Corporate Governance

Improve Corporate Governance

Protecting Investors by Strengthening Gatekeeper Roles

Background

Corporate scandals from Enron to WorldCom have highlighted the importance of effective corporate governance – the policies and practices that determine how a corporation is operated and governed. In the wake of these scandals, Congress hastily passed the Sarbanes-Oxley Act of 2002 (SOX) in an effort to protect U.S. capital markets and millions of American shareholders.

SOX promotes accountability and transparency in corporations. It also has a few provisions that enhance the effectiveness of "gatekeepers"—corporate directors, in-house and outside counsel, and internal and external auditors. But while SOX may have increased investor confidence in the short term, ongoing compliance with its requirements, as well as the heavy fines imposed by the Securities and Exchange Commission (SEC), have proven extremely expensive for some companies.

Recommendations

The strength of U.S. capital markets is in large part based on effective corporate governance. Without it, the valuable securities – including those in 401(k) plans and other retirement vehicles – of millions of Americans would be at risk.

The next President should protect the investments and retirement plans of millions of Americans by leading the effort to strengthen the roles of gatekeepers. Key recommendations include:

- The New York Stock Exchange's listing requirement that a company's compensation committee be comprised of independent directors should be codified.
- The SEC should develop an inspection program to review corporations' financial statements and accounting practices.
- The SEC should consider requiring attorneys to pass a competency examination before being permitted to appear before it.
- Board members should be required to participate in an initial orientation as well as in periodic continuing education.

- Shareholders should be given a greater role in voting, through nominations, election of individual candidates instead of slates, and majority instead of plurality decisions.
- The board of directors should be involved in the decision to hire, retain and compensate the general counsel.
- The board's compensation committee should be required to approve the compensation of all top-tier executives.
- The board's audit committee should obtain control over the internal audit function as well as over the outside auditors, including the power to terminate personnel and to approve compensation.

Key Facts

- In June 2002, WorldCom (later MCI and now Verizon Business) disclosed substantial accounting irregularities, which eventually would result in the largest bankruptcy filing ever.
- Before SOX, the largest civil penalty by the SEC against a single company was $10 million (against Xerox in 2002). By contrast, the fine imposed against WorldCom was $750 million.
- SEC-imposed fines rose five-fold between 2003 and 2004 from $350 million to $1.7 billion.

A full version of this proposal, as well as supporting background material, is available at www.opportunity08.org.

About the Author and the Project

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Dick Thornburgh is Counsel in the Washington DC office of Kirkpatrick & Lockhart Preston Gates Ellis LLP. Thornburgh served two terms as Governor of Pennsylvania and was Attorney General of the United States under Presidents Ronald Reagan and George H.W. Bush. From 1992 to 1993, he served as undersecretary general to the United Nations. He was appointed in August 2002 as the Examiner in the WorldCom bankruptcy proceedings.

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