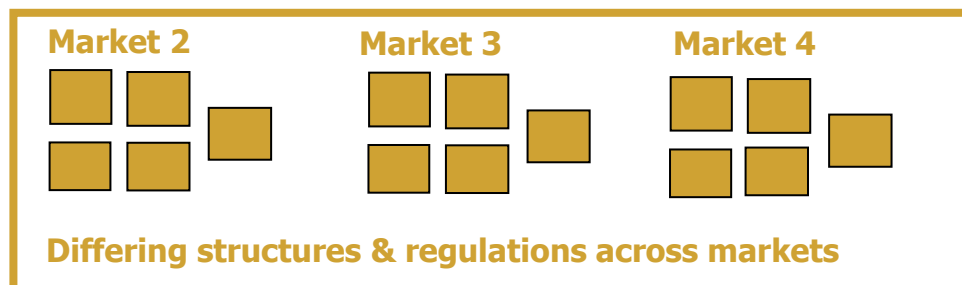
Optimising Entitlements in Cross Border Voting

- Serving **20** global and local custodians world-wide in meeting their proxy distribution needs
- Currently linked to **115** markets with direct voting links to the registrar
- Delivering **650,000** votes for over **600** institutional investors holding **15,000+** accounts in 2004
- Electronic voting platform providing a consolidated platform to receive and vote proxies, review and download detailed account information, generate custom reports, store electronic copies of annual reports and other issuer documents
- Users may consolidate their custody accounts and ballots across custodians
- Variable view and vote authority
- Client servicing institutional investors on all their proxy needs with local support around the world

Global Voting Process



- Institutions who seek to vote must understand and/or interact with all infrastructures and relationships



ISS's role is to simplify, inform, and add value to the proxy voting process

Components of the Process



The voting process is improving, but challenges remain

Other Developments

- As a result of ongoing governance developments...
 - More institutional investors are exercising their vote
 - Cross-border voting is on the rise
 - Those who previously voted demand greater transparency, more effective process

- Voting challenges remain
 - Lack of cross-border standards creates issues
 - Documentation, structural requirements still complicate the voting process
 - End-to-end vote confirmation remains a work in progress
 - Much work to be done toward true straight-through proxy processing

Proxy voting change is accelerating

Other Developments

- Electronic voting initiatives on the rise
 - France, Germany, Australia among markets whose structure technically allows electronic voting
 - CREST system taking root in UK: use of electronic voting among UK issuers this year will more than double 2003 levels.

Agenda

- General

- **Process & Output**

- Content of the ratings
- Data examples

Corporate governance assessment is performed through easy to use ratings indicating best practice or questionable standards

Rating Scale



Corporate governance ratings provide significant advantages to the investor

Benefits

Assess Governance Risk

- Avoid investing in poorly governed companies
- Reduce the risk of investing in the next governance failure
- Examine and compare corporate governance practices

Improve Financial Return

- Profit from the valuation gap between well-governed and poorly-governed companies
- Consider Active Shareholder Fund strategy engaging in and leading to improved shareholder return
- Companies with high governance standards are indicated to have better performance than badly governed companies

Complement Voting Research

- Become familiar with voting procedures and prepare for an informed and coherent active voting policy
- Understand governance related legal and procedural issues

Complement SRI Research

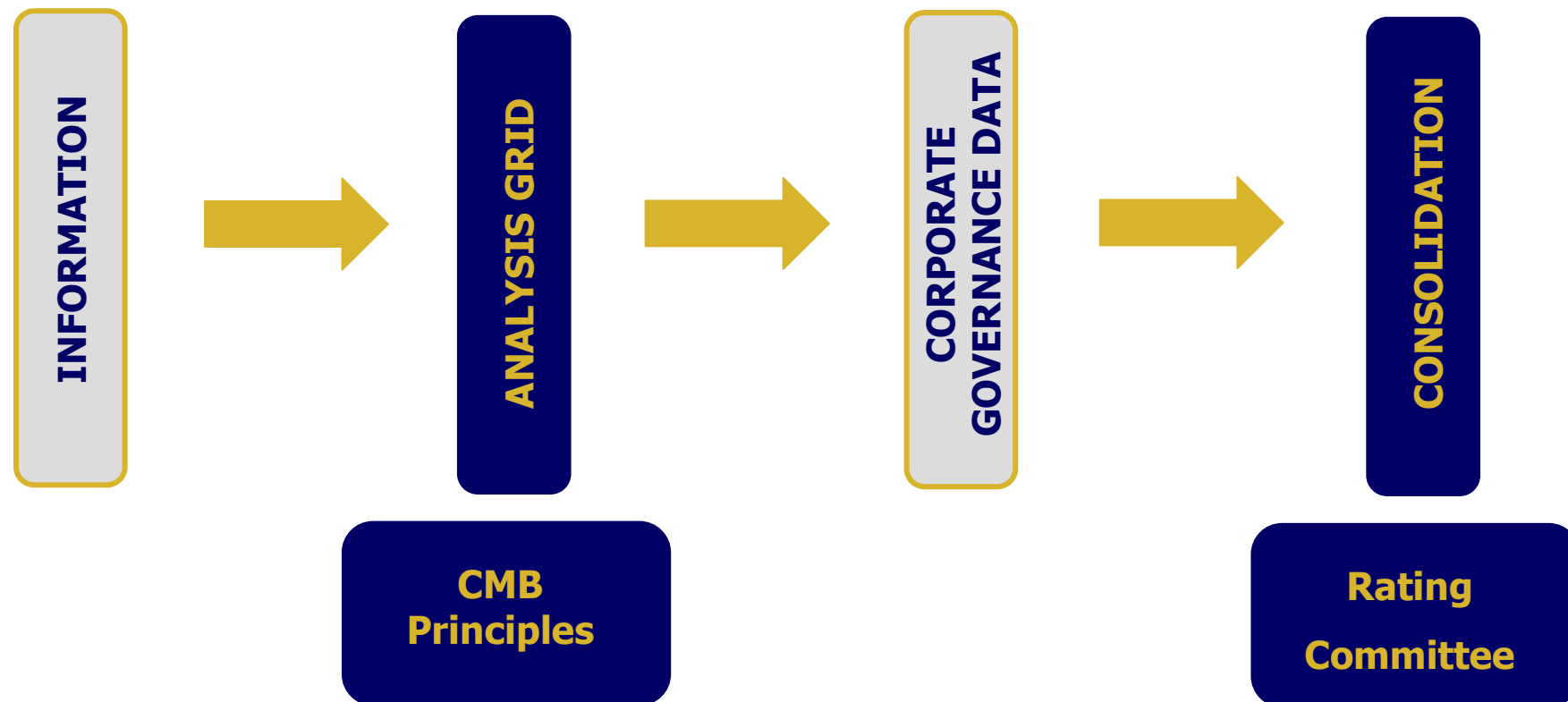
- Add a strong governance risk assessment layer to your social responsible investment approach
- Extend your SRI Research into the ethics of good governance and proper conduct on management and board level

Prepare for Relationship Investment

- Use the ratings as a benchmark to review governance practices

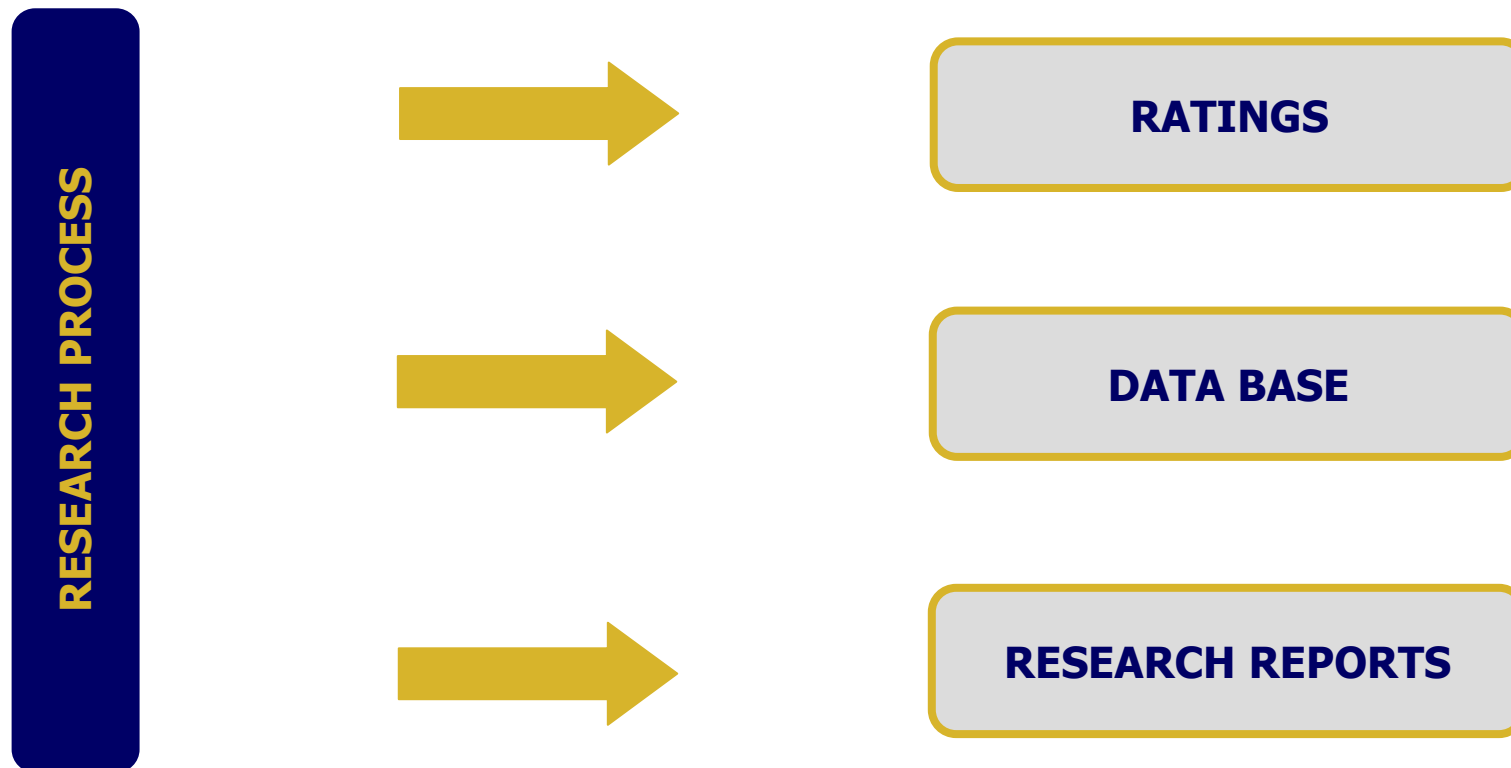
Research is performed on a systematic, objective and market oriented process

Research Process



Research output consists of three basic levels of reporting

Client Output



Through the various levels of reporting, clients can assess, position, compare and study corporate governance in dept

Three levels of reporting



- Overall Chapter Ratings
- Diversified Subratings

- Ratings
- Subratings
- Key governance indicators

ON

- Company level
- Country level
- Sectorial level
- European level

- Full governance story
- Governance evolution
- Analyst input

ON

- Company level
- Country level
- European level

Agenda

- Overview
- Process & Output
- **Content of the ratings**
- Data examples

The corporate governance assessment is spread into four different corporate governance criteria

Content of the ratings

CMB Principles

- Rights and duties of shareholders
- Public Disclosure & Transparency
- Stakeholders
- Board structure and function

Global Best Practise

- Rights and duties of shareholders
- Range of takeover defences
- Disclosure on corporate governance
- Board structure and function

The rating on shareholder rights assesses the position of a shareholder in a company in terms of rights and obligations

Rights and Duties of Shareholders

- Respect of the “one share – one vote – one dividend” principle
 - Voting right and ownership ceilings, multiple voting, priority shares, golden shares, depository receipts,...
- Voting issues
 - Percentage of board members elected by shareholders, vote on remuneration, vote on capital increases, vote on dividend, vote on discharge, vote on share repurchase, ...
- Voting procedures and formalities
 - Timing of the procedures, proxy voting, voting by mail, oriented proxies, vote by show of hands,...
- Shareholder proposals
 - Possibilities to convene EGM, possibilities to put items on the agenda, sending questions, ...
- Maintenance of pre-emptive rights

The rating on takeover defences shows an objective mathematical approach for checking the probability to resist a hostile bid

Range of Takeover Defences

- Structural takeover defences
Shareholder control, voting right distortions, board insulation, ...
- Capital takeover defences
Authorised capital, share repurchase, targeted stock placement, ...
- Other takeover defences
Crown jewel option agreements, locked sisters, golden parachutes,...

The rating on disclosure assess the level of transparency on a company's corporate governance

Disclosure on Corporate Governance

- General information disclosure

Annual reports, articles of association, agendas of general meetings, minutes of the meetings, corporate governance statements, mission statements, accounting standards,...

- Capital and shareholder structure

Capital structure, shareholder structure, authorisations, potential capital, targeted stock placement, breakdown of the free float, shares held by employees, cross-shareholdings, ...

- Information on company's boards

Age, academic background, classification, number of shares held, outside positions, nationality, term of the mandate, short term remuneration,...

- Information on company's committees

Composition, reporting, meetings held, functioning, ...

- Information on long term plans (equity based)

Volume, timing, objectives, beneficiaries, pricing, ...

The rating on board structure assesses the accountability, independence and functioning of the governing bodies

Board Structure and Functioning

- Election of the board members

Proportion of members elected by shareholders, type of election, age limits, executive elections,...

- Composition of the board

Proportion of independent directors, proportion of executive directors, diversity of the board, separation of chairman and CEO, shares held by non-executive directors, ...

- Functioning of the board

Number of meetings held, attendance rates, definition of independence, conflict of interest procedures, risk management, code of conduct,...

- Remuneration of the board members

Short term performance related payments, attendance fees, consulting fees, share based plans, granting of loans, bonus policies, severance payments, ...

- Committees of the board

Audit, nomination, remuneration committees, composition of the committees, workings, ...

Agenda

- General (what, coverage, scale, Standard, benefits)
- Process & Output (general client output, ratings, database, research reports).
- Content of the ratings

- **Data examples**

Assess and compare the corporate governance performance of any given company in a blink of an eye

Overall Rating : rely on ISS Europe's experience

	KBC Holdings 2004	Barclays 2004
	<ul style="list-style-type: none"> ▪ Belgium ▪ Banks 	<ul style="list-style-type: none"> ▪ UK ▪ Banks
Rights & Duties of Shareholders	5.5	8.0
Range of Takeover Defences	1.0	9.0
Disclosure on Corporate Governance	5.0	8.0
Board Structure and Functioning	4.0	7.0
	<i>Bad Performer</i>	<i>Good Performer</i>

Linking Governance Reporting and Long Term Performance

Good Corporate Governance has Equity Value

Two external studies, and ISS own internal study, have concluded that there is a link between well governed companies and long term performance and a reduced cost of capital and equity risk.

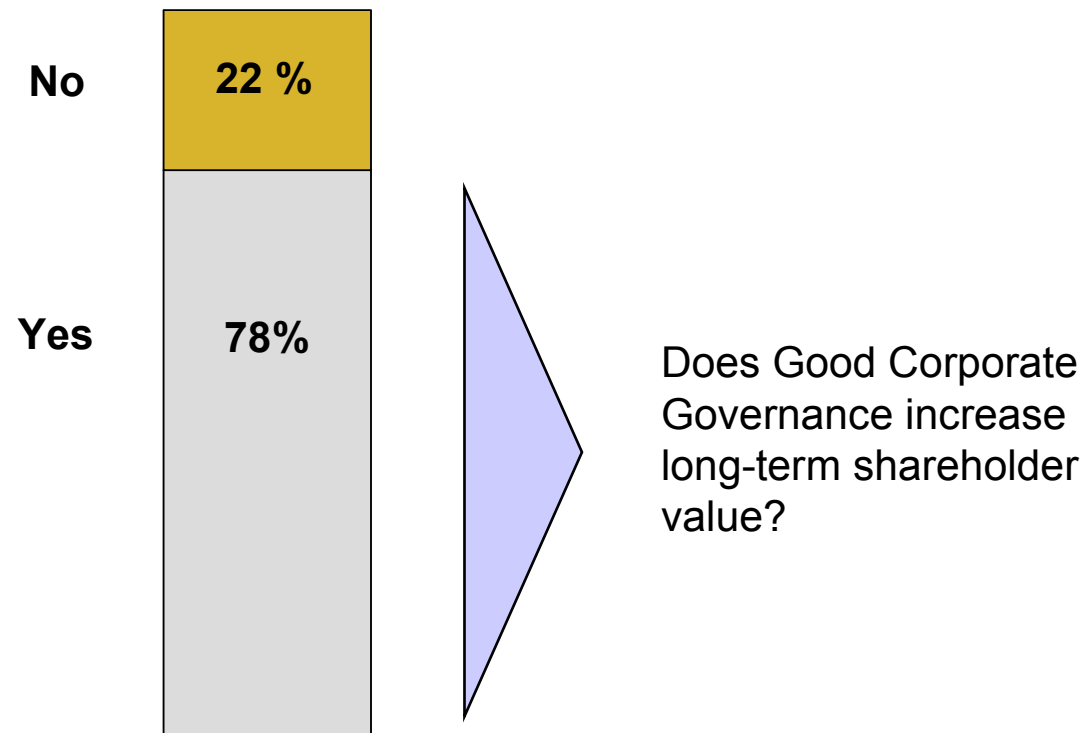
- Well-governed companies = **higher return**
- Well-governed companies = **lower risk**
- Investors **trust** well-governed companies
- Active investors earn **superior performance**

Examples of three recent studies:

- 1) Rob Bauer: Empirical Evidence on Corporate Governance, 2003
- 2) McKinsey: Global Investor Opinion Survey on Corporate Governance , 2002
- 3) ISS: Corporate Governance Quotient Regression testing against Performance, 2005

An overwhelming majority of investors are willing to pay a premium for well governed companies

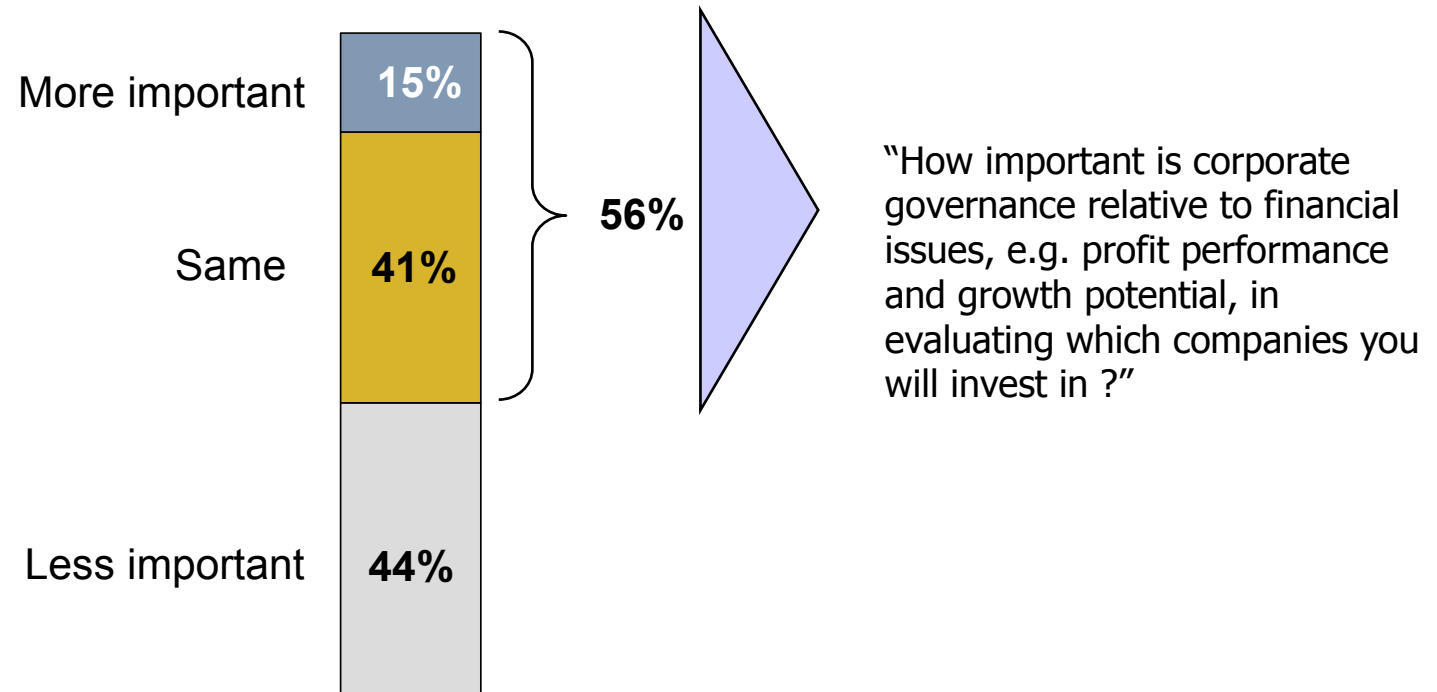
Good Corporate Governance has Long Term Value



Source: McKinsey Global Investor Opinion Survey on Corporate Governance, 2002

Governance practices are as important when compared to financials in selecting companies in which to invest

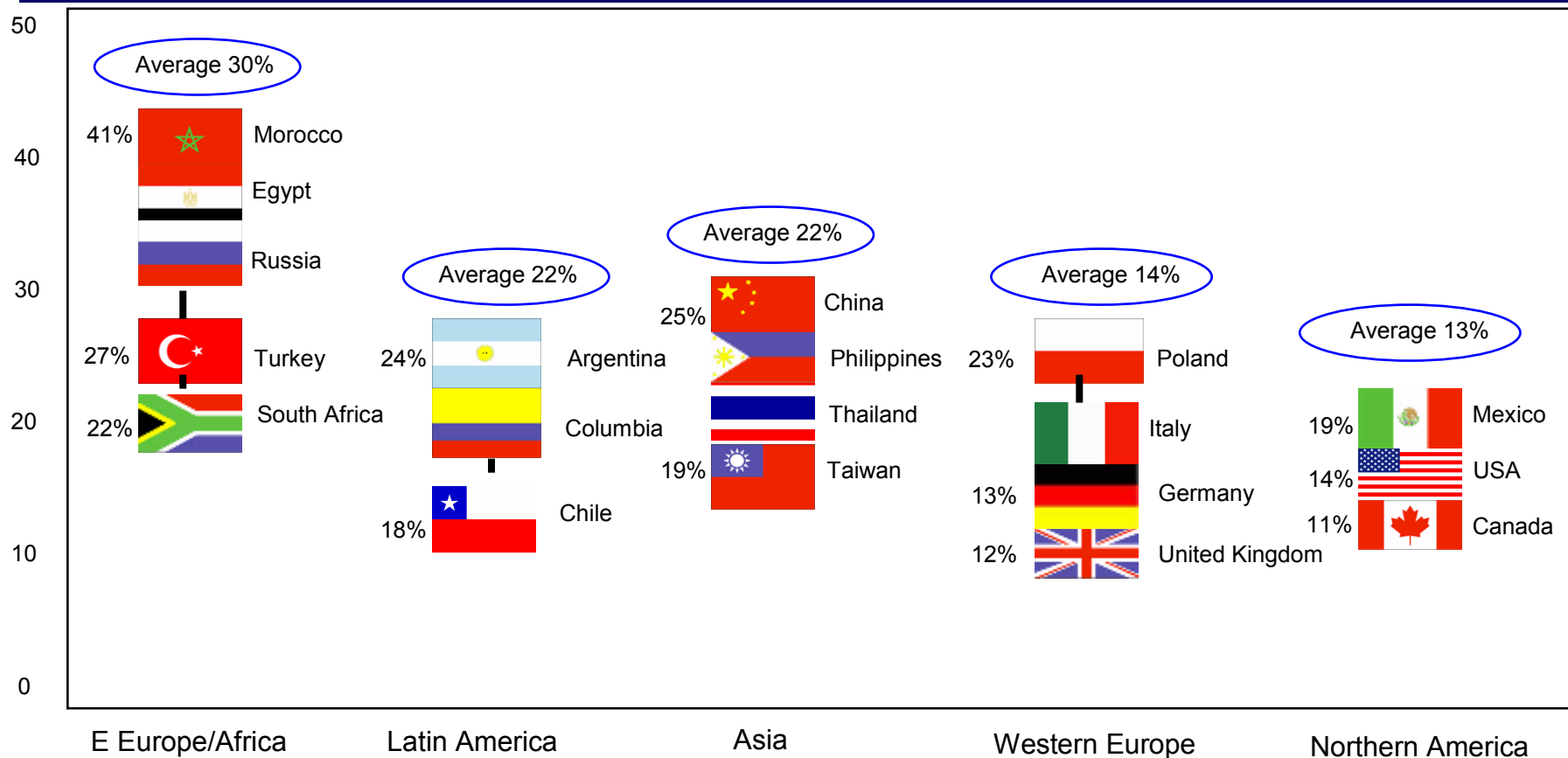
Good Corporate Governance reduces Equity Risk



Source: McKinsey Global Investor Opinion Survey on Corporate Governance, 2002

Average premium investors would be willing to pay differs by country and regions

Good Corporate Governance increases Long Term Performance



Source: McKinsey Global Investor Opinion Survey on Corporate Governance, 2002

Deminor Ratings & Equity Return: Portfolio Construction

(Eurozone 1999 – 2002)

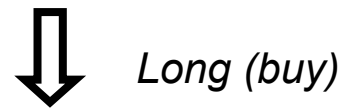
Corporate Governance Ratings are valuable information for Investors

DR = 20



- Decile 1
- Decile 2
- Decile 3
- Decile 4
- Decile 5
- Decile 6
- Decile 7
- Decile 8
- Decile 9
- Decile 10

« Good governance portfolio »



« Bad governance portfolio »

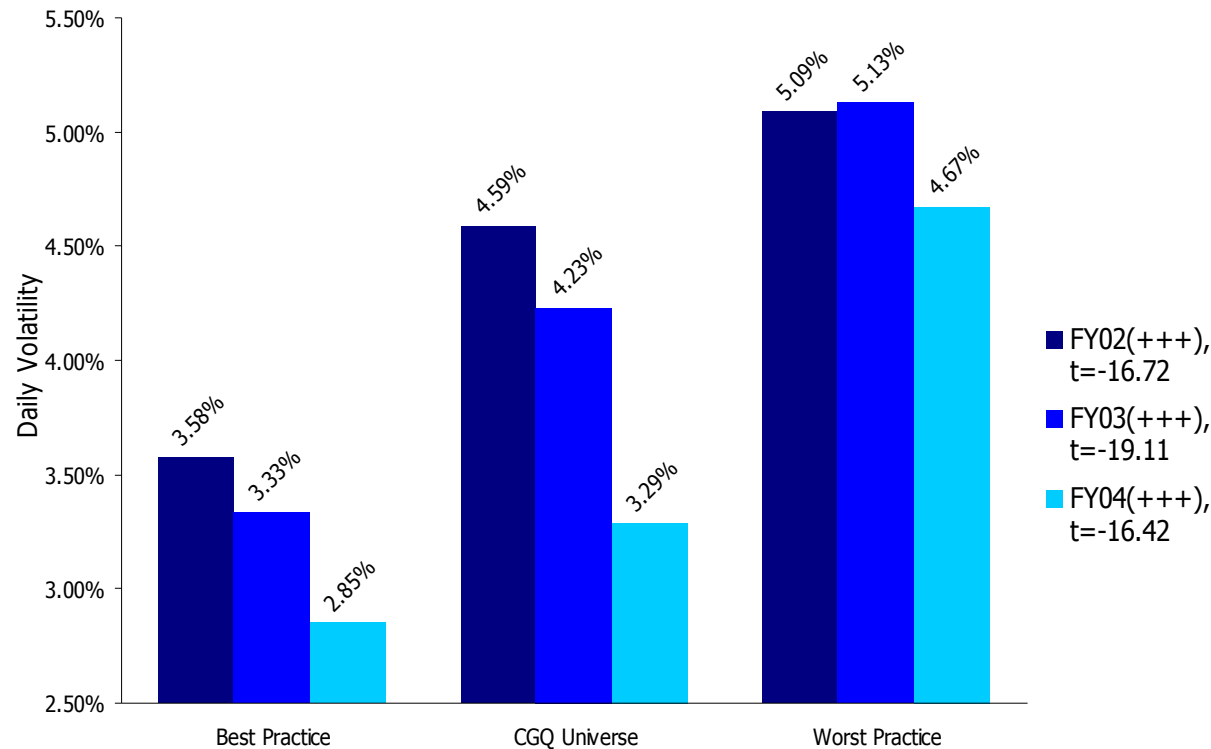
Annual Excess Return
2.97%

Source: Rob Bauer and Nadja Guenster, "Empirical Evidence on Corporate Governance in Europe"

Companies with fully independent nominating committees have lower volatility

The relationship between rating factors and performance metrics

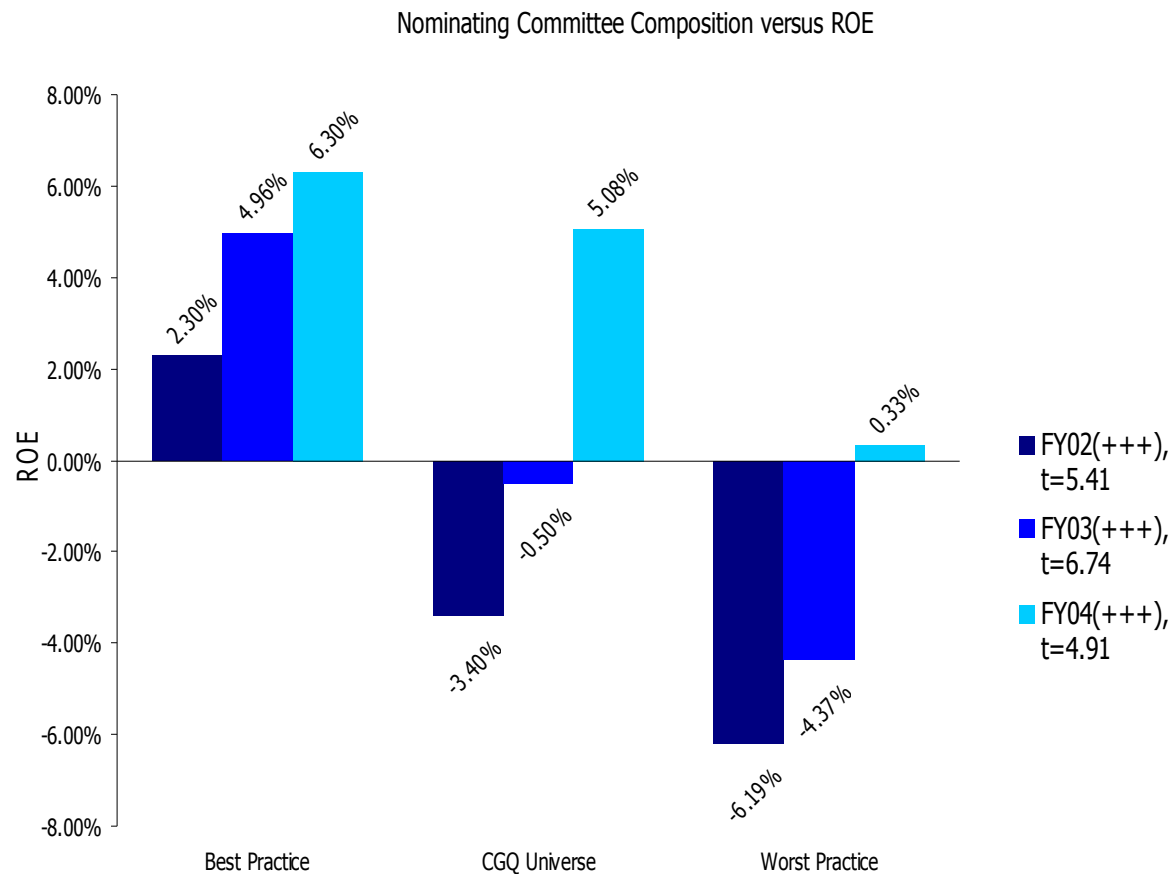
Nominating Committee Composition versus Volatility



- Companies in the best practice group, i.e., those having fully independent nominating committees have lower volatility relative to companies without a nominating committee or companies having insiders on the nominating committee

Companies with fully independent nominating committees experience better financial performance

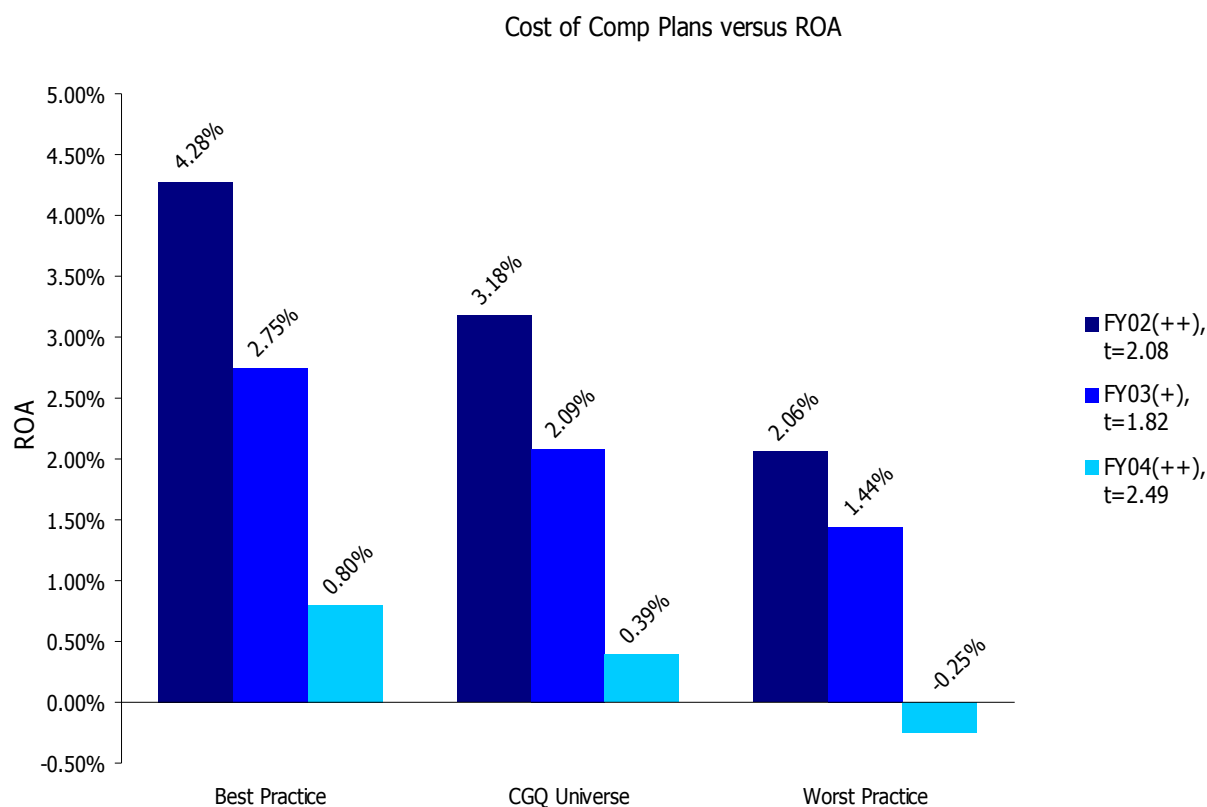
The relationship between rating factors and performance metrics



- This chart illustrates the relationship between one of the profitability measures, ROE, and the nominating committee composition
- Companies with fully independent nominating committees have greater ROE than companies with insiders on the nominating committee or no nominating committee

Well structured compensation plans have an impact on financial performance

The relationship between rating factors and performance metrics



- This chart shows the relationship between return on assets and companies having compensation plans with reasonable costs and companies having compensation plans with excessive costs.
- Companies in the best practice group (i.e., those having compensation plans with reasonable costs) outperform companies in the worst practice group.

“The governance of the corporation is now as important in the worlds economy as that of the worlds governments”

- James Wolfensohm, President, World Bank

Comments and Questions



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