THE CORPORATE GOVERNANCE ALLIANCE DIGEST

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Published by Eleanor Bloxham, CEO of The Value Alliance and Corporate Governance Alliance, a board and executive education, information and advisory firm, and John M. Nash, President Emeritus of the National Association of Corporate Directors, below are complimentary summaries of up to date news, information and perspectives on issues in value and corporate governance.

IT IS A TIME OF CHANGE

by Eleanor Bloxham

Boards and investors are in a swirl of change at the moment with no end in sight. The days are not languid. "Nearly eight in 10 say things are going badly in the country, with just 21 percent suggesting that things are going well...three out of four Americans are angry about the way things are going in the country. But three out of four questioned say that things are going well for them personally." (CNN, Steinhauser, February 23)

Reading between the lines prevents surprises for boards and investors: as boards and investors plot their short term, medium range and long term strategies, the selections from the articles below are intended to provide useful insights. Thank you to all the dedicated writers and journalists that created the inspiration for these ideas.

Twelve strategic ideas to consider.

1. **Look for small signals that may be important**: "The lesson for corporate management is even clearer. When you start receiving polite e-mails telling you the company is doing something wrong, pay attention. You may see the same words in a parliamentary report." (Financial Times, Skapinker, February 16)

2. **Be aware of how the operations in one company (and governmental policy) impact international perceptions:** "China Investment Corporation, the country's sovereign wealth fund, had not even begun formally operating when it spent $3bn on a 9.9 per cent stake in the private equity group. With Blackstone's shares down 84 per cent since flotation, CIC's new executives have become the target of furious attacks by bloggers who think China was conned. "They are worse than wartime traitors," says one recent chat-room posting. "Blind worship of the US by so-called 'experts'," complains another."…"Even at the elite level, the sense of frustration occasionally bubbles over. 'We hate you guys,' Luo Ping, a director-general at the China Banking Regulatory Commission (CBRC), complained last week on a visit to New York. 'Once you start issuing $1-$2 trillion ... we know the dollar is going to depreciate, so we hate you guys, but there is nothing much we can do.'" (Financial Times, Dyer, February 22)

3. **If something is working elsewhere, why is it working?:** "US banks are cutting off consumer lending as they contract, but Chinese banks are actually increasing their lending to the manufacturing and infrastructure sector in order to generate growth and employment." (Financial Times, Petits, February 17)

4. **Lessons from one kind of organization may be transferrable to another:** "Rau notes that higher ed[ucation] administrative salaries in the past decade have soared far out of proportion to faculty and staff. The salaries of chancellors and presidents at some institutions approach $1 million annually, with even deans being paid more than $250,000 ..'Trustees must put reasonable caps on administrators' salaries before public opprobrium and anger tar our institutions, as has happened in the corporate world.'" (Baton Rouge Business Report, Clark, February 23)

5. **Try to reach out for as many sources of wisdom as possible:** Regarding the stress tests of the large banks which will be provided over the next couple of weeks, "Treasury and Fed officials said they had consulted with industry executives in devising the tests… Bank executives reached over the weekend said that the tests might not produce information that is very different from what regulators already know about the banks. The Federal Reserve already has hundreds of examiners on site at the largest banks, monitoring their businesses." (New York Times, Andrews, February 22)

6. **Being explicit and repetitive – and signing documents may actually reduce ambiguity and surface issues:** "Having participants read or sign an honor code significantly reduced or eliminated unethical behavior" (Harvard Business School paper, Shu, Gino and Bazerman, highlighted in HBS Working Knowledge, February 23)

7. **Take a look at how others might view it:** "The SEC has sided with only two financial companies on pay-related shareholder proposals leading up to this spring's annual-meeting season. SunTrust Banks Inc., a regional bank based in Atlanta, may exclude a proposal made by the International Brotherhood of Teamsters, the agency ruled, because the union didn't specify the period for the pay limitations. "We believe our executive compensation is performance-based and consistent

with shareholder interests," says Mike McCoy, a SunTrust spokesman." (Wall Street Journal, Karmin, February 12) "SunTrust Banks Inc. CEO James Wells received a 62 percent pay increase in 2008 to $5.45 million even as profit fell by more than half." (Bloomberg, Levy, February 24)

"Money manager John Harrington tried to propose new board committees at Bank of America, Citigroup and Goldman Sachs that would ensure that the companies take steps to support U.S. economic interests…Bank of America and Citigroup wrote letters to the SEC asking for permission to disallow the proposal. The SEC told Citigroup it had the authority to do so, Harrington said. 'It's shameful that the SEC is still supporting corporate management right down the line,' he said." (The Washington Post, Goldfarb, February 22)

8. **Review all the pressure points and their implications for business segments:** Regarding pension funding, "it may not seem like a lot to assume a 6% or 7% annual return rather than 8%, but a rule of thumb is that every 1% less in performance requires an extra 10% in annual funding to counteract"… "there is one group that will find itself very vulnerable if we face an extended period of very low inflation and investment returns: investment managers and advisers. It is one thing to pay out 1% a year to a mutual fund manager if you think you can make 9% a year, quite another if it's only six. As for hedge funds charging 2% of assets under management plus 20% of gains, well, the math is even worse." (Financial Week, Saft, January 26)

9. **Address issues with respect to board education, nominations and disclosures**: Research by The Corporate Library shows "Citigroup, McGraw-Hill, and Merrill Lynch had directors who sat on too many other corporate boards and who received an unusually high percentage of disapproval votes from shareholders." (Financial Week, Roland, February 23)

"Securities and Exchange Commission Chairman Mary Schapiro plans to look into whether the boards of banks and other financial firms conducted effective oversight leading up to the financial crisis, according to SEC officials, part of efforts to intensify scrutiny of the top levels of management and give new powers to shareholders to shape boards."…"As she examines what went wrong, Schapiro is also considering asking boards to disclose more about directors' backgrounds and skills, specifically how much they know about managing risk, said the officials, who spoke on condition of anonymity because no policy initiative has been launched." (The Washington Post, Goldfarb, February 22) See also http://www.thevaluealliance.com/PDF/CGADigest122908.pdf for a look at this topic.

10. **Pay parity matters and employees have ideas for improvements**: "Lots of bank tellers and bank employees are really angry that they face mass layoffs while executives are getting huge bonuses," says Stephen Lerner, assistant to SEIU President Andy Stern. "Bank employees are talking with co-workers and with us about how to fix the financial industry so it works for consumers, workers and the country, not just executives." (Financial Week, Massey, February 23)

11. **Regulatory fixes can generate ideas for private sector innovations**: The Congressional Oversight Panel has produced yeoman's work in a short time. Their recommendations include: 1. Identify and Regulate Financial Institutions that Pose Systemic Risk 2. Limit Excessive Leverage in American Financial Institutions 3. Modernize Supervision of [the] Shadow Financial System 4. Create a New System for Federal and State Regulation of Mortgages and other Consumer Credit Products 5. Create Executive Pay Structures that Discourage Excessive Risk Taking 6. Reform the Credit Rating System 7. Make Establishing a Global Financial Regulatory Floor a U.S. Diplomatic Priority 8. Plan for the Next Crisis. Read the full report here. http://cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf

12. **Take daily steps toward continuous learning:** "Should regulators have a requirement that bankers understand the long-term implications of different business models, incentive systems, leverage ratios and approaches to liquidity management for the global economy, UK society and the UK taxpayer as well as for their particular bank? Should there be an obligation for continuing professional development to keep people up to date? Indeed, there should be both. We also need a greater understanding of corporate governance within the whole ecosystem. We need to ensure that executive and non-executive board members understand the financial system better and so can challenge an overweening CEO." (Financial Times, Board, Scott-Quinn, February 23)

    Peter Eavis' columns in the Wall Street Journal provide useful information on reported numbers for both investors and boards.

    In the last issue of the Digest, we recommended a review of the OECD governance principles to create a dialogue around new practices. Since that issue, The Corporate Library now provides country by country corporate governance codes free online; find them here: http://www.thecorporatelibrary.com/info.php?id=117.

From the Mailbag – A Letter from our Readers:

January 22, 2009

Dear Eleanor: Greetings from foggy Warsaw! Happy New Year! Thanks very much for sending this edition of the Digest.

In my opinion, the biggest problem is a lack of leadership. Accountants, auditors, bankers, banks, boards, business schools, corporations, law schools, political parties, politicians, rating agencies, regulators, risk management departments, stock exchanges - they have all failed us.

We have been reading about excessive executive compensation and risky business practices at Fannie Mae for years. Yet in Congressional testimony, its CEO states that he simply could not have predicted that things could have gone so wrong so quickly. This is impossible; however, if it is true, it means that he does not have the qualification and skills necessary to be CEO!

Sadly, this is only one of a plethora of examples. The Emperor has no new clothes. The current model is broken, outdated and unsustainable.

We have a hard road ahead. The most urgent, and most difficult task, will be to educate the present generation and future generations about common sense. It has been in exile for too long.

Thank you for your efforts!
Best Regards,
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