THE BROOKINGS INSTITUTION

THE MODERN SHAREHOLDER:
HOW A SHORT-TERM FOCUS IS HARMING U.S. CORPORATIONS

Washington, D.C.
Friday, June 1, 2012

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P R O C E E D I N G S

MR. WEST: Good afternoon. I'm Darrell West, vice president of Governance Studies and director of the Center for Technology Innovation at The Brookings Institution, and I'd like to welcome you to our forum on the modern shareholder. And we are webcasting this event, so we're pleased to welcome viewers from around the country. We also have set up a Twitter hashtag at #BILTD. That's B-I-L-T-D for those of you who wish to offer comments or pose questions during the course of the forum. And when we come to our audience Q&A we will integrate questions both from our live audience here in the auditorium as well as those of you who are watching via the webcast.

The people who own shares in corporations have changed radically over the past 50 years. The household sector holds relatively few direct shares in corporate equities and a significant majority of stocks are owned by institutional investors. This includes mutual funds, pension retirement funds, life insurance companies, and foreign entities. It is estimated that nearly 70 percent of American stock trading arises from companies using high-frequency trading strategies that emphasize holding stocks for very short periods of time. As a result, many current shareholders lack a long-term time horizon and prefer short-term results. And this makes it difficult for corporate executives to pursue strategies based on the long-term welfare and growth of a company.

Today we will have a discussion of the social, economic, and political ramifications of the changed nature of corporate shareholders. We have a distinguished set of experts who will explore how the short-term focus of shareholders and directors and investors affects corporate behavior and government policy and how to encourage longer term time horizons among shareholders, directors, and executives.

Stephen Davis is executive director of the Millstein Center for Corporate Governance and Performance at the Yale School of Management. He works on many aspects of corporate governance and performance, and speaks widely around the world. He has a new paper that Brookings just put out today entitled, “Mobilizing Ownership: An Agenda for Corporate Renewal.” It looks at corporate ownership and proposes a policy agenda for what he calls prudent ownership, and we’ll talk more about that in a minute.

Bennett Freeman is senior vice president of sustainability research and policy at Calvert Investments. He oversees the company’s research and analysis as well as its policy and advocacy work. From 2003 until 2006, he led Burson-Marsteller’s global corporate responsibility practice, advising multinationals on policy development, stakeholder engagement, and communication strategies related to human rights, labor rights, and sustainable development. During the Clinton administration he served as deputy assistant secretary for democracy, human rights, and labor.

Elliot Schwartz is vice president and director of economic studies at the Committee for Economic Development. He’s directed several CED reports on corporate governance issues and long-term performance. He manages CED’s work under the Digital Connections Council. And prior to joining the committee he was chief of the Commerce Unit at the Congressional Budget Office.

So we’ll start with Stephen. We put out your paper today. It lays out a number of problems from what you call “misgovernance” to the “lack of cops on the financial beat.” So what do you see as the most serious problems in terms of the contemporary shareholder?

MR. DAVIS: Well, thanks, Darrell. It's delightful to be here. And actually it's a great moment to discuss this topic because if you look at the newspapers every day, we are in the middle of presidential campaign in the United States where the purpose of the corporation is center stage. It's front-page headlines. And it's really because of the experience that Mitt Romney has brought to the campaign and that then becomes a key issue. You know, what is the purpose of capital? What's the purpose of private equity? And also, how do corporations work in the world and, in particular, how do shareholders work in the world? Is the entire capital market too short term? Is it too focused on making money for shareholders and not enough on social interests, such as job creation and ways that can benefit the country as a whole?

This is, by the way, not just something that's a focus of the United States. It's something that is a debate that's happening worldwide.

Where I come at this is to make the point that I think the debate is missing a critical component, which is this: That if we think about -- and Darrell's mentioned at the outset -- who owns corporate America today? Up to 80 percent of equity is owned now by institutional investors. That is to say these very large, sort of faceless institutions, many of them mutual funds, some of them private equity funds, pension funds, a whole raft of institutions. And in some respects, if you think about sort of how capitalism works, that it's, you know, a most elemental phase, if you think that sort of 1960s maxim, "You are what you eat," well, if you're a corporation you are what your shareholders, what your owners want you to be. And the question then is what do these big owners, who do account for such a large percentage of ownership of corporate American, what do they want companies to do?

And in some respects, if we're looking at companies acting short term, is it because their owners are short-term oriented? Is that what their owners want them to do?

And where I come into the question is really asking are the owners, are institutional investors, fit for purpose? Because if you think about these institutions, they are part of the formula, but who do these institutions represent? Well, generally they are carrying the capital and managing the capital of tens of millions of Americans, at least for this country, but actually, in fact, tens of millions of people from around the world that invest in American companies. And most of those people tend to be investing for the long term, for their retirement, for health care savings, for education. So you would think that their interest is exactly in long-term performance by American companies that they invest in. But in some respects, what has occurred, and this is the heart of the problem, is that citizen investors have given their money to agents and too many of those agents are acting short term and, therefore, the signals that they're giving to management is actually to -- of corporations is to act short term.

Now, here's the big problem. We've spent the last two decades making company boards much more accountable. We know more about who are on these, you know, who serves on boards of directors, what their executive pay is. They are much more accountable to the shareholders. But the shareholders are really the agents. And if there is this disconnect between the people that actually -- for the moms and pops, the working families that provide the money and their agents who act short term, then maybe that big bet that we've placed, that the shareholders, if they're given power, if they're given information, that they can police the market and make sure companies, you know, do what they're meant to do, that maybe that bet is misplaced.

Now, there are two reactions you could come to on that. One is you say, well, the solution really is to let boards be boards. Free them from these nasty short-term shareholders so that they can act for the long-term interests of the company. That's one approach. The debate, though -- and the debate is focusing on that.

I would argue that we need to focus in a different way. We've spent lots of time making companies accountable. It's now time at the policy level to think about making our institutional investors more accountable. How do we create that accountability between the agents and their ultimate capital providers, the working families of the United States? How can we align those two? And there are a whole series of things that we can do, which maybe you'd want to talk about a little bit later.

MR. WEST: Okay, hold onto that for a minute.

MR. DAVIS: I will.

MR. WEST: And we will come back to that point.

MR. DAVIS: Okay.

MR. WEST: Bennett, Calvert is the largest social responsibility firm, and Stephen was telling us about the role of the institutional investor, so what role do you see these investors playing? And what issues are raised by them?

MR. FREEMAN: Well, thank you, Darrell, and a pleasure to join you on the panel, together with Stephen and my long-time friend and colleague, Elliot.

You know, I love the title of the panel, "The Modern Shareholder," because I feel that at Calvert we've been the modern shareholder now for three decades. For that period of time, we have applied rigorous research and analysis to the environmental, social, and governance performance of companies, as well as to their basic financial fundamentals and investment characteristics, of course. But we have taken that broader view for many years now, and we've done so because we really believe that companies that pay attention to that range of issues, call them corporate responsibility, sustainability issues, will be those that are best managed over the long term, will perform best over the long term, but particularly will be more aware of both risks and responsibilities, risks and opportunities, which will shape their performance.

` And there have been so many lessons that we should have learned over the years of the risks in not paying sufficient attention to, say, environmental or social issues. ExxonMobil took a couple decades to apply the lessons it learned from the *Exxon Valdez* disaster in 1989. Shell is still absorbing and applying -- trying to apply the lessons that perhaps it's learned from its problems in Nigeria, stemming from the early 1990s. BP, an early leader on climate change policy and on human rights and on revenue transparency, nonetheless got its comeuppance in not paying sufficient attention to safety and operational integrity with the results for all to see. Just today, Walmart is being challenge on its home turf at its annual general meeting by investors of all stripes. Who knows if they're liberals or conservatives, Republicans or Democrats? I know they're both, who are angry at the company for taking its eye off the ball on corruption and bribery in Mexico, with results for all to see: an immediate drop in the share price in the couple of days after that extraordinary story in the *New York Times* just a few weeks ago.

So we've been looking at these environment and social and governance factors now for a long time. I would like to think, I would hope, that investors of all stripes would be looking at corporate governance in particular much more carefully in the wake of the financial crisis and not least at the corporate governance structures and risk management oversight of the major banks. We learned once again, just two weeks ago, when Jamie Dimon made a rather mea culpa that even JPMorgan Chase, which had weathered the storm better than any of its peers, burned 2 billion-plus and counting a hole in its books due to insufficient risk oversight.

The other point I want to make before we want to turn to Elliot is that it's not just Calvert and the so-called SRIs. We call ourselves now "sustainable and responsible investors," who've been carrying this torch. The good news, and to turn to Stephen's challenge, is that we're now being joined -- tentatively by some, but I think very forcefully by others -- by some of the biggest institutional investors out there. It's CalPERS that's front and center today in Bentonville, Arkansas, with Walmart.

We see initiatives, such as the United Nations' PRI -- Principles for Responsible Investment -- which brings together trillions of assets under management, and not just the traditional SRIs like Calvert or the long-time responsible investors, as they called themselves, in the UK, but growing numbers of pension funds and institutional asset managers who are controlling hundreds of billions in assets. And we've come together under a common umbrella of basic commitments around environmental, social, and governance factors and analysis. And we're beginning to see some of the giants use their voices, use their assets, use their dollars, use their euros to be forces at least for better governance. We've seen progress, also, on environmental issues, particularly in connection with climate change.

So I'm very hopeful that institutional investors are going to be focusing more sharply. We at Calvert welcome them to the fold. It's been lonely out there for a number of years, together with our long-time SRI peers. We're only going to change the nature of the corporation; we're only going to use capital as a force for good if we can mobilize these institutional investors. And I have some grounds for optimism that we're beginning to see that positive movement.

I want to make a few comments later in the discussion about the particular power of shareholder advocacy where we really can and are making a difference every day. Thank you.

MR. WEST: Okay, thank you. So, Elliot, we've heard a little bit about the role of the shareholders. I know that you have focused on the role of the director and how to get directors to become more active, so can you tell us about that?

MR. SCHWARTZ: Right. Thank you very much and thank you for inviting me and I'm really happy to be here with both Stephen and Bennett, two men who I greatly admire, though I'm going to quibble a little bit with what they've said. The advantage of going third is you get to hear what the others have to say and you can sort of put some nuance on it.

The first thing really is, and Stephen talked about shareholders as owners and I think that's not really right. I mean, I'm in the Lynn Stout School that shareholders are not the primary owners of the corporation. They are one very important stakeholder group. I do agree that their voice should be stronger and I'm happy with many of the accomplishments the groups like Calvert and CalPERS have had, but shareholders are not the only economic interest in how a corporation performs. It's really the corporate directors who are the stewards of the corporation, who have the total interest of the corporation at heart, and should not be let's say slavishly following the direction of shareholders. I mean, one of the things that I worry about is that while there are many good, progressive shareholders, like Calvert, there are a lot of shareholders who don't do good things and are more interested in sucking the lifeblood out of the corporation than in seeing it do good, progressive things. So I'm really looking to directors.

And Stephen did mention that there is a school of thought, to which I guess I'm subscribing, let boards be boards. I do think that there have been a lot of changes in corporate governance, certainly over the last 25 years, absolutely over the last 5 years. Most of these have worked to empower either boards or shareholders or both. I think we have reached a point where maybe we don't need to go much further in terms of at least regulatory or legal empowerment. We really ought to give shareholders and boards a chance to try to work it out. I mean, we're in a period where, I mean, dialogue has improved. Shareholders certainly have a lot more power, they can make themselves heard, and I'm all for letting that happen.

I also think that we're not in an either/or situation. I certainly support Stephen's emphasis on learning more about the shareholder principles, about who they are, what their missions are, how they operate, how they pay their investment managers. There's a lot of information and Stephen and his colleague, Ben Heineman, recently wrote a paper on shareholders suggesting that there's a lot more information to be had and there's a lot more that we might want to know about shareholders and how they operate.

So all that said, I do think, you know, shareholders have a very important role to play. They have some formal powers in terms of votes. Most of those votes are advisory, but they certainly have a place at the table and I think we've probably let that place work itself out over time.

The last thing I want to say, and Stephen did really touch on this, is that it's easy to overgeneralize here. When we think about shareholders, sometimes we think about Calvert and other times we might think about a hedge fund or a private equity group or some other investment fund, a mutual fund that is owning shares. It's a very diverse group. And one of the things that I know Stephen has been working on is trying to get a handle on who they are, and I think that is important.

So, I mean, just to kind of end, I mean, my feeling is we're in a very different place than we were 25 years ago, when the shareholder movement got started. I think when the emphasis of groups like CalPERS and the Council of Institutional Investors and others started to say, you know, look, boards are lazy, CEOs are imperial, performance is poor, you know, we need to have more, we need to have more rights, we need to pay more attention to shareholders, they've been very successful. And I think that has been a good thing. Boards, I think, are listening more. There's much more of a dialogue going on. And I think we're well positioned for good outcomes to come.

MR. WEST: Okay. Stephen, I'm going to give you two options: either you can respond to Elliot if you would like, but I also would like you to respond to the more general point you made in your paper in terms of you laid out a policy agenda for what you call "prudent ownership." So what is prudent ownership and what do we need to do in order to encourage that?

MR. DAVIS: Yeah, thanks, Darrell. And I should just make a quick comment about Elliot's remarks.

Elliot and I have known each other for a long time and actually our positions here are much closer than it would seem. And the reason is, it really us brings us to your, Darrell's, original remarks, and that is if we look about the change in ownership over time, our institutional investors right now constitute a vast percentage of the American population. It's no longer so easy to make a clear distinction between the investors on the one hand and some stakeholders on the other. Actually, they're all the same today.

The investor has an interest, of course, in savings and making sure that there's money there for retirement. But that same person has an interest in a healthy environment, a good health care system, a good educational system. So you can't really any longer say that there's a distinction. So the old shareholder versus stakeholder argument I think is actually not all that relevant to today given the way that things have changed.

And as to whether shareholders are owners of companies, I take the point that there's a legal debate going on as to whether shareholders actually own corporations, but I think in the marketplace that's because shareholders have the right to elect directors, who, in turn, set the policy for corporations. There is, in the way the market acts, there is a sense of ownership that occurs.

Now, having said that, I then get to the question about how do you move toward prudent ownership? How do you make sure -- because I agree with Bennett that, you know, Calvert and some -- a few peers, it's been lonely, have been doing great work and really have been at the vanguard of prudent ownership for many, many years. And that we do have more institutions, like CalPERS and others, that are moving to the fore. That's all to the good. The question is how do you make that happen right across the board so that institutional investors are together looking -- acting as prudent owners?

Now, there are a couple of issues. One is that part of the problem is a lot of institutions have inherited a culture of what I would call empty ownership. For many years, there were very few rights that shareholders had in the United States, even to elect directors. We now, in more companies, shareholders do have that right, but that's very recent. So generally, it has been considered a compliance exercise or monitoring companies, corporate governance has been considered something that really has nothing to do with value. That's an old way of thinking. That's an old culture and it doesn't reflect the way we are now in a position where government through Sarbanes-Oxley, Dodd-Frank, and in other markets, other jurisdictions there are similar actions, where shareholders have been given more power, but they don't have the culture yet of understanding how to exercise that power.

Just taking that one point, voting on boards of directors, institutional investors in the United States have almost never had that power and they don't really know how to participate in doing that. They're beginning. CalPERS and CalSTRS have started a project, but it's very, very beginning, so we have a culture of empty ownership.

We also have a culture where the governance of the institutions doesn't reflect what needs to happen. The agents who really are speaking for the citizen capital providers, for the most part, have governance that is opaque. You really don't know very much about them. You don't have much accountability to make sure that they are aligned with the ultimate investors. So that's a big problem. We've got to be spending time working on the governance of the institutions just as we have spent the last couple of decades working on modernizing the governance of the corporations.

Another problem is that law is obsolete. You know, Elliot rightly talked about how, you know, boards really need to look at the companies' impact on a whole variety of factors, which are not confined to the traditional financial statements. Well, the law, fiduciary duty law, would still seem to dictate, or many institutions see it as dictating, that they can only pay attention to those strict financial statements. They can't really look at the environmental issues, for instance, that Bennett mentioned, even though they're clearly relevant to risk. Even though we know that human capital today is critical to value creation, investors under the fiduciary standards may not be able to look at that as part of value. So law is out of date.

And then the last thing I would mention is that our regulation is out of date. We, back in 1974, in the United States, created the ERISA law and we gave the Department of Labor the right to oversee what would become of mainly a whole rate of defined benefit pension plans. Well, we know that those defined benefit pension plans, those traditional plans, are dying off and that most companies now offer something like a 401(k) plan. Well, that's really now the jurisdiction of the SEC. But the SEC doesn't really have any mandate to look at the retirees or retirement funds. And that's a big problem because most retirees or most members of 401(k)s are reluctant investors. They're not doing it because they want to invest and, you know, play the market. They're in the market because they have to be, because their plans dictate that they are. And we need to change regulation so that it addresses that fact of life.

MR. WEST: Okay. So, Bennett, Stephen has put a number of possible policy remedies on the table. What do you think?

MR. FREEMAN: Yeah. You know, I want to hit on the head this idea of giving more power to corporate boards. We'd be all for it if we're talking about the right kinds of boards who are really tackling the right issues. And, frankly, we're just not seeing it sufficiently yet, although there is some progress.

First of all, almost every board in corporate America is chaired by the CEO. We're seeing a couple of examples where the chair and the CEO role may be split. That's the norm, of course, for the most part in the UK and Europe. But we need to see in most circumstances, for most companies, a separation between chair and CEO to have real board accountability.

Second, boards need to exercise, impose when necessary, more restraint on executive compensation, which remains, in many cases, excessive. And whether one is concerned for reasons of optics or politics or just sheer shareholder dollars, the spread between lowest and highest paid has gotten so far out of whack as to really violate, I think, most people's sense of decency and commonsense. And that perception, really that reality, was among the drivers, of course, of the Occupy protests across the country last year.

A third problem is that too few directors really pay attention to the environmental and social risk factors. Sure, there have been corporate social responsibility or public responsibility committees, whatever they're called, with varying mandates over the years, but we're just not seeing enough boards really pay attention to those kinds of risks. Where was the Walmart board on bribery? Where was the BP board on post Texas City, pre *Deepwater Horizon* safety oversight? They were focused on it to some extent in the case of BP, but not enough and I think that's reflected in the fact that due to pressure from Calvert and some of our allies on both sides of the Atlantic, BP strengthened its board oversight of safety and environmental risk on its board.

Last and not least, and I really want to emphasize not least, too many, almost all corporate boards are -- I'll just say it -- they are too white and too male. They are insufficiently representative of the United States of America, their shareholder base is of the -- they're employee bases and their markets, their customers, both in this country and around the world. We need to have much greater balance and diversity on our boards with respect to race and diversity. At Calvert we've published several studies on diversity on corporate boards in the United States and while we've seen some improvement over the years, it's still inadequate. And we are part of an overall movement to achieve at least 20 percent female representation on corporate boards by 2020. That sounds like a modest goal, but it's starting from such a low base that achieving even that goal will be a reach.

So to sum up, sure, I'm happy to put more responsibility on corporate boards, but I think that in the meantime, before we get there, shareholders need to put more pressure on corporate boards to do their jobs right.

MR. WEST: So, Elliot, we've heard some of Stephen's ideas and Bennett's ideas. What do you think we need to do?

MR. SCHWARTZ: Well, all of the above. I mean, I think we're really all talking about the same thing and ultimately that is better corporate performance, and performance in a multidimensional plane. That is, not just performance on one measure, one financial measure, but across the board better corporate performance. Stephen comes at it with some I'll call them aspirational goals about prudent ownership, about what prudent owners can do and efforts to push that group, prod that group into doing more, acting better, educating them on what they ought to do.

I mean, I come at from the board's point of view. That is, we want prudent boards and prudent directors, people who we can educate to -- and really the same issues, you know, again, across a multidimensional area, looking at getting more women, and diversity on corporate boards, getting boards to pay more attention to environmental and social issues, getting boards to not solely look at ownership and what the traders in the market -- have them look at what investors want and not what traders want. And I think we're kind of all on the same page, looking at the same goal, and I really don't think it's an either/or question.

As far as, you know, some of the things that Bennett had to say, I mean, I agree with him, but I guess when I look at the glass, it's more half full than half empty. And I know Bennett's been around in this area for a while, but boards are much more responsive than they used to be. There are more independent chairs or lead directors who can check the -- the imperial CEO is not what he once was. And so I look at the progress and, obviously, there's more to come, but I think we've made great strides.

MR. WEST: Okay. Let's open the floor to some questions from our audience. So we have someone with the microphone. Just raise your hand and if you can give us your name and your organizational affiliation.

Okay, in the front row, right up front we have a question. We have a microphone coming up for you.

MR. MACRAE: Hi. Chris Macrae, Norman Macrae Foundation. I'd like to start in a slightly different place, which is let's suppose that the net generation can still be the most sort of productive one ever for America, in which case corporates, their purposes and the purposes even of the biggest markets that America leads, are, you know, important in terms of those long-term consequences. So what are the edgiest movements you see in terms of moving corporations towards making this decade the most productive one for young Americans?

MR. WEST: Okay, good question. Panelists?

MR. DAVIS: Well, I could maybe take a quick crack at it and maybe relate it to Elliot's last point. I think it's right that what we need to do is to move into a new era of corporate creativity. And I think the way to do that is to make sure that these institutions, like boards and institutional investors, are fit for purpose and really geared up to the modern world. So I think Elliot was right, we are seeing American boards moving now into a different era. The kind of board that we have today is not the same as we had 10 years ago, but we've got a long way to go. You know, I think we are about half now, about 46 percent of companies do have a separate chairman of the board, not necessarily independent, but we're moving now towards accountability.

It used to be that boards didn't want to talk to shareholders, let alone other stakeholders. We're now moving into dialogue. And the fact is that if we start moving in these directions of accountability, we're going to get boards that are much more attuned to what the real world is like. Same point that Bennett was making earlier, if we think about trying to reach 20 percent of boards being other than white males by 2020, we're really shorting ourselves. I mean we can do a lot better than that. Companies are, you know, working in a world with very diverse business factors, and the fact is that boards need to adapt to that. That's one of the ways. If we think about modernizing the board, we get it more diverse, we get it better led, and we get it more into a dialogue with the different stakeholders that make a difference in the way companies succeed, then I think that's a way forward for companies.

MR. SCHWARTZ: Yeah, I agree.

MR. FREEMAN: Yeah, let me just clarify. I mean, believe me, at Calvert we would like to see way above 20 percent. It's just that we're starting -- we're still at a relatively low base despite a decade, as you say rightly, of progress. There are still too many corporate boards where, you know, all the directors are male. One happens to be the well-known retailer Urban Outfitter. We just filed a resolution with them a couple of weeks ago for the second time in a row. Their market -- their customers are mostly female, their board is all male. It's a complete disconnect.

So, look, I'm, by nature, an optimist and I tend to see the glass more half full than half empty. But we really are starting from a low base in a lot of these areas, whether it's gender diversity on boards or real attention to environmental or social risk or real independent directors. But I admit -- not only admit, proclaim because we've been part of it -- that there has been progress. We need to accelerate it and we really need to gain much more traction, as I said, I think we've all said, on the part of these large institutional asset managers.

MR. WEST: Okay. And just to remind those of you watching through the webcast, if you want to ask a question you can go to Twitter hashtag #BILTD, B-I-L-T-D.

Christine actually has a question from one of our web viewers.

STEPHANIE: Yes, this question is from Michael --

MR. WEST: Excuse me, Stephanie has a question.

STEPHANIE: Michael Maylove in New York with Third Avenue Mutual Fund. And he asks what can be done to end the prominence of non-binding shareholder resolutions?

MR. SCHWARTZ: Well, I will just say I think non-binding shareholder resolutions are fine. I mean, I certainly don't see any problem with it. It has increased the dialogue. I know that there are directors who -- and CEOs who feel that too much of their time is taken up with I'll put quotation marks around "frivolous" shareholder resolutions or resolutions that don't speak to the core issues of the corporation. But most -- at least most of the CEOs and directors that I've had contact with say that, you know, these are important ways of having dialogue, that it's important to find out what's going on.

They would not like to see any of these shareholder resolutions become binding. For example, to the say-on-pay resolutions now, our votes are non-binding. Most directors, I think, would not want to see those binding. But as far as the current state of play on shareholder resolutions, I don't see that as a problem.

MR. DAVIS: It's a great question and actually it gets to that whole point about moving from a legacy market to a new market. The legacy market was a market in which the share owners really had no power on the core question of who serves on the board of a company. And as a result, what we've called corporate governance for decades has really been, I would argue -- it's maybe a little provocative -- a lot of sideshow stuff, namely those non-binding resolutions. We've had -- shareholders have been forced into using these kinds of proxy ways to try to make companies accountable because they didn't have the real power to figure out who's on the board. Now we're at a moment where about 80 percent of companies, the largest companies, do provide shareholders that right to elect board members, to vote up or down on board members. And so we are, hopefully, moving into a different culture.

Having said that, I also think that the say-on-pay issue, which was introduced by the Dodd-Frank bill, which is a non-binding vote, which gives shareholders every year in American public companies the right to have a vote of confidence on the pay policies installed by the board, has proven to be critically important and not if you look at the actual returns, the actual results of the votes. What's important is that it has provoked dialogue. It has been a catalyst for dialogue between boards and shareholders, and that has been extremely important. If companies don't hear the lessons that shareholders or the advice that shareholders are telling them about their pay, then they may lose their vote. But actually if this becomes a systemic problem, then we'll be in a situation that Britain is in right now, where they've had non-binding say-on-pay since 2005; the government's been frustrated, the public has been frustrated; the pay continues to be out of whack and now it's about to go into -- become a binding vote.

MR. WEST: Okay. Other questions. Right there on the aisle we have a question. There's a microphone coming over to you.

MR. OAKLEY: Tom Oakley, just an independent consultant. I just want to ask this question.

One of the things, it seems, is that we impose these social responsibility costs on "Western companies" or American companies and, meanwhile, we see the debate about Foreign Corrupt Practices Act is not something that the French companies abide by or others, or certainly the Chinese. And that until governance in the countries that are, you know, most malleable to manipulation come up to those standards, that the best investment is any investment. And just sort of, again, can America compete with these “handicaps” that some might say? And then, too, a lot of these industry mandates, like extractive industries and Kimberley process, you know, are those affordable with the, you know, dire consequence of not having any jobs? Thank you.

MR. FREEMAN: Yeah, I appreciate the question. It’s a challenging one and you’ve touched a lot of hot buttons for us at Calvert and for me personally. I’ll just make a couple of points.

First of all, when it comes to corruption and bribery, the United States stood out alone as the leader with the passage of the Foreign Corrupt Practices Act in the mid-1970s. We’ve been in a less lonely position over the last couple of decades, first due to the enactment of the OECD Convention Against Bribery and Corruption. That was a U.S. initiative going back to the first Clinton administration, 1994. And second -- and by the way, OECD encompasses a lot of non-European countries now that are huge investors with major multinational corporations of their own. Second, Britain and Germany now have very strong laws that are at least as tough as the Foreign Corrupt Practices Act. And so there’s now more global coverage, more of a level playing field for American business. I know that’s been a concern.

But I have to say that the efforts in recent months to challenge and really dilute the Foreign Corrupt Practices Act would take us backward when we should be going forward. We should be leveling up, not leveling down.

The SEC and the Justice Department are completing some guidelines for implementation of the Foreign Corrupt Practices Act in light of some of the 21st century realities, and we look forward to seeing what those look like. But we need strong and continuing encouragement of American business, not least in the wake of the wake-up call that we should have all gotten with the revelations about Walmart a few weeks ago.

Second point -- and I'll just make this the second and final because I really could go on at length about this because it's such an important subject -- but you mentioned non-Western companies and, of course, there's been a debate about Chinese companies in particular. And the fact is, is that, for the most part, Chinese companies, which are, of course, becoming more and more multinational along with other Asian companies based in Taiwan, South Korea, India, generally operate at lower levels than -- when it comes to environmental and social standards than do their Western counterparts. And sometimes those of us who've been pushing for higher standards on the part of Western companies take some criticism that we ought to be directing our attention elsewhere. Well, I think we need to work on both.

And without getting too optimistic, you know, I can point to a few tentative encouraging signs on the part of some Chinese companies, among them other Asian companies, that are now willing to engage on some tough, tough issues, partly through the umbrella of the Principles for Responsible Investment, the U.N. initiative, but, for example, beginning to engage on how to operate in the zones of conflict, particularly in Sudan. There is a dialogue underway now with a couple of the Chinese oil companies in that regard. That doesn't mean that Beijing is going to sever its relationship with Khartoum, but I do think that the divestment movement that gained a lot of force and focus here several years ago sent a message to the Chinese government, not just to the

Chinese oil companies -- it's tough to distinguish between them anyway -- that there are some reputational risks as well as operational challenges dealing with human rights issues in countries with repressive governments or conflict zones.

So I think that the Chinese companies, other Asian companies, other multinationals emerging outside the North America and European theater, if you will, are going to be more sensitive to these issues and not out of some moral conviction, but out of just good management of risk. And, frankly, that's the way to frame a lot of these issues. We at Calvert care about human rights as human rights, as well as risk factors for investors. But I think that sometimes we make as much or more progress when we talk about these issues as investors in terms of minimizing or mitigating risk as business managers, operational managers, as navigating tough places that we all want to operate.

We'll see what happens in the coming months in Burma, which should be a test bed for more responsible investment and operations. I'm a little worried that too much of a green light is being shown here that Burma is open for business all of a sudden. I'd rather see a flashing yellow light, proceed with caution, and particularly caution with respect to some of the severe human rights problems that persist in Burma even as the country seems to be moving towards democracy.

MR. WEST: So, Elliot, you wanted to respond to that question.

MR. SCHWARTZ: Yeah, I just wanted to add a note. Of course, I agree with everything Bennett said. There's nobody more knowledgeable about this than Bennett.

I want to react a little bit to your saying that this is a handicap for U.S. companies.

MR. OAKLEY: Yeah, I'm not saying it, but, you know, there's --

MR. SCHWARTZ: Well, right. You know, the current research I'm doing at CED is largely about what's called the social license to operate and it's about trust in business and the reputation of business. And I think in the Walmart case, you know, it's not just that they may have broken the law, but they lost a lot of trust from the shareholder community, from their customers, and from others, from the society at large. I think it's important -- and in a way, the Foreign Corrupt Practices Act is an important protection for the company to keep them ethical, you know, give them integrity, give them something they can fall back on and say, hey, we can't do that. So, you know, I tend to view it from that perspective, from sort of the reputational risk and the social license to operate.

MR. DAVIS: Yeah, and I would just add I also agree with everything Bennett -- (Laughter)

MR. WEST: Wait a minute. There's too much agreement on this panel.

MR. DAVIS: But I would just add one perspective, which is going back to the question if your company are what your shareholders want you to be. If you look at -- I mean, there have been a whole series of problems of non-U.S. companies: Siemens, Parmalat, Sino-Forest, Olympus in Japan, one after another. And the fact is, in each of those cases, those are, many of them, widely held companies, where the shareholders weren't doing their job. You know, quite apart from what the law says, the shareholders have a real interest in making sure the companies are avoiding the huge hits that take place when reputation and trust collapses. So they need -- it gets back to the question of prudent ownership. The shareholders have to have their eyes wide open; they have to watch the store.

MR. SCHWARTZ: Yeah.

MR. FREEMAN: Yep.

MR. SCHWARTZ: I think Stephen prudent directorship.

MR. WEST: Okay. Right here, we have a question on the aisle up front.

MR. MULLOY: Yeah, I'm Pat Mulloy. I actually worked for Bill Proxmire, who wrote the Foreign Corrupt Practices Act.

MR. FREEMAN: Well, good for you.

MR. MULLOY: And I should note that he put a provision in an ADA trade bill directing the administration to go get an OECD bribery convention, so that came out of Bill Proxmire as well.

MR. FREEMAN: Very good.

MR. MULLOY: I was on the staff of the Senate Banking Committee, and I just want to comment and then ask a question. The economic figures today were disappointing. Some people look and say over the last 30 years, the United States has run $9 trillion of trade deficits. Over the last 10 years, we've run about $3 trillion worth of trade deficits with China.

Now, some people would question that countries like China have figured out how to incentivize U.S. corporations to increase shareholder value and compensation for their CEOs by moving manufacturing and technology from here to there and then shipping back here, and that that's part and parcel of why these trade deficits are completely out of control in this country, and that the jobs that our young people used to have, they're not having anymore. I wonder have you guys thought about that issue and do you think it's something that may have some truth behind it? And what can we do about it if it is something that we ought to be thinking about?

MR. SCHWARTZ: Well, I'll just take a quick stab at it. I mean, the trade deficit is really a macroeconomic phenomenon. I mean, we spend a lot more than we save. And we consume a lot, and we're going to have to get the things we consume from somewhere and we get it from overseas, and lately we've been getting it a lot from China. But I personally don't think that the corporations or that corporate policies or that Chinese enticement of business, either business investment or trade, really is an important explanatory variable in looking at that trade deficit.

MR. MULLOY: Anybody else have a comment on that? As an economist, Stephen.

MR. DAVIS: Yeah, the only thing I would add, because I think Elliot's right about the macroeconomic aspects of this, is that the shareholders and the boards really have to make sure that when they make outsourcing decisions, that they take into account the whole panoply of risks that are out there, including, as we've seen from that investigation of Foxconn and the work that it does on Apple's behalf in China, that there are risks that occur that affect the American company, in this case Apple, when the Chinese company may -- or as is alleged -- mistreat, in some respects, the workforce. So there are -- these are big issues that actually cost companies money if they get it wrong. And I think for the shareholders and the boards, they really just need to make sure that when those decisions take place, that they do take into account the full panoply of risks that are out there.

MR. FREEMAN: Yeah. I would just add quickly that -- not to comment on Apple-Foxconn, although we've been quite focused on that at Calvert as a shareholder in Apple and being very focused on labor and human rights in China and elsewhere. But, you know -- and I don't want to sound like the two-handed economist that President Truman decried, but, you know, on the one hand, you can't fault companies for doing most of their manufacturing basic assembly where labor is relatively cheap. And we're seeing now, of course, China beginning to worry about the erosion of its manufacturing base as its wages are rising for a variety of reasons.

But, on the other hand, you know, from a national security point of view and I think a long-term economic growth point of view, we need to maintain a manufacturing base in the United States. That base will never be as dominant a portion of the U.S. economy as it was a half or even a quarter century ago, but we really do need to maintain for every conceivable economic, strategic, and political reason, I think, a strong manufacturing base. And our ability to do so will shape our trade deficit to some extent, along with a lot of other macroeconomic factors.

But, of course, our ability to maintain even that base is going to depend on updating and improving skills. And, you know, I'm hardly an expert on it and everybody else talks about this, but the best thing we can do to deal with -- to maintain that manufacturing base and to deal with a lot of the trade issues even is to invest in improving American education at all levels.

MR. MULLOY: Thank you.

MR. WEST: Okay, other questions. Near the back there's a hand that's up.

MS. GOLDSTEIN: My name's Rebecca Goldstein. I'm a student. Given that Dodd-Frank has not weathered the rule-making process particularly well, I'm wondering if you think that there's a role for government to play outside of federal regulation. And in particular, I'm wondering if you think there's a role to be played by the fact that a lot of these institutional investors are the pension funds of public employees.

MR. DAVIS: Well, I think that -- I'm not sure that I'll go exactly -- I'm not sure that I'll go exactly to the point where the federal government should have no role, but I would say this. I think that we go wrong if we're too prescriptive in our law and dictate to investors, or to companies, for that matter, how they should approach, you know, all sorts of issues that face them in the marketplace. But I do think that we need to focus on the accountability of those institutional investors. And the way to do that is to think about the way in which we operate in other parts of our lives.

Right now social media are extremely important, of course, and you can find, if you're citizen A, an app to figure out what the best restaurant is in your neighborhood or, you know, where the best doctor might be for a particular kind of ailment. And yet, we have almost no information required of institutional investors that go out there that allow a similar kind of comparison, so that if you were an employee at a company and you're kind of locked into a set of retirement options, you really don't know whether those 401(k)s or the mutual funds are actually operating in alignment with your interests. And we have more and more reports out, the latest one being I think from Demos, that talks about how there's an enormous amount of leakage from retirement systems into intermediaries at Wall Street and away from the ultimate beneficiaries.

If we had the federal government coming in and saying a simple thing: an institutional investor ought to have a nutrition label-style disclosure, where they need to explain how it is they make sure their actions are aligned with the interests of the ultimate beneficiaries. Don't prescribe exactly what that disclosure should be, but just tell us how is it that you align with your shareholders. How do you pay your fund managers? Do you pay them to act short term or do you pay them to act long term? Things like that. Once that is exposed, then it may be possible for us to -- for ordinary citizens to figure out whether their agents are actually acting in their best interests, and whether the signals that those agents are passing to boards of directors are about short-term performance or long-term performance.

MR. WEST: Elliot?

MR. SCHWARTZ: Just two quick points. One just from the corporate side, corporations are chartered by the states, not by the federal government. And, of course, most of them are chartered in Delaware, but nonetheless it's a state responsibility and not a federal responsibility. And, of course, there's a lot of back-and-forth between the states and the federal government over the federal government's assertion of authority and power in this area, and I'll just get that out as a point of clarification.

The other just small point, because Stephen mentioned reports coming out, there was a report by one of his colleagues, recently a study, a research study by Martijn Cremers, about investment funds -- or pension funds, I guess, in particular some of the results they got from public pension funds, about how much more risky those funds were than other similar funds elsewhere around the planet, probably due to regulation and for other reasons. But I think the kinds of reporting actually that Stephen is calling for would be very good and we would be able to get a better handle on whether the pension funds were investing prudently, whether their behavior was going off in a more risky direction, or whether they were doing what you would expect them to do in the current situation, which is to become a little bit more conservative in their allocation of investment choices.

MR. WEST: Okay. We have another question from our webcast audience from Stephanie.

STEPHANIE: Yes, we have a question from Heather Struck, who's a Reuters reporter in New York. And she says how can we expect shareholders to hold companies accountable today with so few individual holders?

MR. DAVIS: Well, I think -- oh, sorry. You go ahead.

MR. FREEMAN: No, you go and I'll follow.

MR. DAVIS: Well, the --

MR. WEST: Rarely have I seen panelists be so shy up here. (Laughter)

MR. DAVIS: The individual holders, individual Americans are invested in the market in many different ways, but the fact is that, you know, a couple decades ago, institutions held a very large percentage of equity in American companies. Now it's a pretty small percentage. And instead, the way most individual invest is through collective vehicles. Calvert, you know, is one of those, but it could be a mutual fund, a Fidelity, a Vanguard, whatever it is. And it's those institutions that really have the clout to make change in corporate boards; to make sure, for instance, that boards are strong and are looking at the broad issues of risk that face companies.

So it's those institutions and not necessarily -- you know, I hate to say the individuals don't have a great deal of power, but -- and I think they should be voting. And there actually are new ways, through the use of social media, to try to have individuals vote in alignment with institutions that they might like. There's a group, Moxy Vote, which allows people to do that if they like Calvert, for instance, and the way Calvert votes. They could say, okay, for my individual shares I want to vote however these guys vote.

MR. FREEMAN: Yeah.

MR. DAVIS: But the big power is really with the institutions. I don't know if you think that's right.

MR. FREEMAN: It is. And Moxy Vote is an innovative new tool. There's another one, SumOfUs, which uses social media very aggressively to go after companies, not necessarily on behalf of shareholders, but just ordinary citizens on an issue -- a company and an issue a week, one after the other, and have been scoring victory after victory. I think we're going to see much more use of social media.

But, you know, whether it's institutional asset managers beginning to use the proxy process more or firms like my own, Calvert, and others that bring these tools to bear, we do have a big tool chest. We vote our proxies. We file shareholder resolutions; in our case, usually several dozen a year. But we also engage with companies in direct dialogue with senior management, often up to the CEO level.

In our case at Calvert, we're in dialogue with several dozen companies a year, many of them up to the CEO on a particular labor/human rights issue, a particular environmental issue. And we find that we have access on the basis of our ownership, but also, I think, on the basis of our brand and our ability, though, to do our homework and put across some pretty important, urgent issues, but to do so in ways that are reasonable and management is willing to engage. And they don't always agree with us -- far from it

-- but to a growing and even surprising extent we are getting to “yes” with companies. And I see this as a growing trend and I think that whether it’s on the part of mutual fund companies like the Calverts of the world or the really big institutional managers, the pension funds, through vehicles like PRI we can engage company management much, much more.

You know, the annual general meetings -- Chevron’s was yesterday, Walmart’s today -- are big shows and they’re critically important, particularly for shareholder resolutions. But there are a lot of other avenues that we’re using and I think we’re making progress.

MR. WEST: Elliot?

MR. SCHWARTZ: On this question of retail individual owners versus the institutional owners, I think actually a more interesting question relates to active versus passive management.

MR. WEST: Yeah.

MR. SCHWARTZ: Because I think both Stephen and Bennett are talking about actively managed funds, where the fund is choosing stocks and it’s using its voice and vote in very active ways. The market has a large number of funds that are just indexed. I mean, and there are several pension funds that are too small to be actively managed and they’re just indexed and they’re very passive. They don’t go through this process. I know Stephen would like to encourage them to, I know, to be more active, at least in -- maybe not as trading, but active in terms of using their shares.

MR. DAVIS: And their voice.

MR. SCHWARTZ: And their voice. And I think that’s -- in today’s market it's not -- really I wouldn't look at the retail versus institutional. I'd really look within the institutional what's active and what's passive.

MR. DAVIS: That's a good point.

MR. WEST: Okay, other questions.

MR. MULLOY: Well, I have one more. You mentioned having diversity on corporate boards. My understanding is in Germany, labor unions are on corporate boards.

MR. FREEMAN: Yes.

MR. MULLOY: And that this gives the workers a chance to have some input in the corporate decisions about whether to outsource or other sorts of decisions. Do you think that's a good idea that we find a way of getting labor unions and representatives of the working people on our corporate boards in this country?

MR. SCHWARTZ: Over to you.

MR. FREEMAN: I think it would be a fine idea to get more representatives of average Americans, those who work in factories or offices, on corporate boards, whether they're union representatives or otherwise. I think that that would lend an important perspective. I think it would make companies more sensitive in the way that they treat workers and communities, make them more sensitive in the way that they conduct themselves overseas.

That said, I don't see it happening, at least not in terms of any kind of structured or designated union representation, and I'm not happy about that. But the fact is that, as you know all too well, the representation of American workers by unions has contracted severely over the last several decades. I'm about a half a century old and I think when I was born more than a third of American workers were represented by trade unions, and I don't think that that figure now is barely in the double digits, you know, maybe 12 or 13 percent. So I just don't see that happening politically, even if it would desirable.

That said, if we do push for more diverse boards with respect to gender and a number of other factors, we can get those perspectives on the board. And I would not discourage, though, unions from trying. And through the power of collective bargaining, if there's a will, there may be a way. And even with the very reduced union movement in this country, we've got some very skillful union leaders who should press for that if they think that's in their members' interests.

MR. DAVIS: Can I add to that? It's a great question. I think that the German system really isn't a system that works best for the modern world where you have multinationals.

MR. FREEMAN: Yeah.

MR. DAVIS: A great example of that was Daimler when Daimler owned Chrysler. When the time came to think about how to rationalize or shrink that workforce, the German unions, which, as you're quite right to say, have sway in the supervisory board of Daimler, made it clear that if there were cuts to be made, they weren't going to happen at Germany -- in German factories. They were going to happen in American factories. And the American union representation was very low on that supervisory board. So if you have a multinational corporation, you know, the decisions then get very, very skewed.

The other problem is that the -- with a supervisory board system, about half the board is really not accountable to the shareholders. They're accountable solely to the workforce in that particular country.

Now, if the question really is how do we diversify boards so that they really reflect the business that the company is in, and that I think is a great question: how do we do that? That's the kind of debate that really is needed in this country. We're kind of locked in and have been. The old system is that American boards appoint themselves, in effect. Until recently there were meaningless elections at annual meetings. Now they are becoming meaningful.

We're just crossing into that new kind of culture of making boards accountable. There are other countries that do it differently that may be worth looking at. Sweden, for example, has a situation where the large shareholders will come together once a year. They're not part of the board and they put the slate forward to the annual meeting. I know in Britain they have been talking about other ways. Are there ways to get, you know, trade union representatives or employees represented on compensation committees, for example? So there are all kinds of things that we probably ought to be thoughtful about.

One of the things that we shouldn't do is to have one-size-fits-all approach. Companies ought to be able to experiment and shareholders ought to be flexible enough, frankly, to allow that experimentation so long as it is really aimed or done for the right reasons.

MR. MULLOY: Thank you.

MR. WEST: Other questions? Well, I have one that I'd like to close with. At the very beginning of his comments, Stephen kind of put this discussion in the context of the presidential campaign, so I just want to come back and get our panelists' sense of Obama versus Romney on some of the questions that we're talking about in terms of the role of the shareholder, board composition, some of the shareholder advocacy issues that we've been talking about. What difference would it make if a Romney wins versus an Obama wins on these types of questions?

MR. DAVIS: Should I start? Well, the fact is that this should not be a partisan issue. If we look back at the history of how this capital market is structured in terms of shareholders and boards and such, which administration was it that mobilized shareholders to play a big role, you know, in corporate governance? It was the Reagan administration. It was the Department of Labor under the Reagan administration that said institutional investors have to vote their shares because the share is an asset of ownership and it needs to be protected. That was a Republican administration.

And the fact is it should not be an issue of partisanship. This is really about shareholders who are losing lots of money when their agents are operating for their own, you know, interests other than the long-term interests of the citizens. That's a problem for them in terms of saving for retirement. It's also a problem for American companies because they get the wrong signals. They get the short-term signals.

So what I think would be the right policy is for either party to come and say, look, this is really about modernizing our market. It's about strengthening boards. It's about strengthening savings. And, therefore, what we really need to do is to empower the citizens by giving them the information they need, that kind of, you know, nutrition label approach that I mentioned, make sure our regulation is up to date.

Now, in practice, it's very hard to see that this is going to come up in the campaign in terms of the actual solutions because there are too many, you know, interests involved. And that's -- they have the ability to express their interest whether it's a Republican or a Democrat.

MR. WEST: Bennett?

MR. FREEMAN: I will avoid any partisan comments working for a non-political, nonpartisan company, Calvert, but also in light of the fact that in the past I've been a political appointee in the U.S. Government. But, you know, I would observe, though, that we definitely should have bipartisanship on a lot of these issues.

And you cited, Stephen, the Reagan administration on shareholder rights. I would cite the Nixon administration for having created the Environmental Protection Agency. And whatever else happened in the Nixon administration, from Vietnam to Watergate, the fact is that that was one of the best environmental administrations in American history.

I guess the one -- the two points I would make here in this context of our discussion today about the modern shareholder, where I think there is a significant difference here between the candidates, first is Dodd-Frank, where the President very clearly supported the legislation. He would have liked something stronger, I think, on some of the provisions. And Governor Romney has said unequivocally that he would repeal certain aspects of Dodd-Frank. I think that would be a mistake, where Dodd-Frank is an attempt to apply some of the lessons -- only some of the lessons -- we should have learned from 2008 about how our financial markets operate and ought to be governed and they contain a lot of -- it contains a lot of modest provisions for the most part. And I think as a shareholder I'd very concerned to see a watered down Dodd-Frank.

The other issue I would point to from a long-term shareholder interest point of view is climate change. Climate change is a reality. It's a crisis, but it's also an opportunity from a business and even an investment point of view: investing in alternative energy, renewables. And the Obama administration has been focused and supportive of encouraging solutions to climate change, encouraging investment in renewables in particular. And, you know, Governor Romney went to the Solyndra factory -- offices, rather, yesterday to dramatize that failure, and he has every right to do so. But we need investment in renewable energy and alternative energy if we're going to have the kind of economy and society we'd like to have in what is going to be a carbon-constrained world here.

So those are two areas where in a non-political way I would see as real differences from a long-term shareholder point of view and a corporate governance point of view.

MR. WEST: Okay. Elliot, we'll give you the last work on this.

MR. SCHWARTZ: The last word. Well, I started the session by saying it was good to go third because you could react to what the others had said, but the disadvantage with going third is that the others have already said pretty much everything I would like to say.

I, too, would like to remain nonpartisan on this issue. I was going to focus my remarks, as Bennett did, on Dodd-Frank. I think that's probably the biggest difference between a Romney administration and another Obama administration would be in the funding and the operation of Dodd-Frank and the regulations that go along with it.

I do worry about cutbacks in staffing at the SEC, funding for the SEC. Also, to put a plug in for Stephen, I think ERISA and the Labor Department would also be a concern about whether there would be the right kind of regulation to do the kinds of things that he's interested in. So I think there would be real differences from that point of view.

Other than that, I agree with Stephen that as far as shareholders are concerned, it really shouldn't matter. And there's a great deal that can go on between shareholders and corporations and the directors that really has nothing to do with politics.

MR. WEST: Okay.

MR. SCHWARTZ: Thank you.

MR. WEST: Thank you very much. Stephen, Bennett, and Elliot, thank you very much for sharing your views with us. Thank you. (Applause)

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