

Corporate Governance Ratings

.....and how they are used in Company Valuations

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Director - Corporate
ISS Europe**

9 May 2006



INSTITUTIONAL SHAREHOLDER SERVICES

Enabling the Business of Corporate Governance

Agenda

- Who is ISS?

ISS has provided leadership in corporate governance for 20 years

ISS Overview

- **Founded in 1985**
 - two decades of experience
- **Recognized industry leader**
 - 1500+ 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

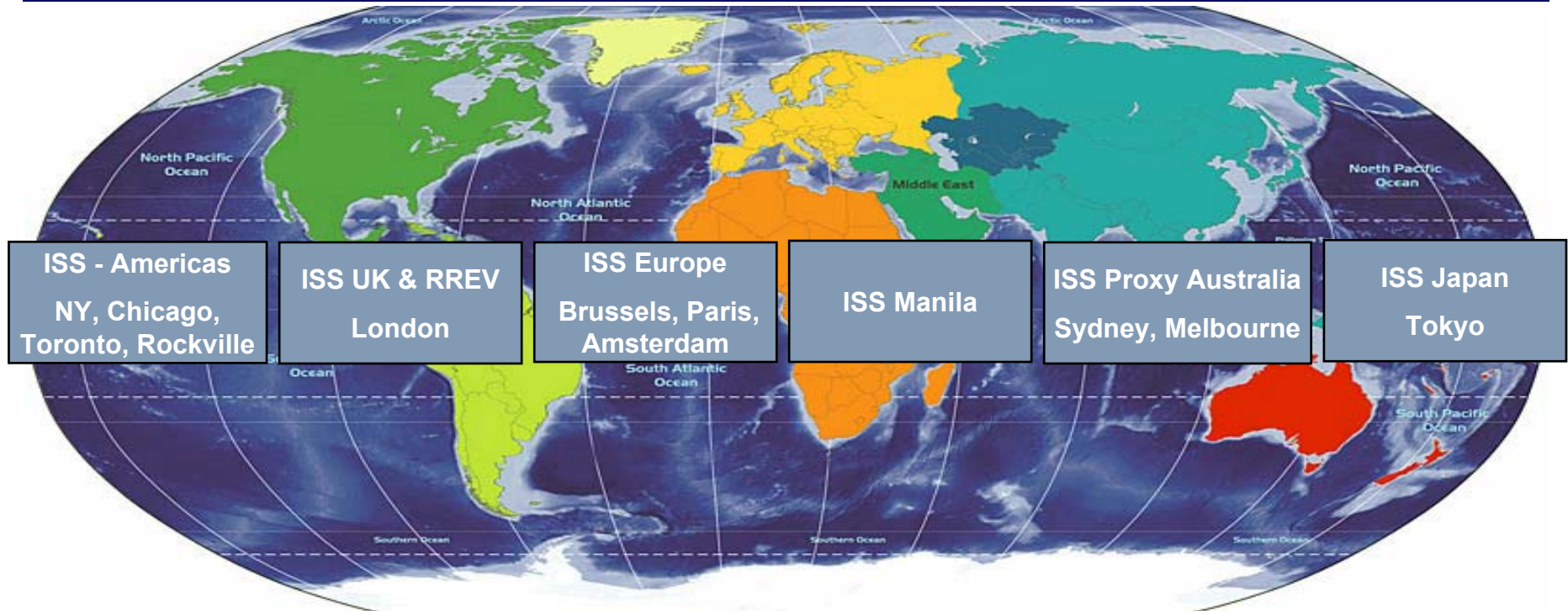
ISS Governance Philosophy

- **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 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.

Agenda

- **Who is ISS?**
- **Why Ratings?**

We incorporate ratings into almost all facets of our daily lives



CATHAY PACIFIC



A STAR ALLIANCE MEMBER



Editors' Rating
8.8

Consumer Rating
9.5
[RATE IT](#)



MICHEL RICHARD
C I T R O N E L L E



Wine Spectator

96

We use ratings to distill large sets of attributes into a simpler value for the basis of comparison



2005 Stats ^a	
Comp./Attempts	305/453
Completion %	67.32
Yards	3,747
Yards / Attempt	8.27
Touchdowns	28
Interceptions	10
Passer Rating	104.1

2005 Stats ^a	
Comp./Attempts	345/509
Completion %	67.77
Yards	3,836
Yards / Attempt	7.54
Touchdowns	32
Interceptions	12
Passer Rating	101.1

(a) Source: www.nfl.com

Company ratings are widely used in the financial services industry during the investment process

Company Ratings

Credit Ratings	Performance and Business Outlook	Specialty
   Plus Brokers, independent research firms, and Buy-Side In-house	   Plus Brokers, independent research firms, and Buy-Side In-house	 <small>INSTITUTIONAL SHAREHOLDER SERVICES</small>

Ratings are not exotic products. Investment managers use them everyday.

Agenda

- **Who is ISS?**
- **Why Ratings?**
- **Overview of ISS Ratings Products**

Our array of ratings products offers clients the greatest range of options available

Governance Ratings and Data Offerings

CGQ	CMB Rating (formerly Deminor Ratings)	Benchmarker (formerly IRRC)
<ul style="list-style-type: none"> ▪ Flagship ratings product ▪ Broadest coverage ▪ Profiles and datafeed ▪ Proprietary rating methodology ▪ Ratings model is weighted based on performance ▪ Datafeed available 	<ul style="list-style-type: none"> ▪ Focuses on Turkey ▪ Considers a large number of variables (300+) ▪ Ability to include very detailed research reports 	<ul style="list-style-type: none"> ▪ Offers the ability to compare a company with a standard or user defined universe of companies ▪ Datafeed available

ISS Europe's ratings are exclusively based on an extensive number of corporate governance indicators

Corporate Governance Ratings: general

- Data, research and ratings exclusively related to corporate governance criteria
- Over 300 corporate governance indicators
- Objective and quantifiable approach
- Based on publicly available information

Agenda

- **Who is ISS?**
- **Why Ratings?**
- **Overview of ISS Ratings Products**
- **Ratings & Company Valuations**

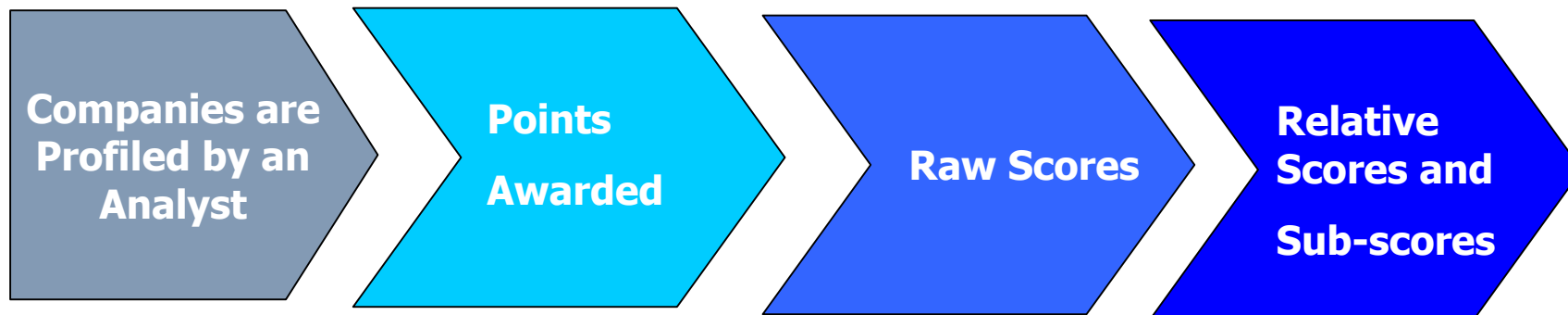
CGQ provides investors with a metric for evaluating corporate governance risk within their portfolios

CGQ Overview

- **Corporate Governance refers to the set of monitoring, ratification and sanctioning mechanisms that align the interests of managers and owners (shareholders) as closely as possible**
- **Corporate Governance Quotient (CGQ)**
 - A corporate governance rating system that evaluates the strengths, deficiencies and overall quality of a company's corporate governance practices and board of directors
 - CGQ was first developed in 2001 with substantial input from governance experts in academia, industry and ISS. CGQ was first released to the marketplace in July, 2002
- **Institutional CGQ Products**
 - **CGQ Profiles** – Access scores and profiles for individual companies
 - **CGQ Database** - via FTP and FactSet: CGQ Ratings and all underlying corporate governance criteria collected on each company are delivered in an ASCII format easily imported into Excel or any database
 - **ISS/FTSE CGI Indices** – FTSE Indices based on CGQ ratings
 - **Custom Research** - Custom data sets available on topical, industry, index or country issues.

CGQ employs a bottom up approach to rating companies

Ratings Process



Board Issues Sub-Score: 4 [DETAILS](#)

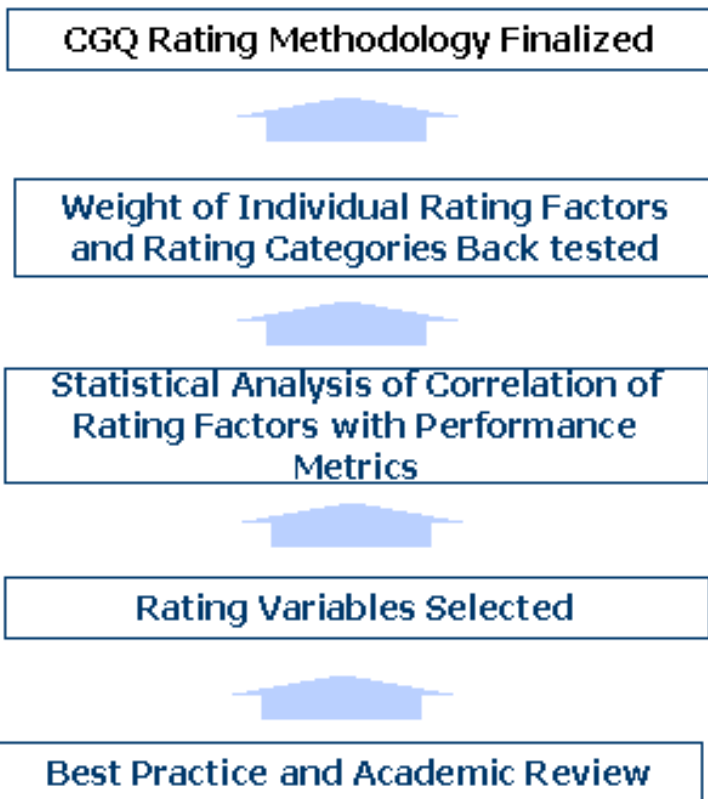
Takeover Defenses Sub-Score: 4 [DETAILS](#)

Audit Sub-Score: 5 [DETAILS](#)

Compensation/Ownership Sub-Score: 4 [DETAILS](#)

CGQ version 3.0 incorporates statistical correlations between governance and financial performance

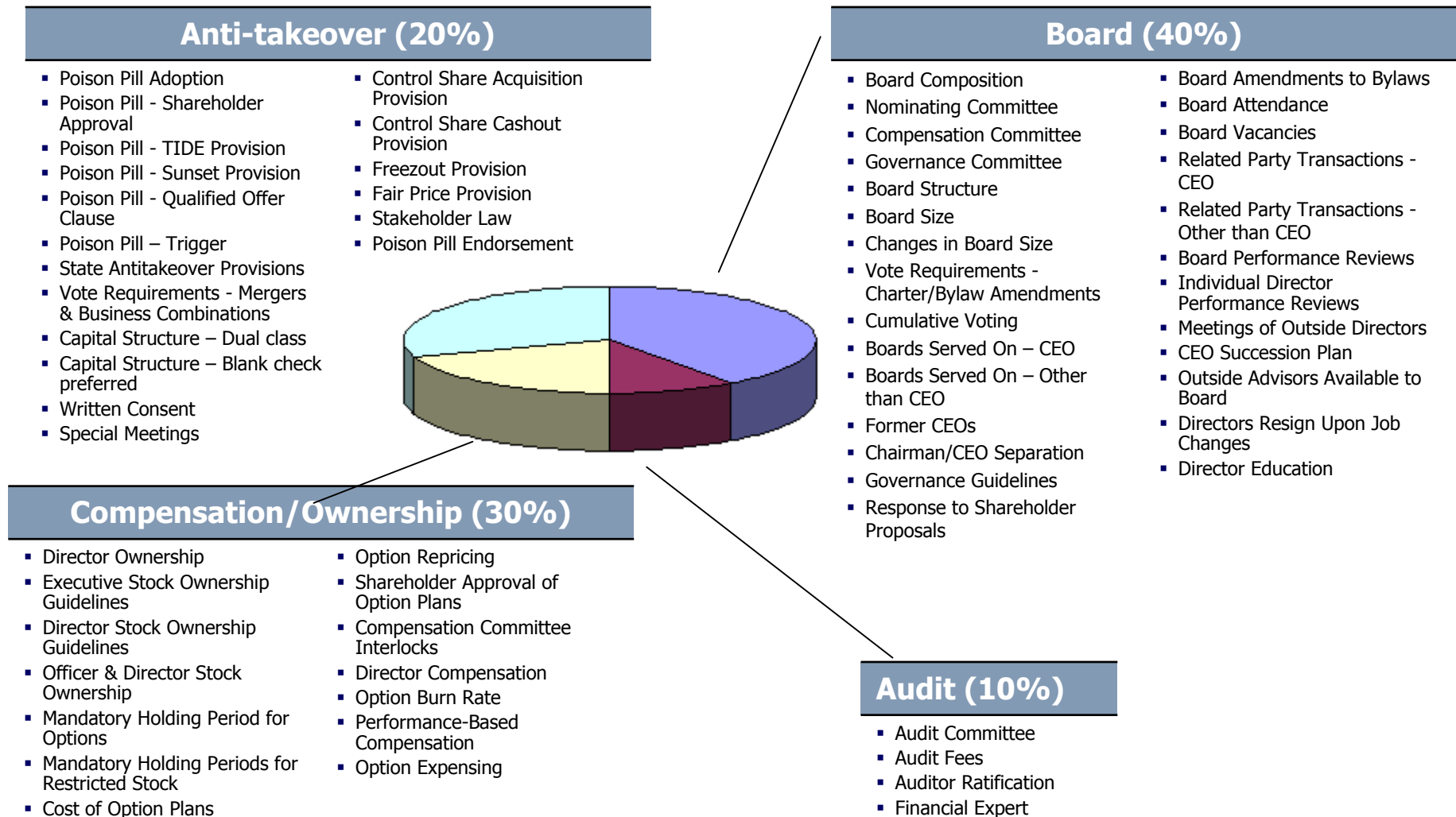
Constructing CGQ 3.0



CGQ 3.0

- Factors were updated using available academic research and consultation with internal and external governance experts.
- 4,000+ statistical tests examined the correlation between 77 ratings factors and each of 16 risk and performance metrics.
- Factors with a higher correlation with risk and performance metrics receive a correspondingly high weight in the model.
- After weighting the factors, the model was back-tested using data from 2002, 2003, and 2004 to check validity.

CGQ uses 63 governance factors to evaluate US companies and a subset of 55 factors for all other companies



Institutions now look at governance as another tool to employ in the chase for superior returns

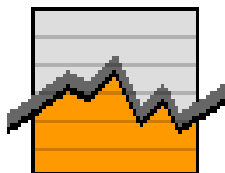
"The governance of the corporation is now as important in the world economy as the government of countries."

***James Wolfensohn
Former President,
Worldbank***



Initial focus was on compliance and risk mitigation

- Pension funds aligned governance with investor protection principles
- Absolutist approach – avoiding the next Enron



Focus is becoming more balanced between risk mitigation and performance

- Governance ratings and data as indicators
- Move away from absolutist approach – less exclusionary screening

Investors use CGQ ratings to uncover governance related risk within existing holdings

Ratings can identify higher risk companies

XYZ Healthcare Fund – Top 10 Holdings

Ticker	Company Name	Value Held	Index Group	Index CGQ	Industry CGQ
JNJ	Johnson & Johnson	154,753,473	S&P 500	37.7	94.3
UNH	UnitedHealth Group Incorporated	150,988,500	S&P 500	16.7	75.6
DNA	Genentech, Inc.	149,571,904	Russell 3000	32.7	32.8
AMGN	Amgen, Inc.	126,737,496	S&P 500	7.4	65.2
ABT	Abbott Laboratories	86,172,260	S&P 500	32.4	92.9
MDT	Medtronic, Inc.	86,139,279	S&P 500	8.5	65.8
WYE	Wyeth	84,870,532	S&P 500	79.8	99.1
WLP	Wellpoint Inc	57,653,970	S&P 500	49.9	94.5
HNT	Health Net, Inc.	52,321,148	S&P 400	61.2	88.2
SGP	Schering-Plough Corp.	42,207,900	S&P 500	58.6	97.7

These companies score in the bottom 10% of their primary index, in this case the S&P 500

Investors use CGQ ratings to uncover governance related risk within existing holdings

Ratings can identify higher risk companies

XYZ Healthcare Fund – Top 10 Holdings

Ticker	Company Name	Value Held	Index Group	Index CGQ	Industry CGQ	Board	Comp	Takeover Defenses	Audit
JNJ	Johnson & Johnson	154,753,473	S&P 500	37.7	94.3	5	1	3	5
UNH	UnitedHealth Group Incorporated	150,988,500	S&P 500	16.7	75.6	1	1	5	4
DNA	Genentech, Inc.	149,571,904	Russell 3000	32.7	32.8	1	1	5	1
AMGN	Amgen, Inc.	126,737,496	S&P 500	7.4	65.2	1	2	1	4
ABT	Abbott Laboratories	86,172,260	S&P 500	32.4	92.9	5	1	3	5
MDT	Medtronic, Inc.	86,139,279	S&P 500	8.5	65.8	1	4	2	1
WYE	Wyeth	84,870,532	S&P 500	79.8	99.1	5	2	4	4
WLP	Wellpoint Inc	57,653,970	S&P 500	49.9	94.5	3	4	3	4
HNT	Health Net, Inc.	52,321,148	S&P 400	61.2	88.2	5	3	2	5
SGP	Schering-Plough Corp.	42,207,900	S&P 500	58.6	97.7	4	4	1	4

- Sub-scores allow you to zero in on areas of concern.
- Both AMGN and MDT score in the bottom 1 or 2 quintiles of S&P 500 companies in 3 of the 4 subcategories.

The raw data underpinning the weightings can highlight particular areas of concern for investors

Governance issues at selected companies

XYZ Healthcare Fund – Higher Risk Companies

Ticker	Company Name	Value Held	Index Group	Index CGQ	Industry CGQ	Board	Comp	Takeover Defenses	Audit
AMGN	Amgen, Inc.	126,737,496	S&P 500	7.4	65.2	1	2	1	4
MDT	Medtronic, Inc.	86,139,279	S&P 500	8.5	65.8	1	4	2	1

Amgen Negative Anti-takeover Practices Include

- The company has a poison pill in place
- A supermajority vote of shareholders is required to amend certain provisions of the charter or bylaws
- A supermajority vote of shareholders is required to approve certain types of mergers or business combinations
- Shareholders may not act by written consent
- Shareholders may not call special meetings

Medtronic Negative Audit Practices Include

- The audit committee includes affiliated outsiders

CGQ scores can be used to develop portfolio level scores to compare portfolios or individual companies to the average

Governance issues at selected companies

XYZ Healthcare Fund

Companies in Portfolio: 135 **Median Index Score:** 44.70

Equity Assets: US\$2,040,807,440 **Weighted Avg. Index Score:** 40.22

Ticker	Company Name	Value	% of Portfolio	Index CGQ	Industry CGQ
JNJ	Johnson & Johnson	154,753,473	7.58%	37.7	94.3
UNH	UnitedHealth Group Incorporated	150,988,500	7.40%	16.7	75.6
DNA	Genentech, Inc.	149,571,904	7.33%	32.7	32.8
AMGN	Amgen, Inc.	126,737,496	6.21%	7.4	65.2
ABT	Abbott Laboratories	86,172,260	4.22%	32.4	92.9
MDT	Medtronic, Inc.	86,139,279	4.22%	8.5	65.8
WYE	Wyeth	84,870,532	4.16%	79.8	99.1
WLP	Wellpoint Inc	57,653,970	2.83%	49.9	94.5
HNT	Health Net, Inc.	52,321,148	2.56%	61.2	88.2
SGP	Schering-Plough Corp.	42,207,900	2.07%	58.6	97.7
PHS	PacifiCare Health Systems, Inc.	39,756,558	1.95%	63.2	88.8
BAX	Baxter International Inc.	37,511,278	1.84%	30.1	86.3
AGN	Allergan, Inc.	36,694,385	1.80%	49.3	96.6
PFE	Pfizer Inc.	34,732,515	1.70%	94.8	100

Scores provide additional analytics when applied as part of a screen

Sample Value Screen

Screen Criteria

- **Index = S&P 500**
- **Dividend Yield \geq 5.00%**
- **CGQ Index Score = Top 20%**

	Symbol	Company	Prior Close	Market Cap (\$Bil)	Industry	Dividend Yield	Index CGQ	Industry CGQ
✓	GM	General Motors	23.51	13.84	Autos	8.2	98.1	100.0
	CZN	Citizens Communications	12.64	4.194	Telecom	8.0	28.9	91.9
✓	EOP	Equity Office Properties Trust	30.4	12.4	REIT	6.6	86.6	98.7
	AIV	Apartment Investment and Managem	39.34	3.788	REIT	6.1	53.6	88.8
	PGL	Peoples Energy Corporation	36.3	1.386	Utility	6.0	55.5	61.2
✓	PGN	Progress Energy, Inc.	43.68	10.95	Utility	5.4	95.9	100.0
✓	SBC	SBC Communications Inc.	23.89	78.59	Telecom	5.4	81.6	83.5
	UST	UST Inc.	40.78	6.633	Tobacco	5.4	68.9	93.5
✓	KSE	KeySpan Corporation	34.76	6.07	Utility	5.2	80.0	81.8
	VZ	Verizon Communications	31.14	86.82	Telecom	5.2	68.0	97.0
	BMJ	Bristol Myers Squibb Co.	21.75	43.22	Pharmaceutica	5.1	60.0	98.3
	MRK	Merck & Company nc.	30.03	65.66	Pharmaceutica	5.1	53.0	97.2
	ED	Consolidated Edison, Inc.	46.2	11.24	Utility	5.0	71.1	76.0
	F	Ford Motor	7.82	14.81	Autos	5.0	8.2	56.6

Scores provide additional analytics when applied as part of a screen

Sample Value Screen

Screen Criteria

- **Index = S&P 500 AND Dividend Yield \geq 5.00%**
- **CGQ Board Structure Factor = All directors are elected annually**

	Symbol	Company	Prior Close	Market Cap (\$Bil)	Industry	Dividend Yield	Index CGQ	Industry CGQ
✓	GM	General Motors	23.51	13.84	Autos	8.2	98.1	100.0
✓	CZN	Citizens Communications	12.64	4.194	Telecom	8.0	28.9	91.9
✓	EOP	Equity Office Properties Trust	30.4	12.4	REIT	6.6	86.6	98.7
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✓	VZ	Verizon Communications	31.14	86.82	Telecom	5.2	68.0	97.0
✓	MRK	Merck & Company nc.	30.03	65.66	Pharmaceuticals	5.1	60.0	98.3
✓	ED	Consolidated Edison, Inc.	46.2	11.24	Utility	5.0	71.1	76.0
✓	F	Ford Motor	7.82	14.81	Autos	5.0	8.2	56.6
✗	PGN	Progress Energy, Inc.	43.68	10.95	Utility	5.4	81.6	83.5
✗	UST	UST Inc.	40.78	6.633	Tobacco	5.4	68.9	93.5
✗	BMJ	Bristol Myers Squibb Co.	21.75	43.22	Pharmaceuticals	5.1	53.0	97.2

Combine factors and/or scoring criteria to further refine your search

Sample Value Screen

Screen Criteria

- **Index = S&P 500 AND Dividend Yield \geq 5.00%**
- **CGQ Board Structure Factor = All directors are elected annually AND Index CGQ = Top 20%**

	Symbol	Company	Prior Close	Market Cap (\$Bil)	Industry	Dividend Yield	Index CGQ	Industry CGQ
✓	GM	General Motors	23.51	13.84	Autos	8.2	98.1	100.0
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✗	BMJ	Bristol Myers Squibb Co.	21.75	43.22	Pharmaceuticals	5.1	53.0	97.2

Incorporating CGQ ratings and factors into existing screens helps to satisfy a variety of investment approaches

Alternate Value Screen

Screen Criteria

- **Index = S&P 500**
- **Dividend Yield \geq 5.00%**
- **CGQ Index Score = Bottom 40%**

Symbol	Company	Prior Close	Market Cap (\$Bil)	Industry	Dividend Yield	Index CGQ	Industry CGQ
CZN	Citizens Communications	12.64	4.194	Telecom	8.0	28.9	91.9
F	Ford Motor	7.82	14.81	Autos	5.0	8.2	56.6

Some managers will look for companies that pass their financial screens but that have below average governance, hoping to capture increases in value as governance improves.

Investors are starting to look at governance as one of their leading indicators for performance



► **APR '03** Board has only 1 officer and no AO's; added independent nominating committee; Comp committee 100% independent; simple majority vote required to approve mergers; ownership guidelines for executives; auditor ratification

► **AUG '05** Universe Expansion

► **SEP '05** New CGQ methodology

► **OCT '05** Board has outside advisors; Audit Comm has financial experts

Investors are looking for opportunities to capture value as the market rewards companies with improving governance



- ▶ **DEC '03** Comp committee independent; increase board size; limits on board service
- ▶ **JAN '04** Majority of board is independent; nominating committee independent
- ▶ **FEB '04** Shareholders vote to fill board vacancies; policy on auditor rotation
- ▶ **DEC '04** Disclosed CEO related party transaction
- ▶ **JAN '05** Option plan costs are deemed reasonable
- ▶ **SEP '05** New CGQ methodology
- ▶ **OCT '05** Board independence increases

There are some basics steps that companies can take to *help* investors.

- 1 Communicate proactively with investors
- 2 Know your score
- 3 Know what drives your score
- 4 Be prepared to answer questions – do not hide from a low score
- 5 Help shareholders to understand how your governance profile may fit a particular investment approach



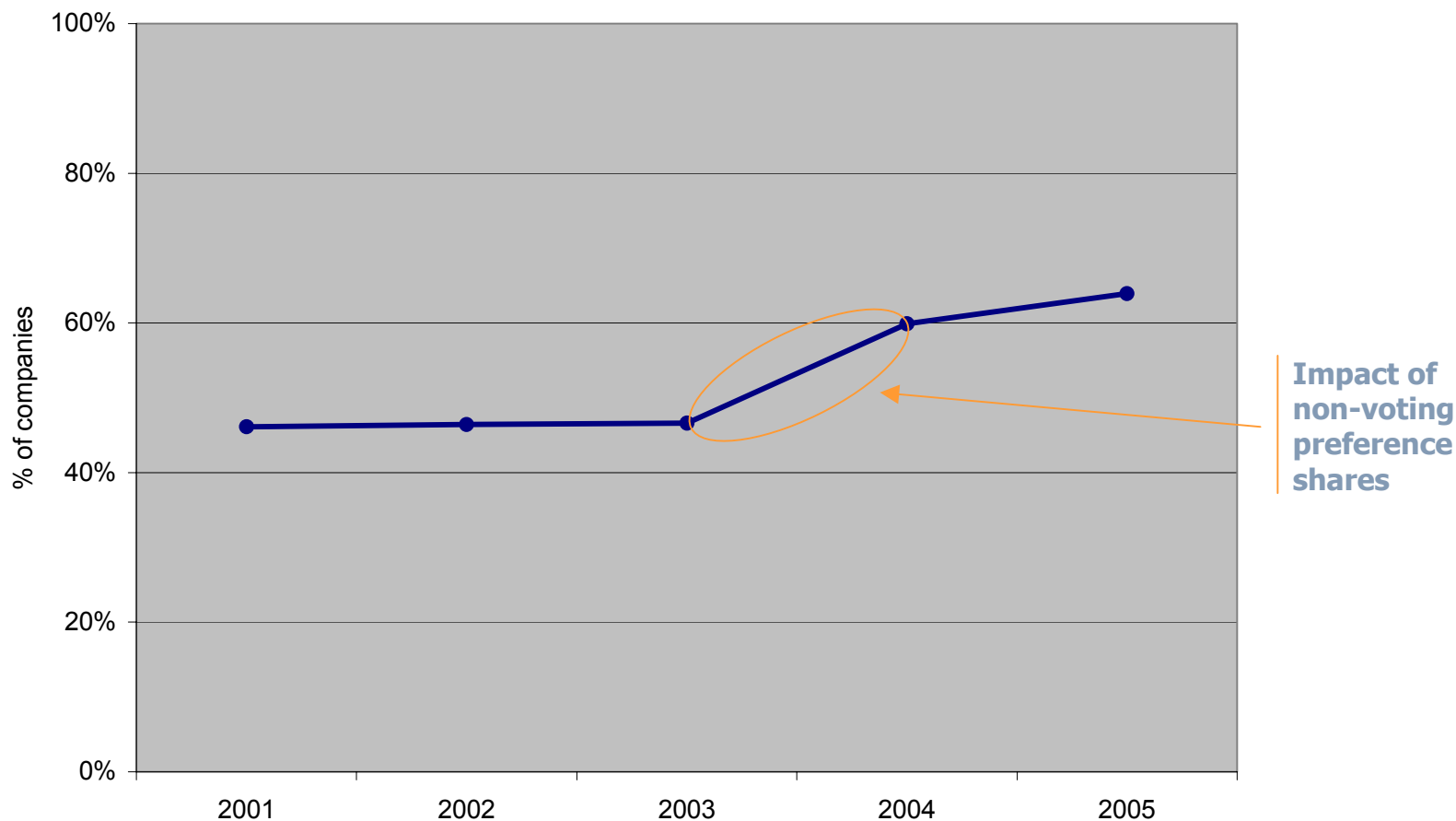
Institutions are not necessarily looking for companies with the highest score but, rather, the governance characteristics that best fit their investment approach.

Agenda

- **Who is ISS?**
- **Why Ratings?**
- **Overview of ISS Ratings Products**
- **Ratings & Company Valuations**
- **A look at European Corporate Governance Trends**

Overall there is relative few evolution in the respect of the 'one share - one vote' principle in Europe

Evolution of 'one share - one vote' principle in Europe



A large number of issues of the EU Commission`s Directive Proposal have been endorsed and are analysed by ISS Europe

European Commission Proposal for Directive on shareholder rights

General meeting notice

- Any notice convening a general meeting on a first call shall be sent out no less than 30 calendar days before the meeting

Add items on the agenda

- The threshold shall not exceed 5% of the share capital of the issuer or a nominal value of EUR 10 million

Admission to the general meeting

- The right to participate and vote shall not be subject to any requirement to block the shares

Proxy voting

- In principle no restrictions on proxy voting are allowed

Voting in abstentia

- Any shareholder shall have the possibility to vote by post in advance of the general meeting

Counting of votes

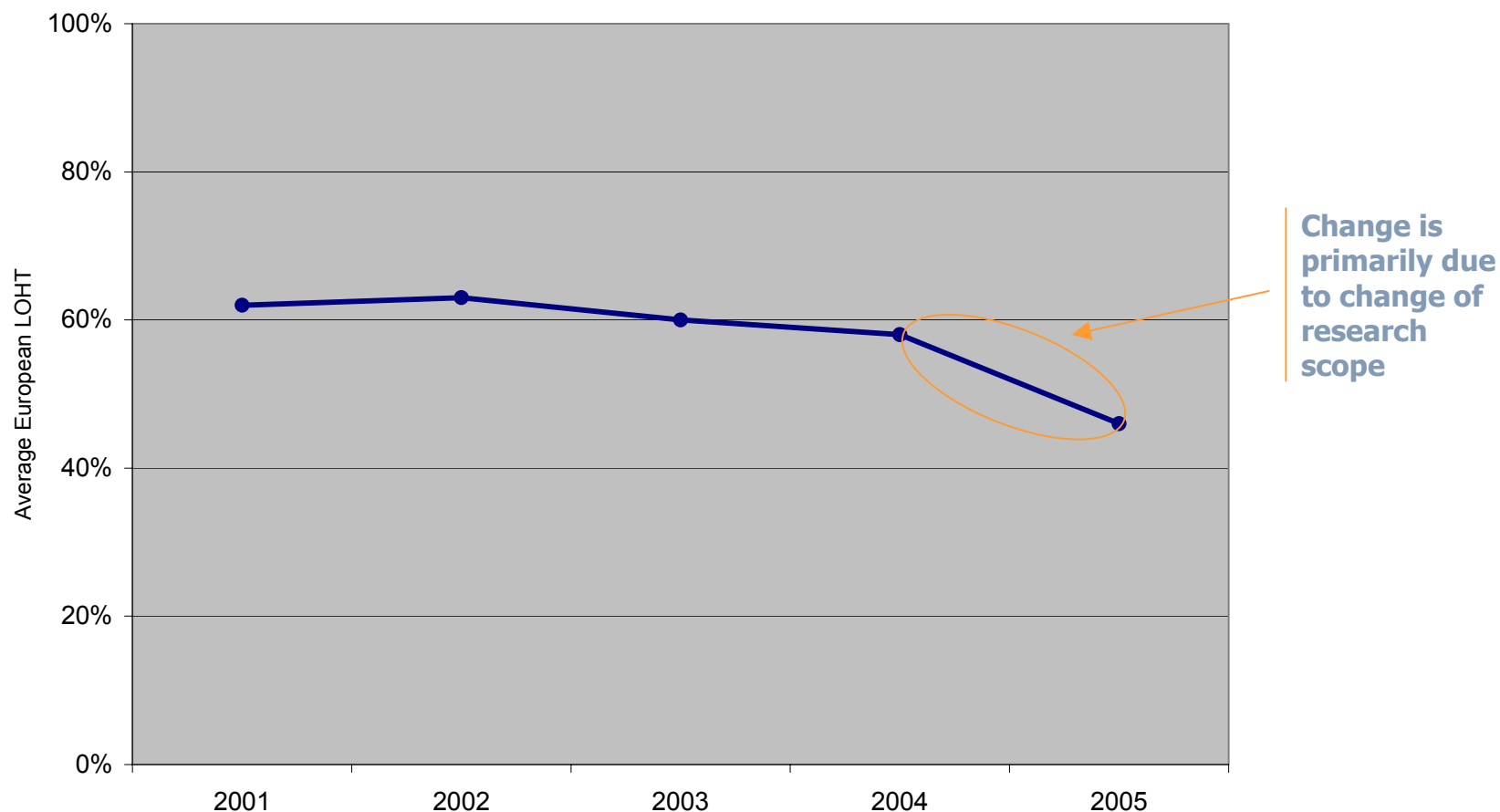
- All votes in relation to any resolution shall be taken into account

Post general meeting information

- The issuer shall publish the results of the votes on its internet site within 15 calendar days

Overall there is but a slight decrease of protection against hostile takeovers in Europe

Evolution of the average level of obstruction against hostile takeovers in Europe



Regulatory developments can impact future ratings on takeover protection

Overview of regulatory developments in the field of takeovers

Netherlands

- Discussion on takeover protection in parliament

France

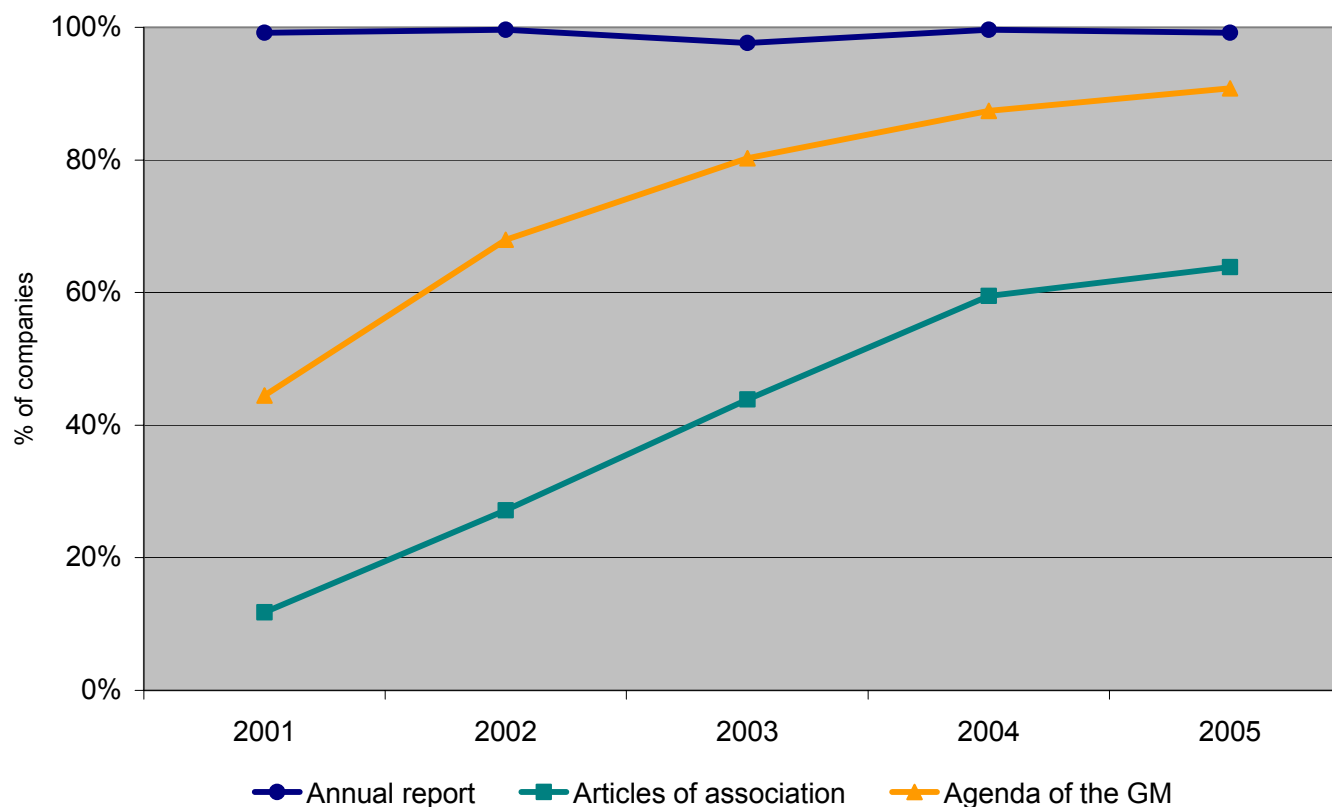
- Possibility to use poison pills in the form of warrants during tender offer
- Approval by general meeting with simple majority
- Under the condition of reciprocity the board is authorised to use the poison pill

Italy

- Discussion on the role of the Bank of Italy in takeovers on financial companies

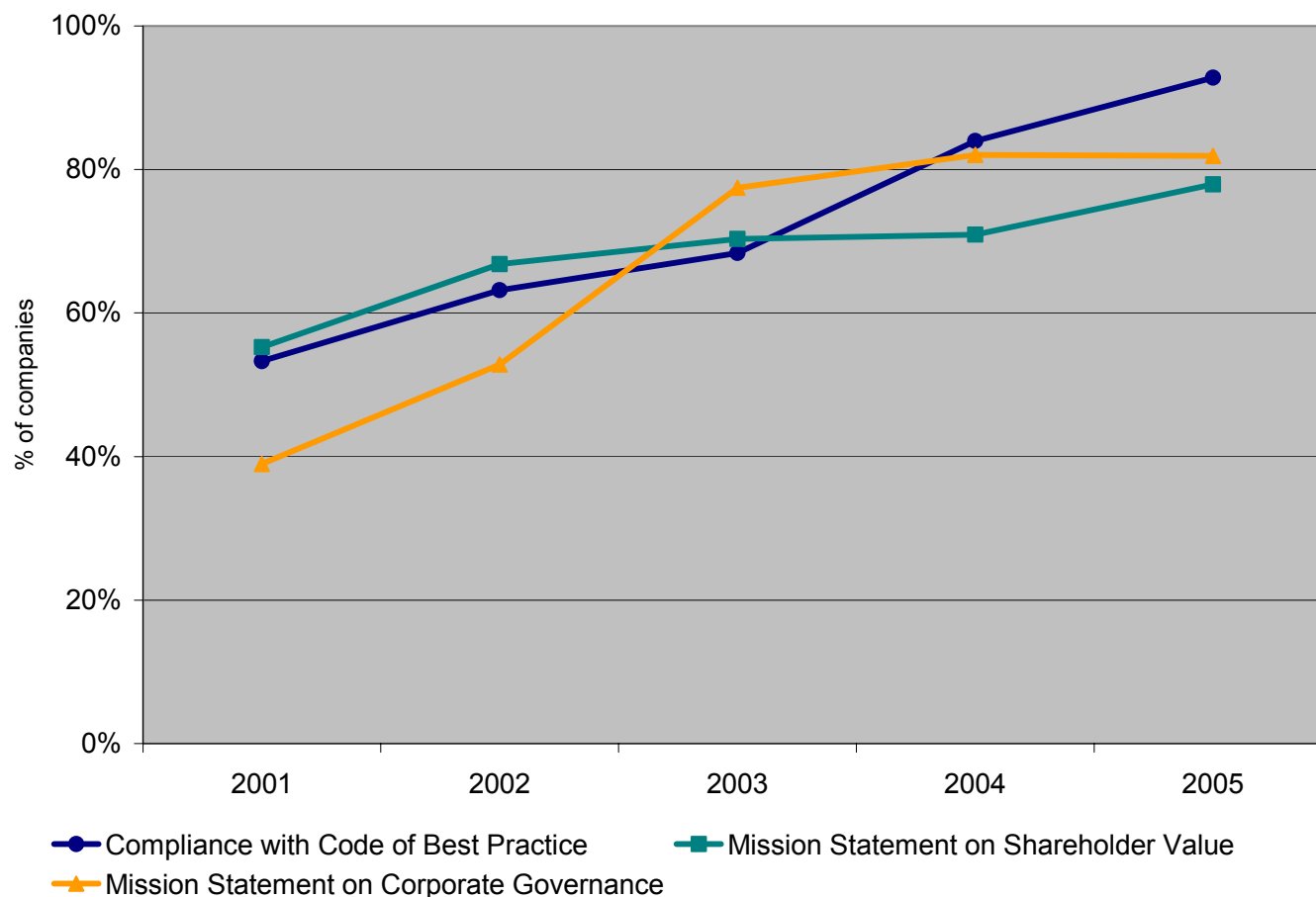
There is a significant rise in the use of websites for shareholder documents

Evolution of availability of documents on websites in Europe



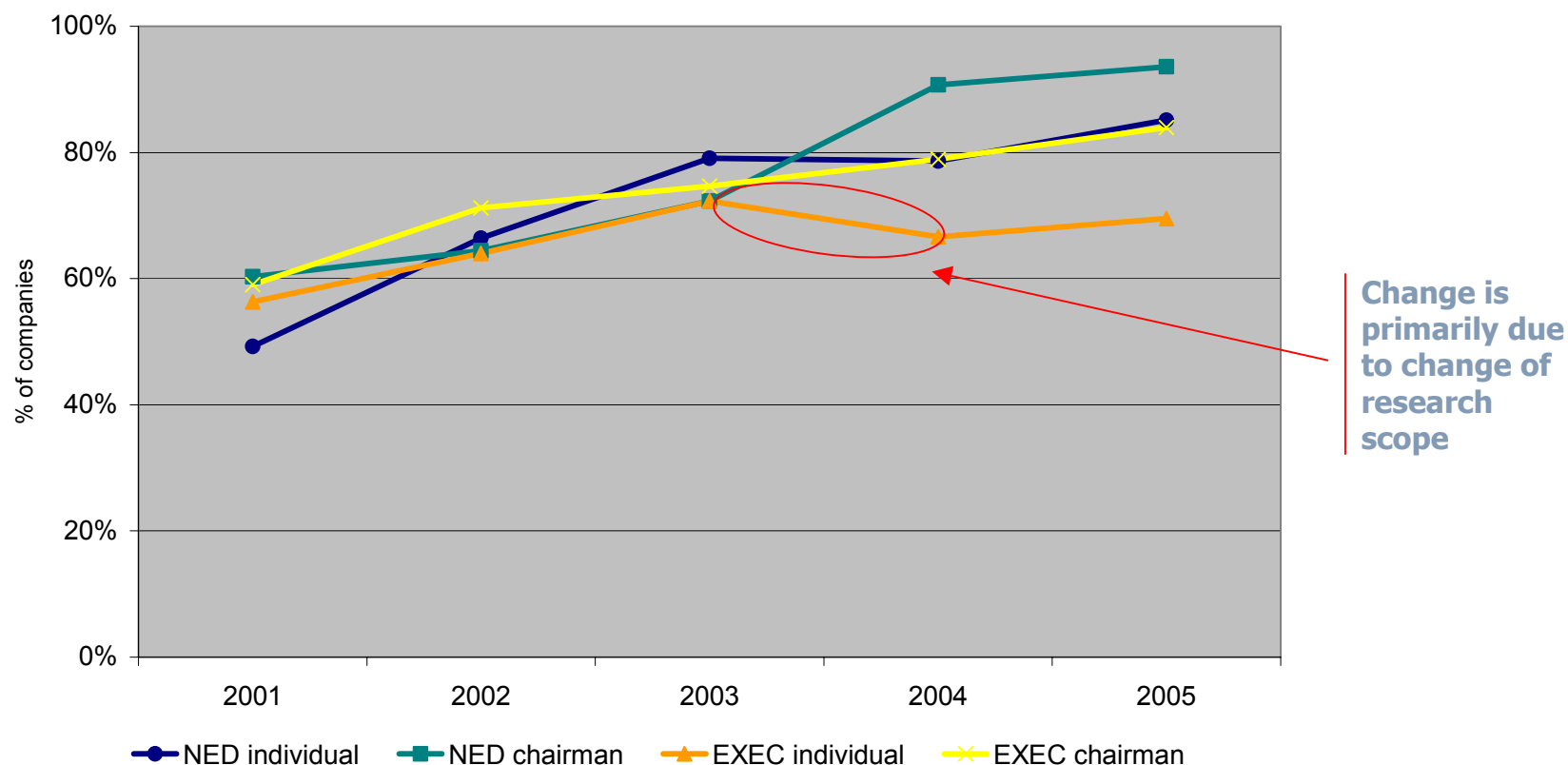
There is a significant rise in corporate governance awareness

Evolution of mission statements and compliance in Europe



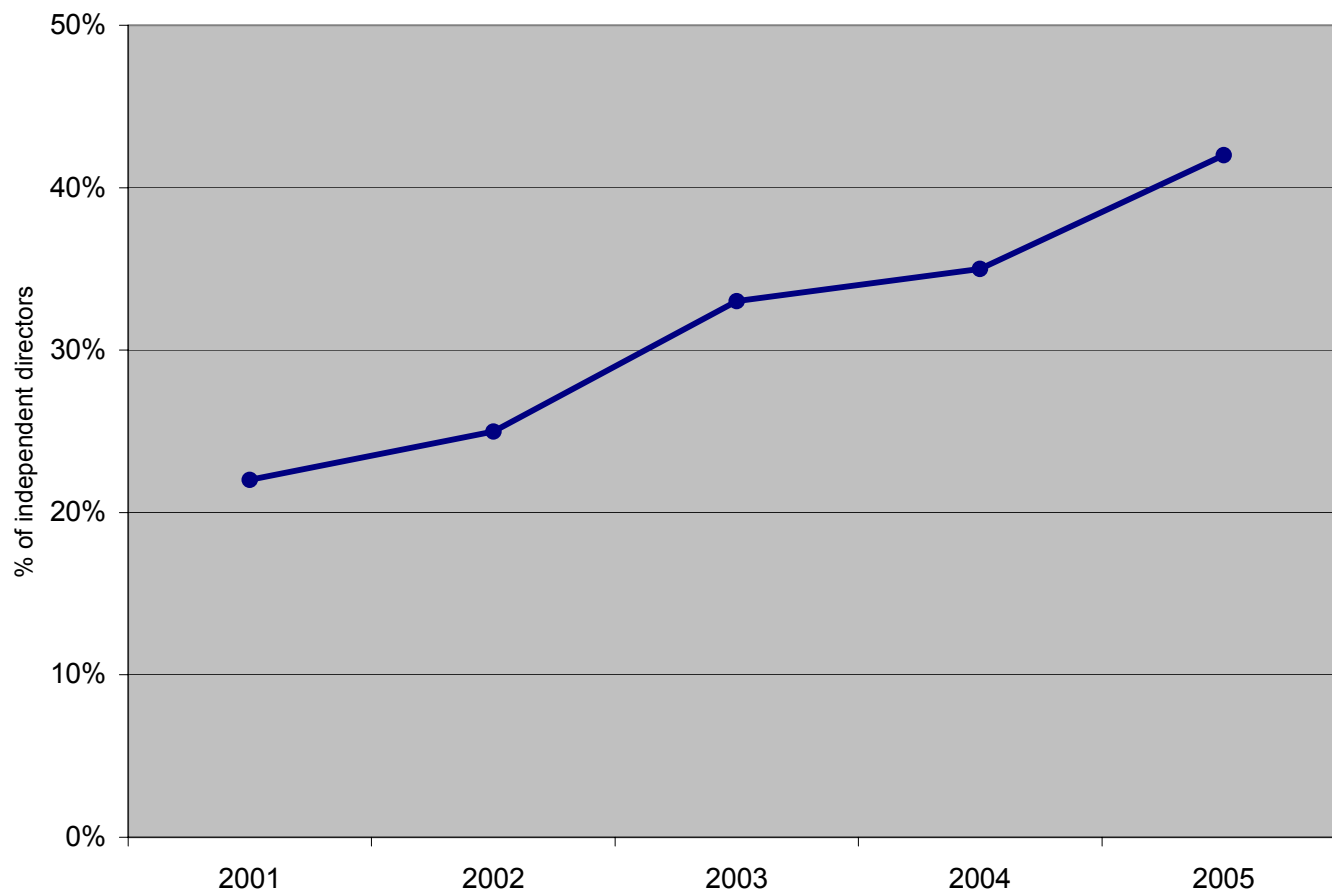
Individual disclosure on remuneration has risen by one third in five years

Evolution on disclosure of remuneration in Europe



The proportion of independent board members has nearly doubled in five years

Evolution of proportion of independent board members in Europe



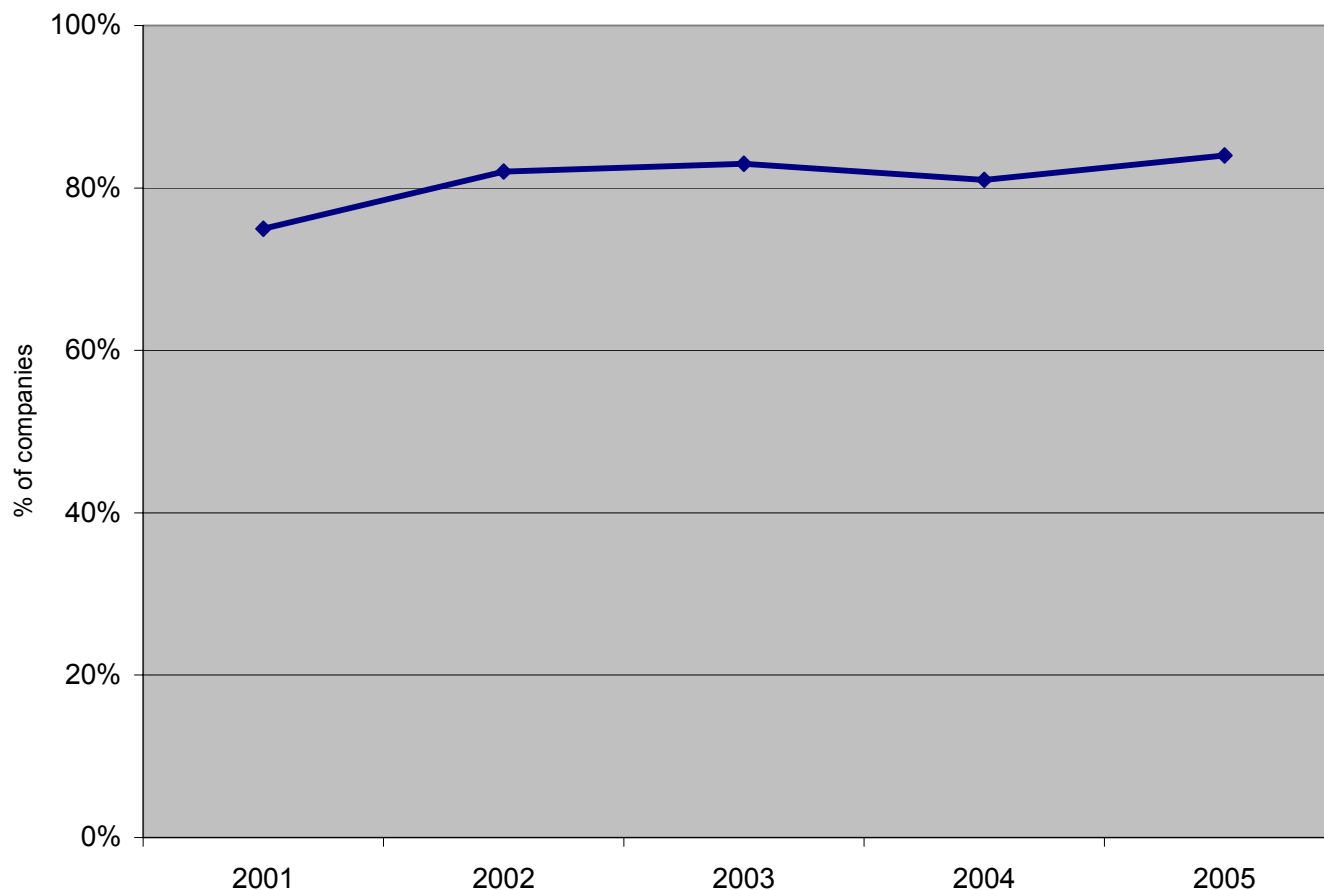
EU Commission advocates for sufficient independence on the board of directors and committees

EU Commission in a Recommendation on non-executive directors

- | | |
|--------------------------------|--|
| Non-executive directors | ▪ There should be an appropriate balance between executive and non-executive directors |
| Independent directors | ▪ There should be a sufficient number of independent directors to ensure any material conflict of interest will be properly dealt with |
| Nomination Committee | ▪ Should be composed of at least a majority of independent non-executive directors |
| Remuneration Committee | ▪ Should be composed exclusively of non-executive directors of whom at least a majority should be independent |
| Audit Committee | ▪ Should be composed exclusively of non-executive directors of whom at least a majority should be independent |
| Evaluation | ▪ Every year the board should carry out an evaluation of its performance |
| Communication | ▪ At least once a year, the board should disclose information on the corporate governance structure of the company |

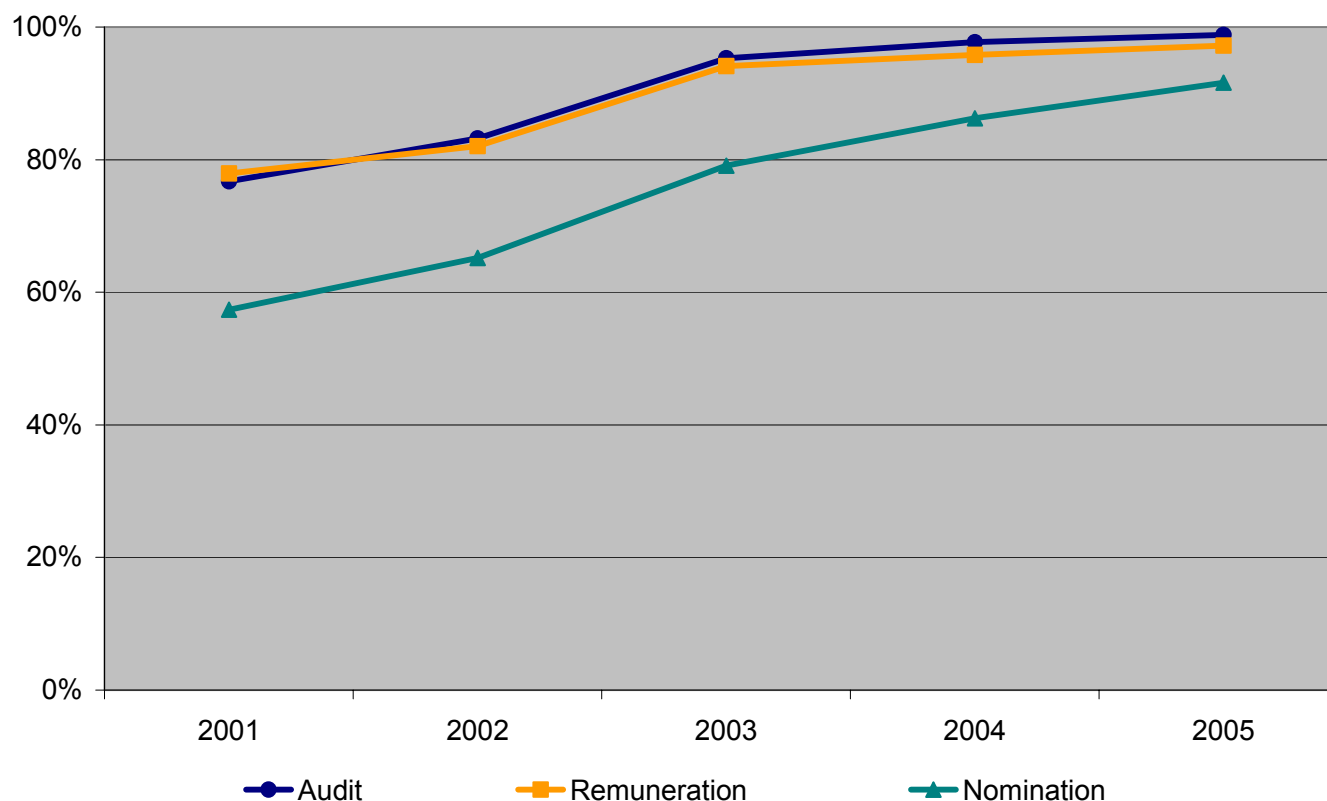
There is a slight tendency into separating the roles of chairman and CEO

Evolution of the separation of the positions of chairman and CEO in Europe



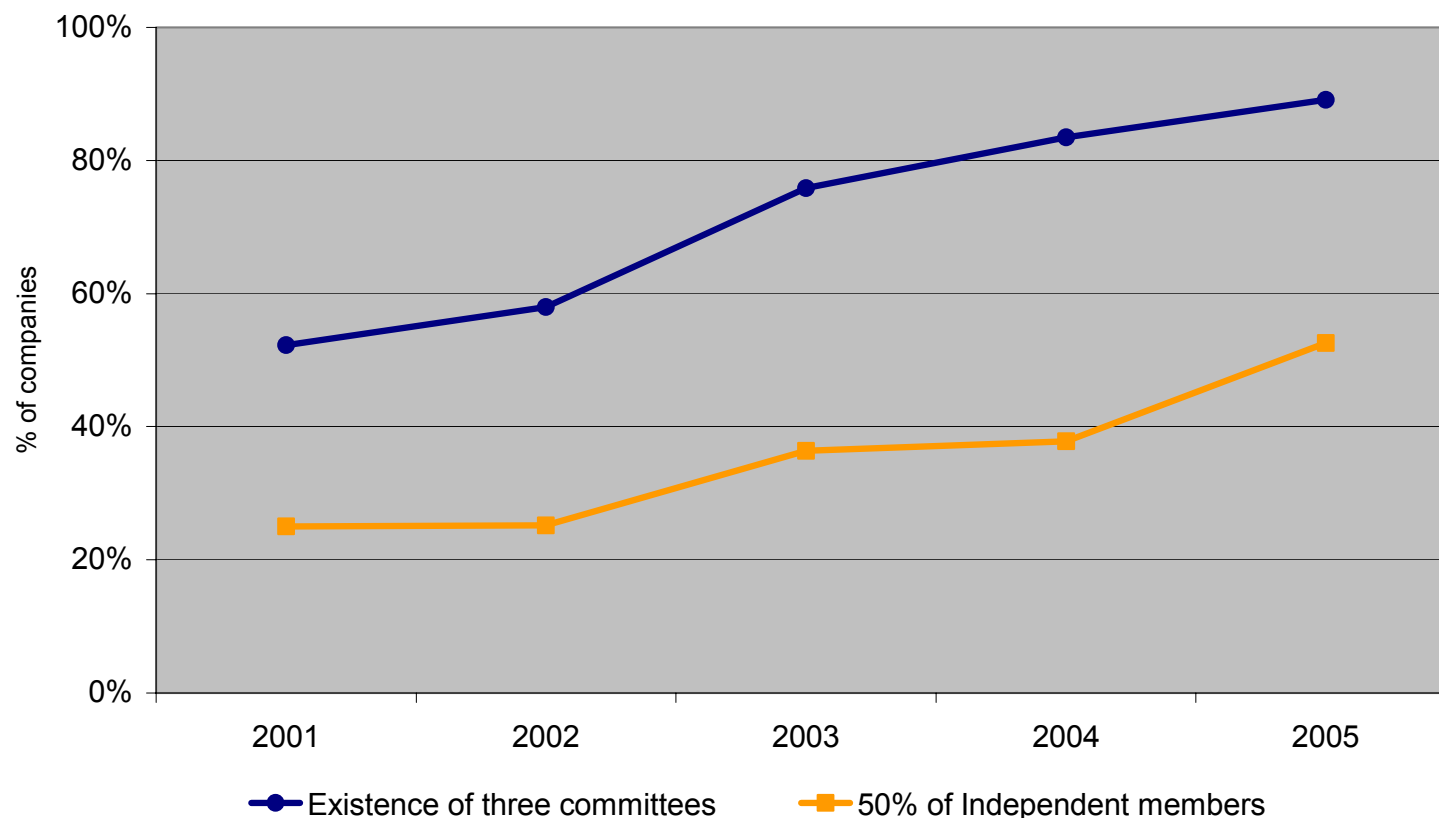
There is a significant rising trends towards the installation of audit, remuneration and nomination committees in Europe

Evolution of existence of board committees in Europe



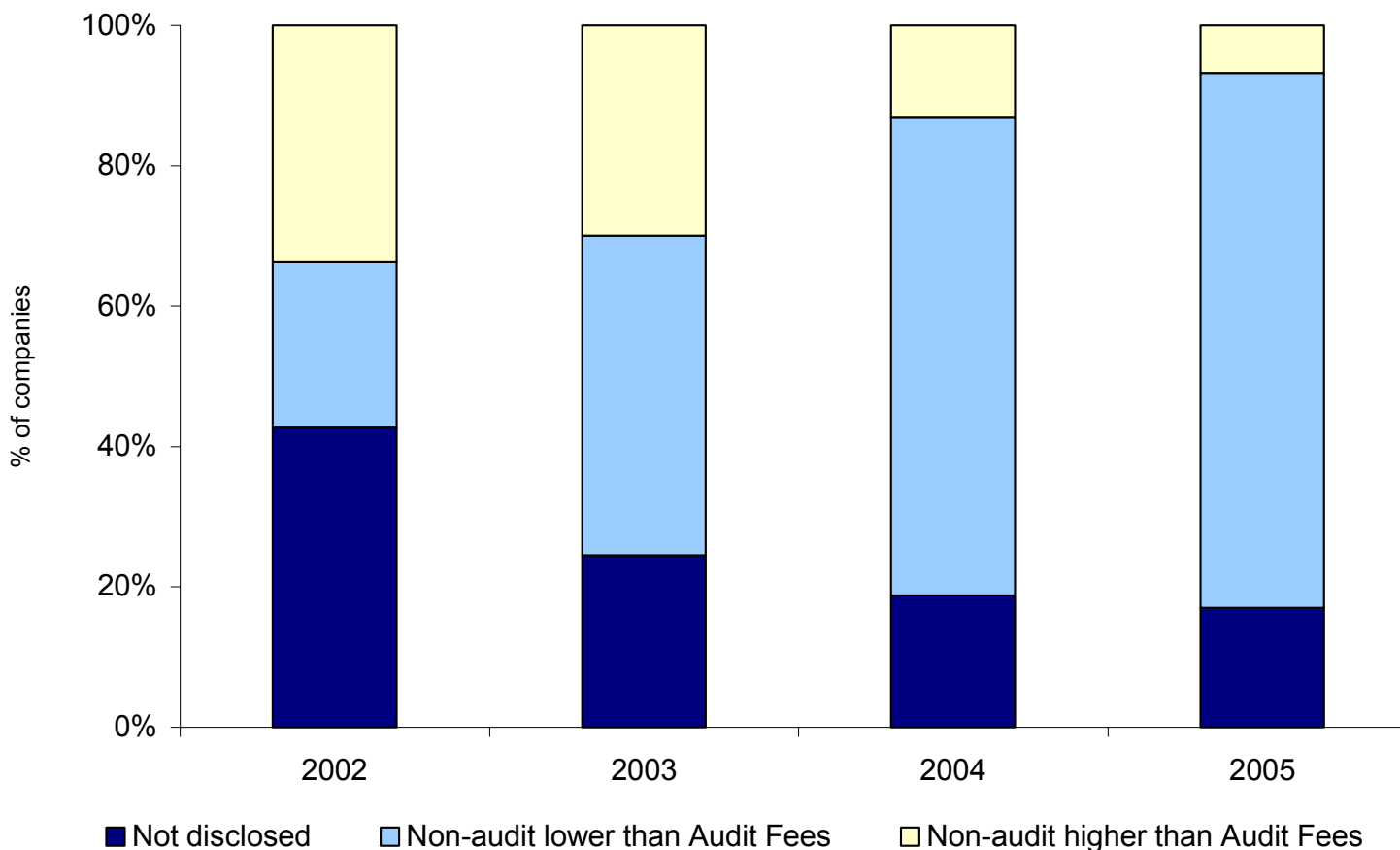
There is a significant rising trends towards independence in the board committees in Europe

Evolution of independence in board committees in Europe



The number of companies where consulting fees exceed audit fees has decreased significantly

Evolution on fees paid to the auditor in Europe



Information standards and board structures are improving

Conclusion

Rights of Shareholders

- Minor developments in respect of the 'one share - one vote' principle
- Regulatory improvements are expected in issues regarding general meeting

Defences against takeovers

- Minor developments in the use of takeover defences
- Regulatory developments in a number of individual countries might affect future ratings

Disclosure

- Significant improvement of disclosure standards over the past five years
- European and country regulations are expected to have higher demands on timely disclosure

Board structure

- Significant improvement of independence in board of directors and committees
- Audit companies receive significantly less consulting fees

Notes from the latest Global Investor Study, show

Conclusion

- **investors see corporate governance as important**
- **investors DO use corporate governance as a factor in making investment decisions across portfolios**
- **governance ratings ARE one way that investors measure governance**
- **companies NEED to be aware of and understand their ratings**
- **an increased focus on corporate governance in Europe is leading to improvements**

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

- James Wolfensohm, Former President, World Bank

Comments and Questions



INSTITUTIONAL SHAREHOLDER SERVICES

Enabling the Business of Corporate Governance