The Honorable Barbara Hackman Franklin
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Corporate Governance
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Remarks as Delivered

Thank you, Tom, for a most gracious introduction. Good afternoon. It is a great pleasure to be here.

First, I want to say that I believe the financial services sector is a foundation of our nation's economy and is an important part of our country's economic success. I enjoyed the part of my career in which I was engaged in this sector, at First National City Bank – now Citibank – in the 1970's. You, as bankers, have taken your share of heat lately. I sincerely hope that the worst of this storm is over, and I salute you for your contributions to our great economy.

Corporate Governance – today's topic

My topic today is Corporate Governance. I speak from the perspective of a director of public companies. I'm sure that most of you are serving on boards of directors, and/or you are CEO's of companies which have boards of directors. Even those of you with companies based outside the U.S. probably have U.S. boards of directors. So there is a commonality of interest.

Since 1980, I have been a director of 14 public companies, with time off to be Secretary of Commerce. In all of this time, I have never seen such volatility in the business environment – both economic and political. Public trust in American business is at the lowest ebb in my memory. In the most recent annual Gallup Honesty and Ethics poll, business people are far down the list but above Congress, advertising practitioners, insurance salespeople, stockbrokers, HMO managers and car salespeople. I'm a great believer in the American system of entrepreneurial capitalism which has produced the world's largest and most dynamic economy. That is why we cannot allow this lack of trust to persist. If we do, over time there will be irreparable damage to our great economy.

Public Trust in Business at a Low Point

In the early part of this decade it was the scandals at Enron, WorldCom and others that caused an erosion of public trust in American business. These scandals were rooted in fraudulent and illegal activity. The Sarbanes-Oxley act was the response of the U.S. government. That law and the regulations that came with it gave more power and responsibility to boards of directors.

Now, public trust has been damaged again, this time by the financial meltdown and global recession. On the heels of this meltdown, as all of us well know, the U.S. government stepped in to stabilize our financial system and shore up our economy. Along with this wave of government involvement came a drive for more shareholder power in the boardroom – a drive to hold directors more accountable.

Boards of directors were certainly not the cause of this downturn but we are getting our share of the blame along with CEO's and the way corporations are governed – or not. A key problem is that many in our society, on Capitol Hill and the media do not understand the role of the board. They think the board and CEO are one in the same. They do not understand that our system of corporate governance is based on checks and balances in which the board sets policy and hires the CEO, the CEO runs the company and shareholders elect the board of directors.

The Shareholder Bill of Rights

There is a "Shareholder Bill of Rights" containing reforms which appear in various bills introduced on Capitol Hill, including the new Dodd bill. I will focus on the two game changers – proxy access and majority voting.

- **Proxy access**. The SEC proposed a rule last summer; the agency received a large number of comments. The agency re-opened the comment period briefly in January, closed it, and the staff is again reviewing the comments. What the agency will do and when is not clear, but we anticipate the promulgation of a final rule. If enacted, this would allow shareholders owning a certain percent of a company's stock for a specific time period, to place director nominees directly onto the company's ballot for vote at the annual meeting, thus eliminating the need for expensive proxy fights.

- **Majority voting**. Already, about two-thirds of S&P 500 companies have a majority voting standard, which means that a director must receive a majority – not a plurality – of votes cast in non-contested elections.

These two powers – if enacted and used together – would make it easier for some shareholders to elect directors of their choosing, thereby changing the power alignment and checks and balances among board, CEO, and shareholders. This could result in the election of "special agenda" directors who have particular missions, such as selling the company or parts of it, pushing for human rights, environmental, or other concerns – missions which could run counter to a company's strategy and be disruptive in the boardroom. This is why proxy access and majority voting are game changers.

What should boards do?

Given the changing external landscape, what should boards of directors do now?

In my experience, directors on the whole are working valiantly to do a good job, and boards are performing better than they ever have before. As directors we are more engaged with management in strategic planning, "tone at the top", CEO succession, executive compensation and the oversight of risk. I'm proud to be a director. I think this is important and worthwhile work.

But, still, it is time for another step up in vigilance and performance. Times are tough and will be for the foreseeable future. Directors have a responsibility to be part of the solution – to do our part to help restore trust in corporate governance and in American business, help to build long term value for shareholders, and do our best for the company as a whole. This is a call to action and it is urgent.

Here is what I believe we, as directors, must do. I am talking to myself, as well as, to you. Three things:

First, rededicate ourselves to understanding fully the companies we serve. How does the company make money? What is the strategy? What are the drivers of success? What are the risks? How strong is the "tone at the top"? If we as directors are not really knowledgeable and current, we cannot do an adequate job of overseeing performance and engaging in these important decisions regarding strategy, risk and succession.

Second, reevaluate how board members work together. A board, as we all know, is a group usually of 6–12 people. So it must do its work as a group, by consensus. A key dimension of board effectiveness – often overlooked – is the group dynamic at work around the board table and also, importantly, how the group interacts with the CEO. There are a variety of cases where person for person, the directors sitting around the board table are excellent people. Yet somehow the group process didn't work well enough or quickly enough when action was needed. We board members should be honest with ourselves about how well things are working and change what isn't.

Third, participate in NACD's initiative – "Leading the Way: Directors Strengthening Corporate Governance." We ask every board in the country to self-assess its own governance practices using the *Key Agreed Principles* as a framework.

The Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies are contained in a unique document. (It's in your packet of material from NACD.) It was a year and a half in preparation and is a distillation of various governance principles on which we believe there is agreement from management (such as the Business Roundtable), directors (NACD), and shareholder groups. There are 10 principles. They are not prescriptive. They are not a "cookie cutter" one-size-fits all list of do's and don'ts. This is not a compliance or check the box exercise. No additional liability accrues because a board participates in this self-assessment. We simply ask each board to evaluate its own practices and then strengthen them in whatever way it sees fit.

Let me run through the 10 principles briefly.

1. **Board Responsibility for Governance**. The board's fiduciary objective is long-term value creation for the corporation; therefore, the form and process of governance should support this. So, ask yourself: what does your board do to provide oversight and guidance to management regarding strategic planning, the

assessment and management of risk, and operational excellence? List the things the board does and when. Discuss them, first in the Governance Committee and then at the full board. If needed, make improvements. Go through this same process for each of the Principles.

2. **Corporate Governance Transparency**. Your governance guidelines would reflect your practices. Does your board explain to shareholders in the annual proxy statement why the governance structures and practices it has developed are best suited to the company?

3. **Director Competency and Commitment**. The SEC is requiring in the proxy this year more information regarding director qualifications. What type of disclosure are you making – fulsome or minimalist? Does your board regard diversity in the broadest terms, beyond gender and race? Does your definition include a mix of skill sets and experiences around the table to align with corporate strategy? Does diversity include a mix of longer serving and new directors (continuity and fresh thinking)?

4. **Board Accountability and Objectivity**. We assume that directors are "independent", according to listing standards. But do they have "independence" as a mindset? Do independent directors hold executive sessions without management at each meeting? Who presides? Are these sessions productive?

5. **Independent Board Leadership**. What is the leadership structure – are chairman and CEO roles combined? If so, is there a presiding or lead director? Or are chairman and CEO roles separate? Is each of the roles defined and agreed to by the board? In this year's proxy the SEC requires an articulation of why your leadership structure is best for the company. Here is a question to ponder: if there were "special agenda" directors on the board, how would the board's working structure be impacted?

6. **Integrity, ethics and social responsibility**. How does the board oversee "tone at the top" and promote the building of an ethical culture? What is the importance of the internal control structure, financial disclosures and a host of other things?

7. **Attention to Information, Agenda and Strategy**. This one is key. If we consider that CEO succession, strategy and risk oversight are central board concerns; then do governance practices provide the right priority, information and opportunity for discussion at the proper time for the board to do its job effectively?

8. **Protection Against Board Entrenchment**. Does your board have policies which allow the board to refresh itself? Are there age limits? Self-evaluations?

9. **Shareholder Input in Director Selection**. Are there opportunities for shareholders to recommend candidates for board seats: Do you have majority voting?

10. **Shareholder Communications**. Does your board have mechanisms to reach out and develop relationships with investors through candid dialogue? Do you feel you need such mechanisms – or is it sufficient to monitor management's outreach to shareholders? Direct interaction between the board and shareholders is pressed by some shareholders who hope that **say-on-pay**, the non-binding shareholder advisory vote, will accelerate such direct communication. We know that this principle is the one which many boards have discussed, but not acted on.

If you go through this self-assessment, what does your board get out of this effort?
First, it is a good way to focus on your own governance practices and strengthen them. Beyond that, you can be part of a larger effort to show that directors are taking initiative and actively working to do their jobs better. That, in turn, as it is recognized, can help to restore public trust in American business and work to change the negative thinking impacting the business community now.

When your board is participating in this self-assessment, tell us at NACD. When we know that a critical mass of boards are participating, we will communicate this to public policy makers, shareholder groups and the media to let them know that directors are stepping up and making a difference. NACD aims to be the "voice of the director", to provide a board-of-director point of view to these stakeholders. There are now many voices for CEO's and for industry sectors, such as yours. But there is no voice for directors. Instead there is a vacuum. Leaving that space open invites others to fill it and this may not be in the best interest of directors, CEO's or the company as a whole. So, we at NACD, aim to give directors a voice in these processes.

Executive compensation
I cannot conclude without a comment on executive compensation – the subject of another speech for another day. We all know this is a hot topic and will continue to be. As long as there is grassroots anger about excessive compensation, it will be a political issue. Compensation decisions are not always easy. Those of us who serve on compensation committees feel the tension between paying fairly for performance yet keeping pay from getting out of control. There are a variety of best practices out there – some from a Blue Ribbon Commission I co-chaired for NACD several years ago. Just to focus on one:

> **Pay for performance** is a concept on which there is consensus. But in order to do this, there must be metrics which measure the performance the board and management want to incentivize. Ideally, on a balanced scorecard, metrics are both financial (such as EPS growth, cash flow, or whatever is important at the time) and

non-financial (such as customer satisfaction and employee engagement). They should measure annual performance as well as the creation of long term value. Above all, the metrics should support the company's strategy. An important and inescapable fact is that strategy, risk and compensation are inextricably linked. Therefore, compensation plans and the decisions made under them should not be done in splendid isolation.

Conclusion

Let me conclude where I began. These are challenging times. But challenge always brings opportunity. I truly believe that good corporate governance can contribute significantly to a company's better financial and ethical performance and the creation of long term shareholder value. We are at a moment in time when it is critical that directors step up, improve performance, show that corporate governance works effectively and prove that our American system of capitalism really is the best.

Thank you.

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