Oxley – Feinberg - Castellani Panel

Greg Ip: It was back in 1987 that that iconic Wall Street fellow Gordon Gecko said, "Greed is good." That captured what I think became the code of ethics for the financial sector for the next two decades in the sense that they didn't need to really think about what was ethical because whatever you did had to be good. You were sort of an invisible hand. And that's a philosophy that's kind of been turned on its head in recent years. The president last September at Federal Hall called on bankers to think about what was right and responsible and not wait for the law to change to reconsider their pay practices. I think it's the kind of dilemma that not just bankers but anybody who thinks about this question from the theoretical point of view deals with now. How do you make what is supposed to be a market-based decision and run it through the process of what is ethical? It used to be you paid your employees what they were worth. Now you also have to take in what is right, and how do you fold that into your thought process.

[Panelists are seated]

Ip: The question under discussion is, can government impose ethical leadership? I'd like to expand it a little bit to be can and should government impose ethical leadership? Ken, in your marching orders have you been asked to judge not just what is accepted risk but have you also asked the question, what is right, what is ethical as far as executive compensation? And how would you ask that question and do that, if you were asked to do it?

Feinberg: I must say, that to me is sort of a loaded question. I'm not sure how to answer. I'm going to give a very bad answer. I have a statute that circumscribes what I'm supposed to do. It doesn't say in the statute, "And you will impose a new ethical culture on corporate America." It says, "You shall calculate what is appropriate compensation with an adding machine." So I'm loath to say that as part of my jurisdiction I'm doing anything other than the end game, which is add up the numbers, satisfy your statutory obligation and it ends there. And maybe somebody's going to explain to me how what I'm doing has an ethical component, but I want to hear that because I'm not sure I see it.

Ip: Do you think that *could* government dictate something that's not just appropriate but ethical?

Feinberg: Well, what does that mean? Can the government have a law that says in setting compensation, compensation committees will be ethical? I guess they could say that. Or, is the better point, if the compensation committee is truly independent, it's moved in the direction of promoting an appropriate ethical objective. I don't know. I'm in deep water here based on the questions.

Ip: John, can the government. . .?

Castellani: Well, in reality the government does. Because the government, particularly the Congress, is reflecting the views of the people who vote – who sent them there. So whether it's environmental standards, whether it's compensation levels through tax policy or through government policy, in fact it does. But what the government does not do well, and what is the dilemma really facing people who set compensation, not just Ken but boards and directors, is it doesn't do well with the mismatch in priorities. And if you ask the American people – which we did because I was the prop for the over-paid at Ken's unveiling at the Treasury Department, so they had all their labor people, all their activists, and me – I said at that time that probably nobody's spent more time or money trying to figure this out than those of us who represent the affected class. And when we asked the American people what we have asked them, "What are the attributes, what are the standards that you apply to a high-quality company?", what they say, in roughly this order, is one that has high ethical standards, one that has high-quality goods and services, one that is hiring people, one that is a good steward of its environment and its communities, one that is a good steward of its work force, one that has good financial performance and one that has good stock performance. When you ask a board of directors what are the value-sets against which they are judged, they say good financial performance and good stock performance, and maybe not in that order. The dilemma in dealing with issues like compensation is that mismatch between the stakeholder and what a board of directors and what management is there to do for a corporation and its owners, which is to create more value. That's the dilemma. What government is talking about now is not just the few companies that are now still part of TARP, but applying a set of governance provisions and standards to every publicly traded company. And that is going to be a very difficult thing for management and boards to work through. So the answer is, it already does. But it doesn't do it particularly well because it does it on a one-size-fits-all basis.

Ip: Mike?

Oxley: Yeah, I think the easy answer is the government doesn't do it and shouldn't do it but I do agree with John that in terms of setting a standard and so forth it's inevitable in our society today where we elect our representatives to do the people's business. So clearly the legislative body is the responsive body to a constituency and when that constituency is exercised about a particular issue it's reflected in what happens in making laws. I don't think we want a system any other way. And so that's how the whole system itself works. I talked earlier about how Greenspan continued to talk about the resiliency of the American system, the resiliency of the American economy, and it is true, it's a remarkable set of principles we have that allows us to recognize that the fallibility of people – actually the framers of the Constitution understood very, very well, that's why they have the balance of power and the three sections of government to check each other, and checks and balances, precisely because we are dealing with imperfect individuals who make imperfect decisions. And so instead of trying to force-feed ethics on the rest, it seems to me the role of government ought to be as transparent – to have the business sector be as

transparent as possible. If you look back at compensation and traditionally the reports at the SEC were very difficult to decipher in terms of executive compensation. A lot of perks were hidden somewhere else, you had to go to all kinds of different ways to figure out what the actual package of compensation for the top wage-earners in a company was. And even good reporters like Greg had a hard time doing that because I think it was purposely set up that way. And so the SEC and the Congress have moved in a direction that provides for more immediacy, more transparency. It's still not perfect. I think Chris Cox did a great job of moving that ball forward and I suspect that Mary Schapiro will continue on that effort. But there's also no question that you're going to get a lot of pushback from the executive suite. I do a lot of visits with Nasdaq-listed companies throughout the country and besides complaining about Sarbanes-Oxley the next complaint is about the SEC requirements because, guess what, some enterprising reporter in Boston, the Boston Globe who does a weekly story about a CEO in the Boston area and of course it's sexy to write about how much money they're making and so the executives don't like that because their neighbors find out how much money they're making. But that's the world we live in, it's a more fish bowl existence, like when you get elected to Congress. And lastly I just think, and I mentioned it in my comments, the real test of our ability to deal with these kinds of problems without massive intervention by the government rests with the board of directors in every publicly traded company in this country. And time is running out to see some courage and some leadership on the part of the boards of directors. Not just in the compensation area but in all kinds of different areas. After all, they are elected to represent the shareholders. The shareholders own the company. And these people are elected representatives, just like I was, to represent that constituency. And we've tried to make it so that there are more independent directors. We no longer have, hopefully, Jimmy Cayne's board, but a real board that understands the issues and are willing to ask the tough questions and are willing to make the tough decisions. But if that doesn't happen, somebody's going to do it for them. And that's not very far from here. And so that's the issue. If we come back here in a year, two years from now, I can pretty well tell you what the future's going to be and what it's going to look like. I'm optimistic that the boards will take that challenge but I wouldn't bet the ranch on it, either.

Ip: Well, let me respond to that and get Ken's comments because [?] might say on say-on-pay, if the shareholders know enough through the process of the board of directors they would put the brakes on excessive or reckless compensation practices. But the experience in Great Britain, for example – they've had say-on-pay for, I guess, seven years now and the vast majority of [?] are approved without dissent. It seems to be that when the company is making a lot of money, as Goldman Sachs has for a long time, shareholders are very happy with them, which, again, brings a dilemma. Whatever the compensation practices, however bad it looks to us, with this populist backlash – if the shareholder's happy with it, how do you resolve that difference?

Oxley: Well, because it was a false reality. There was no transparency. Nobody knew, even on the board, that Goldman was up their ears in CDOs and others of those kinds of contracts and nobody knew what they were worth. That's the whole concept behind transparency. It's not just for the media, it's not just for the board, it's for everybody to determine. So I can't just say, if I

were a Goldman shareholder, that I would have – all I know was that they were doing well and that my stock price was going up.

Castallani: But, Greg, there's an inherent fallacy in your question. This is not the things we're hearing from our shareholders. We have to think about who our shareholders are. Let's pick one – my favorite one, when I was at Tenneco the chair of our compensation committee was [Cliff Ford?], the CEO of TIAA-Cref, and Cref – if you want a way not to get rich, have Cliff as your comp committee chair. What's the average holding period of TIAA-Cref? One month. What's the average holding period of a Business Roundtable stock? Seven and a half months. We have share renters; we don't have shareholders. The preponderance of the complaints that are coming and the issues that are coming to the board are coming from other stakeholders. I'm not saying they're not important, but we had the stakeholder debate in the '80s. We shouldn't confude what the shareholders want because their horizons are becoming shorter and shorter for the most part, the preponderance of them. There are some long-term shareholders, don't get me wrong. But we've now ended up with this barbell effect that the long-term shareholders of the company tend to be the index pension funds in the management of the company for the employees and their 401(k). Everybody else is in and out pretty quickly. They're in and out and back in many times, but they are in and out. That's not who you're hearing from. Who you're hearing it from are activists, other stakeholders, and that's what I say is the dilemma going forward. Say-on-pay is a wonderful concept but it is almost incomprehensible blunt instrument. Suppose the shareholders of the Wahoo Corporation disapprove in fiscal year 2011, the first year it will probably take effect. Well, I'm on the comp committee. What do I know from that vote? Was it the total level? Was it the structure of long-term versus short-term? Was it the split between cash and equities? The only thing I'm going to know is, I'm going to have to engage the shareholders. Who are the shareholders I'm going to engage? I'm going to engage the ones who are the biggest shareholders. What's their interest? Stock price. That's the dilemma.

Ip: [paraphrasing] What's the effect of ethical – an employee's moral center – versus legal, where they have to go look something up in a book? Some see the tax code as a set of parameters to work around. Discuss that question – that the more government prescribes, we actually remove the responsibility from employees.

Feinberg: Well, that's not my experience. My experience is that the law is the outer limit of what is appropriate. What I'm doing is to implement a statute. Now, if there should be a higher level of ethical responsibility in the company, fine. Fine. That might be corporate governance. It might be SEC transparency. It might be something that I'm interested in, and you're the experts, the variations in corporate cultures around the country. One size does not fit all even with seven companies that I'm seeing. But I must say, be careful about asking the government to try to inculcate virtue. That sounds pretty Orwellian to me. I have a statute that I have in front of me that circumscribes my authority and I do nothing more or less than apply the legal standards. And if there's a high virtue to be promoted, that to me is something that will have to come either

from other government intervention or, I think, as a citizen, that's something that really has to come from the company itself.

Castellani: Greg, it's an interesting question and of course everybody in this room are the people who grapple with this every day. I go back – you were talking about this earlier – I go back to when I thought Mike Oxley's first name was Mike, not Sarbanes, when we first started down this path, and I still keep on my credenza the Enron Corporation's [?] and I was at Tenneco at the time, right down the street. We looked like each other in terms of our pipeline business, of course we had a lot of other businesses that we were in, and the analysts were coming to us regularly every day and saying why aren't you getting the kind of returns that Enron is. We came to the conclusion that we were obviously not smart enough because we couldn't figure out how they were. But they were the darlings and we were kind of the dog at the time. But it gave us an important lesson and I think the lesson is what you grapple with all the time here and that is there is a distinction between what is legally right and proper and allowed and what is ethically desirable. The legal part never bothers me. We're pretty good as a country at finding drugs. There's a miscue every once in a while but we're pretty good at finding people that break the law and prosecuting them and punishing them. What bothers the corporations that are in this room, what bothers the institutions in this room and what bothers the companies that are part of the Business Roundtable are those little sets of decisions that are made across an organization for good reason, for the individual who makes that decision, but when they are added up or put into a different context they jeopardize the viability of the organization. That's the hard thing to find. That's the thing that you cannot legislate, that's the thing you cannot regulate, that's the thing that really has to come from the culture of the company that you all grapple with every day.

Oxley: You know, we talked a lot about when we dealt with SOX and the overall concept as I indicated earlier because transparency and accountability through better corporate governance restores investor confidence. But I also want to talk about tone at the top. I thought Norm Augustine really hit the nail on the head when he said he made the distinction between what he says is compliance versus ethics. And there is a difference. You all know there's a difference. Compliance, in some ways – and part of the criticism is well-taken in terms of SOX – is to some extent checking the box, okay? And you're checking the box all the time and its, I don't know, a kind of feel-good. It's good to have the structure and so forth. But at the end of the day it's kind of a box-check. Then the next step would be where you folks come in and that is the whole structure of ethics and what is good business ethics and the like. It's very, very difficult because, like John said, you don't know what your competitors are doing. . .

Castellani: Well, everybody has to make a profit, bring a profit. This is a great little document. This is called "Business Roundtable: Principles and Commentary on Executive Compensation." And the reason why it's relevant to this discussion is, when this issue, which is really at an intensely hot level now, was just at a 'your hair's on fire' level, we sat down with our friends at CalPers, the Council of Institutional Investors, the AFL-CIO and ourselves, and sat down and

said let's talk about whether or not there is a structure, a set of guiding principles that should affect how compensation is determined. So we all brought our little books. And Ira Milstein, from Yale, sat down with one of his partners and they cooked the books and they said 'we're going to create a matrix about what's in common and what's in disagreement.' And he came back and said 'you've wasted your money on us – 99.9 percent of it is in common.' There are just very small differences between the AFL-CIO guides and principles on compensation and the Business Roundtable. The issue isn't in the principles. We can all come up with how you design the guidelines, how you should be determining compensation. The issue is in the application and in the answer. And whether the answer, Ken, is $16 million or $410,000 really drives the argument here. Not how you should be doing it; it is how you do it.

Question: Maybe more a comment than a question. If I read things right in today's paper, Goldman Sachs has reduced their compact for 2010. That means the average salary is still $498,000. If $498,000 is the average for everyone at Goldman Sachs there's some outrage that goes on. . .Something's wrong with the whole perspective.

Castellani: Well, full-disclosure, Lloyd [Blankfein] is a member of the Business Roundtable and a beloved member. The questioner at the back really hit what's at the core and that is that they're still acting like they're a privately held, mercantile bank in a lot of people's views when in fact they're now a publicly traded corporation. And what was entirely appropriate for Brown Brothers Harriman, and remains appropriate, is maybe not appropriate for a publicly traded corporation. That is a big mindset change. You look at their compensation structures and they are as alien to ITT or the Crain company structures as the planet [?] is to the Earth. It's a completely different structure. Now, am I expert enough to say it's wrong or right in this circumstance? I didn't come out of the financial services sector so I don't know. It's worked fairly well for a long period of time. I think a more important question is, is it right for the current political structure? Because the consequences of it being wrong are consequences for all 12- or 14,000 publicly traded companies. And one of the other things we've found in some of the other work we've done about American attitudes is that everybody thinks that anybody who makes $450,000 a year is overpaid. Flat out. Nobody can agree on how much the CEO of the Wahoo Corporation should make versus the CEO of Goldman Sachs. But what they do know is that they should be sharing in sacrifice. So go back to that value-set again. If you're laying off people or things are tough in the economy then you should not have your compensation be increased within that same context.

Questioner: That same article by the way said compensation went up in 2009.

Castellani: May be entirely appropriate within the confines of Goldman Sachs but you take it outside into the value-set that is now bearing on the rules we're going to have to operate under for the foreseeable future and it is problematical.

Oxley: If you make the conscious decision to become a publicly traded company, you have certain obligations. You make that decision with your eyes wide open. You have obligations to the SEC. You have SOX obligations. There are numerous obligations. And nobody forces you to go public. Matter of fact, Goldman was the last partnership to go public. But once that decision was made, those are smart people. They have to understand that they are a publicly traded company. SOX only applied to publicly traded companies. If you didn't want to be a publicly traded company, if you didn't want the responsibilities of SOX, then don't go public. I had a discussion with a fairly high-ranking Goldman official a few years ago. And he was complaining about the cost of compliance under SOX right after they'd gone public. And I said, 'I'm just curious. What does it cost you to comply with SOX on a yearly basis.' He told me. And I said what was your CEO's bonus? The CEO's bonus – the cost of SOX was a third, a third of the CEO's bonus. And I said you know what? I may be some dumb lawyer from Ohio but I can figure this one out. That always stuck with me. And that what I kept hearing from my constituents back home and that's what all these members are hearing. Exactly what you pointed out. Some of it is irrational, but at the end of the day public opinion counts in this country.

Question from a Mr. Gelb: Yes, this is for John. John, you mentioned the attributes that the American public wants to see from corporations and then you said but for boards there's just two or at least there's the top two – financial performance, stock price. So the question is, is that the right criteria for the board? I know they have obligations to shareholders, they have to make money. But is it money at any price?

Castellani: Well, I think you have to look at what the pressures are around boards. I think the challenge for boards and for management going forward is to rationalize that mismatch. You know we had these discussions in the '80s when a lot of shareholders, particularly the activists in the '80s, were saying 'you're spending too much time on stakeholders, your employees and communities and the impact of a hostile takeover on the stakeholders. And so the shareholders became very, very dominant over the last several years. It's interesting when you go back and look at the history of our own membership, for example, which I have done, with few exceptions those CEOs who are fired by their boards, the articles that you all wrote and the media covered, talked about stock performance during their tenure as the way – as the reason why they were fired. So they're very, very attentive – and I'm not saying it's wrong, because ultimately that's the measure of the people who own the companies value investing in our company. But I think what has become difficult has been rationalizing the broader set of issues with the time horizon of the patience of the shareholder. Because when you are dealing in increments where you're having turnover of a major percentage of your stock that's measured in months rather than years and you're managing a complex organization, if you as a board and a representative of all shareholders and that's your legal obligation, have to be responsive to that short-term pressure. And a lot of these other things that are driving the public policy process really become nonessential. The challenge going forward is, since they are the things that will drive the governance structure in the future and are driving it now, how do you rationalize the two so you can meet both. I also think we have to ask ourselves, now, how do we – do we really want an

ownership structure for our publicly traded entities in this country that's measured in days and months? And do we really understand what the consequences are, because there's another interesting disconnect – I'm sorry for going on so long but this is a lot of fascinating stuff that I learned about – when they ask the individual investor what their time horizons are, they say three to five years, because I'm a long-term investor. And you say, wait a minute – why are you a long-term investor? I put 6 percent of my salary in my 401(k) each and every month and I never touch it. And then you say wait a minute, what do you invest in? Well, I invest in the Fidelity Wahoo Fund. The Coosbay Fund. Well, what's the average holding period of the Coosbay Fund? Well, it's three and a half months. Well, no, no, no, I'm a long-term investor, I've never taken my money out of the Coosbay Fund. Okay, fine. That's the disconnect. And we never ask ourselves that question. Because I personally think, well, as much as we'd like to blame somebody, and I think quite personally that's the reason why we have Ken here, the reason why we had to have TARP. It would be easier for us if as a country we found some guy in Iowa to blame it on and then move on to how we avoid doing it again. I believe at the real core of it was the unrelenting drive for short-term results. There's nothing wrong with short-term results. But when it is unrelenting and it is short, short-term, you get silly things to make money.

Questioner: So to bring it to the practical vein a little bit, we're ethics officers and we're, as you said, a little bit under the radar and you want to learn from us. Part of your mandate is helping these five companies now thrive and looking at the long-term. So how do we link – intuitively I think there's a link between high ethical standards and high long-term performance and I think there's some studies out there. But when you listen to an analysts call every quarter where no one ever asks questions like that or links it up. . . So what can we do inside our companies to really influence that connection between ethics and long-term profit?

Oxley: First of all, we're talking about a few extreme examples. Let's remember that there are thousands of companies out there that get it right day-in and day-out, get it right month-in and month-out, get it right quarter-in and quarter-out. And when you look at the best of them, and I get to see a lot of the leaders of investment banks, they're ones that know how to balance short-term and long-term. They know that positive long-term performance is nothing more than a series of good quarterly results consistently year-in and year-out. And so it's not flat-out we're just going to do it for the third quarter of 2010. It's what's its impact on the fourth quarter, the first quarter, all the way through. How do you build value, how do you change the model, how do you incentivize behavior within the company. Does it right but does it successfully. We know how to do that. You all know how to do that. What I think we have to guard against is the overreaction, which is going to occur, to those pressures. Now we went through a circumstance where for better or worse – Greg, you're the economist, you can tell me whether this is right or wrong; I was a biochemist by training so my learning about the economy has been on the job – right or wrong, we went through a period of time where there were a lot of investors in publicly traded companies whose horizons were such that they were buying substantial portions of companies, coming in and saying 'what I want you to do is leverage up the company, buy back the stock and I'll be back, I'll be gone.' They didn't do so well recently but that mentality will

return. Is that illegitimate? I don't know. But it's real. The best companies know how to balance.

Questioner: This question is for Ken. Ken [inaudible]. . .

Feinberg: The latter question's very easy to answer. Bank of America and Citigroup, having paid back TARP, are now completely out from under any of my jurisdiction. Technically, I guess, they can do now what the free marketplace tells them to do without the imposition of the special master's office. Now, if you're still in TARP is it possible for creative internal officials to find loopholes? I'd like to think the answer to that is no. We have pretty good descriptions and pretty good monitoring authority, so I think it unlikely that there will be those types of loopholes. But again, I've been around a while and vigilance I think is a virtue.

Questioner: For a second question, something I read the other day. In defining the nature of the problem, the equity markets now account for what I understand is about 70 percent of the investors, institutional investors, so really the individual investor – it may be long-term when they're investing directly in equities, but from what I understand decades ago it was more like 20 percent of the equity market was held by institutional investors. Has this really become part of the basic problem? The institutional investment nature of the market or is that related at all to this issue?

Castellani: Well, problem is not the word I would apply to it. It is the circumstance under which, and it has institutional investment and the growth of mutual funds particularly but investment vehicles for institutions has had some tremendous beneficial impact in terms of improving the availability of capital for a lot of good economic activity, it really has. It has changed the nature, and again it gets back to the heart of my premise and that is that there is a fundamental mismatch between the incentives of the institutional investors on behalf of their fiduciaries, all of you who invest in their funds, and your own, collectively, as the nation's view of some of the issues of the corporations and how they're regulated. The mismatch is just the system we have to deal with now. You think one different thing when you're putting your money into a mutual fund than you do when you're calling your congressman from central Ohio and saying you've got to rein in those bastards. Bastards is too strong [laughter]. Those scoundrels. It's not bad. There's a lot to be said for it that is good. But it is different and it is in dealing with those differences – and in themselves they're not monolithic. Union pension funds act different from mutual funds. Mutual funds act different from hedge funds. Hedge funds act different than private equity funds. There's nothing that says they're good and bad but they are different and they present the challenge that I think every manager, every board member and quite frankly every member of Congress and the Administration now has to deal with. I would say, Ken, I would have modified your answer a little bit. Not within the context of your legal requirement, but there is a reaction to that. The reaction was proposed by the President just a couple of days ago. We're going to propose a $90 billion tax over the next 10 years on large financial institutions so that they pay back the money that the American taxpayer loaned them.

Now wait a minute – they paid it back. But it's not going to be imposed on General Motors or Chrysler. Why? Because there's a public outrage. They may have created themselves as what Russell Long used to refer to as the man behind the tree. Mr. Long as chairman of the Finance Committee used to say, "Don't tax you, don't tax me, tax the man behind the tree." Congress has been looking for that man behind the tree for a long time. The one person you could tax and the American people would say, hey, that's a fine idea.

Oxley: Good point on mutual funds. Mutual funds became the vehicle for the average guy to invest in equities and it's been a huge success – 95 million-plus Americans own mutuals. And so there are a lot of positive upsides, but Jack Vogel, who started Vanguard, became kind of a crank, at least perceived by many people as a crank in his later years after he left Vanguard and, I think, became president emeritus. He used to come in and see me all the time and was really upset about the lack of transparency of mutual funds, a lot of things going on. But for the most part, certainly within the ICI, their trade association, was seen as kind of a crazy uncle in the closet. But at the end of the day Jack Vogel turned out to be pretty accurate. He foresaw the late trading scandal that developed several years ago with the mutual funds. There was a lot of shenanigans going on with a lot of mutual funds that were not in the best interest of the individual investor, that is the person who owned these mutual funds shares. That scandal took everybody somewhat by surprise and of course changes were made by the SEC and the Congress to make it more transparent and fair. And I think it has, but I think the mutual fund industry as an industry took a big hit because of that and it was fairly widespread. So you're right, it's been amazing the change in the way investors are perceived and actually are because 70 percent, I think that's about right. I will say this, I think it's a little bit misleading only by the fact that at the end of the day those funds have to come from somewhere and they're coming from you and me. They're coming from individuals. And to some extent they have some obligation to kind of keep an eye on things. And the plus has been this amazing growth as we've become an investing country, an investing society, a country of investors. That's pretty exciting stuff. And for all of its flaws, I think we've shown the rest of the world that you can as an individual really prosper and grow and invest capital in America. And that's why we are the magnet for companies investing, people investing from other countries in here. A lot of companies when they really want to go public and really want to raise capital, they come to the United States. At one time Israel was the largest country to have the number of companies listed on Nasdaq. Now China has far exceeded Israel and it is a growing thing, that the Chinese companies understand that they need to come here if they're going to be taken seriously and raise capital. That's a positive sign. It means that we have the necessary stability and the deep pools of capital that other countries frankly just can't. Some are catching up and that's a good thing. But at the end of the day they've got to come here and we don't want to mess that up. Every time we've got these kind of scandals it really does hurt us, not just among domestic investors but worldwide. It's something that we need to take very, very seriously.

Questioner: One last question. I want to mention a point that Mike made, which was the difference between ethics and compliance. And then I look at the title of this panel and it's "Can

the Government Impose Ethical Leadership?" I think we all agree that that's really not possible. We can't legislate ethical leadership. However, you can legislate certain things that require companies to think about it, to work on it. And the example I will use is the United States Sentencing Commission that in its 2004 amendments incorporated ethics and culture as a requirement to analyzing an effective ethics and compliance [program]. So that it would be my recommendation going forward when Congress and the Senate are looking at legislation, that you not only legislate the formula for devising compensation but you also plug in some kind of indicia of ethical leadership. Because there are things that can be done. I mean the things that we're all doing inside our own companies. Those things can be done. And if they're required or some aspect of the measurement – that's the only way to raise the level of awareness, move this forward, get boards of directors thinking about who they put on the board, what kind of background and experience those people have and what they're looking at as they provide oversight for the company.

Ip: I have one observation from my own experience covering the financial sector. Banks in this country were originally regulated by a prudential regulator, by the Federal Reserve, and they were only interested in being sure that whatever management did kept the bank safe and sound. But that created a gigantic loophole because if you decided to do something unethical that was nevertheless highly profitable, you were actually making the bank safer and sounder. And so some of the things that banks did, for example, moving loans off their balance sheets especially if they were risky, might have been unethical to the naked eye but had the effect of making the bank look safer and sounder because they'd gotten rid of all the toxic assets. It wasn't actually until in the wake of the Enron and WorldCom scandals the Federal Reserve added to their list of factors the examiners would look for – reputational risk – so from now on the banks . . .what's good for the bank and what's good for their reputation. [inaudible]. I'll ask one other question. What about the law of unintended consequences? Whenever we've tried to do this, sometimes the opposite happens. I'll bring up two examples. In the early 1990s there was a lot of concern about executive compensation. The IRS imposed a $1 million limit on how much pay. So a $1 million limit was tax deductible unless it was performance-based. So what happened, everybody started paying stock options and other stuff and that resulted in all the craziness and manipulating of numbers that forced you to write the new law. More recently, rightly or wrongly, people were blaming all the enormous compliance costs and [led to] the rush to go private. Hey, we don't need it. Let's lever up and [inaudible] shareholders and people would argue this was an unintended consequence. So do you see unintended consequences on the horizon?

Oxley: Having served in the Congress for 25 years, that's a fact of life when you're trying to deal with a broad-based subject like that with so many interests, trying to put together a coalition in a bipartisan – you're going to have that. We safely predicted on the $1 million what was going to happen and it clearly did. I think that to some extent is a legitimate argument in terms of costs of compliance. But I think it has to be put in perspective as I pointed out about Goldman Sachs and put it in some kind of context. I saw an article the other day that said that Silicon

Valley, they don't expect a lot of IPOs to come out this year or next year. That companies are looking to sell and not do IPOs and cited Sarbanes-Oxley and cited the last two years there have been a dearth of IPOs. They also said in the article that two years before that there were record IPOs, which was true certainly at Nasdaq and I think the New York Stock Exchange. So I guess because of Sarbanes-Oxley the last two years we didn't have any IPOs and two years before that I guess in spite of Sarbanes-Oxley we had IPOs. So I give up. It goes back to what Pat said quoting Sarbanes, that we get blamed for everything anyway.

Feinberg: I must say, I hear this argument about the law of unintended consequences. My problem is the law of intended consequences. I don't have the luxury of worrying about the law of unintended consequences. The law says you shall determine compensation with an intention not to hurt the competitive nature of these seven companies, now five companies, when their competitors are not subject to my determinations. So how you balance that is what deputy secretary Wolin calls threading the needle. And it's the law of intended consequences that keeps me up at night.

Castellani: It's a good question. Let me give you another example, because, again, these are very, very blunt instruments being applied universally to very, very complex organizations for which there really is no application. For example, in the proposed legislation related to the proposed financial regulatory reform and in a series of amendments Senator Schumer has proposed it would require every publicly traded company to have a risk management committee. Well, one very large publicly traded company that is not a financial institution at whose board meeting I was speaking in the education portion said 'This is outrageous. We are now so concerned about risk at our company that we have the entire board as the overseers of risk management in the company and we go through a risk assessment and a risk management plan as a board because none of us trusts any of the other five, four or five of our directors to have a purview that's wide enough given the complexity, diversity of this manufacturing company – not a financial services company. Risk management will actually be worse if we have to create a risk management committee. You can give example after example because the reality is that the outrage that drives a lot of this is aimed at anything that looks like a publicly traded company, anything that looks like a CEO, anything that is aimed at compensation that looks like a certain level – every one of these 12- or 15,000 companies that are publicly traded – every one is different. Ultimately that's what the board of directors is supposed to determine on behalf of the shareholders. And the key to this is that we have to as a country either – and as shareholders – believe that boards of directors are properly constituted, properly doing their job in their oversight of the management and the stewardship and the ownership of the company or those board members and the way that they operate needs to change.

Oxley: Unintended consequences reminds me, when the Senate was dealing with the Sarbanes-Oxley bill after the House had passed it, and this was right during the end of the WorldCom meltdown where it was just World War III headlines every day. And the Senate was deliberating on the floor and they were debating amendments. And these amendments would be debated for

20 minutes and passed almost 97 to nothing. And I watched from afar in almost total shock about what was going on. Any senator who ever thought about running for president or running for reelection had to have an amendment. So Senator Biden who at the time was the chairman of the Foreign Relations Committee offered an amendment on the floor that would provide under Section 312 that the nonexecutive board chairman certify the financials along with the CEO and the CFO. Minimal debate. Passed 97 or 98 to nothing in a heartbeat. So when the Senate finally passed it there was an awful lot of pressure on the Hill, in the business community, everywhere else, to take the Senate bill and send it to the president. Not go to the Congress. So I had to go to the Speaker and ask for a Regular Order and the Speaker backed me up. So we had a conference and I was chairman of the conference. So I remember my negotiations initially with Senator Sarbanes. And frankly it was the first time I got any pushback during this whole process in eight months. I started getting calls – I think you [Castellani] set it up – from Andy Grove, John Snow, Scott McNealy, a bunch of CEOs, some of whom I knew, some of whom I didn't. And I think Castellani was dialing the number, you know. And they were saying, the definition of a nonexecutive chairman is not involved in day-to-day operations, how could he possibly certify his financials under threat of going to jail. So I made my case to Senator Sarbanes and to his credit he agreed. And so he agreed to take it out in the conference committee against the wishes of a unanimous Senate and a fellow committee chairman. So that was courageous, it was smart, I was very impressed. It kind of set the tone for the conference and we did some other good things, including putting a [inaudible] at the SEC to be a receptacle for fines and disgorgements that were then. . .to help the victims of Enron and WorldCom and some these other companies and the SEC has paid out billions of dollars to those victims. So we did a lot in that conference committee but had we gone along with the passions of the moment that would still be law. And there were some other things in there as well, including Chuck Schumer's amendment on split-dollar life and so now it's like nobody's making a decision. I had a client the other that was worried about whether they were in compliance or not. We looked into it and the SEC has issued no guidance whatsoever eight years later and it's still kind of in limbo. So it gives you an idea about unintended consequences.

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