



RiskMetrics Group

ISS Governance Services

Canadian Corporate Governance Policy

2008 Updates

November 19, 2007

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ISS Governance Services Canadian Corporate Governance Policy 2008 Updates

Effective for Meetings on or after Feb 1, 2008
Updated Nov 19, 2007

These policy updates present changes and clarifications to ISS Governance Services' ("ISS") Canadian benchmark guidelines for 2008. If new issues arise, such as shareholder proposals or regulatory developments, prior to the next formal update, ISS will adopt policies to cover such issues on an as-needed basis.

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BOARD

Corporate Governance Issue: Audit Committee Withhold Based on Excessive Non-Audit Fees - All Canadian Issuers

Current Policy Position: Currently, ISS Governance Services - Canada ("ISS Canada") may recommend withholding votes from the Audit Committee if fees paid to the external audit firm are not disclosed as required by Multilateral Instrument 52-110 Audit Committees.

ISS Canada also generally recommends a withhold vote from a company's external auditor if fees paid to that firm for "Other" or non-audit related services exceeded fees paid to that firm for all audit related services. Audit services include tax preparation and filing fees.

One time fees disclosed as "Other" that are paid for the preparation of regulatory filings required for an IPO of a newly listed issuer, services provided by the external auditor in conjunction with emergence from bankruptcy, or fees charged for corporate reorganization related services to facilitate a spin-off, are treated as a one-time expense that qualifies as audit-related for application of this guideline and ISS Canada does not recommend that votes be withheld from the proposed Audit Firm in this instance.

New Policy Position: ISS Canada will, in addition, generally recommend withholding votes from a company's Audit Committee as constituted in the most recently completed fiscal year where "Other" or non-audit related fees paid to the external auditor exceeded fees paid to that firm for all audit related services. In the case of slate ballots, a withhold recommendation will apply to the entire slate.

Also, one time fees disclosed as "Other" that are paid for the types of corporate reorganization services described above, will now be excluded from the calculation for determining whether non-audit fees exceed audit and audit related fees paid to the external audit firm. This change recognizes the exceptional one-time nature of corporate reorganization type fees which can be substantial and can therefore affect the results of the audit versus non-audit fee comparison.

Rationale for Update: Due to the seriousness of maintaining the integrity of the audit process, and given that the audit fee disclosure requirements and regulatory best practice rules for publicly listed issuers have been in place in Canada for more than three years, we believe it is now appropriate to extend our policy application beyond the external audit firm to the audit committee, which is ultimately responsible for approving all non-audit related services provided by the outside auditor.

The responsibilities of the Audit Committee as set out in MI 52-110 include recommending the external audit firm and the compensation to be paid to the external auditor to the board of directors, as well as overseeing the work of the external auditor. The Instrument makes clear that the Audit Committee must also pre-approve all non-audit services to be provided to the issuer or its subsidiary entities by the issuer's external auditor where the aggregate amount of all non-audit services constitutes more than five percent of the total amount of fees paid to the external auditor.

COMPENSATION

Corporate Governance Issue: Equity Compensation Plans - Limit on Non-Employee Director Participation - TSX Issuers

Current Policy Position: For several years ISS Canada has followed a policy of recommending a vote against discretionary non-employee director participation in management equity compensation plans.

Due to the continuing use of options in compensation plans in Canada, we have not opposed the use of options for outside directors per se, but have tried to address potential governance 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 scheme but also its corporate governance and long-term sustainability. To this end, ISS Canada policy established an acceptable range for non-employee director option grants of 0.25% to 1% of the outstanding shares. A company was 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 be at the upper end of the range and have a larger pool of shares, options typically, from which to draw. This range was originally 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.

New Policy Position:

Valuing Director Options: ISS Canada will assess the non-employee director component (or reserve) of equity based compensation plans based on the ISS compensation model (binomial) award value that is used for employee compensation purposes. This will be consistent with our methodology for establishing the value of awards for employee participants and the plan generally.

The proposed maximum for non-employee director equity grants including options will then factor in: the difference between options and full value awards (i.e., restricted stock); option terms (5, 7 or 10 years usually); share price volatility; expected forfeiture rate; and any other criteria factored into a binomial type evaluation. We believe it is then appropriate, using this award value, to establish an annual dollar maximum guideline for non-employee director participation based on current market practice, and in conjunction with our reserve limit range of 0.25% to 1% of the outstanding shares.

Enhanced Director Limit: Using the binomial equity award value, on a go-forward basis, we have established a maximum non-employee director participation limit of the lesser of: (i) a reserve of 1% of the shares outstanding; and (ii) an annual equity award value of \$100,000 per director. Equity award refers to options, restricted stock, deferred stock units or any other equity grant made outside of or under an equity compensation plan, other than equity granted or taken in lieu of cash fees.

ISS Canada will generally vote against an equity compensation plan proposal which provides that non-employee director participation in equity awards under the plan is discretionary or exceeds our previously established 1% of the outstanding share limit. We will more closely scrutinize plans where non-employee director participation exceeds the \$100,000 maximum within the 0.25% to 1% range taking into consideration: the overall mix of pay elements (cash vs. equity); the type of equity awards granted (in order of preference deferred stock units, restricted stock, stock options); director share holding requirements and how they are achieved (stock granted outright until a target is met vs. some "skin in the game" in the form of directors taking DSUs in lieu of cash fees); rigor of mandatory and disclosed vesting requirements (i.e., vest when director leaves the board); and potentially overall company performance as well as director pay levels vs.

peers. In the absence of “best in class” director pay practices, ISS Canada will generally recommend a vote against an equity plan proposal if the \$100,000 director maximum is exceeded.

We may also vote against individual equity grants to non-employee directors outside of an equity compensation plan if the director’s annual grants in aggregate would exceed this maximum other than a reasonable one-time grant upon joining the board.

Rationale for Update: The basis for our opposition to discretionary director participation in equity plans has always been the potential for self-dealing on the part of non-employee directors where they may grant themselves options on the same basis and to the same extent as executives, thereby aligning their interests more closely with those of management. The potential conflict of interest inherent in this type of plan participation may also extend to a ‘back scratching mindset’ whereby the non-employee and employee directors look after each other. This conflict may also find its way to other boards where common directors sit on several boards and reciprocal compensation committees.

ISS Canada is aware that there are a number of institutional investors in Canada who are opposed to grants of stock options to outside directors under any circumstances largely because of the potential for many kinds of abuses like those leading to accounting and options backdating scandals. As well, certain institutional investors have pointed out that there are, in their opinion, more effective ways of compensating directors than with the use of stock options.

The most recently published Canadian market benchmarking figures¹ for director compensation have indicated a continuing increase in both the cash and equity components. The average range for the equity component of director compensation at the largest Canadian public corporations was approximately \$37,000 to \$59,000 in 2006. Assuming another increase of 15% for 2007 (as in 2006) in director compensation levels, the range would increase to roughly \$43,000 to \$68,000, again for directors at the largest TSX Index companies. ISS therefore believes that based on current market practice, our newly established annual dollar limit of \$100,000, within our already established range of 0.25% to 1% of the outstanding shares, for the equity component of any Canadian director’s compensation is reasonable if not generous taking into consideration the increase in demands on directors at Canada’s largest corporations.

However, we recognize that there may be director pay structures that have addressed institutional investor concerns so that directors truly have substantial “at risk” pay elements and that achieve alignment of directors’ interests closely with those of shareholders. We therefore believe some limited flexibility in implementing this guideline is necessary for those “best in class” director pay packages.

Best in Class Non-Employee Director Pay would require, at a minimum:

- Mandatory director shareholding requirements met by directors giving up cash for shares;
- Elimination of stock options (including SARs);
- Use of deferred share units, all or a portion of which would be taken in lieu of cash fees;
- Minimal use of restricted stock or restricted share units and ONLY if mandatory vesting of at least three years or ideally until retirement from the board;
- Reasonable limit on non-employee director DSUs or RSUs that is fixed, priced at market and shareholder approved;
- No board discretion to amend the material terms or conditions of shareholder approved plans;
- Complete and clear disclosure of all elements of director pay and discussion of the rationale supporting the current director pay structure.

¹ SpencerStuart; Canadian Board Index, Board Trends and Practices at Leading Canadian Companies 2006.

This list is not all-inclusive and other considerations such as overall corporate governance structure and performance may factor into our policy application.

Corporate Governance Issue: Equity Compensation Plans - Approval of Change in Control Provisions - TSX Issuers

Current Policy Position: ISS Canada does not currently have a voting policy for stand-alone proposals for change in control provisions because shareholder approval for the adoption or amendment of a change-in-control (CIC) provision has not historically been required.

We have included cautionary language stating best practice expectations for CIC provisions within the analysis for an equity plan proposal.

New Policy Position: ISS Canada will generally recommend a vote against a proposal to add or amend a CIC provision under an equity-based compensation plan if the acceleration and/or cash-out of unvested awards is only triggered by a single event, that is solely by the occurrence of a change in control transaction as defined in the plan (which should require consummation of such transaction, not simply its approval by shareholders), as opposed to a double triggering event which also includes termination or adverse change in status of employment. Where approval of a CIC provision is sought as part of a bundled proposal, ISS Canada may recommend a vote against the entire bundled proposal due to an unacceptable CIC provision.

ISS Canada will continue to review change in control provisions in equity plan documents for other equity plan proposals not directly related to approval of the CIC provision specifically and where applicable we will include cautionary language denoting best practice expectations for CIC provisions to the effect that:

“ISS believes that a change in control payment should only be made when a change in control event has been consummated and when there is a loss of employment or adverse change in employment status associated with the change in company ownership (double triggered).”

Rationale for Update: Equity compensation plans, for the most part, contain change in control provisions. However unless the complete plan document is available, disclosure around these provisions varies.

A change in control provision typically provides for the automatic vesting of all unvested equity awards (options, restricted stock, performance shares, etc.) granted under a plan, in order that the plan participants may, in the case of options, exercise them, and in all cases tender the shares received to a takeover bid or similar transaction in exchange for the consideration offered under the change in control transaction.

Shareholders have the opportunity to review CIC provisions only if disclosed under the terms of a new or amended equity compensation plan, however, shareholder approval has not generally been required for the addition or amendment to these provisions specifically.

Recently the TSX implemented new requirements for equity compensation plan amendment provisions with a deadline of June 30, 2007 for listed issuers to adopt a detailed amendment provision for each plan that specifies the types of amendments that will require shareholder approval under the plan. Issuers who have not adopted a detailed and shareholder approved plan amendment provision by the deadline must in future take any and all plan amendments to shareholders for approval, including housekeeping amendments. Because of this extended approval requirement, shareholders are now being asked to approve the adoption of change in control provisions, among other items, where plans had not previously included one. Any amendment to a CIC provision already in place will also require shareholder approval, absent a detailed amendment provision that carves out CIC provisions.

In addition, a change in control should not result in the automatic acceleration of equity awards granted and outstanding under a plan unless the employee's employment is also being terminated or adversely impacted as

a result of the change in control transaction, i.e. a double triggering event. Plan participants should not receive an automatic windfall for shares that have not vested (been earned) when they will continue to benefit from their employment with the company going forward. Ideally in this case, outstanding options or equity awards should be transferred into substantially similar awards under the resulting entity's equity compensation plan.

However, the inclusion of CIC provisions that ensure that insiders will not be penalized by loss of opportunity to realize the value of their equity awards if their employment is at risk as a result of a change in control transaction is widely accepted as necessary to the successful completion of the entire transaction process. Because the willing co-operation and expertise of management is critical to the entire process, it may be acceptable to ensure no loss of equity award benefits in the event the employee's job is lost or adversely impacted as a result of closing the change in control transaction. On this basis only, accelerated vesting of outstanding awards may be supported within the CIC provisions.

As well, some CIC provisions define a change in control as the acquisition of 20% or more of the outstanding voting shares of the company, which is inappropriate for purposes of triggering compensation provisions that permit employees to cash in all outstanding awards. Under this scenario, loss of employment is highly unlikely and the CIC provisions result in a windfall to insiders where shareholders have received no such benefit.

Corporate Governance Issue: Shareholder Proposals on Executive or Director Compensation

The Canadian market has not yet seen shareholder proposals requesting the adoption of a shareholder advisory vote on compensation, however ISS Canada is aware of initiatives on this subject that may culminate in shareholder proposals at one or more Canadian companies during 2008. ISS has been following global developments on binding and non-binding shareholder votes on compensation reports or certain elements of compensation. We have not historically had a policy to address this issue but have instead taken a case-by-case approach for most shareholder proposals targeting compensation issues with the exception of performance stock options which we generally support as indicated in our policy guidelines as follows:

Current Policy Position: ISS Canada recommends votes on a case-by-case basis for shareholder proposals targeting executive and director pay, taking into account the target company's performance, absolute and relative pay levels as well as the wording of the proposal itself.

ISS Canada generally recommends votes for shareholder proposals requesting that the exercise of some, but not all stock options be tied to the achievement of performance hurdles.

New Policy Position: In the event of advisory vote shareholder proposals, ISS Canada is not substantially changing our case-by-case approach at this time. ISS Canada supports non-binding shareholder advisory votes on pay in principle as the ultimate vehicle for board accountability with regard to executive compensation. Working together, ISS' global teams have formulated a set of guiding global principles for executive compensation that would serve as a framework for assessing compensation plans in response to advisory vote management proposals. The global principles are based on the current best practice global governance standards for executive compensation.

ISS Canada will review shareholder proposals requesting the adoption of a shareholder advisory vote on compensation on a case-by-case basis taking into consideration the global principles framework and the company's current compensation practices and disclosure, as well as continued evolution of best practice in the Canadian market. We will also look closely at the proposal wording and intent. We will take into consideration the timing and detail of the finalized new compensation disclosure requirements for the Canadian market as well.

Rationale for Update: In light of the delay of the Canadian Securities Administrators' (CSA) proposed new Form 51-102F6 Statement of Executive Compensation, we continue our support for shareholder proposals that request disclosure of executive and director pay information. The proposed Form 51-102F6 aims to improve the quality and transparency of executive and director compensation disclosure. The proposed new form, which will replace the existing form introduced in 1994, takes into consideration the U.S. SEC's new rules for executive compensation disclosure that came into effect in 2006.

The CSA released the proposed Form 51-102F6 in March 2007 and received comments up until July 2007. The intention was that the new disclosure requirements would take effect in time for the 2008 proxy season. However, at the end of August 2007 the CSA announced that after reviewing comments on Form 51-102F6, it would revise the proposed new form and delay its implementation, subject to further comment. The CSA expects the new Form to be in effect by late 2008 and in time for the 2009 proxy season. In view of this delayed implementation of the new Canadian compensation disclosure rules that will apply to all TSX listed issuers, ISS Canada believes it is prudent to wait to firm up policy around this issue until these rules come into effect. In the meantime, ISS Canada will observe and learn from the U.S. experience as well as that of other global markets like France and Spain as they deal with this issue.

In expectation of more stringent disclosure requirements, some issuers during the 2007 proxy season provided expanded narrative and financial data relating to compensation in their proxy circulars. We expect this trend to continue in advance of Form 51-102F6 coming into effect.

In 2008 Canadian issuers are likely to face some pressure from shareholders to implement a non-binding advisory vote on executive compensation, similar to that which shareholders have been granted in the United Kingdom and Australia. In the 2007 proxy season, advisory vote proposals in the US obtained majority support at eight companies. The list of countries having some form of advisory vote on compensation is growing as France and Spain join the Netherlands, Sweden, and Norway. Spain's say-on-pay provision takes effect in 2008. France just recently adopted a binding vote requirement that will come into effect in 2009 and permit shareholder ratification of severance arrangements for the Chair and CEO of its listed companies.

A mutual fund in the second quarter of 2007 raised the issue of implementing an advisory vote on executive compensation at seven companies; one in the technology sector and six in financial services. One has confirmed that it will not implement an advisory vote. Responses from the financial services companies are expected in late 2007. And, companies on the S&P/TSX Index received a similar request from a second institutional investor to permit a shareholder advisory vote on compensation.