

PRESENTATION TO THE FORUM CLUB

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RESTORING TRUST AND CONFIDENCE IN OUR INSTITUTIONS --

THE NEW ERA OF CORPORATE ACCOUNTABILITY

Over the past three years, some things seemed to have gone terribly wrong.

Did it start with the spring 2000 collapse of the stock market? With news of financial shenanigans at public companies? Maybe it was the wave of corporate scandals. The toppling of CEO heroes and heroines. CEO perp walks on nightly TV news. Colossal corporate bankruptcies. Organized fraud at high levels. The “New Economy” evaporating. Along with seven trillion dollars of investor money. Investors are angry ... anxious.

Maybe it was the organized response, equally dramatic in scope, that made us nervous and uneasy. New risks are clearly posed for executives in Corporate America, with tougher criminal – not just civil penalties -- for white collar crimes. State prosecution of Wall Street’s most respected names ... firms and individuals. Investor class action lawsuits. “**Martha Inc.**” under daily media scrutiny. *Headlines, the endless negative headlines.*

And then again ... perhaps things are happening as they should, this dramatic response to equally dramatic disclosures of misbehaviors. And management-level behaviors that offend our values. As an optimist, I believe that out of the current turmoil, we can create an even stronger nation, and assure the long-term success of our great capital markets. We are on the road to recovery and success -- after all, our major index, the Dow Jones, is up 1,000 points since January! As New Yorkers, we have a ringside seat to all this drama – so much happening here in this city -- the financial and media capital of the world. And the players – *so many New Yorkers!* Black hats and white hats ... scoundrels and saviors ... wrongdoers and reformers ... all playing out the saga on this little island. But these events are bigger than New York – the impact of the current turmoil in our capital markets, in the corporate world, is national, even global in impact!

What is Going on?

What we are experiencing in our capital markets, in Corporate America, in the workplace, in government, in our religious and social sectors is, I believe, a great **reforming ... a long-term process of reformation** ... and part of the continuing perfection of the American Experiment in Democracy.

We are, after all, a Capitalist-based Democracy, with assurance of entry to the good life for all, on the basis of talent and merit -- and fair play.

Above all, our American values are traditionally based on fair play.

Some recent events were not fair play and have shaken investor confidence ... and now haunt the equity markets. Examples -- The sudden collapse of the 7th largest of the *Fortune 500s*, **Enron**. The largest corporate bankruptcy ever, **WorldCom**. Shady dealings at **Tyco International**. **Kmart**'s bankruptcy. **Arthur Andersen** disappearing – *and then were only the Big 4*. **Global Crossing** – with operations in 27 countries on five continents – collapsing without much warning. Are these events becoming old news? Not quite ...

More recently – we've heard revelations of billions of dollars' of shortfalls in employee pension funds at some of the biggest names in American business. Since last August, hundreds of companies "re-stated" former results – regulatory filings that were basically erroneous, fudged or containing totally fraudulent numbers. Restatements are an epidemic – what company is next, we wonder!

Hey, we're paying attention because much of this is personal – these were numbers that we believed, and equity investments that we counted on to build our wealth.

But we seem to be surviving. We have adjusting to the tech wreck of the NASDAQ Exchange, with three-fourths of the values at the high, as I said, "evaporating."

Yes, we get angry at the antics of high-riding executives who prosper handsomely – at our expense -- as the stock prices of their companies plummet and their personal departure packages soar. Decidedly unfair playing field -- 75% down for stock prices, and quadrupling of CEO goodbye payments!

All these seemingly endless revelations, disclosures of misbehavior. Is the news bad? Good?

On balance, good!

As **Justice Louis Brandeis** observed decades ago, "Sunshine is the best disinfectant!" A lot of sunshine is now being directed into some dark corners in Corporate America's executive suites and boardrooms, into the downtown financial district's narrow lanes, and into institutional settings in all spheres of American life. Public sector ... private sector ... social sector ... all are being disinfected by sunshine. At times the process is very painful to watch. And to experience.

The complexity of the problems experienced today by the American Corporate Sector, the U.S. financial markets, and investors can be reduced to four basic English words:

Credibility. Transparency. Trust. Confidence.

The first two – credibility, with abundant and real transparency – create the basis for the next two: Trust and Confidence.

Without trust and confidence in our financial systems, in our democratic way of governance, and in capital markets which underpin our success, our private and public lives would be dysfunctional. Worst case?

Think of the desperate times of October 1929 to Spring 1933. And to the serious economic consequences in the Era of what we know as “The Great Depression.”

Terrible times. One out of four heads of family unemployed. Rampant “deflation” of wages and savings. Warehouses stuffed with unsold goods. Banks failing. After the October 1929 crash, a real economic emergency existed throughout the American nation. The seeds of WW II were sown in those despairing years. We never want to go there again.

Thanks to the adoption of laws directed at securities industry regulation, banking and investor protection, and other reforms over the ensuing seven decades, we probably never will. Nevertheless, the work of reforming is not done yet. It is never really “done.” The stakes of the current reforms – this early 21st Century period of reformation -- are high for each of us. As high, I believe, as they were for our forebears and this nation 70 years ago.

Another word that you are hearing every day now, in news reports, government investigations, financial documents, and in common usage comes to mind:

Accountability!

I am going to speak briefly about **Accountability**, and what I believe is the **New, Long-term Era of Accountability** that our Society has embraced. The dimensions of the Era. And what is already in place as foundation for creating unprecedented accountability on the part of leaders of our institutions – and for every one of us in this room today.

The start of the new era can be traced in part to bold actions initiated by **President George W. Bush** – who focused on corporate accountability in his State of the Union, in January 2002, followed by his Administration’s “**Comprehensive Corporate Reform Agenda**,” which included a 10-point reform plan. This was announced in March 2002. The Bush agenda? To --

- Expose and punish acts of corruption;
- Hold corporate officers more accountable;

- Protect small investors and pension holders;
- Move corporate accounting out of the shadows;
- Develop a stronger and more independent corporate audit system;
- Provide better information to investors.

We are still following vigorously pursuing this agenda in summer 2003.

Congress, after intense debate, reached final agreement on new laws – across party lines, political persuasion, personal points-of-view -- after the bankruptcy of WorldCom, which had effects in many Congressional districts.

The bipartisan **Sarbanes-Oxley** package of new investor protection and corporate accountability laws – “**SOX**” -- was signed into law July 31 last year.

One indication of how important this legislation was: Some provisions took effect literally upon the signature of the President! Others are being phased in.

You’ve heard much about SOX since its passage. We should keep in mind there are 11 separate titles in SOX, some strengthening the landmark 1933 and 1934 securities regulation and investor protection Acts. Others address criminal sanctions and penalties for corporate executives; still others direct important studies by GAO and Internal Revenue Service that are ongoing.

The effects of SOX will be very broad: All publicly-traded companies will be covered by its provisions, to be phased in over the next two years. The impact of the President’s agenda and SOX are resulting in significant reforms. We should not dismiss these as “just today’s headlines.” Unfortunately, *some corporate and securities industry leaders have...and some still do.*

The Securities & Exchange Commission was significantly strengthened as regulator, monitor and prosecutor by SOX. As directed by Congress, SEC is creating tough new rules to implement SOX. Some go beyond the letter of the law.

SEC now has more money, more staff for monitoring and enforcement, and a new chairman, **Bill Donaldson**. He’s a New Yorker with decades of experience and accomplishment in both the capital markets and in Corporate America. He follows another prominent New Yorker – **Arthur Levitt** – who began or attempted to initiate many reforms within SEC during his tenure as Chairman.

We now have “Peek-a-Boo” – the Public Company Accounting Oversight Board – to oversee both the corporate auditing process and activities of public auditors. This body within SEC will “license” public company auditors and issue standards for auditing and accounting. Woe be to the auditors who play the financial reporting games of the 1990s!

SOX also addressed the behavior of corporate boards. The board audit committee now has a number of new responsibilities that cannot be avoided -- including hiring, firing and monitoring of the outside auditors. The audit committee must have a “financial expert” with intimate knowledge of financial reporting.

The historic role of legal counsel is changing. The American corporate bar has been “federalized.” Think about it – lawyers certainly are – states have traditionally licensed lawyers for the past 100 years. Lawyer behavior has been regulated by state organizations ... licensing departments, bar associations, state codes of ethics. Now, under Federal law, certain types of material information must be brought to the attention of the general counsel ... who must bring it to the attention of the CEO ... and the board ... and whistleblowers are to be protected.

Just who is the ultimate client here? One could argue – the shareholders!

Corporations must establish an internal system for what we often call the “ombudsman” process to handle important information from employees.

Talking about sunshine – it is now a federal criminal offense to interfere with internal whistleblowers. If we needed a sign that what some may call “snitches” inside the corporation are being elevated by public opinion and reflecting current values in the Society – take a look at *Time Magazine’s* Persons of the Year for 2002 – three prominent whistleblowers!

But Reform and Reformation doesn’t stop with SOX and the feds.

The New York Stock Exchange’s new corporate governance rules for listed companies were approved a few days ago by SEC. These include --

- Majority of directors to be independent.
- Nominating, compensation and audit committees – to be entirely independent.
- Five year cooling period for board members who were employees or employed by audit firm (before they can join the board).
- Adoption of a formal code of business conduct and ethics.
- Shareholder votes to approve all stock option plans.

NASDAQ Exchange rules, similar to the Exchange rules, were also approved.

Keep in mind that both are “**SROs**” or federally-authorized, self-regulating-organizations that create and enforce important rules for members – such as stockbrokers and investment bankers.

To prevent the financial shenanigans of recent years, SOX addressed accounting rulemaking, assigning responsibility to just two bodies, instead of a patchwork of agencies: the **Financial Accounting Standards Board** (FASB) and the **SEC**.

SOX greatly strengthened the independence of both bodies – to discourage and prevent the kind of posturing and outright political threats such the targeting of FASB by **Senator Joseph Lieberman** in the 1990s ... for suggesting outrageous reforms – such as requiring the expensing of options by public companies!

Masters of the “New Economy,” and especially California’s “New Rules” high tech companies didn’t like that – they were issuing options by the gazillions. Oh, by the way, have we noticed that many of them are quite underwater today? Or, re-priced by the companies at the expense of the shareholding public.

The debate over expensing of options was won, I believe, by the Prophet of Profit, **Warren Buffett**. He asked, “If options are not expenses to the shareholder, since they dilute our holdings, then exactly what are they?”

Some far-sighted corporate leaders have seen the light and now voluntarily expense options – *it is the right thing to do*. Even the usually conservative **Business Roundtable** urged shareholder approval of options in May 2002.

Here in New York we have **Attorney General Eliot Spitzer**, who used his prominent Bully Pulpit, extensive media exposure and state investor protection law – which predated the New Deal era legislation -- to correct some of the bad habits and misbehavior of the Wall Street community.

The \$1.4 billion – B – settlement with 10 major investment banking houses came about after Mr. Spitzer’s special task force read through more than 90 loose-leaf books, some containing self-incriminating internal emails and memoranda. You’ve read the most sensational of these revelations – yes, more sunshine – in the local newspapers. Here is what is important to investors about the settlement –

The words ... “**independent**,” “**objective**,” “**reliable**” “**quality**” ... are to be applied again to financial analysis and research.

Sad, isn’t it, that it took a very public battle to return to tried and true fundamentals of equity and debt valuation? The majority of analysts *were* truthful, independent and objective – but a few rotten apples spoiled the reputation of the profession. And, sad to say, a few were handsomely rewarded for sucking up to management and banking clients and issuing misleading reports.

As part of the historic settlement – signed on to by SEC, NYSE, NASDAQ, the NY AG, and securities enforcers in the states -- financial research must be separated from brokerage and banking. Each of the 10 houses must hire an independent monitor – the most prominent announced is **Laura Unger**, former SEC commissioner – who will retain the services of three (or

more) “independent” research houses with no investment banking or brokerage revenues at stake in the relationship. Their unbiased research – we fervently hope it will be objective and of high quality -- will be made available to customers – alongside the traditional “sell-side” research of the brokerages and banking firms.

Should make for some interesting “**buy**,” “**sell**” and “**hold**” ratings in the future!

There is more going on in this reformation process, leading to greater and stricter accountability.

Such as –

Greater Shareholder Activism – more than 1,000 shareowner sponsored proxy resolutions were successfully filed in 2003, and a significant number achieved majority votes.

More than **90 US Attorneys** across the nation are keeping closer watch on corporate behavior, armed with greater enforcement tools created by SOX.

We are seeing more public employee **institutional investors** applying pressure to underperforming companies – and especially their boards and CEOs.

We have new SEC rules for **mutual fund** disclosure – resulting in large part from the pressure of **Amy Domini** of Domini Funds.

The 6,000 and more funds available to the public as investment vehicles must now publish their proxy voting policies, and report to us how they voted in each year’s proxy contests. Greater transparency is coming to the widely held “trusts” that invest our money in the markets ... more sunshine.

Credit Risk Agencies – **Standard & Poor’s**, **Moody’s** and others -- are now on full alert, after being blindsided by the spectacular collapses of Enron, WorldCom and other high-flyers. With access to far more material information than permitted by law for other players, these agencies are now the real canaries in the coal mine for investors and lenders. More sunshine – their ratings are very public.

A cottage industry of for-profit and non-profit **services to evaluate corporate performance** is in formation. Watch for comparative governance, social responsibility, ethics and other ratings, rankings and scores for companies, boards and executives. These are being issued by such credible players such as **ISS**, **Institutional Shareholder Services**; **Standard & Poor’s**; **The Corporate Library**; **Investors Responsibility Research Center**; the **FTSE 4 Good Index** of the UK; the **Domini 400 Social Index**; **Interfaith Center**, and others.

I mentioned **independent research organizations** – these could in time become a powerful force for sunshine and accountability. We should be encouraged by the creation of the **Investorside Research Association**, with two dozen private, independent members

organizations so far signing pledges to be honest and objective in their reports on public companies. Look for their “Good Housekeeping” pledge of independence status.

Major investment banking houses are instituting reforms – some imposed by the AG settlement as well as self-adopted improvements in policies and practices. The real test will be whether these Chinese walls work for the long-term, of course.

Individual investor – withholding cash from the market – perhaps the greatest punishment for Wall Street brokers and bankers ... and the best market self-correction device of all.

Media attention – I just surveyed media coverage of business topics for April and May – there were 7,600 stories on corporate governance; 1,475 on SOX; 500 on accountants and auditors, and so on. The journalists’ drumbeat has not let up. More sunshine.

All of these are powerful forces for Reform and Reformation. The collective actions will, I believe, in a short time create --

... **Greater Transparency** into corporate operations
... **Increased Credibility** for leaders and institutions ...
... **Restored Trust** ... and **Confidence** in the Capital Markets
... in Corporate America
... and could result in incredible new levels of personal and collective
Accountability.

And we will all benefit.

For we are members of a democratic capitalist society, focused on Money. Income. Building wealth. Investing for the future ... in our homes, businesses, our kids’ education, 401 Ks and pension plans ... creating a cushion for our retirement. This personal investing at its heart is about confidence and trust. In the future. In the honesty and fair play of our system.

Corporate America’s leaders need to keep in mind that their personal **credibility** is important – investors are demanding full disclosure, truth telling, and straight talk, especially when it comes to the financial numbers and what is really going on inside their companies. And SEC disclosure regulations mandate these as well.

To be sure, there are corporate executives, members of boards and members of the financial community who will not agree with these viewpoints. Their traditional argument is that the highest calling of the board and CEO is to maximize profits for the shareholders. I submit that is no longer true as a simple, all-encompassing strategy. And won’t be in this Era of Accountability. In the critical re-balancing of values, stakeholders’ interests will be equally important. And good behavior will be rewarded by investors.

Those leaders in public ... corporate ... social sector ... who ignore the public cry for accountability ... for real reform ... *do so now at their own peril.*

And the outcome of all this will closely watched in our fair city – New York. Where the Era of Accountability could have its greatest impact.

Thank you for your kind attention ...

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