



## GovernanceMetrics International®

### *In Focus*

#### **A Look at Recent Governance Developments from GMI**

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#### **SPOTLIGHT: Satyam 12 Months On: Indian Governance Concerns Remain**

India, which has many corporate governance principles based on British Company Law, was thought by many to have solid governance practices for an emerging market country. However, 2009's Satyam Computer Services Ltd. (Bombay Stock Exchange: 500376) scandal highlighted the fact that despite some governance strengths, Indian governance policies have some serious weaknesses.

According to a recent [study](#) by the Asian Corporate Governance Association ("ACGA"), a year after the Satyam scandal erupted, investor protections remain weak. In a country where family owned businesses are common, minority shareholder rights remain a concern. As of December 2009, 28 of the 53 (52.8%) Indian companies GMI covered have a controlling shareholder (compared to 17.5% globally). Related party transactions with controlling shareholders are a serious concern with 15% of companies that have a majority owner engaging in related party transactions.

Further cause for concern is that many Indian companies allow controlling shareholders to buy stock at below-market prices through the use of preferential warrants, diluting minority ownership. Composition of boards and committees also remains a major problem. A recent Financial Times article highlighted the fact that at real-estate firm DLF Limited (Bombay Stock Exchange: 532868) three of the company's 12 directors are members of the controlling Singh family, and an executive (the Managing Director no less) sits on the audit committee, a very serious concern that has lead GMI to Red Flag the company. Given the audit committee focus following the Satyam scandal, it is surprising that another large company in India retains such a

poor governance situation with its audit committee. In general, levels of independence on Indian boards with an average of 46% in companies covered by GMI (compared to 56% globally) still remain below global standards.

Voting procedures remain inadequate. In India, shareholders can appoint a proxy to attend and vote, but not speak, at a shareholder meeting. However, unlike common practice in developed markets, most Indian companies do not count all votes through a "poll", but usually conduct voting by a show of hands. As a consequence, the proxy is not counted effectively, leaving real voting levels opaque.

Few companies seem interested in adopting more transparent practices, ACGA says, and investors have few avenues for meaningful complaint about governance problems. In fact, "if a minority shareholder doesn't like the way a business is being run, at best he can exit profitably," Deval Patel, a Mumbai based lawyer who advises foreign investors, recently told reporters. There remains plenty to do on Indian corporate governance.

### **Big Splashes in Calm Waters: Germany Sees Rising Wave of Shareholder Activism**

In the past, many of Germany's top firms have been largely controlled by German investors and evidence of shareholder activism has been relatively limited. However, as foreign investors build a larger presence in many of the country's publicly listed companies, activist investors have been more active. For example, after concerns over ongoing problems with multiple investigations and corporate culture concerns, on January 26, 2010, shareholders at Siemens AG (Xetra: SIE) had a non-binding vote on the company's executive pay policies, the first such vote in Germany under new laws enacted in 2009. The say-on-pay resolution was approved with 89.6% of votes cast, which showed there was some dissent amongst shareholders.

On January 25, 2010, hedge funds Elliott, Glenhill, Glenview and Perry Capital filed a US\$1 billion lawsuit in New York, claiming they were misled by German carmaker Porsche Automobil Holding SE (Xetra: POR3), ahead of the company's bid to acquire Volkswagen AG (Xetra: VOW). The lawsuit comes in the wake of complaints from Hermes as well as the Norwegian Government Pension Fund, over treatment of Volkswagen's minority shareholders.

These developments together constitute an important shift in the wake of greater integration into the global economy. Still, the transition to broader shareholder rights and their greater exercise in Germany will not always be smooth. On February 12, recent efforts by Hermes, a U.K. based activist investor, to block the election of Klaus Wucherer as chairman of the board at Infineon Technologies AG (Frankfurt Stock Exchange: IFX), a troubled technology company, failed when 72% of investors sided with Mr. Wucherer, the incumbent. The efficacy of the vote has been challenged with Hans Hirt, head of European Corporate Governance at Hermes, voicing his dissent against the conduct of the vote, saying Hermes would analyze the difference between the more than 66% vote against a share repurchase authorization and the seemingly large approval of Mr. Wucherer. Even so, the fact that a quarter of shareholders did not support Mr. Wucherer, despite his agreeing to only chair the company for one year to head off a negative vote, indicates substantial shareholder unrest and could result in more challenges to directors at underperforming companies.

### **JAPAN: New Disclosure Rules Should Improve Investment Transparency**

New rules adopted by Japan's Investment Trusts Association which are expected to come into effect by June 2010, ahead of the country's proxy season, will require asset management firms

that run mutual funds to disclose how they exercise their voting rights at the companies in which they invest.

Companies will choose their own method of disclosure, but the association wants asset managers to reveal votes cast in favor, against or in abstention for each proposal, such as electing executives or planned profit distributions. The voting outcomes will be listed on firm websites.

Although in the past some firms have voluntarily publicized their voting records, most chose only to reveal their general philosophy rather than the specific details of votes. Greater disclosure could have a considerable effect on the way in which some asset management firms vote, as those votes will now be under scrutiny.

### **CSR Focus: Political Activity: Can Free Speech Come at a Cost to Investors?**

On January 21, 2010, in *Citizens United v. FEC*, a highly publicized case with wide implications, the United States Supreme Court overruled previous decisions, and in a contentious 5-4 decision, ruled that while the government may regulate corporate political speech through disclaimer and disclosure requirements, it may not ban corporate speech altogether. The decision overturned a 1990 Supreme Court decision and reversed part of a 2003 decision upholding the McCain-Feingold overhaul of federal campaign finance regulations.

The ruling has highlighted the issue of disclosure of political spending by corporations. Microsoft, Time Warner, Aetna, Merck, Hewlett Packard and 65 other U.S. companies have already adopted disclosure and board oversight of their political spending with corporate funds.

In 2009, shareowner activists submitted 49 proposals asking companies to report semi-annually on their monetary and non-monetary political contributions and on their policies governing political expenditures. In 2010, investors can expect that corporate political activity will yet again be a subject of debate at shareholder meetings around the U.S. and the world.

### **UPDATE: U.S. Say on Pay in 2010: Still an Area of Focus for Activist Investors**

In recent years, proxy seasons have been marked by the increasing number of "Say on Pay" proposals that shareholders are submitting at the companies in which they invest. In the wake of the outset of the 2008 financial crisis, executive bonuses and pay structures have been a hot button topic. Twenty-four Say on Pay proposals received majority votes in 2009 and 2010 activist investors are already preparing to use non-binding Say on Pay votes as a tool to encourage corporate governance change.

With public ire over bank executive bonuses running high, financial companies, in particular are expected to become the targets of Say on Pay campaigns. The Goldman Sachs Group Inc. (NYSE: GS), State Street Corporation (NYSE: STT), and Bank of New York Mellon Corporation (NYSE: BK) have already taken the step to voluntarily include an advisory vote on pay in their 2010 proxies.

In 2009, all banks that participated in the U.S. Treasury's TARP program were required to submit their executive pay programs to a non-binding shareholder vote. But upon repaying the TARP funds, many banks have reverted to their past position of not offering such advisory votes. So far in 2010, investor groups have submitted Say on Pay vote proposals at 17 U.S. banks including JPMorgan Chase (NYSE: JPM), Morgan Stanley (NYSE: MS), Citigroup Inc. (NYSE: C), Wells Fargo & Company (NYSE: WFC), Bank of America Corporation (NYSE: BAC), and American Express Company (NYSE: AXP) to reverse this trend. It will be a busy proxy season in 2010.

## **U.S. Banks: Are Audit Committees Going “Overboard”?**

For years socially responsible investors have focused on issues related to corporate labor relations. In the wake of the 2008-9 financial crisis the focus on labor issues could be aimed at the corporate board room as well as the factory floor. GMI research indicates that directors at a number of key U.S. banks have taken on the commitment of serving on several other boards.

This issue is a particular concern for investors, when audit committee members choose to serve on many public boards, possibly distracting them from their Audit Committee duties. GMI research shows that 16 of the directors at the 101 U.S. banks GMI covers serve on a total of at least four public boards, which GMI considers to be an overboarding situation. Citigroup Inc. (NYSE: C), SunTrust Banks Inc. (NYSE: STI), and Northern Trust Corporation (NASDAQ: NTRS), each have two “overboarded” audit committee members. Of further cause for concern is the fact that only four of these six directors, (including the two from Citigroup) are classified by GMI as having general financial expertise. Only one of these directors is classified as having substantial experience in the banking sector. These findings indicate that a number of U.S. banks may need to address their Audit Committee membership to ensure members can devote sufficient time to the committee and have the skills needed.

## **Message to IR Officers - Get Engaged!**

In an article published in the National Investor Relations Institute’s January 2010 *Investor Relations Update*, GMI chief executive Howard Sherman urges IR officers to become active participants in their company governance programs and outlines the ways in which upcoming governance reforms will directly impact the investment decision-making process. He asserts that “what’s going on in Washington [in combination with] changes within company charters, bylaws and governance policies and the proxy voting system are going to alter the dynamics of shareholder relations much more over the next couple of years.” The article includes a discussion of the ramifications of changing standards in proxy voting, director elections and shareholder voting, and executive compensation. Mr. Sherman encourages IR officers to prepare themselves for the changes ahead through ongoing collaboration with company governance teams.

The [full article](#) can be viewed in the ‘New and Noteworthy’ section of GMI’s web site.

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*In Focus* is a periodic publication of GovernanceMetrics International (GMI). GMI’s rating system incorporates hundreds of data points across six broad categories of analysis: board accountability, financial disclosure and internal controls, executive compensation, shareholder rights, ownership base, takeover provisions, plus corporate behavior and social responsibility. Companies are rated relative to others in the GMI database on a scale of 1.0 (lowest) to 10.0 (highest). Subscribers to GMI are able to view a company’s overall rating, section ratings, red flags (flags are issued by GMI from time to time to highlight specific characteristics that present notable cause for concern) plus several pages of written analysis. GMI clients include leading pension funds, investment managers, banks, insurance companies, credit rating agencies, regulatory agencies, stock exchanges and professional service firms in 16 different countries throughout North America, Latin America, Europe and the Asia-Pacific region. Please see [www.gmiratings.com](http://www.gmiratings.com) for additional information.

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