Quality Score

Overview and Updates

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Overview

QualityScore is a data-driven scoring and screening solution designed to help institutional investors monitor portfolio company governance. At an overall company level, as well as that relating to Board Structure, Compensation, Shareholder Rights, and Audit & Risk Oversight, scores provide an indication of relative governance quality supported by factor-level data. That data, in turn, is critical to the research process, while historical scores and data provide greater context and trending analysis to understand a company’s approach to governance over time. Originally branded as ISS QuickScore, the solution has been renamed as ISS QualityScore to better reflect the manner in which investors use these qualitative factors to support their company analysis.

With the continued and growing focus on investor stewardship and engagement, alongside the global convergence of standards and best practices, governance plays an increasingly prominent role in investment decisions. As an extra-financial data screening solution, the ISS Governance QualityScore methodology delivers several key benefits.

Employs robust governance data and attributes. Governance attributes are categorized under four pillars: Board Structure, Shareholder Rights & Takeover Defenses, Compensation/Remuneration, and Audit & Risk Oversight. QualityScore rests on the analysis of more than 220 governance factors across the coverage universe which, in turn, is supported by a robust data set. QualityScore analyzes not only adverse practices at a company, but also highlights mitigating factors that help tell a fuller story. The underlying QualityScore dataset is updated on an ongoing basis as company disclosures are filed, providing the most timely data available in the marketplace.¹

Leverages ISS’ global footprint and industry leadership. ISS Governance QualityScore leverages ISS’ industry leading global footprint, which includes deep legal and language expertise across key global capital markets, including many of those within the QualityScore universe. Factors used to assess risk-related concerns for a given company in each market are based on the same principles that form the foundation of ISS’ global benchmark voting policy. Developed through an extensive, transparent, and inclusive process, these policies reflect best practices across jurisdictions, as well as the views of institutional investors, issuers, and governance practitioners worldwide. The QualityScore factor methodology is aligned with ISS’ benchmark proxy voting policy to ensure it is up-to-date and tailored to address appropriate variations in governance practices across global capital markets. (For more on ISS benchmark policies and their formulation, visit www.issgovernance.com/policy.)

Presents at-a-glance governance rankings relative to index and region. ISS Governance QualityScore features company-level decile scores, presented as integers from 1 through 10, plus underlying pillar scores using the same scale that together provide a clear understanding of the drivers of a company’s governance risk. A score in the 1st decile indicates higher quality and relatively lower governance risk, and, conversely, a score in the 10th decile indicates relatively lower quality and higher governance risk. These scores provide an at-a-glance view of

¹ Please see Appendix I for more discussion of event-driven updates.
each company’s governance risk relative to their index and region. The individual factor breakdown takes a regional approach in evaluating and scoring companies, to allow for company-level comparisons within markets where corporate governance practices are similar.

**Coverage**

QualityScore global coverage comprises approximately 5,600 publicly traded companies in 30 markets, including constituents of the following major indices: Russell 3000, S&P/TSX Composite, STOXX600, NZX15, ASX 200, and local European market indices including the U.K. FTSE All-Share (ex-investment trusts.) QualityScore also includes widely held companies in ISS’ coverage universe for Brazil, China, Hong Kong, India and Japan. The term "widely held" refers to companies that ISS designates as such based on their membership in a major index and/or the number of ISS clients holding the securities.

<table>
<thead>
<tr>
<th>QS Region</th>
<th>Country</th>
<th>Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>Canada</td>
<td>S&amp;P/TSX Composite Index</td>
</tr>
<tr>
<td>Canada Small Cap</td>
<td>Canada</td>
<td>Companies outside the S&amp;P/TSX Composite Index</td>
</tr>
<tr>
<td>Latin America</td>
<td>Brazil</td>
<td>Widely held companies in the market</td>
</tr>
<tr>
<td>US - R3K</td>
<td>United States</td>
<td>Russell 3000</td>
</tr>
<tr>
<td>US - S&amp;P500</td>
<td>United States</td>
<td>S&amp;P500</td>
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*Table 1: Americas coverage*

<table>
<thead>
<tr>
<th>QS Region</th>
<th>Country</th>
<th>Coverage</th>
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<tbody>
<tr>
<td>AsiaPac</td>
<td>China</td>
<td>Widely held companies in the market</td>
</tr>
<tr>
<td>AsiaPac</td>
<td>Hong Kong</td>
<td>Widely held companies in the market</td>
</tr>
<tr>
<td>AsiaPac</td>
<td>Singapore</td>
<td>Straits Times Index (STI)</td>
</tr>
<tr>
<td>Australasia</td>
<td>Australia</td>
<td>ASX200</td>
</tr>
<tr>
<td>Australasia</td>
<td>New Zealand</td>
<td>NZX15</td>
</tr>
<tr>
<td>India</td>
<td>India</td>
<td>Widely held companies in the market</td>
</tr>
<tr>
<td>Japan</td>
<td>Japan</td>
<td>Widely held companies in the market</td>
</tr>
<tr>
<td>South Korea</td>
<td>South Korea</td>
<td>KOSPI 100</td>
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*Table 2: Asia-Pacific coverage*
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<thead>
<tr>
<th>QS Region</th>
<th>Country</th>
<th>Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>-</td>
<td>European (multiple)</td>
<td>STOXX 600</td>
</tr>
<tr>
<td>Africa</td>
<td>South Africa</td>
<td>FTSE JSE-40/JSE-MidCap</td>
</tr>
<tr>
<td>Anglo</td>
<td>Ireland</td>
<td>ISEQ 20</td>
</tr>
<tr>
<td>Anglo</td>
<td>United Kingdom</td>
<td>FTSE All-Share (ex-investment trusts)</td>
</tr>
<tr>
<td>Germanic</td>
<td>Austria</td>
<td>ATX 20</td>
</tr>
<tr>
<td>Germanic</td>
<td>Germany</td>
<td>DAX30/MDAX50/SDAX 50/TecDAX</td>
</tr>
<tr>
<td>Germanic</td>
<td>Switzerland</td>
<td>SMI 20/SMIM 30</td>
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<td>Nordic</td>
<td>Denmark</td>
<td>OMX Copenhagen 20</td>
</tr>
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<td>Finland</td>
<td>OMX Helsinki 25</td>
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<td>OBX</td>
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<tr>
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<td>Sweden</td>
<td>OMX Stockholm 30</td>
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<td>Russia</td>
<td>RTS 50</td>
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<tr>
<td>Southern Europe</td>
<td>Greece</td>
<td>FTSE ATHEX Large Cap Index 25</td>
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<tr>
<td>Southern Europe</td>
<td>Italy</td>
<td>FTSE-MIB / FTSE-Midcap</td>
</tr>
<tr>
<td>Southern Europe</td>
<td>Portugal</td>
<td>PSI 20</td>
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<tr>
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<td>Spain</td>
<td>IBEX 35</td>
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<td>Belgium</td>
<td>BEL 20</td>
</tr>
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<td>Western Europe</td>
<td>France</td>
<td>Widely held companies within the CAC All tradable</td>
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<td>Western Europe</td>
<td>Luxembourg</td>
<td>LuxX</td>
</tr>
<tr>
<td>Western Europe</td>
<td>Netherlands</td>
<td>AEX25/AMX25</td>
</tr>
</tbody>
</table>

*Table 3: EMEA coverage*
Summary of Updates

The ISS QualityScore annual methodology review ensures the approach remains closely aligned with the ISS’ benchmark voting policies, which in turn reflect developments in regulatory and market practice. As of November 2016, the QualityScore methodology includes several key updates and involves selected adjustments to factor weights and scoring.

Highlights of factor-level changes included in this release include:

**New Factors as of November 2016:**

**Board**

- Proportion of women directors in all regions (Q354);
- Two additional factors on board refreshment for U.S. regions (Q355 and Q349);
  - Proportion of non-executive directors on the board for less than six years (Q355);
  - Any other mechanisms to encourage director refreshment (Q349);
- Appointment of Lead Director or avenues for effective collaboration among independent directors, management and statutory auditors in Japan (Q367);
- Regularly holding meetings of independent director in Japan (Q366);
- Confirmation of a formal CEO and key executive officers succession plan (U.S.) and the adoption of a mechanism to appropriately monitor and supervise CEO succession planning (Japan) (Q348, and Q368);
- Material failures of governance in the U.S. (Q345); and
- Adequate response by the board to low support for certain management proposals in the U.S. (Q350).

**Compensation**

- Existence of performance-based pay or other incentives for executives in Japan (Q375);
- Disclosure of a policy on executive remuneration and computation basis for pay in Japan (Q376); and
- Employment of at least one metric that compares the company’s performance to a benchmark or peer group in the U.S. (Q353).

**Audit & Risk Oversight**

- Tenure of the external auditor in the U.S. and Anglo regions. (Q347); and
- Disclosure of a policy on evaluating the competence and independence of the external auditor in Japan (Q365).

**Shareholder Rights**

- The existence of class shares with full or multiple voting rights in Japan (Q369);
- The number of days before a general meeting for publication of proxy materials in Japan (Q371);
- The provision of English-language proxy materials in Japan (Q373);
- Disclosure of cross-shareholding voting and related policies in Japan (Q370);
Whether the company collaborates with intermediaries to accommodate beneficial owners seeking to attend shareholder meetings in Japan (Q372);
Whether the company participates in an electronic voting platform in Japan (Q374);
Exclusive venue/forum provision in the U.S. (Q351);
Fee shifting provision in the U.S. (Q363);
Representative claim limitation or other significant litigation rights in the U.S. (Q364);
Proxy access bylaw provisions in the U.S., including:
  » Ownership thresholds (Q359);
  » Ownership duration thresholds (Q360);
  » Cap on shareholder nominees to fill board seats (Q361);
  » Aggregation limits on shareholders to form a nominating group (Q362);
Whether the company can classify its board without shareholder approval in the U.S. (Q77);
Whether shareholders have the right to amend the bylaws in the U.S. (Q89); and
Whether the company can materially modify its capital structure without shareholder approval in the U.S. (Q352).

Application of Existing Factors to New Markets/Regions:

Board

» Proportion of directors with lengthy tenure in Australia and New Zealand (Q13);
» Classification of the chairman of the board in Japan (Q14);
» Identification of a Senior Independent Director or Independent Lead Director in China (Q16);
» Independence level of the nomination committee in Japan (Q19);
» Executives on the nomination committee in China (Q306);
» Classification of the chairman of the nomination committee in China, South Korea and Japan (Q23);
» Independence level of the remuneration committee in Japan (Q25);
» Executives on the remuneration committee in China (Q27);
» Classification of the chairman of the remuneration committee in China and Japan (Q28);
» Independence level of the audit committee in Japan (Q31);
» Executives on the audit committee in China (Q33);
» Classification of the chairman of the audit committee in China and Japan (Q34);
» Directors serving on an excessive number of outside boards in China (Q309);
» Executives serving on a significant number of outside boards in the U.K. and Ireland (Q36);
» CEOs serving on a significant number of outside boards in the U.K. and Ireland (Q37);
» Number of non-executive directors serving on a significant number of outside boards in the U.K. and Ireland (Q38);
» Chairman of the board serving on a significant number of outside boards in the U.K. and Ireland (Q39);
» Disclosure of the attendance record of each director in Hong Kong, Singapore and India (Q337);
» Percentage of directors attending 75 percent of board and committee meetings in Japan (Q44);
» Directors attending 75 percent of board and committee meetings with or without a valid excuse in the U.K. and Ireland (Q45);
» Disclosure of a policy requiring an annual performance evaluation of the board in Japan (Q41); and
» CEO involved in material related-party transactions in China (Q216).
Compensation

- Size of the CEO's 1-year pay, as a multiple of the median pay for company peers in all European regions (Q228);
- Degree of alignment between the company's total shareholder return (TSR) and change in CEO pay over the past five years in all European regions (Q229);
- Degree of alignment between the company's annualized 3-year pay percentile rank, relative to peers, and its 3-year annualized TSR rank, relative to peers in all European regions (Q329);
- Whether or not the company has an equity-based compensation plan in Japan (Q322);
- Maximum dilution level per year in Hong Kong and China (Q128);
- Directors eligible to receive grants/awards under the plan involved in its administration in China and India (Q325);
- Disclosure of details of individual executives' remuneration in Japan (Q112);
- Disclosure of a performance measure for the short-term incentive plan (for executives) in Singapore and China (Q113);
- Disclosure of performance measures for stock option plans (for executives) in China and India (Q122);
- Disclosure of performance measures for restricted shares (for executives) in China (Q123);
- Disclosure of performance measures for other long-term plans (for executives) in China (Q125); and
- Voluntary adoption of a management 'say on pay' advisory vote resolution for the most recent annual meeting in South Africa (Q166).

Shareholder Rights

- Authorization of the board to issue blank check preferred stock in South Korea (Q83);
- Number of board vacancies in Japan (Q262);
- Cumulative voting for directors in Hong Kong and Singapore (Q338);
- Late filings of proxy materials in Hong Kong and Singapore (Q335);
- Dilution limit of general mandate to issue shares in China (Q318);
- Discount limit of general mandate to issue shares in China and India (Q319);
- Dilution limit of the general mandate to issue repurchased shares in China (Q320); and
- Aggregate dilution limit of shares issuance and resissuance mandates in China (Q321).

Audit & Risk Oversight

- Restatement of financials in the past two years in South Korea (Q3);
- Non-timely financial disclosure in the past two years in South Korea (Q4);
- Late filings of the annual report for the most recent fiscal year in South Korea (Q302);
- Initiation of enforcement action by a regulator in the past two years in Hong Kong, Singapore and India (Q200);
- Investigations initiated by a regulator against the company, any of its directors or executives in South Korea and India (Q201); and
Factors No Longer Applicable by Markets/Regions:

- Non-timely financial disclosure in the past two years in China (Q4);
- Percentage of directors attending 75 percent of board and committee meetings in the U.K. and Ireland (Q44);
- Lowest support rate for directors at the last annual meeting in Japan (Q310);
- Annual director elections in China (Q77);
- Employment of a U.S.-type board committee structure in Japan (Q291);
- Takeover defense provisions or shareholding structures that hinder hostile takeover in Japan (Q317);
- Level of disclosure on performance measures for the latest active or proposed long-term incentive plan in China and India (Q246);
- Disclosure the metrics used to evaluate performance-based compensation in the most recent Yuho Filings in Japan (Q326);
- Disclosure of numerical figures related to performance-based compensation in Japan (Q327);
- Identification of a problematic pay practice or policy that raise concerns in China (Q301);
- Disclosure of the set up of a compensation committee in the most recent Yuho filings in Japan (Q307); and
- Disclosure of whether or not the compensation committee is comprised of a majority of outside directors (Q308).

Appendix II includes a complete listing of all QualityScore factors alongside their market applicability.

Appendix III shows factor listings by market and region. The rationale and guidelines for all QualityScore factors are detailed below.

Scoring Methodology

ISS Governance QualityScore is derived from a scoring methodology that is built and tested by ISS' global team of governance experts, and focuses on quantitative and qualitative aspects of governance including the analysis that supports ISS voting policies and voting recommendations, with a focus on the global governance best practices in each region. A score in the 1st decile indicates relatively higher quality and relatively lower governance risk, and, conversely, a score in the 10th decile indicates relatively lower quality and higher governance risk. The methodology is updated in November 2016 for select adjustments to the factor weights and scoring.

The 1-10 score is a relative measure based on the raw score calculations of the other companies in the relative index or region. This process is conducted at each pillar and at the overall score levels. Each pillar as well as the overall score generates an independent range of scores and the resulting decile rankings. For example, raw scores for S&P 500 U.S. companies are ranked and grouped into deciles, with the first decile (designated with a
“1”) being indicative of a higher raw score and lower governance risk. See the hypothetical example in the table below.

<table>
<thead>
<tr>
<th>Rating Category</th>
<th>Raw Points</th>
<th>Governance Quality Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board</td>
<td>23.3</td>
<td>8</td>
</tr>
<tr>
<td>Audit</td>
<td>56.9</td>
<td>7</td>
</tr>
<tr>
<td>Shareholder Rights</td>
<td>28.3</td>
<td>5</td>
</tr>
<tr>
<td>Compensation</td>
<td>19.2</td>
<td>10</td>
</tr>
<tr>
<td>Total</td>
<td>127.7</td>
<td>8</td>
</tr>
</tbody>
</table>

The Audit & Risk Oversight pillar decile scoring differs from the other pillars. While the QualityScore methodology is reviewed on an ongoing basis to strengthen the analysis of governance risk, there are a limited number of prevalent risk factors or controversies in the Audit and Risk Oversight pillar. Consequently, QualityScore does not assign a 1-10 rank for companies where practices are similar or “force rank” to ensure companies are in each of the 1-10 decile scores. In most of the QualityScore regions, the Audit scores are limited to a few relevant deciles only.

**ISS Governance QualityScore Factor Criteria**

There are more than 220 factors analyzed under ISS Governance QualityScore, with the specific factors under analysis varying by region. The following section details the questions analyzed and rationale for inclusion in the factor methodology. The parenthetical number associated with each question is the ISS question identification number, and it is highlighted for easy reference throughout the QualityScore documentation and product tools.

The complete QualityScore methodology and market applicability is detailed in Appendices II and III.