

Council adopts seven new corporate governance policies

On Oct. 7, 2008, General Members of the Council of Institutional Investors voted to adopt new policies on gross-ups, severance pay, proxy solicitation, executive stock sales, timely disclosure of voting results, shareowner rights to call special meetings and the independence of accounting and auditing standard setters. The language and rationale for each of the new policies is detailed below.

Gross-ups: “Senior executives should not receive gross-ups beyond those provided to all the company’s employees.”

Rationale: Shareowner dollars should not be used to pay senior executives’ taxes due on stock grants, signing bonuses and perquisites such as country-club memberships and shopping excursions. Gross-ups are not linked to performance, and special gross-ups for officers can raise optics concerns within and outside the company.

Severance Pay: “Executives should not be entitled to severance payments in the event of termination for poor performance, resignation under pressure, or failure to renew an employment contract. Company payments awarded upon death or disability should be limited to compensation already earned or vested.”

Rationale: Severance pay awarded to executives that leave a company as a result of poor performance amounts to “pay for failure,” and death benefits do not reward any actual value created by the executive for shareowners. Both severance for poor performance and death benefits violate basic pay for performance principles.

Proxy Solicitation: “Advance notice bylaws, holding requirements, disclosure rules, and any other company imposed regulations on the ability of shareowners to solicit proxies beyond those required by law should not be so onerous as to deny sufficient time or otherwise make it impractical for shareowners to submit nominations or proposals and distribute supporting proxy materials.”

Rationale: Advance notice requirements can make proxy solicitations impractical by requiring investors to commence a contest far in advance of the annual meeting, or worse, forcing shareowners to maintain a constant state of readiness in anticipation of an unknown deadline. Holding requirements can be especially powerful board entrenchment devices.

Executive Stock Sales: “Executives should be required to sell stock through pre-announced 10b5-1 program sales or by providing a minimum 30-day advance notice of any stock sales. 10b5-1 program adoptions, amendments, terminations and transactions should be disclosed immediately, and boards of companies using 10b5-1 plans should: (1) adopt policies covering plan practices; (2) periodically monitor plan transactions; and (3) ensure that company policies discuss plan use in the context of guidelines or requirements on equity hedging, holding and ownership.”

Rationale: Boards should take steps to ensure that executives are not trading on inside information using 10b5-1 plans for cover. To ensure that boards consider 10b5-1 plans in the larger context of protecting and enhancing the alignment of interests between executives and long-term shareowners, company policies should discuss how 10b5-1 programs fit with equity-based compensation policies on hedging, holding and ownership. Board adoption of clear and effective 10b5-1 plan policies should discourage inappropriate plan adoptions, amendments and terminations. The immediate disclosure of these sorts of 10b5-1 plan events—and of sales made under such a program—would allow shareowners to monitor the strength of board oversight.

Timely Disclosure of Voting Results: “A company should broadly and publicly disclose in a timely manner the final results of votes cast at annual and special meetings of shareowners. The information should be available via Web site announcement, press release or 8-K filing as soon as results are tabulated and certified. With the exception of extenuating circumstances, this should be completed no later than one month after the meeting. Whenever possible, a preliminary vote tally should be announced at the annual or special meeting of shareowners itself.”

Rationale: Early release of final tallies would cultivate an environment of open communication and board accountability to shareowners. Timely acknowledgment of shareowners’ positions on important governance matters could also result in the more efficient use of company and shareowner resources.

Shareowner Rights to Call Special Meetings: “Shareowners should have the right to call special meetings.”

Rationale: Many states, companies and organizations support the right of shareowners to call special meetings. This right grants shareowners the ability to present, consider and vote on important issues more often than just once a year, thereby fostering an environment of continuous board and management accountability to investors.

Independence of Accounting and Auditing Standard Setters: “Audited financial statements including related disclosures are a critical source of information to institutional investors making investment decisions. The efficiency of global markets—and the well-being of the investors who entrust their financial present and future to those markets—depends, in significant part, on the quality, comparability and reliability of the information provided by audited financial statements and disclosures. The quality, comparability and reliability of that information, in turn, depends directly on the quality of the financial reporting standards that: (1) enterprises use to recognize, measure and report their economic activities and events; and (2) auditors use in providing assurance that the preparers’ recognition, measurement and disclosures are free of material misstatements or omissions. The result should be timely, transparent and understandable financial reports.

The Council has consistently supported the view that the responsibility to promulgate accounting and auditing standards should reside with independent private sector organizations. The globalization of financial markets has brought calls from some regulators, stock exchanges, corporations, auditing

firms and other parties for the replacement of U.S. accounting and auditing standards and standard setters with international standards and standard setters.

The Council supports U.S. accounting and auditing standard setters cooperatively working with their international counterparts toward a common goal of convergence to a single set of high quality standards designed to produce comparable, reliable, timely, transparent and understandable financial information that will meet the needs of institutional investors and other consumers of audited financial reports. The Council, however, does not support replacing U.S. accounting or auditing standards or standard setters with international standards or standard setters unless and until all of the following steps have been achieved:

- In the aggregate, the information that results from the application of international accounting and auditing standards is, at a minimum, of the same quality as the information resulting from U.S. accounting and auditing standards;
- The application (by U.S. companies and their auditors) and enforcement (by U.S. regulators) of the international accounting and auditing standards are at least as rigorous and consistent as the application and enforcement of U.S. accounting and auditing standards;
- The international standard setter has sufficient resources—including a secure stable source of funding that is not dependent on voluntary contributions of those subject to the standards;
- The international standard setter has a full-time standard-setting board and staff that are free of bias and possess the technical expertise necessary to fulfill their important roles;
- The international standard setter has demonstrated a clear recognition that investors are the key customer of audited financial reports and, therefore, the primary role of audited financial reports should be to satisfy in a timely manner investors' information needs. This includes having significant, prominent and adequately balanced representation from qualified investors on the standard setter's staff, standard-setting board, oversight board and outside monitoring or advisory groups;
- The international standard setter has a thorough public due process that includes solicitation of investor input on proposals and careful consideration of investor views before issuing proposals or final standards; and
- The international standard setter has a structure and process that adequately protects the standard setter's technical decisions and judgments (including the timing of the implementation of standards) from being overridden by government officials or bodies.”

Rationale: The policy language: (1) supports convergence to a single set of high quality accounting and auditing standards; and (2) opposes the replacement of U.S. accounting or auditing standards and standard setters with international accounting or auditing standards and standard setters unless and until certain criteria have been met. The criteria were designed to promote comparable, reliable, timely, transparent and understandable information in audited financial reports. Such information could lower Council members' costs in comparing U.S. and non-U.S. companies' audited financial reports and improve the usefulness of the resulting information in making investment decisions.

About the Council and its corporate governance policies

The Council's corporate governance policies are a living document that is constantly reviewed and updated. These policies set standards or recommend practices that Council members believe companies and boards of directors should adopt to promote accountability, independence, integrity, rigor and transparency. Council members are not obligated to individually endorse all or any portion of the Council's policies, and companies aren't obligated to adopt the policies and procedures recommended by the Council.

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