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ROUNDTABLE

CORPORATE GOVERNANCE

Calls for greater transparency, broader accountability and enhanced shareholder participation in boardroom processes are constantly increasing. Such issues have returned to the spotlight in many countries, and a range of initiatives have been put forward with potential implications for corporate leaders. Recent changes mean that companies will face greater challenges when establishing and implementing an efficient governance strategy that meets new legal requirements and the demands of today's market.

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Lajoux: Are boardrooms under greater pressure to become more transparent? Where is this pressure coming from and how are boards responding?

Copnell: There is no doubt that boardrooms are under increasing pressure to be more transparent – both due to external influences, such as regulators and investors, but also because good transparent governance disclosure can make good business sense. Research continually indicates that investors are willing to pay more for a well-governed company, rather than a poorly governed company with similar financial performance. This is supported by anecdotal evidence that analysts are asking more questions about how organisations are governed and how risk is managed. The implications of this are immense. Directors can add significant shareholder value simply by demonstrating that they take corporate governance seriously and have robust, fit-for-purpose governance procedures in place. At its most basic level, demonstrating good governance means replacing anodyne, boilerplate and bland reporting with meaningful, balanced and company, as well as stakeholder, specific communications. However, caution must be exercised by regulators, as transparency can have unintended consequences as we have seen with the executive pay in countries where extensive disclosures are required.

Ball: Pressure has come from activist institutions, in particular public sector funds, proxy advisory firms, individual shareholders who have seen their investments crater, as well as from the press. Pressure is also coming from recent new disclosure rules from the SEC regarding compensation, the director nomination process, and risk. The withhold vote on directors that shareholders wield has become a very effective tool to pressure boards. I expect withhold votes to become even more prevalent and effective with the loss of discretionary voting and with more companies moving to majority voting to elect directors. The pressure is also political – for example, the pay issues at AIG and the TARP banks – and there is strong potential for additional legislation, particularly in the area of compensation. I think most corporations would rather be proactive and adopt some measures in advance of legislative and regulatory action to hopefully forestall some of that legislation.

Gregory: The pressures for transparency around boardroom processes are increasing in the US for publicly-traded companies, as a result of regulation and shareholder activism. The SEC has recently adopted new rules that require greater disclosure by companies about how the board approaches issues ranging from board leadership decisions to risk oversight to board composition and diversity to executive compensation. These are all matters that have been of significant interest to active institutional investors, who are especially influential with legislators and regulators in a political environment that is reacting to the financial crisis.

Stockton: Pressure is coming from more activist shareholders and the advisory services that they are listening to, from regulators like the SEC and from plaintiff's lawyers when things go south. As a result, transparency is increasingly the buzz word for good corporate governance. I don't see boards taking dramatically different actions in response to these demands. They are doing the same things they have been doing, just doing more of them and

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HOLLY J. GREGORY

doing them better. They put more effort into reviewing public disclosures and then testing management, accountants and lawyers about disclosures and how they can be approved. They also spend more time discussing and analysing the various aspects of their company, so the frequency and duration of board and committee meetings are way up. It's a matter of better blocking and tackling rather than changing up the whole game plan.

Stephens: Although the main stakeholders are their shareholders, companies have other key stakeholders, such as major lenders, institutional investors, rating and regulatory agencies, key clients and major supply chain partners. Many of these stakeholders are advising board members to have more oversight of how senior executive management executes enterprise-wide risk management. Stakeholders want a better understanding of how the company understands emerging risks, manages known risks with limited mitigation capital, and how risk management activities integrate with other functional activities. More boards are aware that the confidential, ad hoc, intuitive decision-making of the past must give way to more formalised processes that can respond to a more transparent environment. Boards' response to the pressure is fragmented. There is no consistency among peer groups but market leaders are showing a more favourable response.

Pickworth: Many boards, it seems, were guilty of ineffective oversight of their companies. There have been calls for more transparency on the appointment and financial rewards for those sitting on boards. Generally, the pressure is not yet coming from the shareholders – at least not from institutional shareholders whose main aim seems to be to keep their heads down. There have been calls, worldwide, for greater transparency and accountability from those who lead large companies. This represents a daunting challenge for boards. The complexity and time constraints of their roles are already enormous, and keeping abreast of the legal duties and liabilities associated with good governance are becoming ever more burdensome.

Lajoux: Would you agree that more boards are identifying a direct link between good corporate governance and effective risk management at the highest level? If so, how is this affecting their decision making processes and agenda items?

Stephens: More boards are attempting to link corporate governance and risk management into a formalised governance, risk & compliance framework. This is where the functional activities of risk, compliance, audit, legal, finance, IT can intersect and provide more certainty to operating plans, protect the balance sheet and add value to strategic planning. Since managing risks at an enterprise level is still a developing concept, and with rating and regulatory agencies just starting to formalise GRC frameworks into their requirements, most companies have not fully moved ahead to implement successful GRC programs. There are several GRC maturity stages that companies find themselves in, and moving from one stage to the next is challenging. The most advanced companies at integrating good corporate governance and effective enterprise-wide risk management are beginning to understand the ROI associated with these activities.

Stockton: Risk management is undoubtedly one of the areas receiving the most focus from boards over the last several years. This is due in part to the recent spectacular business failures in the financial services industry that were caused, in large part, by excessive risk taking, but also because many boards recognise that this is an area that has not gotten enough attention in the past. So, there's a big push by boards to catch up in the area. An incredible amount of time and energy is being spent on processes that are designed to identify, prioritise and control enterprise risk. It reminds me of preparing for the Y2K crisis, so I sometimes wonder if all this process is really going to be worthwhile. I think it will only be worthwhile if it causes boards to include consideration of risk management implications as a regular part of their decision-making process.

Pickworth: The link between governance and risk management has mainly been made in FTSE 250-type companies, less so for FTSE 500 and smaller. Companies are responding by appointing, where they don't already have one, chief risk officers who will report directly to the board and have independent access to the chair. We are finding that risk management is becoming a regular board topic. Boards are now assuming direct responsibility for articulating the company's risk strategy, monitoring risks, and ensuring that there is appropriate company-wide training. However, more could be done and boards need to get better at evaluating their role and performance, as it pertains to risk management. They also need a better understanding of how to react in crisis situations. What do they do if they uncover fraud or corruption for example? Turning a blind eye is no longer acceptable in a world of increasing regulatory enforcement action.

Governance changes that are deemed to be good, because they help to achieve a higher governance score or satisfy the criteria of a proxy advisory firm, may in fact not be the best decision for a company.

THOMAS BALL

Gregory: For a variety of reasons, the boards of US publicly-traded companies are increasing their focus on their multi-faceted role in risk oversight and management. This role has three components: first, understanding the material risks associated with business plans is a key element in providing strategic direction. Second, the board needs to provide oversight of the processes and systems that management uses to identify, manage and mitigate risk. Finally, there are certain areas of risk that the board itself must manage – the risks associated with governance and the selection and compensation of the senior management team. Based on this understanding of the board's various roles with respect to risk oversight and management, each board needs to determine how best to organise and apportion these tasks at the full board level and through committee assignments. In the aftermath of the financial crisis, the issue of risk oversight and management, and how boards can best organise their efforts in this area is gaining more attention on board and board committee agendas.

Copnell: There is no doubt in my mind that boards see a direct link between good governance and effective risk management. The two are synonymous, and for many boards, risk management is now top of the agenda. It's been on the radar over the past several years, but many boards are now asking whether the ball is really being moved forward, and whether risk management needs to be thought about in a different way. Good governance demands that management can provide the board with a holistic view of the company's major risks, understand the company's risk appetite – including that for low-probability yet catastrophic risks – and rigorously stress-test key risk assumptions. Boards also need to consider whether their information sources are sufficiently varied and objective, and how the corporate culture – including executive incentive schemes – impacts the company's risk profile. In addition, it's imperative that directors engage in a dynamic dialogue with the executive team to make sure that management can, and does, identify, assess, and manage risk effectively.

Ball: I think it is important to define what good corporate governance is. Governance changes that are deemed to be good, because they help to achieve a higher governance score or satisfy the criteria of a proxy advisory firm, may in fact not be the best decision for a company. I believe directors need to do what is best for their company and not make changes in pursuit of better scores or because of what is currently in vogue. SROs, regulators, activist investors, traditional investors and advisory firms all have different takes on what constitutes good governance and a board needs to effectively filter what they're hearing from all sides and do what is best for the company and its shareholders. However, when making corporate governance decisions that may run afoul of the policies of institutions and proxy advisory firms, boards need to be fully aware of possible voting repercussions by institutions. This potential problem can be assessed with sophisticated vote forecasting.

Lajoux: How much of a successful governance framework depends on an appropriate board structure with clear oversight duties?

Gregory: Effective governance requires getting the right people with the right skill sets and experience on the board, with appropriate leadership, and then creating the structures and practices that will support the board to be engaged, objective and informed. Of course, clarity of duties is critical but so is getting the group dynamic and the boardroom culture right. This is more art than science and is very much a function of human nature and behaviour in group settings.

Stephens: A successful governance framework is dependent on an appropriate board structure with well understood reporting hierarchies, policies and procedures. The operations of the risk and audit committees of the board set the stage for how senior executive management, the functional groups and the business lines manage risk. Strategy, goals and expectations are well known and then the tactical execution of the process receives routine oversight and transparency. Managers who administer these risk processes come and go on a regular basis but the process must be sustainable, repeatable and institutionalised.

Pickworth: The right tone must always start from the top and be effectively disseminated throughout an organisation. Boards need to lead but they must ensure that there are clear and accessible policies, processes and structures which permeate the rest of the organisation. These structures, policies and processes must be regularly and independently strength-tested, not least to identify any gaps. They must be living and fluid, not set in stone.

Ball: The board needs to set the proper framework for the company and have sufficient measures in place to ascertain how the plan is being executed. They also need to review their oversight regularly to make sure management is moving in the right direction. Again, each company is different and the board has to determine the best structure based on the skill sets of the directors, and the history and culture of the company. From a shareholder perspective it is very important for the board to establish and clearly communicate an appropriate board structure with duties clearly laid out. The key attribute in this structure and advisement is an emphasis on the independence of directors. I think this can be evidenced by the move towards separating CEO and chairman, the suggestions of the proxy advisory firms that boards should have a super majority of independent directors, and that the major committees of the board are chaired by truly independent directors.

Copnell: Board oversight today is – or needs to be – very different than it what was a year or two ago. Whether it's the nature of the board's interactions with management, discussions at executive sessions, or review of disclosures and earnings releases, boards, and audit committees, are applying greater focus and intensity to their oversight activities. Perhaps suggesting that they were overly-focused on process in recent years, a number of board members are now talking about a return to the basics of effective oversight. Such basics include knowing the people, understanding the business, exercising scepticism and insisting on accountability for management and the board.

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>
> MARK STEPHENS

Stockton: Of course, an appropriate board structure with clear oversight duties is essential to establish a successful governance framework. But I believe that's the easy part. I've found that the more important element of successful governance is not the procedural framework but the perseverance and diligence of board members in fulfilling their assigned roles and responsibilities. It really comes down to directors taking the time and putting in the effort necessary to perform at the highest levels. While all directors want to do a good job and to be part of a successful and thriving business, and no director wants their company's operations or public disclosures to be considered opaque, coaxing that extra effort needed to achieve the highest level of board performance often depends on effective board leadership.

Lajoux: What key considerations do companies need to make when assigning roles and responsibilities as part of their governance strategy?

Ball: I would assume that the most elementary consideration would be to put people in place who have knowledge and experience to handle the job – management – and a board that is prepared to consider views that are diverse, without being divisive. Companies need to be aware of the guidelines of the major proxy advisory firms as well as their largest shareholders. Again, it is critical to understand that each company's situation is different and the board needs to make choices based on what it believes is best for the company and its shareholders. What works well for company A may not be appropriate for company B. This is where strategic corporate governance consulting by professionals is most beneficial. All boards have one thing in common: all need to be aware of what their major shareholders are thinking in regards to roles and responsibilities and the potential for withhold votes at the annual meeting if they go against the policies of their institutional shareholders.

Stockton: The most important thing to consider is the particular characteristics of each individual director. What is the particular director's level of commitment, availability, training and education, business experience, personal temperament? These are the ▸▸

critical questions. These individual traits need to be matched up with the governance responsibilities to be assigned. A director with a demanding role as the CEO of another business cannot be given the most time consuming board responsibilities. A director with primary responsibility for a governance area, whether it be compensation, governance, or audit, should have some meaningful background and experience in that area. Boards must give serious thought to the background, experience level and availability of each director when assigning governance responsibilities.

Copnell: Having directors that are both independent and have a deep knowledge of both the business sector in which the company operates and the company itself is fundamental. Independence is essential – however, overreliance on this single attribute can easily lead to a board filled with independent directors selected precisely because they have no affiliation with, or any historical or current interest in, the company's business or its fate. That is an odd group to help develop a business strategy. If there is a lesson to be learnt it is this: we need to get back to basics and accept the limitations of the governance model we have. Companies need talented directors who can, at any time, take a holistic view of the market they operate in and sensibly ask themselves: "should we be doing this and if so, are we fully aware of the risks involved?"

Pickworth: Before companies can think about assigning roles and responsibilities, they need, generally, to be better informed of their risks on the ground, particularly in developing markets and dealing with those countries and industries known to have a poor corruption record. The key to good governance is having the right quality and mix of people on the board with the right mix of knowledge and skills. Roles and responsibilities should be clearly defined so that everyone understands what is required of them. This should be followed up with appropriate training, so that they are properly equipped to deal with corporate governance requirements and any crisis situations which might arise.

Gregory: In the US, state corporate law defines the roles of the shareholders and the board, and allows the board to delegate authority for managerial functions to professional managers subject to board oversight. The role of the board, once it has delegated authority to a management team for the day-to-day running of the business, is one of oversight and is fairly well understood. That said, many companies find it helpful to draft a formal document detailing the authority that the board has delegated to management, including, for example, guidance about what dollar threshold of transactions management may enter into without first receiving board approval. Another area of delegated authority that boards typically consider relates to the establishment and role of board committees. While certain functions and independence requirements for certain committees are dictated or impacted by listing rules and SEC and tax regulation – for example, for the audit committee, compensation committee and nominating/governance committee – the board may wish to delegate additional responsibilities to these committees or establish other committees, for example finance and risk committees. These decisions about governance structures and delegation should be made based on the needs of the company and considerations of efficiency in the decision-making process.

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TIMOTHY COPNELL

Stephens: Some of the key considerations would be to assign roles and responsibilities that deliver tangible value to the business, are easy to understand and execute and are auditable. The process that is supported by the roles and responsibilities must be repeatable, and not a point in time snapshot that might not be suitable in a more dynamic environment. In addition, companies must balance the need to identify and manage risks with the need for disclosure. Further, the business line managers must be at the front line of identifying emerging risks, executing mitigation tactics, prioritising limited mitigation capital and integrating with other functional activities. Finally, boards should consider a diversity of perspectives so that various opinions are considered about how risks emerge and how they are brought within tolerance limits.

Lajoux: In your opinion, should regulators have more or less control in terms of setting and enforcing standards of good governance? Is the process more effective and beneficial when it originates at company level? Or does a stable system require a balance of the two, and if so, where should the line be drawn?

Pickworth: Regulation is essential for establishing a level playing field and ensuring that companies which do not play by the rules suffer the consequences. However, every operation is unique and must have systems and procedures which reflect this. There is no one size fits all when it comes to good governance, which is why the current 'comply or explain' approach is appropriate. If the regulators try to be too prescriptive, they will stifle innovation and enterprise. There has to be balance of the two. A culture of good governance must be encouraged on an internal level – after all, companies are best placed to understand their own business and the degree of risk they face.

Stockton: The problem with regulators setting and enforcing standards of good governance is that they tend to take a one-size-fits-all approach. Invariably, one size only fits a few, and everybody else suffers. The best recent example of this is the SEC's approach to shareholder access to the director nomination process. The SEC staff has proposed a complex regulatory regime where all shareholders of a certain size and longevity will be entitled to nominate a specific number of directors, with a 'first come, first served' tie-breaker mechanism. Commentators are pushing to give companies ▸▸

the ability to modify or even opt out of portions of this regime and use stricter or more lenient provisions as they prefer. The idea is to give the flexibility to encourage experimentation so that the best practices can then rise to the top. In my opinion, this market approach to governance standards is the preferable alternative.

Ball: I believe the process is more effective and beneficial when it originates at the company level. The dynamics and particulars of each company are different, and prescriptive regulations may not provide the flexibility required for individual companies. For example, a separate chair and CEO may work for Company A, but could be counter-productive from both an operational and/or corporate governance perspective for Company B. And if there are failings, investors should be the ones taking the lead in prodding companies to do things differently.

Copnell: If the recent financial crisis and economic downturn has shown us anything, it's the marked difference in behaviours employed by different companies. This should come as no surprise, as good governance should never be about regulation but about people, behaviour and instilling ethical and moral probity throughout an organisation – including, but not limited to, the board of directors. Simply complying with statute, regulation and codes of best practice is not enough. Boards need to consider how they behave in practice and recognise that their 'tone at the top' and culture pose critical risks to their corporate reputation and possibly survival. In short, the behavioural aspects of governance are paramount. Furthermore, there is a limit to which any regulatory framework can deliver good governance, but this is not an excuse for complacency. All parties should strive to eradicate, or at least minimise, governance failure. But the solution does not lie in an overly prescriptive regulatory response; rather, it lies in renewed focus on how boards discharge their responsibility.

Stephens: Regulators are more effective and receive more compliance when they establish principles and guidelines rather than when being prescriptive and granular. Companies vary by industry, size, markets, products, complexity, maturity and other characteristics that make it impractical for regulators to dictate every requirement down to the tactical level. Although well-established standards are still evolving for GRC practices, many progressive companies are learning that tangible value and ROI can be captured for these processes. Some companies may rush to produce a GRC homework assignment for submission to a rating agency or regulator instead of building institutionalised practices that deliver real business value and support the key goals of the business.

Gregory: Effective governance requires both regulation and the freedom of private ordering. In the US, the historic focus of SEC regulation on disclosure as a tool for regulating corporate behaviour, including corporate governance, has been largely beneficial, since it has left room for state corporate law to develop and to allow significant decisions about governance to be made by shareholders and boards of directors. The federal regulatory and legislative focus appears to be shifting toward more mandates – for example, the potential for mandatory proxy access, majority voting, say-on-pay and other governance requirements. It is unclear that this shift is either necessary or likely to provide any significant benefits, but it is a shift that appears to be supported by a number of vocal institutional shareholders and their proxy advisers.

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DAVID STOCKTON

Lajoux: When a company is reviewing its existing corporate governance framework, what steps should it take to effectively integrate internal controls and governance mechanisms?

Stockton: Although not typical in the early days of Sarbanes-Oxley, in today's world, every board committee's activities should reflect some element of internal control. Until recently, only the audit committee would normally have been involved in monitoring internal control. Some of the spectacular business failures of the last few years have made it very clear that compensation structures can have a significant effect on a company's risk profile and its internal control. So compensation committees are more actively working to assure that compensation arrangements support rather than undermine internal control. It also has become more apparent in recent years that the committee with responsibility for implementation and enforcement of a company's code of conduct, which is typically the governance committee, also has an important role in supporting strong internal control.

Stephens: The integration of internal controls and governance mechanisms within a GRC framework begins with how the data is gathered, what the frequency of the process is, how effective the analytics are, how prioritisation is accomplished, how we deploy limited mitigation capital, how we balance risk with reward, whether the incentives are properly structured to support our risk policy, how approvals are embedded in the process and finally what the reporting and auditing procedures are. Many companies do not understand how to limit business process fatigue in risk reporting and we see risk processes that are under-resourced, viewed negatively and unaudited. Effective controls must be simple, well understood, easy to administer and not unnecessarily restricting to the business lines.

Pickworth: Education, education, education. Employees must understand and be able to act in accordance with the company's values without needing to look up the appropriate response in a policy document. The culture must be natural and endemic. After education comes penetration testing – behavioural questions circulated independently and anonymously to identify where the gaps are, whether in terms of communication between different parts of the business, specific to particular countries or regions or confined to identifiable contracts or service lines. Effective compliance systems are key and should include an understanding of ▸▸

where the risks lie and the potential impact on business, but also board level and senior management commitment to conducting business in a fair, honest and ethical manner, as well as well-designed policies, procedures and controls tailored to the current business environment. Such systems should also involve communicating the policy to employees, stakeholders and business partners, as well as continuing monitoring, evaluation, reassessment and remedial action.

Copnell: Many companies face significant challenges in maximising the effectiveness of their risk and control activities. Two of the most significant challenges are understanding risk in all its permutations and addressing the shortage of specialist resources required to respond to the expanding gamut of risk and control. If risk and control are to be taken seriously, companies need to raise their profile within the business and ensure risk and control become part of all activities and a consideration in every business decision. Those companies that have already invested heavily in enhancing their risk and control activities are now seeking more innovative ways to improve efficiency and overcome the barriers to effective risk management and control. One method that can be employed is continuous monitoring and auditing whereby business information is reviewed and reported upon in real or near-real time. Another innovation is integrated assurance, whereby duplication is reduced and efficiency improved by coordinating assurance across a common framework.

Lajoux: To what extent is there a trend towards reinforcing and augmenting shareholder rights? What notable developments have you seen in this area?

Ball: There has been a trend over the last two decades to reinforce and augment shareholders rights. Poison pills, which were once adopted by boards at will, now, in most cases, won't be implemented or are implemented with shareholder approval in a watered-down state. In addition, just a few years ago, almost all directors were elected by a plurality vote. Now, many companies have moved to majority voting. The same thing with classified boards, which at one time were almost the norm, now, as a result of shareholder pressure, classified boards are in the minority. Certainly, the proposed SEC rule change that would allow shareholders to have access to the company's proxy to nominate directors will provide shareholders with a significant additional tool. Proxy access would lower the threshold for running a proxy contest and open many companies to the possibility of having contested elections. This has the potential to be a game changer for activist shareholders. As activists force companies to capitulate on certain issues, they move on to other issues. For example, an issue that is gaining popularity is giving shareholders the right to call a special meeting. There has been a movement among activists to promote this ability, and the trend is accelerating. The activists are using shareholder proposals that either encourage the board to allow for the calling of special meetings or to lower the threshold for calling a meeting – often seeking a 5 percent or 10 percent level to call a meeting. Having a special meeting call in place does not necessarily insulate an issuer from a shareholder proposal; companies with the right in place at 25 percent may see shareholder proposals to lower the threshold to 10 percent. Also, one other trend we are seeing is that activists are starting to focus on the next tier of companies. Initially, larger-cap companies were targeted, but now that many larger companies have made the governance changes asked for by the activists, the activists are starting to target smaller companies.

Gregory: The SEC has recently expanded disclosure requirements for public companies to provide shareholders with more information about how the board approaches risk oversight, board leadership, executive compensation and board composition. The SEC has also reinterpreted its own rules to allow shareholders to make proposals about succession planning and risk oversight. In addition, the SEC is currently considering a proposal to allow certain shareholders access to the company proxy to nominate their own director candidates.

Stockton: This trend is due in part to shareholders being bigger, more powerful and more active than ever, but also to the widespread belief in the current economy that shareholders have been abused by excessively compensated and reckless management, and that the shareholders need to exert more control. Evidence of this trend is everywhere, from say-on-pay proposals for TARP recipients and on a broader scale, to the SEC facilitating shareholders' ability to make proposals at shareholder meetings. As already noted, the most significant new development in shareholder rights has been the SEC's director nomination access proposal. Although the details are still being debated, it undoubtedly will make it easier for shareholders to cause their nominees to be included in the company's proxy statement rather than being forced to prepare and mail their own proxy statement.

Stephens: In some cases, shareholders are receiving the right to comment on compensation issues without managing the final outcome. Some of the largest shareholders, such as institutional investors, are having more frequent and more in depth conversations with executive management about their views on which decisions can improve shareholder value.

Pickworth: In the UK, structures have been implemented to enable shareholders more straightforward access to legal remedies. But this is not always the answer due to the inherent uncertainties and cost regimes. Recent corporate governance reports have called upon institutional shareholders to take a more proactive role in managing their investments, but there is little apparent enthusiasm or incentive for them to do so. We have not seen any notable developments or an increase in shareholder action so far but this may follow further down the line.

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JONATHAN PICKWORTH

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Copnell: Satisfactory engagement between company boards and investors is crucial to the health of any corporate governance regime and, in the UK, much as elsewhere, the impact of shareholders in monitoring the governance could and should be enhanced by better interaction between the boards of listed companies and their shareholders. There are, of course, practical and administrative obstacles to improved interaction between boards and shareholders. But, certainly, there is also scope for an increase in trust, which could generate a virtuous upward spiral in attitudes towards governance. One particular pitfall is the role of short-term activist shareholders. Intuitively, the UK's 'comply or explain' governance framework works best where shareholders take a responsible approach to any compliance/non-compliance in the long-term interests of the company. However, activist users of shareholder rights may be primarily driven by short term objectives whereas longer-term shareholders may be passive. What this means for shareholder enforcement as a driver of good governance is an important question in a world increasingly influenced by hedge funds.

Lajoux: How is the ongoing debate over executive pay and benefits altering the way companies approach their corporate compensation structures? In your opinion, what will be the long term legacy of this backlash?

Pickworth: The debate is largely confined to the banking and financial sectors, where pay is more obviously linked to risk taking and performance. This model is far less prevalent in other sectors, where strategies are more long-term and achievements less easy to quantify on an annual basis. There are likely to be knock-on effects in the public sector but the long-term impact on the corporate sector is likely to be minimal. However, we generally try to make companies aware that they need to think carefully about bonus structures linked to performance targets. Pressure to meet or exceed targets can tempt employees to use underhand or illegal methods to boost their income or, in straightened times, just to keep their jobs. In the long term, the attention is unlikely to go away and companies will have to be prepared to moderate executive pay and benefits, or stand up and account for their decisions.

Gregory: Companies are more actively considering adoption of claw-back policies and devices to more easily seek the return of incentive compensation that has been paid in instances of fraud or error. Heightened interest in how compensation is linked to company performance and concern over compensation decisions and the processes and policies the board uses is also causing more transparency in this area.

Copnell: The ongoing debate around executive pay and benefits is certainly proving to be a thorny issue for remuneration committees – particularly in the financial sector and in those banks that had to be rescued by government money. There is a groundswell of public opinion that banks, and big business in general, pay their executives too much. Certainly, the UK has seen increases in executive pay far outstrip average pay since detailed executive remuneration disclosures were mandated in the mid 1990s – a good example of an unintentional consequence of regulation. However, from the remuneration committee's perspective, a balance has to be struck between recruiting and retaining the best talent and the price paid to secure that talent. Incentive mechanisms change behaviour and create risk. These risks and the impact on the business plan and the financials must be understood by the board.

Stockton: The recent backlash over excessive compensation has been truly extraordinary. Compensation committee members are reading the same horror stories as the rest of us detailing how opportunities to earn outlandish bonuses incited irrational risk taking that took down venerable institutions, which in turn almost took down the global economy. They are reacting by reining in pay practices on a wide variety of fronts, including limiting base compensation, eliminating some of the more generous provisions such as tax gross ups and tying incentive compensation much more closely to meaningful performance goals. They are also making a much greater effort to understand the complete picture of an executive's comp package in change of control and severance situations. While many of the lessons learned from the recent economic difficulties will, I'm sure, be quickly forgotten, I expect that some of the limits put on executive compensation practices will be more long lasting.

Ball: The backlash has resulted in a rash of say-on-pay shareholder proposals; we expect to see over 100 submitted for the 2010 US proxy season. As a result, a number of companies have tried to get ahead of the curve by adopting their own version of say-on-pay that they may consider more favourable. For example, Pfizer and Prudential have opted for biennial votes, while Microsoft will hold triennial votes. We have also seen other notable movements, such as the elimination of tax gross ups and the elimination of single triggers for change in control. Excessive perks for NEOs are also under fire. The general sentiment seems to be that these executives are compensated handsomely to begin with, and they should be able to pay for their own taxes and perks. In addition, proxy advisory firms are monitoring pay-for-performance and when they deem there to be a disconnect between the compensation paid to executives and the performance of the company, we are seeing withhold vote recommendations on directors, and against vote recommendations on management say-on-pay proposals and compensation plans.

Stephens: On 16 December 2009, the SEC adopted amendments to its rules requiring expanded disclosure regarding executive compensation and corporate governance matters. The new rules require companies to provide additional disclosure with respect to: overall compensation policies and the impact of such policies on corporate risk taking; director and board nominee qualifications, including how diversity is considered in the director nomination process; board leadership structure, including the board's role in the risk management process; and compensation consultants. Many companies are examining how risk versus reward tradeoffs are considered when executing operating plans that many times have stretch goals as the key measuring stick or KPI. Recent history has shown us that unusually high returns can be intoxicating to the business lines, and short-term incentives will drive performance along with constant pressure from shareholders to increase market value. Compensation plans must have a long-term adjustable component that considers a reasonable long-term performance horizon, as well as a near-term component that brings more balance to what is driving daily behaviour. The potential long-term effects of this ongoing debate are more brakes on business lines, which put challenges on companies striving to be leaders in their peer group. Another potential effect is that on talent management; compensation levels have to be relative to peer groups for effective talent acquisition and retention. ■