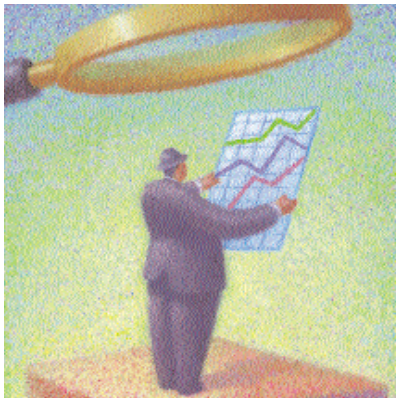


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Corporate Governance

60 **DISCLOSURE TOPICS AND ISSUES**
Corporate Governance Rating

Article
Reprint

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Disclosure Topics and Issues

CORPORATE GOVERNANCE RATING

HANK BOERNER

What is your company's beta? P/E? Corporate Governance Quotient™?

The collection of shorthand metrics with which investors and the broader financial community rate and rank public companies is expanding by one—the Corporate Governance Quotient determined and assigned by Institutional Shareholder Services.

The Corporate Governance Quotient represents a serious attempt to develop an objective, standardized process to help institutional investors rate the quality of U.S. corporate boards and corporations' governance practices. The initial rating system covers the Russell 3000 companies. Its universe gradually will expand to include up to 9,500 U.S. publicly traded companies.

ISS' Corporate Governance Quotient initiative comes at a time when other powerful forces for change are focused on corporate governance practices. The New York Stock Exchange and Nasdaq are in various stages of implementing a wide range of governance rules for listed companies. The Conference Board has created a Commission on Public Trust

and Private Enterprise to explore corporate governance issues, including board makeup and performance. President George W. Bush in March 2002 described a 10-point program intended to restore public confidence in the capital markets. Some observers have predicted that one outcome could be a corporate governance rating system that would encourage boardroom and executive suite reforms and could result in a public rating like a credit rating.

The Institutional Shareholder Services system for public companies could set the pace for these and other corporate governance initiatives, especially given ISS' reach and influence among the nation's large institutional investors.

ANALYTICAL APPROACH

In designing the Corporate Governance Quotient, ISS assembled an advisory panel of company executives, academics and institutional money managers and consulted with them over an 18-month period. It performed regression analysis on company financial performance and governance practices to determine which factors have the strongest relationship

to a company's long-term financial performance.

The seven core topics identified through the ISS process are board structure and composition, charter and bylaws provisions, laws of the company's state of incorporation, executive and director compensation, financial performance and other qualitative factors, director/officer stock ownership and director education. The scores assigned to these seven factors reflect 51 sub-issues that make up what ISS terms governance variables.

In assigning its ratings, ISS looks at the individual factors as well as their interaction. For example, a board with a majority of independent directors and key board committees made up entirely of independent directors would be assigned a higher rating for each attribute compared with the rating it would receive for either situation without the other.

INFORMATION SOURCES

In the process of assigning its rating, ISS draws on corporate proxy statements and related materials, annual reports, prospectuses and other disclosure documents. The firm extends an open invitation to corporate secretaries and others in the reporting and disclosure process

to supplement public filings with information that could help develop a more complete and accurate picture of the company's corporate governance policies, practices and processes. It encourages companies to provide information year-round, not just in conjunction with preparation of their proxies, and to provide data in addition to the specifics required in public documents.

ISS invites corporations to sign on for a review and comment period during which they can have access to their corporate governance score and provide feedback. ISS built that step into the process to help ensure accuracy and completeness of the initial CGQ information.

After ISS analyzes a company's corporate governance policies, practices and processes, it assigns the Corporate Governance Quotient on a scale of one to 100 and posts that score on the Web page to which its institutional investor clients have access. For context and comparison, it posts traditional information such as the S&P index and industry peer group with the CGQ. More than 750 institutions, with investments representing trillions of dollars of market capitalization, have online access to the CGQ ratings.

CORPORATE GOVERNANCE QUOTIENT USES

ISS designed the CGQ to speak to its institutional clients' interest in an effective way to make a quick call on companies' governance practices. CGQ and the accompanying ISS database provide a way for those institutional investors to determine the best performers in their portfolios and to screen for certain types of activism on governance issues, information that can help them determine whether to vote their proxies with or against management or to withhold their votes. ISS intends for the CGQ process to be ongoing so that information on governance-related issues that could affect specific ratings remains current.

ISS limits access to the CGQ postings to its institutional clients, which means it excludes media representatives, government agencies and shareholder activists. The organization's goal for CGQ is to build a relationship between a company's corporate governance quotient and financial performance, demonstrate the importance of the relationship over time, and help expand director education and appreciation of effective corporate governance policies and practices.

The CGQ rating will appear on the

front page of each ISS proxy analysis with information that provides basic context for the rating. More details will be available on the second page of the analysis, including the key factors for determining the governance rating. ISS' ProxyMaster.com Web site is the electronic platform for delivering its research to its institutional clients.

Companies wanting to sign on for the review process can do so at www.isscgq.com, where they will be asked to provide the name, title, e-mail address and telephone number of the corporate contact who will review the file.

NEXT STEP: DIRECTOR EDUCATION

ISS provides a range of services to institutional investors, including detailed analysis of proxy proposals and resolutions and its recommendations for voting shares. In recent years it has become a major factor in certain proxy campaigns, including the contentious Hewlett-Packard and Compaq merger effort in early 2002. Some Wall Street observers interpreted ISS' recommendation to its institutional clients that they vote in favor of that merger as a signal to all investors to approve the proposal.

An important next step in the ISS

process is furthering the education of board members.

It has recognized a small universe of director education providers as accredited director education programs. It has also identified as allies in the CGQ process nonprofit providers such as the National Association of Corporate Directors and some for-profits and universities such as Dartmouth's Center for Corporate Governance and the Stanford Directors' College. More will be accepted. ISS reviews the core curriculum and faculty and approves the course of study. Companies can suggest their own private-sector providers for ISS accreditation. The objective is to develop a broader network of providers of ongoing director education and formal introduction of good governance practices to current and prospective board members. ■■