



After Enron

The International Corporate Governance Network's eighth annual conference in Milan in July 2002 took place at a revolutionary time for corporate governance.

The failure of Enron and WorldCom in the United States, coupled with a collapse in investor confidence in the accounts of numerous other companies, has caused governance reform to move to the forefront of the political agenda in the US.

In other markets too, Enron et al have had a profound influence, as regulators review their own systems of audit and financial reporting.

Alastair Ross Goobey, newly elected chairman of the ICGN and ex chief executive of UK fund manager Hermes, noted that the world was experiencing the first post-war bear market caused principally by governance concerns.

Delegates in Milan were keen to stress that the ICGN's voice should prove influential in such turbulent times. "This is our moment," said Nell Minow of governance portal The Corporate Library. "The world is waiting to hear from us."

Bill Crist, president of CalPERS, the California public fund giant, said: "Now we know the importance of governance. We were right all along."

Accounting standards

The reporting crisis facing the US has catalysed efforts to harmonise the world's accounting standards.

Traditionally, there has been conflict between International Accounting Standards, which will apply in Europe from 2005, and US GAAP. US regulators have been reluctant to weaken GAAP in favour of what they see as less rigorous standards.

But the credibility of US GAAP has taken a pounding in the recent spate of scandals, and standards setters worldwide

will be keen to learn the lessons from Enron and apply them to global standards.

John Biggs, chairman and CEO of TIAA-CREF, said. "I'm very optimistic we're going to make progress on accounting standards."

Much of the debate surrounding accounting failures in the US focuses on the American preference for rules based accounting, as opposed to principles-based approach which emphasises a 'true and fair' view of the company's position over compliance with a proliferating number of precise rules.

But Biggs doubted whether broad principles could apply in the US, where fear of litigation means that accountants want interpretations nailed down. "It's almost impossible to get away with [principles]" he said.

Kings of the jungle

Boards of directors must also recognise that they have a critical role to play in checking over-mighty CEOs. Alastair Ross Goobey said that "star CEOs have been lionised. So it's no surprise if they behave like kings of the jungle."

Boards must concentrate on creating the conditions for exercising genuinely independent judgement, said Ross Goobey, rather than simply taking such judgement for granted. "I'm yet to meet the non-executive director who didn't believe he was a paragon of independence – and that includes the chairman's brother in law."

Richard Koppes, former general counsel of CalPERS and now with law firm Jones, Day Reavis & Pogue, said that investors need to use tougher tactics with laggard firms than merely withholding votes from directors or filing shareholder resolution. Nominating director candidates to compete with management nominees is "going to heart of the power" in a

company, he said.

Investors will also exert their influence through the courts. A few years ago, institutional investors seldom acted as lead plaintiffs in class action suits but they are increasingly taking this route to disciplining management. "You're going to see some smart clients," said Koppes.

William Lerach, an attorney with Milberg Weiss, which is playing a leading role on behalf of shareholders and employees who lost money in Enron, said class action lawsuits led by institutions would put directors on notice that they had to commit to the job, and not just mark time on the board.

The courts, he said, would prove a better vehicle for improving corporate accountability than Congress. "Corporate governance reform is hard to come by. Corporations are too strong."

Pay problems

The Enron/WorldCom fiasco has revived the debate on excessive executive pay. John Biggs said that "good CEOs can't be overpaid." But he said that options can reward executives whose companies have underperformed their peers but whose share price has risen on the back of generally favourable market conditions. This, he said, "is an exploitation of us as shareholders."

Biggs sits on the board of Boeing, which is one of the few US companies to account for share options as an expense. Other companies, including General Motors, General Electric, and Citigroup, have since announced that they will follow suit.

Domenico De Sole, CEO of fashion group Gucci said he had no problem expensing share options. He said: "Overall, the system works. There have been abuses, but in general, options have created a lot of wealth, primarily for investors."

Governance Milanese

The ICGN conference, which in recent years has taken place in Frankfurt, New York and Tokyo, seeks local market views on corporate governance, and the eighth annual conference in Milan was no exception.

Italian investors, executives and regulators were well represented. Many made the point that the travails in US markets proved that no one system of governance was necessarily superior to any other.

At the same time, however, they stressed that Europe would do well to study the collapse of Enron and see what lessons could be learned.

Alessandro Profumo, CEO of Unicredito Italiano, the Italian financial services company, defended the common ownership structure in Europe, whereby companies are typically dominated by one or two sizeable shareholders. He said: "There is no system of superior quality. Wide share ownership structure is not superior to close ownership."

Massimo Capuano, president and CEO of the Borsa Italiana, said: "I don't see a serious gap between our regulation and international best practice. Nor do I see great room for improvement."

Luigi Spaventi, chairman of Consob, the main Italian markets regulator, said that Europe's governance standards are the equal of any market. "Recent regulation means that Europe is not behind the US, and in some ways is ahead," he said.

Capuano pointed out that among the top 55 Italian companies, 98% now feature independent directors on their boards, and 92% have appointed a person to run the internal control system, up from just over 50% last year.

Additionally, 84% of companies have remuneration committees, up from less than two-thirds in 2001. External auditors must also be rotated at least every nine years. Capuano said: "The move by Italian companies to good corporate governance is a significant change."

Standards of reporting have also improved, though this is frequently not realised by global investors. Capuano said: "Sometimes, the international community isn't aware of the ways they can get information from the Italian market."

Governance in Italy has improved, but the speakers stressed that there was more to do. Spaventi said: "The legal protection of shareholders has been greatly improved in Italy. But while legal remedies are adequate, they have been used rarely if at all by minority shareholders, because of the cost and length of the judicial process."

Profumo said "we lack the presence of long-term institutional investors. The pension system is not yet developed."

Other European speakers were also keen to guard against complacency. Jaap Winter, legal adviser to Unilever and chair of the 'wise men' group advising the European Commission on company law reform warned that meltdowns on the scale of Enron and WorldCom "can and will happen here."

Although the scale of US corporate fraud has been stunning, said Winter, at least a police force, in the form of the SEC, exists to pursue wrongdoers. He asked: "But who is going to chase EU companies? I do not feel comfortable about the EU system."

ICGN – a transatlantic presence

In July 2002, the ICGN was active in pressing regulators in both the US and Europe to adopt the highest possible standards of good governance.

Just prior to the annual conference in Milan, the ICGN's outgoing chairman, Peter Clapman, wrote to Frits Bolkestein, the EU internal markets commissioner, to register the ICGN's concern at draft EU directives on prospectuses and company reporting.

The directives set common European standards for information provided in company prospectuses and in financial reports. But, according to the ICGN, the standards represent the weakest standards found in the EU, rather than the best. Markets with relatively demanding reporting requirements, such as the UK, would find those standards swept away.

Clapman wrote: "Given recent events, it seems a strange time to prevent local regulators from setting levels of investor protection above the very minimal levels set in the directives.

"There would be no scope for variation in the protections of shareholders from the very low level set in the directives and investors might find themselves faced with a range of possible investments with low levels of corporate governance and shareholder protection."

Shortly after the Milan conference, Alastair Ross Goobey, the Network's newly appointed chairman, wrote to the New York Stock Exchange exhorting them to adopt tough new listing standards on corporate governance.

The proposed standards were the work of a NYSE committee, which recommended that listed company boards be required to include a majority of independent directors, that companies seek shareholder votes on all equity-related compensation plans, and that CEOs certify all material disclosures as accurate. A new, more rigorous definition of director independence was advanced, as were new standards for audit committees.

"We believe that the recommendations of the NYSE Committee will be important in helping to re-establish investor confidence in the wake of the series of corporate governance, accounting and disclosure scandals that have caused investors to question the treatment of investors in American stocks," wrote Ross Goobey.

"The Committee report is a responsible set of incremental improvements, based on the established principles of independence, accountability and transparency," he wrote.

The letters can be viewed at www.icgn.org/principles.htm

Global pact on pay

At the 2002 annual meeting, the ICGN membership endorsed a set of principles designed to check excessive executive pay.

The principles, which were drawn up by an international committee of investor, corporate and company adviser representatives, offer a common-sense approach to the setting of pay. They emphasise transparency and pay for performance, and seek an end to egregious pay practices such as company loans to executives.

The committee, chaired by the ICGN's newly installed chairman Alastair Ross Goobey, said the aim of the draft principles was to "help create a consensus about the structure of remuneration packages around the world that both company and investment managers will accept."

"The risk," writes Ross Goobey in the committee's draft report, "is that with such a diverse membership, we might only have been able to agree on a 'lowest common denominator' structure, but I hope that in the event we have made more progress than that."

The principles were broadly approved by the ICGN. Linda Selbach of Barclays Global Advisers and a member of the ICGN's board of governors, has taken over as chair of the committee and will work through members' suggestions on amending some of the fine detail of the draft.

One key change will be made, following an earlier consultation with members. The principles currently propose that all companies should submit the report of the remuneration committee to an annual vote. At present, no market has such a requirement (although it will become mandatory in the UK from 2003) and ICGN members felt there was little chance that such a measure would be adopted in other markets.

US investors, in particular, saw no chance of this reform gaining ground in their home market. "It may be a step too far," conceded Ross Goobey.

Instead, the amended principles will call for "a clear process of making pay accountable to shareholders." Ideally, this would be a vote on the pay report, but the ICGN recognises that practice will vary by market.

Other principles call for remuneration committees to publish statements on the expected outcomes of pay schemes, for options to be issued regularly rather than in one large batch, and for pay committees to have the power of appointment over pay consultants.

The ICGN also censures companies making loans to executives, a widespread practice in the US and one of the key elements of the WorldCom scandal.

The ICGN voiced its support for efforts by the International Accounting Standards Board (IASB) to introduce a standard for stock options to be booked as an expense.

While US companies vigorously opposed such an accounting treatment when it was first mooted in 1995 by the Financial Accounting Standards Board (FASB), the US standards setter, the recent scandals have caused the ground to shift in the debate. Numerous companies – including GM, GE, Coca-Cola, and Citigroup – now want to demonstrate the integrity of their accounts, and have announced that they will expense options henceforward.

ICGN Draft Principles of Best Practice on Executive Remuneration

- 1-The fundamental requirement for executive remuneration reporting is transparency. The base salary, short-term and long-term incentives, as well as other payments and benefits for all main-board directors, should be published.
- 2-Remuneration committees should publish statements on the expected outcomes of the remuneration structures, in terms of ratios between base salaries, short-term bonuses and long-term rewards, making both 'high' and 'low' assumptions as well as the 'central' case.
- 3-We accept that share options, although not ideal vehicles, will continue to play a part in remuneration packages. We believe they should not be the only means of creating longer-term incentives. They should also be issued regularly, rather in one large batch. This should obviate the need for repricing. In exceptional circumstances, a company should put any proposal for repricing to its shareholders through a vote at an annual meeting. Shareholders would be better served if the vesting period for options was to be no less than three years in most circumstances.
- 4-The Committee supports the attempts by the IASB to make the true cost of options (and any other benefits) a charge to the revenue account.
- 5-The Committee recommends that a remuneration report be presented as a separate voting item at every annual meeting.
- 6-Remuneration Committees should have the ultimate say over the appointment of and terms on which remuneration consultants are recruited.
- 7-Companies should not lend to their directors, or set up remuneration schemes by which executives are substantially incentivised separately from the outcome to shareholders.
- 8-The Committee is opposed to the payment of cash transaction bonuses on the completion of takeovers or mergers.
- 9-Investing institutions need to increase the resources being addressed at the analysis of remuneration resolutions.

These principles will be finalised following consultation with members.

See www.icgn.org/principles.htm for the final version

And ... action!

The ICGN ushered in an ambitious programme of research, awareness raising and campaigning for the forthcoming months.

The Cross-Border Voting Committee will devise model rules to protect investors in American Depositary Receipts, following an ICGN analysis of the investor rights shortcomings of many ADR programmes. (See ICGNNews issue 4, April 2002)

The ICGN will initiate a set of principles covering the governance of pension funds and fund managers. Geer Raaijmakers, a legal expert at the Dutch pension fund ABP, will head a panel to draft the principles. He promises a "framework of fiduciary duties."

The Network will also re-visit its corporate governance principles, first issued in 1999. Peter Dey will lead a project to see how the principles should be updated.

Go Dutch ...

The ICGN membership voted to approve Amsterdam as the venue for the ninth annual conference in July 2003. The Euronext stock exchange has kindly agreed to act as hosts.

... on the road to Rio

Get ready to pack your beach towel and sunscreen for the 2004 tenth annual conference, due to be held in Rio de Janeiro, following a joint invitation from BOVESPA (Bolsa de Valores de Sao Paulo, CVM (Commissao de Valores Mobiliarios), and IBGC (Instituto Brasileiro de Governanca Corporativa).

Hallelujah chorus for Monks and Jesus

The ICGN Awards Committee lauded two governance pioneers for their contribution to improved global governance.

The annual awards, now in their second year, were made to:

- ▶ Robert Monks
- ▶ Dr Jesus Estanislao

Robert Monks is a veteran leader of the governance movement, both in the US and worldwide. In the 1980s, as the US private pensions regulator, he first alerted funds to their responsibility to use their voting rights conscientiously.

He later founded Institutional Shareholder Services, now the world's largest proxy vote adviser, before establishing the Lens fund as a dedicated shareholder activist vehicle for targeting underperforming and poorly governed firms.

His latest venture, with Nell Minow, is The Corporate Library, an online portal for governance news, analysis and opinion. Monks is also the author of numerous books, including, Power & Accountability and Corporate Governance (both with Nell Minow), and The Emperor's Nightingale and The

New Global Investors.

Dr Jesus Estanislao has a long and distinguished career of fostering better governance practice in the Philippines, and in Asia generally.

He has headed the Development Bank of the Philippines and has served as the Secretary of Finance. As his country's chief economic officer in the late 1980s, he oversaw the economic recovery and reform programme in the newly reinstalled democracy.

Currently, he chairs the President's Governance Advisory Council, which advises President Gloria Macapagal-Arroyo on governance issues. He is also University Professor at the University of Asia and the Pacific.

Additionally, he heads two private institutes committed to governance reforms: the Institute of Corporate Directors (for corporate governance) and the Institute for Solidarity in Asia (for national governance).

Monks and Estanislao now join a distinguished roll call of ICGN Award recipients, which includes Sir Adrian Cadbury, Ira Millstein and Professor Hasung Jang, who were each recognised in 2001.

New governors on board

At the business meeting following the annual conference in Milan in July 2002, the ICGN membership elected three new individuals to the board of governors, as well as a new chairman. The incoming governors are:

- ▶ **Peter Dey**, a partner with Toronto law firm Osler, Hoskin & Harcourt, and author of the influential Dey Report, the Toronto Stock Exchange's prevailing governance code
- ▶ **John Wilcox**, vice chairman of Georgeson Shareholder and chair of the ICGN's cross-border

voting committee

- ▶ **Alastair Ross Goobey**, ex chief executive of UK fund manager Hermes and currently chairman of Hermes Focus Asset Management (HFAM)

Stepping down from the board, after serving their three-year limit, were Peter Clapman and Claude Lamoureux. Peter Butler of HFAM also stood down.

Ross Goobey was appointed the new chairman of the board of governors.

A full list of board members can be found at the bottom of this page.

The International Corporate Governance Network seeks to bridge the gap between corporate management and shareholders. The ICGN is an international, informal network of institutional investors, shareholder advocates and corporate governance experts. ICGN members together hold assets totalling some US\$10 trillion.

The ICGN Board of Governors

- Peter Dey, Osler, Hoskin & Harcourt LLP, Canada
- Alastair Ross Goobey (chairman), Hermes Focus Asset Management, UK
- Stephen Davis, Davis Global Advisors, USA
- Peter deKoning, Corporate Governance Research

Foundation For Pension Funds, Netherlands

- Leo Goldschmidt, European Assoc. of Securities Dealers (EASD), Belgium
- Sandra Guerra, Instituto Brasileiro de Governanca Corporativa (IBGC), Brazil
- John Wilcox, Georgeson Shareholder, USA

- Sophie L'Helias, Franklin Global Investor Services, France
- Jon Lukomnik, Sinclair Capital, USA
- Ariyoshi Okumura, Lotus Corporate Advisory, Japan
- Linda Selbach, Barclays Global Investors, USA
- Dario Trevisan, Trevisan & Associati, Italy

The ICGN Secretariat is administered by Ms Caroline Phillips, Director of the Policy Unit of the Institute of Chartered Secretaries & Administrators (ICSA).
16 Park Crescent, London W1B 1AH, UK Tel: +44 (0)20 7580 4741 Fax: +44 (0)20 7612 7034 Email: icgn@icsa.co.uk

Editor, ICGN News: Kit Bingham Tel: +44 (0)20 7328 6656 Fax: +44 (0)20 7328 7237 Email: kbingham@governance.co.uk