

RESTORING CORPORATE INTEGRITY AND PUBLIC TRUST

SUMMARY OF A CONFERENCE BOARD CONFERENCE

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Introduction

An exceptional group of speakers drawn from corporate and government sectors gathered in New York City in mid-April to discuss the demise of trust in corporations resulting from corporate malfeasance. They offered some thoughts about how to rebuild that trust. Among the speakers were President Clinton, NYSE Chairman Dick Grasso, New York State Attorney General Eliot Spitzer, President John Sweeney of the AFL-CIO, and Arianna Huffington, author and columnist. What follows is a summary of the highlights of their remarks.

WELCOME

WALTER H. SHORENSTEIN

Founder, The Shorenstein Company

RICHARD E. CAVANAGH

President and CEO, The Conference Board

LEON PANETTA

Director, The Panetta Institute

DICK GRASSO

Chairman and CEO, New York Stock Exchange

WELCOME DISCUSSION

- Panelists agreed that there is a need to bring confidence and trust back to capital markets. The market is currently discounted by war, terrorism and lack of trust.
- Interest in markets is broad as there are 15,000 publicly traded companies and 46% of adults are shareholders.
- Currently, we are experiencing the best and worst outcomes of a free market. The best part is that we are leading a global economic expansion. The worst part is the loss of trust in a great capital markets. What we must do:
 - Communicate openly and without spin
 - Send the message to the American public that wrongdoers will be routed out; no one is above the law. If you rob a bank, you go to jail. If you rob shareholders and employees, you go to jail. Swift punishment is needed for those who abuse public trust.
 - Reform must happen with Sarbanes-Oxley. Also, there is a need for self-regulation and change initiatives.
 - Customers must come first. We have lost focus on the customers. Any business not putting customers first will eventually go out of business.

- Banker and Analyst must never “meet.”

PANEL: WHAT ARE THE NEW RULES OF THE GAME?

MODERATOR

DAVID GERGEN

Director, Center for Public Leadership; John F Kennedy School of Government,
Harvard University

PANELISTS

M. JANE BRADY

Attorney General, Delaware

CAROLYN KAY BRANCATO

Director, Global Corporate Governance Research Center, The Conference Board

ALAN G. HEVESI

New York State Comptroller

JAMES H. QUIGLEY

U.S. Chief Executive Officer-Elect, Deloitte & Touche

MELVIN I. WEISS

Senior Partner, Milberg, Weiss, Bershad, Hynes & Lerach LLP

DISCUSSION:

- There should be a balance of power among management, Board, and shareholders; management runs the company, the Board oversees it, and shareholders elect the Board. The SEC, stock exchanges, state legislation, shareholders and enterprise risk must put on pressure to keep the balance. In response to this lack of balance, The Conference Board Commission looked at compensation, Board structure and processes, and shareholder involvement.
- Corporations need better tools to raise “red flags” to signal when they are “out of balance.” Boards need professional management processes.
- Globalization has created complexity.
- 80% of corporations are domiciled in Delaware and their Attorney General needs to be reckoned with. In addition, case law is now going beyond “the letter of the law.” Regulation of business practices has grown.
- We need to absorb the changes resulting from the new legislation, and then evaluate its effectiveness before rushing into new regulations. It is difficult to detect fraud when large numbers of people are involved.
- Investors do not have trust yet and feel that more regulation is needed. Legislation has been adopted hastily. Attorney Generals are involved because regulatory agencies failed. SEC failed. Institutional investors failed. We have to ensure regulations are obeyed.
- Mergers and acquisitions destroyed the “familial” relationships that corporations used to enjoy with employees, vendors and suppliers. Society is transient. Shareholders now have a short term view; average holdings are about 1 year. We went through a period of self-indulgence, feeling of self-entitlement and greed. Sarbanes-Oxley has given us rules, now we must abide by them. It is of concern that only 4 big firms are left to audit the large companies. It will be difficult for

(3)

- them to act independently when billions of dollars of business is at stake.
Accounting firms must be free to ferret out the fraud.
- Well-run companies are doing 70-80% of what should be done for good corporate governance.
 - Boards need to be more proactive and need to determine better means to uncover red flags.
 - Enforcement processes are necessary, but we also have to have reform processes within institutions. A Board should have its own legal counsel. Boards need to be trained to ask the right questions.
 - The challenge for the Audit Committee is that its responsibilities are more complex and time-consuming. CEO compensation needs to be addressed. When investigations within a company take place, the Board should bring in new legal counsel.

PANEL: ENFORCEMENT OPTIONS AND ACCOUNTABILITY

MODERATOR

ELIOT SPITZER

Attorney General, New York State

PANELISTS

STUART J. BASKIN

Senior Partner, Shearman & Sterling

ARIANNA HUFFINGTON

Columnist and Author

CHARLES A. JAMES

Vice President and General Counsel, ChevronTexaco Corporation

RICHARD H. MOORE

North Carolina State Treasurer

JOHN J. SWEENEY

President, AFL-CIO

DISCUSSION:

- In 1980, the ratio of CEO pay to average worker pay was 42 to 1. In 2001, this ratio was 411 to 1. The executive compensation issue is not a legal or procedural issue, it is a Shareholder issue.
- The links in the chain of corporate decision making (CEO, Legal, Auditors, and Board) have failed. We need to examine these links and determine if we have really been addressing the issues. Shareholders have to have greater voice.
- Institutional investors have to exercise responsibilities and rights. Institutional investment managers need to vote in the best interest of the shareholders. The dilemma is that they do not have the sophistication to take on these responsibilities.
- Management needs to understand that they cannot continue to get golden parachutes.
- Employee representation is needed on the Board.

- The issue is how to eliminate groupthink on Boards. Independence is absolutely necessary. Reporting to shareholders must be clear so that it is easy to see the obvious. Institutional investors have abdicated rather than flexing their muscles.
- Current tax system is so complex, it is difficult to disclose.
- Companies should not get huge tax shelters on one hand and huge government contracts on the other e.g., Accenture moved to Bermuda for tax shelter and got \$1 Billion contract to redo government web site, Halliburton's contract in Iraq.
- Labor union members are soliciting changes in corporate governance.
- It is shameful that the wealthiest 1% is getting the greatest benefit from the tax cut.
- CEOs should return their additional compensation when abuse occurs.

SPITZER: Should there be structural reform, or indictments which may mean the demise of a company, e.g., Andersen?

- It is of concern that if a company is big enough, it gets bailed out. This is not true for small companies. Just paying fines will not change the culture; individuals should be made an example of, not just corporations.
- Punishment should be proportionate to the offense. At Andersen, a few individuals' actions brought down the company.

SPITZER: Will self-regulation work?

- It will generally work. Procedural changes have fostered new thinking in corporate America.
- No. There is a need for structural system of legislative requirements. Regulation is needed. In the eyes of corporations, self regulation means hiring lobbyists to manage the regulations.

SPITZER: How do we restore trust?

- We need to have several periods where earnings have not had to be restated.
- Trust will not be restored as long as we have current CEO compensation structures and amounts.

LUNCHEON DISCUSSION

MODERATOR

MARVIN KALB

Senior Fellow, Joan Shorenstein Center on the Press, Politics and Public Policy
John F. Kennedy School of Government, Harvard University

GUEST

PRESIDENT WILLIAM JEFFERSON CLINTON

DISCUSSION:

KALB: Did you see or should you have seen these scandals coming? (the following is not meant to be direct quotes, but rather summaries of remarks.)

CLINTON: We did not see specific cases, but Levitt and Summers were trying to address the abuse. We knew that regulatory climate was inadequate. Republicans blocked efforts.

KALB: What would you do to help the economy?

CLINTON: Scrap the proposed tax cut. It is not right that the affluents' taxes will be reduced while cutting back on important programs like after school programs. We would put a ceiling on the high end income relative to the 2001 tax cut. A group of distinguished economists and investors should be brought together to discuss ways to stimulate business investment, incentives to pay off debt, and what to do to bring back foreign investment.

KALB: How do we restore trust?

CLINTON: More regulation is needed. SEC oversight is important to ensure that Boards of Directors are doing their jobs. Significant stock sales by executives should be revealed immediately.

KALB: Please share your thoughts on world issues.

CLINTON: There is interdependence in the world. We cannot send mixed messages. During the 1990's we highlighted interdependence and we felt the benefits. We opened borders and had easy immigration. Underneath, the issues were there, e.g., terrorism. We need to turn the interdependent world into an integrated global community. When people are under stress, they don't like to think; this is when they need to think. We cannot have the attitude that everyone else in the world must agree with us, or we tell them to go to hell. We cannot badmouth the U.N., France and Germany; we didn't when they were helping in Afghanistan. Over the long run, we work together in the world. I think Bush has a wonderful opportunity to use the victory in Iraq to unite the world, e.g., rebuild Iraq, and defuse Korea.

MOVING FORWARD: RESTORING INVESTOR AND PUBLIC CONFIDENCE MODERATOR

RICHARD E. CAVANAGH

President and CEO, The Conference Board

PANELISTS

JOHN C. BOGLE

Founder and Former Chairman, The Vanguard Group, Inc

B.A. (DOLPH) BRIDGEWATER, JR

Retired Chairman and CEO, Brown Shoe Company; Senior Consultant,
Corporate Governance, TIAA-CREF

GAIL D. FOSLER

Senior Vice President and Chief Economist, The Conference Board

RODERICK D. GILLUM

Vice President, Corporate Relations and Diversity, General Motors Corp.

THOMAS J. HEALEY

Senior Fellow and Adjunct Professor, Center for Business and Government
John F. Kennedy School of Government, Harvard University

JAMES E. TIERNEY. ESQ.

Former Attorney General, Maine; Instructor, Columbia Law School

DISCUSSION:

- There is major damage to investor trust. This is illustrated in the Conference Board's Commission on Public Trust and Private Enterprise document.
- Public thoughts on the prevalence of incidents of corporate wrong doing:
 - 46% - every company does it
 - 38% - much more to come
 - 16% - just a few bad apples
- People who can be trusted:
 - 75% people who run small businesses
 - 75% military officers
 - 23% CEOs of large corporations
 - 15% car dealers
- Do top executives of a large corporation take improper actions to help themselves at the expense of the corporation?
 - 79% responded that improper actions are "very" or "somewhat" widespread
 - 20% occasionally happens
 - 1% never happens
- How do you rate the investment climate?
 - 60% said it is bad
- What will the investment climate be in 6 months?
 - 15% worse
 - 65% same
- How credible are earnings reports?
 - 3% very credible
 - 30% not at all credible
- How credible are profit projections?
 - 2% credible
 - 40% not all credible
- Trust in Auditing firms:
 - 2% more trust
 - 36% less trust

- It is the first time in post WWII that the stock market and bonds are going down in a recovering market. Investors are not willing to take a risk because trust is so low.
- SEC has a lot of priorities. They need rapid victories to restore confidence; they need to help in recruiting and training accountants and lawyers; they need to ensure auditor rotation; need disclosure of CEO compensation; if found guilty

- e.g., HealthSouth, executives need to spend time in jail. Voltaire said, “Every once in a while we need to hang an Admiral, just to show we can.”
- Institutional investors in the short term need to help shape and influence regulatory and legislative response. In the long term, they need to help honest institutions be successful by developing governance principles, structuring processes, talking with companies out of line, and making Boards more effective.
 - We need to have independent Chairmen and independent Directors. They need to have a set of principles which will build global trust and monitor them. There is a cost to malfeasance. There are positive returns from good corporate governance, e.g., increased revenue because people like doing business and employees like working for companies with ethical reputations. Independent Directors mean independence of perspective, having strong Committee Chairs with high integrity, being knowledgeable and willing to challenge. Directors need to push as hard during good times as during bad times. Ethics is doing the right thing, even if no one knows if you did the wrong thing.
 - Federation of Long Term Investors is hesitant, fearful of upsetting companies.
 - Ethics programs are very important. They should be in place and measure against Code of Ethics. Individuals need to be held accountable.

MEDIA COVERAGE: TELLING THE RIGHT STORY

MODERATOR

ALEX S. JONES

Director, Joan Shorenstein Center on the Press, Politics and Public Policy
John F. Kennedy of Government, Harvard University

PANELISTS

ANDREW HILL

U.S. Business Editor, *Financial Times*

CAROL HYMOWITZ

Senior Editor/Columnist, *The Wall Street Journal*

JEFFERY MADRICK

Columnist, *The New York Times*, Editor, *Challenge Magazine*

GRETCHEN C. MORGENSON

Columnist, *The New York Times*

STEPHEN B. SHEPARD

Editor in Chief, *Business Week*

DISCUSSION:

JONES: Does the Media have responsibility in the scandals and loss of trust?

- Media did not question enough the statements by executives, or earnings.
- We wrote about systemic issues, but did not relate them to specific cases, e.g., CEO compensation.
- Press did not want to find out about Enron. It was one of Fortune’s “Best Managed Companies.” It had such a compelling story that the press did not look deeply. Press became a participant in the process.
- Up until 2 years ago, the press was not allowed to talk directly to Directors. Press had to go through corporate management.

(8)

- We became concerned with “deals;” dotcoms distracted us.

JONES: Now, what has changed?

- We need to continue to report scandals.
- Journalists need more financial acumen, more training.

JONES: Are we currently distorting behavior of corporations by focusing on scandals?

- We are not looking hard enough to find things that are going well and there is a lack of people coming forth with positive stories.
- Remaining issues include: We have a lot of new leadership; where will they make a stance? How will SEC perform under new leadership? How will the economy perform? How will we handle the business of bankruptcy? What management ethos will replace the old?

CLOSING REMARKS:

JOHN C. BOGLE

Founder and Former Chairman, The Vanguard Group, Inc

- Directors need to change the way see themselves. Since there has been a diffusion of shareholders, Boards are not taking responsibility. Corporations that are privately owned or publicly owned by one major owner are not directly affected by regulations. Growth in CEO compensation has outpaced growth in earnings. Recently, there was a 25% reduction in profits while CEO’s compensation went up 5%.
- CEOs became master of the Board and the Board has not been taking care of faceless Shareholders. Management has controlled information, management and Board enjoy collegiality, CEO is considered an angel, so corporate governance is deemed not necessary and Directors fail to focus on long term interest of Shareholders. Stockholders should be responsible for corporate governance.
- Institutional investors should take responsibility; 100 of the largest institutional investors control ½ of all U.S. equity. However, they show little interest in exercising power. There is short term speculation (hold stock for an average of 11 months) and lack of interest in long term strategy. There is a conflict of interest in that they manage 401k’s in companies where they hold stock, so they do not want to upset management.
- It is necessary to (1) Improve corporate citizenship- shareholders need to vote; (2) Give institutional managers access to proxy statements; (3) Separate management ownership, have independent Chair; (4) Return to long term financial perspective; (5) Let sunlight shine on accounting, full disclosure of all accounting decisions; (6) Provide tax incentives, 50% tax on short term gains; (7) Bring back dividends, higher dividends on stock, higher the long term gain. Turnover of non-dividend stocks is 2 times that on dividend stocks. (8) We need a stronger set of corporate governance principles. Character is needed.