Asia-Pacific
Economic Cooperation

2011/SOM1/EC/WKSP1/009
Session 4

Advancing Good Corporate Governance

Submitted by: Georgetown University

APEC
USA 2011

Workshop on Advancing Good Corporate Governance by Promoting Utilization of the OECD Principles of Corporate Governance
Washington, D.C., United States
2 March 2011

Advancing Good Corporate Governance

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APEC – Advancing Good Corporate Governance

March 2011

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Changing Regulatory Structure

- Board Structure
- Director Election
- Compensation
- Proxy Access and Voting
- Disclosure/Registration

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Public Criticism of Boards

Company	Industry	Nature of Criticism
Bear Stearns	Financials	The board lacked sufficient financial expertise and failed to challenge sufficiently the company's dominant CEO.
Countrywide	Financials	The board failed to challenge sufficiently the company's dominant CEO.
Lehman Bros.	Financials	The board lacked sufficient financial expertise and failed to challenge sufficiently the company's dominant CEO.
WaMu	Financials	The board failed to safeguard the company.
Dillard's	Consumer Discretionary	The board was too loyal to the Dillard family, founders of the company.
Anheuser-Busch	Consumer Staples	The board was too "clubby" and too loyal to the Busch family and CEO August Busch IV.
Merrill Lynch	Financials	Directors moved too hastily in agreeing to sell the company to BOA.

Source: Cheffins, Brian R., 2009, Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Business lawyer, Vol. 65, No. 1.

Publicized Senior Executive Turnover

Company	CEO	Other Senior Executives	Circumstances
Circuit City	Yes	Yes	CEO quit under pressure from shareholders
Commerce Bancorp	Yes	No	CEO and founder quit in late 2007
Bear Stearns	Yes	No	CEO stepped down but remained board chairman
Ambac Financials	Yes	No	CEO resigned
Fannie Mae	No	Yes	The CFO and two other senior executives were replaced
Lehman Bros.	No	Yes	COO and finance director were replaced

Source: Cheffins, Brian R., 2009, Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Business lawyer, Vol. 65, No. 1.

Dodd-Frank Act 2010

- Sweeping in scope
- More powerful Federal Reserve Board
- Does not address Fannie and Freddie
- Significant regulations for derivatives
- Regulators are to write the detailed rules
- Global regulatory arbitrage?
- Reduced leverage and systemic risk, increased capital

New Agencies

- Consumer Financial Protection Bureau ("independent" with Fed)
- Financial Stability Oversight Council (stand-alone)
- Federal Insurance Office (Treasury)
- New Offices of Minority and Women Inclusion (banking and securities regulators)
- Investor Advisory Committee (stand-alone; to advise SEC)
- Office of Investor Advocate (SEC)
- Office of Credit Ratings (SEC)
- Credit Rating Agency Board (SEC)
- — Office of Financial Literacy
- Office of Financial Research (Treasury)
- Office of Housing Counseling (HUD)
- Office of Fair Lending and Equal Opportunity (Fed)
- Office of Financial Protection for Older Americans (Fed)

Shareholder Approval Vote of Executive Compensation

Say on Pay (January 2011)

— Gives shareholders the right to a non-binding vote on executive pay at least once every three years

- Nonbinding vote on golden parachutes

- Institutional investors must disclose how thy voted on say on pay

Pay and performance disclosure requirements

— historical relationship between executive compensation and financial performance of company (changes in total shareholder return)

— median annual compensation of all employees and annual compensation of the CEO

— disclose of whether employees can hedge the value of equity securities

Recovery of Erroneously Awarded Compensation

- **Clawback, Recovery of “excess” incentive compensation**

— Take back executive compensation if it was based on inaccurate financial statements that don’t comply with accounting standards

— Restatement due to noncompliance with financial reporting requirements

- Recover “excess” amount paid during the three years preceding the restatement date
- Applies beyond CEOs and CFOs to all executive officers

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Compensation Committee Independence

- Compensation committees must consist of only independent directors
- Compensation Committee responsible for appointment, compensation, and oversight of independent compensation consultants and other advisers
- These will be part of exchange listing requirements.

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Some Notable Cases

under Section 304 of the Sarbanes-Oxley Act of 2002

SEC's First Use of SOX "Clawback" Against Uncharged Executive

- *SEC v. Jenkins (2009)* – lawsuit against Maynard L. Jenkins, former CEO of CSK Auto, to reimburse the company and its shareholders more than $4 million he received in bonuses and in profits from selling stock while the company engaged in alleged accounting fraud.

- *SEC v. O'Dell (2010)* – seeking reimbursement for bonuses and other incentive-based and equity-based compensation against Walden W. O'Dell , Diebold's former CEO and chairman. (The settlement was reached. O'Dell agreed to reimburse the company more than $470,000 in cash bonuses, 30,000 shares of Diebold stock and 85,000 stock options even though he wasn't accused of misconduct.)

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Shareholder Proposals

Company	Nature of Proposal	Type of Shareholder	Votes Cast in Favor
Electronic Data Systems	Adoption of "say on pay"	Individual	41%
WaMu	Split CEO/chairman of the board	Union pension funds	42% to 51%
General Growth Properties	Repeal classified board	Union pension funds	76%
Ashland	Majority voting for directors	Union pension funds	63%
Anheuser-Busch	Adoption of "say on pay"	Individuals	42% to 44%
Wachovia	Adoption of "say on pay"	Union pension funds; individuals	6% to 29%
Merrill Lynch	Adoption of "say on pay"	Union pension funds; individuals	9% to 36%

Source: Cheffins, Brian R., 2009, Did Corporate Governance "Fail" During the 2008 Stock Market Meltdown? The Business lawyer, Vol. 65, No. 1.

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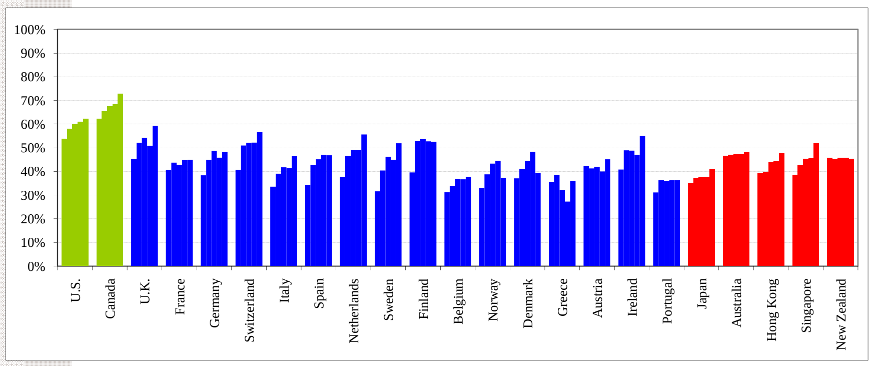
Governance by Country

Figure 1
Governance Index by Country and Year

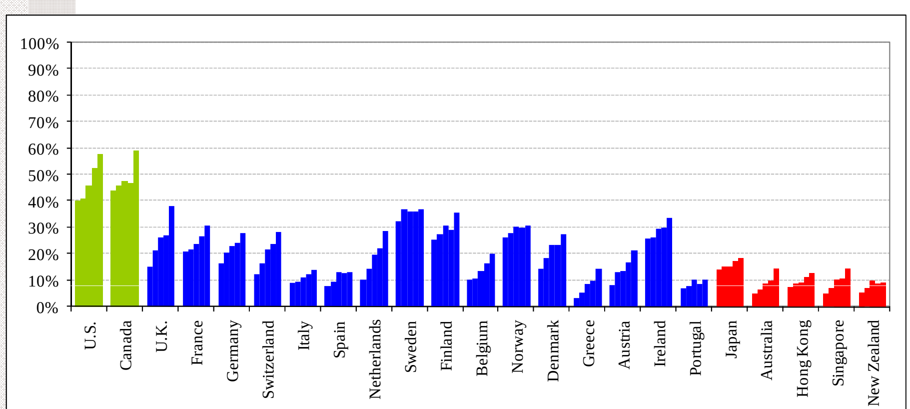
This figure shows the average of the firm-level governance index (GOV_{41}) by country and year in 2004-2008. GOV_{41} is the percentage of the 41 governance attributes that a firm meets, as described in Appendix A. An index of 100% means that a firm has adopted all 41 governance provisions.



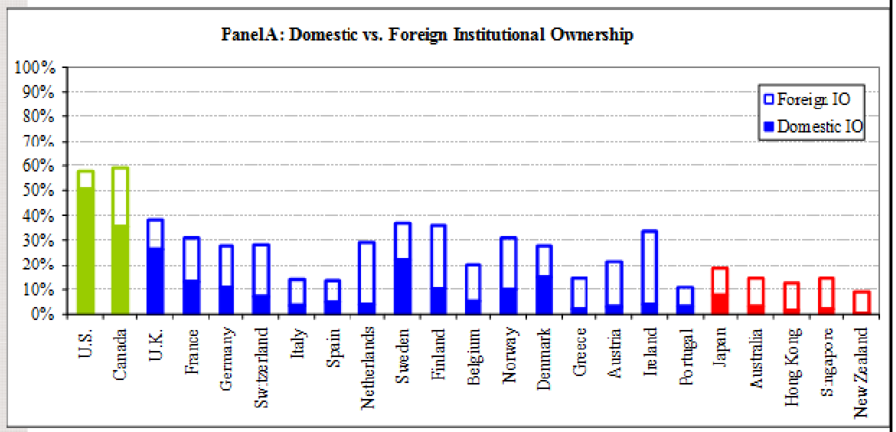
Source: Aggarwal, Erel, Ferreira and Matos (2011) http://faculty.msb.edu/aggarwal/

Figure 2
Total Institutional Ownership by Country and Year

This figure shows the average total institutional ownership by country and year in 2003-2007. Institutional ownership is the sum of the holdings of all institutions in a firm's stock, as a fraction of its year-end market capitalization.



Source: Aggarwal, Erel, Ferreira and Matos (2011) http://faculty.msb.edu/aggarwal/



Source: Aggarwal, Erel, Ferreira and Matos (2011) http://faculty.msb.edu/aggarwal/

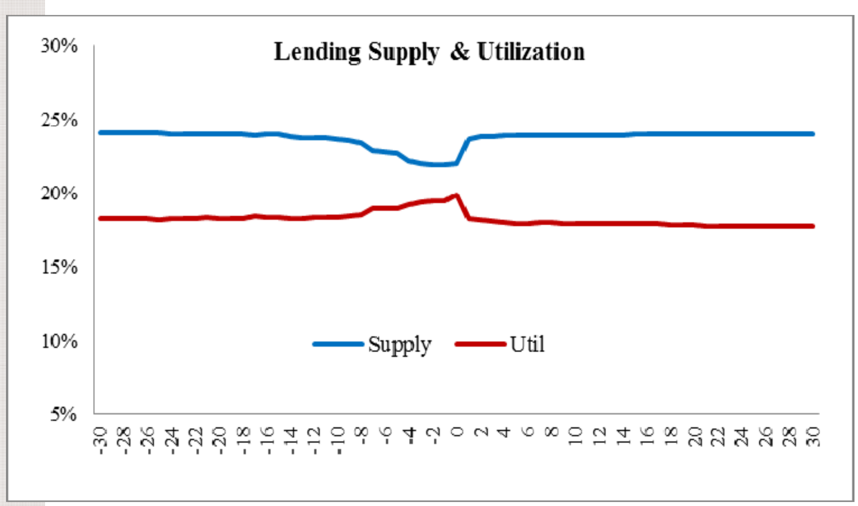
Broker Votes

- Prohibit brokers from voting shares for director elections, executive compensation, or other significant matters
- (January 1, 2010 – SEC has prohibited broker voting in director elections)

Potential Impact

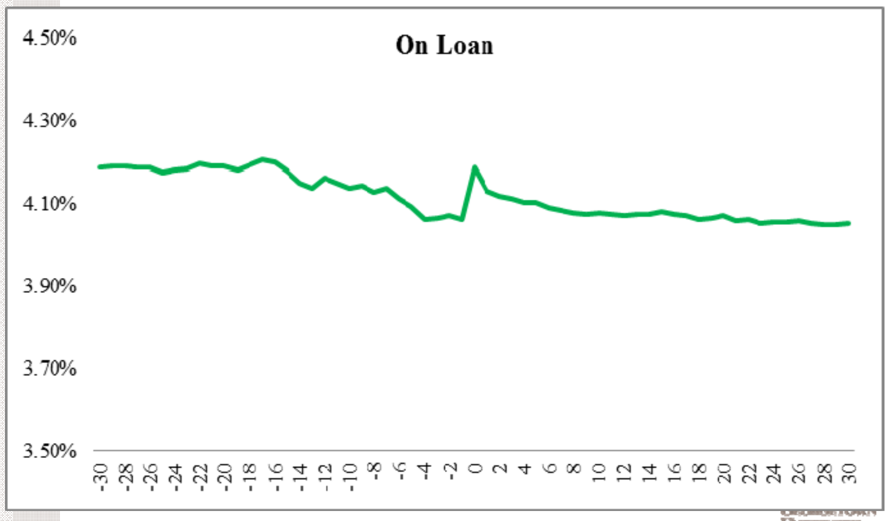
- Reduce the number of proxy votes in firms with a high proportion of retail stockholders (particularly for SMEs)
- Increase the influence of institutional investors
- Proxy advisory firms' position?

Securities Lending and Proxy Voting



Source: Aggarwal, Saffi and Sturgess (2011)

Securities Lending and "Empty" Voting



Source: Aggarwal, Saffi and Sturgess (2011)

Proxy Access

- SHs can nominate directors to be included in the company's proxy materials
- 3% ownership, 3 years
- Smallest companies (less than $75 million) are exempt for 3 years
- Up to 25% of companies boards

Potential Impact

- Give more power to institutional investors or large shareholders
- Decrease shareholders' costs to wage proxy fights and simplify the process
- Lots of unknown consequences, experiment on larger companies first

Governance Trends

		2003	2009
1.	Directors attended 75% of board meetings	93.0%	99.94%
2.	CEO serves on the boards of two or fewer public companies	95.9%	99.13%
3.	Board is controlled by more than 50% independent outside directors	69.3%	92.04%
4.	Comp committee comprised solely of independent outsiders	62.1%	82.59%
5.	Chairman and CEO are separated or there is a lead director	52.6%	48.27%
6.	Nominating committee comprised solely of independent directors	22.6%	72.20%
7.	Annually elected board (no staggered board)	44.5%	53.01%
8.	Board has authority to hire its own advisors	5.3%	95.84%
9.	Performance of the board is reviewed regularly	6.8%	72.05%
10.	Board approved succession plan for CEO	5.4%	61.32%
11.	Outside directors meet without CEO and disclose # of times met	1.7%	53.81%
12.	Consulting fees to auditors less than audit fees	64.0%	99.48%
13.	Audit committee comprised solely of independent outsiders	70.3%	90.28%
14.	Majority vote to approve mergers (not supermajority)	59.4%	74.67%