NAST

National Association of State Treasurers

RESOLUTION

Enhancing Corporate Governance

Urging the U.S. Securities and Exchange Commission, the U. S. stock exchanges, and publicly-traded corporations to adopt and place into practice additional policies in order to enhance the shareholder value of U.S. corporations.

WHEREAS, During the past several years, the country has seen the integrity and stability of our financial markets buffeted by revelations of corporate malfeasance, deception and fraud. For months, virtually every day, a new, shocking story of impropriety came to light. Too many corporate officers and directors, financial consultants, accounting firms and investment banks have been caught up in scandal. The systemic breakdown in ethics and standards of conduct has shaken the very foundations of our financial institutions, damaged our economy, and harmed millions of Americans; and

WHEREAS, As a result, corporate governance practices continue to be placed under heavy scrutiny due to pressure from shareholders and new accounting regulations. Companies are closely reviewing their governance structures and audit committee policies to ensure accurate and transparent communication and reporting. Additionally, Congress has enacted legislation and regulatory bodies are certain to entertain additional rules that would require companies to improve their corporate governance; and

WHEREAS, In the last two decades, the share of stock held by large institutional investors and pension funds has increased dramatically. According to a 1998 Conference Board report, institutional investors now own over half (60 percent) of all the equity in U.S. corporations and 57 percent of the largest 1,000 public companies. Institutional investors, including state and local government pension programs, now hold a substantial portion of publicly-traded securities; and

WHEREAS, Almost every state pension fund and other state government trust funds are invested in the U. S. domestic equity markets. Tax revenue generated from individuals' investment income are an important source of revenue for state governments. These earnings are used to fund vital public services, cover public employee retirement obligations, and fund beneficial economic development programs, among other uses. In contemporary financial markets, maximizing this source of revenue is a complex and time-consuming undertaking. To make the best use of investible public funds, investors like the state treasurers must attempt to earn the best returns possible without sacrificing the safety of their funds or subjecting their portfolios to undue risks. State treasurers and other public investors must achieve this goal within the constraints of applicable state and federal law. State treasurers must make their decisions within the overriding principles of safety, liquidity and yields; and

WHEREAS, Based on this fiduciary role, institutional investors, particularly public sector investors, should be able to act more like owners of the corporation. They must continuously work to induce positive change and, as shareholders, they should have the ability to participate more readily in the corporation's election process through involvement both in the nomination of directors and in proposals in the company's proxy statement about business issues and shareowner concerns regarding governance of the corporation; and

WHEREAS, Corporate governance systems must be continuously redesigned to account for changing economic conditions, and to increase accountability to shareholders. As corporate governance systems are developed and refined to increase accountability, more wealth will be generated; and

WHEREAS, Institutional Investors believe the reforms embodied by the Sarbanes-Oxley Act and the recently revised New York Stock Exchange listing standards form the "first tier" of regulatory and industry response to the recent corporate scandals. All participants in the domestic capital markets must now build on this newly laid foundation and construct a second tier of corporate responsibility reforms; and

WHEREAS, Governance, which allows shareholders access to corporate proxy cards for the nomination of directors, ensures corporate managers will become more accountable to the beneficial owners of these public companies. This is the essence of protecting the interest of investors and maintaining the integrity of the securities markets upon which more and more individuals depend for their financial security.

NOW THEREFORE BE IT RESOLVED, that the National Association of State Treasurers urges the U.S. Securities and Exchange Commission, the U. S. stock exchanges, and publicly-traded corporations to adopt and place into practice additional policies – including as a starting point the attached example policies – in order to enhance the shareholder value of U.S. corporations.

Approved this 7th Day of September 2003 by
the National Association of State Treasurers

Brian K. Krolicki,
NAST President and Nevada State Treasurer

Enhancing Corporate Governance

Institutional investors believe the recent reforms implemented through the Sarbanes-Oxley Act and by the major United States stock exchanges form the "first tier" of regulatory and industry response to the recent corporate scandals. The National Association of State Treasurers believes all participants in the financial markets must now build on this newly laid foundation and construct a second tier of corporate responsibility reforms. The following reforms will help to restore public and investor confidence.

Access to Board Members

- All companies should establish a mechanism by which shareholders with concerns can communicate directly with independent directors. At a minimum, there should be an open meeting in connection with the company's annual meeting at which shareholders could ask questions and communicate their concerns to the independent directors. When shareholders communicate with a company they usually wind up talking with investor relations or the corporate secretary or some other appropriate representative of management. It is the role of independent board members to protect shareholders' interest. Management should encourage communication with independent directors, and SEC proxy rules should ensure this happens.

Proxy Access

- The election of directors is one of the most powerful ways that shareholders can influence the strategic direction of a company. However, using this influence has become almost meaningless, because nominees for corporate boards are controlled by the board itself. Mounting a successful campaign to elect a person to the board who has not been nominated by the Board's own nominating committee can be quite expensive and almost impossible to achieve. In addition, when it does occur it is often as part of a battle for control of the company, rather than as a mechanism to improve the management and board oversight within its current structure.

- Too many board members at too many companies have failed to adequately fulfill their responsibilities and have not been acting in the best interest of shareholders. When this happens, shareholders need a process that allows them to replace those board members and install qualified replacements. Access to the company's proxy ballot is the best mechanism to achieve this goal.

- Developing a system of access to the proxy ballot that meets this goal while not weakening the board's ability to work as a team, and ensuring that the board has a diversity of skills and backgrounds, may be difficult. However, it needs to be done, because it is clear the current system is not working.

- Companies should provide access to management proxy materials for a long-term investor or group of long-term investors to nominate less than a majority of the directors. Eligible investors must have owned the stock for at least three years. Company proxy materials and related mailings should provide equal space treatment of nominations presented by qualifying investors.

Separation of Board Chair and CEO/Lead Director

- The positions of Chair and CEO should be held by different people. The Chair of the Board should be an independent director.

Audit Committees

- Strengthening financial accountability through auditor independence, audit committee oversight, and assurance of adequate resources and training. Companies can revise their audit committee charters to explain precisely how terms such as "consulting" and "independent" will be defined in practice, and detailing the ongoing education and training that will be provided to audit committee members.

Majority Vote

- In recent years a considerable number of shareholders resolutions have received the support of a majority of those shares voting. In many cases, corporations ignore these messages from a majority of their shareholders – year after year after year. Shareholders are the owners of the company. When a majority of shares vote in support of a resolution, corporate boards should not be permitted to ignore the message. The proxy rules should have a mechanism which mandates that companies consider these majority vote issues and communicate with shareholders on these issues.

Board Compensation

- Compensation not directly linked actual corporate performance can have negative effects, both financially and in the public eye. Because of the current corporate governance climate, executive compensation that is inconsistent with a company's financial performance severely threatens the credibility of leadership at a company and has the potential to damage shareholder and public trust in that company. Therefore, executive compensation should be performance-based and linked to the achievement of a company's financial and programmatic goals.

Board Composition

- The nominating committee of a corporation should consider adopting model charter language that creates a roadmap for nominating committees to commit to board diversity. Among the critical corporate governance issues to consider in board composition are the gender, racial, and cultural composition of the board of directors itself. Boards of directors of major corporations should be drawn from the broadest pool of talent and expertise. Board diversity enhances business performance, by enabling a company to respond more effectively to the needs of its customers worldwide.

RESOLUTION

INVESTOR PROTECTION PRINCIPLES

Urging all institutional investors, including all state and local public fund investors, to exercise their full fiduciary responsibilities by adopting and actively enforcing the Investor Protection Principles as central to their investment management practices and procedures and rules and regulations; urging all public fund investors, public finance managers and investment management boards to adopt the Principles as part of their policies and procedures governing fixed income investments and public debt management; and urging the United State Securities and Exchange Commission to implement the Investor Protection Principles as rules covering all investment banks and brokerages.

WHEREAS, In recent years, state and federal regulators have grown increasingly concerned about conflicts of interest between investment research analysts and related investment banks, particularly about whether research they provided their customers was independent and unbiased. Regulators were concerned that high profile analysts, who had appeared before various media outlets, did not disclose their own conflicts of interest so that investors could evaluate their recommendations against their possible biases. The regulators focused on analysts' financial interests in companies they covered, as well as analyst compensation arrangements and reporting structures, and whether analysts reported to investment banking personnel; and

WHEREAS, In examining these issues, regulators found it was commonplace for research analysts to provide research reports on companies that the analysts' employer firm underwrote; that many firms paid their analysts largely based upon the profitability of the firms' investment banking units; that investment bankers at some firms were involved in evaluating the firm's research analysts to determine their compensation; that some firms permitted analysts to own stock in companies they covered but prohibited them from executing personal trades that were contrary to the analysts' outstanding recommendations, and that compliance with stock-exchange rules that require firms to monitor the private equity investments of employees, including analysts, was poor. Firms did not always know whether their research analysts owned stock in companies about which their analysts issued research reports. The regulators also had serious concerns about the conflicts of interest analysts face that may taint or bias their recommendations. The regulators were also concerned that investors were simply not aware of these conflicts of interest; and

WHEREAS, Restoring the public's faith in our financial system is critical to our sustained economic prosperity. The public's willingness to invest in the future is predicated on the belief that our financial markets operate with integrity, transparency, and fairness. As the states' chief investment officers, and as trustees of billions of dollars in state pension and taxpayer funds, the state treasurers are deeply committed to safeguarding the public treasury; protecting pensioners, families, and taxpayers; and restoring the faith and confidence of investors. The state treasurers have taken an active role in advancing corporate reform—using the power of states' considerable investment portfolios and market presence to combat corporate fraud and abuse and to set new standards of integrity and corporate responsibility; and

WHEREAS, Beginning 2001, the regulators called on the National Association of Securities Dealers ("NASD") and the New York Stock Exchange ("NYSE") to work together to craft new rules intended to restore investor confidence in analysts' work. These rules were designed to address the conflicts of interest identified by the Securities and Exchange Commission. In 2002, the Commission approved sweeping rule amendments by the NYSE and NASD addressing analyst conflicts. The amendments closed a number of regulatory gaps and took considerable steps towards promoting greater independence of research analysts by prohibiting tying analyst compensation to specific investment banking transactions; restricting personal trading by analysts in securities of companies followed by the analyst; prohibiting offering favorable research to induce firm business; restricting investment banking review of research reports; and defining quiet periods on the issuance of research reports; and

WHEREAS, In May 2002, New York entered into a settlement agreement with Merrill Lynch which included provisions to eliminate conflicts of interest between the company's equity research and investment functions; and

WHEREAS, In July 2002, a number of state treasurers, and other public pension fund fiduciaries announced that they were adopting the key elements of the Merrill Lynch settlement as Investor Protection Principles, and would ask all their investment managers to abide by these principles; and

WHEREAS, In April 2003, ten additional investment firms settled enforcement actions which included similar provisions to the Investor Protection Principles. Joining this settlement action were the Securities and Exchange Commission, the New York Stock Exchange, the National Association of Securities Dealers, the North American Securities Administrators Association, and the New York State Attorney General; and

WHEREAS, The state treasurers, with their significant pension and investment portfolio, have a special obligation and opportunity to be a leading force for change as the nation struggles to regain its financial footing. The states' pension funds have played an important role in the past in promoting corporate governance reform; and

WHEREAS, Based on this special obligation, the state treasurers and other investors of public funds must use their market force to restore integrity to our financial system if they are willing to mobilize and take strong action in the cause of corporate reform; and

WHEREAS, A number of state treasurers and other public fiduciaries have endorsed and implemented the Investor Protection Principles; and

WHEREAS, The objective of the Investor Protection Principles is to eliminate conflicts of interest between stock research analysts and investment banks, so that investors will have true and accurate information, and to ensure that money managers adhere to the highest standards of ethics and disclosure.

NOW THEREFORE BE IT RESOLVED, that the National Association of State Treasurers considers these principles to be best practice standards and where possible, they should adhere to these standards.

BE IT FURTHER RESOLVED, that the National Association of State Treasurers urges all institutional investors, including all state and local public fund investors and investment management boards, to exercise their full fiduciary responsibilities by adopting and actively enforcing the Investor Protection Principles as central to their investment management practices and procedures and rules and regulations.

BE IT FURTHER RESOLVED, that the National Association of State Treasurers urges all public fund investors, public finance managers and investment management boards to adopt and enforce the Investor Protection Principles as part of their policies and procedures governing fixed income investments and public debt management.

BE IT FURTHER RESOLVED, that the National Association of State Treasurers urges the United State Securities and Exchange Commission and all state securities regulators to implement and actively enforce the Investor Protection Principles as rules covering all investment banks and brokerages.

Approved this 7th Day of September 2003 by
the National Association of State Treasurers

Brian K. Krolicki,
NAST President and Nevada State Treasurer

INVESTOR PROTECTION PRINCIPLES

The Investor Protection Principles, as adopted on September 7, 2003 by the National Association of State Treasurers, set out standards to be met by investment banks and money management firms doing business with the State Treasurer. These state officials pledged that, in retaining or hiring investment banks and money managers, they would give significant consideration to whether such financial organizations had adopted the Principles. The Principles set out the following obligations, among others:

I. Investment Banks

- Sever the link between compensation for analysts and investment banking;
- Prohibit investment banking input into analyst compensation;
- Create a review committee to approve all research recommendations;
- Require that upon discontinuation of research coverage of a company, firms will disclose the coverage termination and the rationale for such termination;
- Disclose in research reports whether the firm has received, or is entitled to receive, any compensation from a covered company over the past 12 months;
- Establish a monitoring process to ensure compliance with the principles.

II. Money Management Firms

- Disclose client relationships, including management of corporate 401(k) plans, where the money management firm could invest state or pension fund monies in the securities of a client;
- Disclose the manner in which portfolio managers and research analysts are compensated, including but not limited to any compensation resulting from the solicitation or acquisition of new clients or the retention of existing clients;
- Disclose the amount of commissions paid to broker-dealers, and the percentage of commissions paid to broker dealers that have publicly announced that they have adopted the Investor Protection Principles;
- Adopt safeguards to ensure that client relationships of any affiliate company – including banks, investment banks, insurance companies or other financial services corporations – do not influence the firm's investment decisions. Firms shall provide the relevant public investment officers with a copy of the safeguards plan and shall certify annually that the plan is being fully enforced;
- In making investment decisions, consider the quality and integrity of a company's accounting and financial data, as well as whether the company's outside auditors also provide consulting or other services to the company;
- In deciding whether to invest state or pension fund monies in a company, consider the corporate governance policies and practices of the company.

NAST

National Association of State Treasurers

RESOLUTION

CORPORATE INVERSIONS

Urging Congress and the President of the United States to enact legislation to amend the Internal Revenue Code to end the financial incentives for American corporations to re-incorporate overseas to avoid U.S. taxes and to strongly encourage companies from reincorporating to countries where shareholder rights would be diminished.

WHEREAS, In recent years, numerous major U.S. corporations have reorganized offshore in order to take advantage of favorable tax laws and to avoid certain restrictions on corporate legal practices. Under present tax law, U.S. corporations may reincorporate in low-tax foreign jurisdictions and thereby replace the U.S. parent corporation of a multinational corporate group with a foreign parent corporation. These transactions are commonly referred to as inversion transactions. Inversion transactions may take many different forms, including stock inversions, asset inversions, and various combinations of and variations on the two; and

WHEREAS, These transactions allow the corporate group to remove some or all of the group's foreign operations and income from the U.S. taxing jurisdiction; and to reduce the U.S. taxes that otherwise would be incurred on income from U.S. operations, through the use of various "earnings stripping" strategies; and

WHEREAS, Corporate inversion transactions may greatly diminish shareholder rights. For example, many foreign nations lack any meaningful limitations on insider transactions. Other nations fail to provide shareholders with decision-making authority on fundamental changes in the corporation. Most states require that shareholder approval be obtained before the corporation may sell or dispose of a substantial portion of the assets of the corporation. In the United States, shareholders may bring actions on behalf of the corporation against officers and directors seeking to harm the corporation. The availability of derivative lawsuits is a profoundly important tool to protect shareholders from the malfeasance and self-dealing by officers and directors. It is a central tenet of American corporate governance. This form of protection is all but unavailable in many foreign laws. Finally, corporate inversion transactions will greatly impede states in protecting the public interest and safeguarding shareholder rights including the state's financial interests – stopping a shareholder vote, for example if shareholders are provided with misleading information; and

WHEREAS, Expatriation in this manner may weaken investor rights, insulate companies from investor claims, and further weaken investor confidence and perceptions of the integrity of the domestic financial markets; and

WHEREAS, Inversion transactions resulting in a minimal presence in a foreign country of incorporation are a means of avoiding U.S. tax and should be curtailed. In particular, these transactions permit corporations and other entities to continue to conduct business in the same manner as they did prior to the inversion, but with the result that the inverted entity avoids U.S. tax on foreign operations and may engage in earnings-stripping techniques to avoid U.S. tax on domestic operations.

NOW THEREFORE BE IT RESOLVED, that the National Association of State Treasurers urges Congress and the President of the United States amend the Internal Revenue Code to end the financial incentives for American corporations to make "paper moves" overseas to avoid U.S. taxes and undermine investor and consumer confidence.

BE IT FURTHER RESOLVED, that the National Association of State Treasurers urges Congress and the President of the United States to enact legislation to strongly discourage companies from reincorporating to countries where shareholder rights would be diminished.

Approved this 7th Day of September 2003 by
the National Association of State Treasurers

Brian K. Krolicki,
NAST President and Nevada State Treasurer

RESOLUTION

Expensing Stock Options

Urging the implementation of accounting standards that would require all companies to expense the cost of stock option grants in the same year as they are granted and urging all institutional investors, including all state and local public fund investors and investment management boards, to exercise their proxy rights to compel corporations which they own to report the cost of stock option grants in the same year they are granted.

WHEREAS, Stock options are widely used for employee compensation, but are generally not treated by most corporations as a corporate expense for financial statement purposes; and

WHEREAS, Under current accounting standards, publicly traded corporations are required to report stock options in the footnotes to the financial statements. Companies are permitted but not required to report stock options as an expense against income. Under the footnote method, companies report the pro forma effect on net income and earnings per share; and

WHEREAS, Questions have arisen about the role of executive compensation practices in promoting a culture too focused on short-term earnings and stock prices. Although investors have been encouraging the use of stock options to align executive and shareholder interests, in the last few years investors have begun to question the benefits of "plain vanilla" stock options (which allow some executives to profit from the rising stock market, even when their company's performance lags competitors) and the "pay-for-failure" severance arrangements that effectively eliminate financial risks for top managers; and

WHEREAS, Stock options are a real expense to a company. When they are exercised, value is transferred from all other shareholders to the person exercising the option. This is the same economic transfer of value that occurs when employees cash their paychecks. However, not expensing stock options hides this actual cost; and

WHEREAS, In recent months, several large U.S. companies have announced their intention to change their method of accounting for e stock options to an approach that recognizes an expense for the fair value of the options granted in arriving at reported earnings. The Financial Accounting Standards Board (FASB) is studying this approach and may develop a rule to mandate this type of reporting; and

WHEREAS, Several state treasurers and other institutional investors have recommended mandatory expensing of all stock options. This policy has become a critical feature of their investment guideline and proxy voting procedures. These treasurers actively use their proxy rights to address concerns about stock option reporting. The policy generally requires that companies report the cost of executives' stock option grants in the same year as they are granted. Doing so will show investors how this form of compensation affects earning and will provide a more accurate picture of the financial status of a company for its shareholders.

NOW THEREFORE BE IT RESOLVED, that the National Association of State Treasurers urges the implementation of accounting standards that would require all companies to report the cost of stock option grants in the same year as they are granted.

BE IT FURTHER RESOLVED, that the National Association of State Treasurers urges all institutional investors, including all state and local public fund investors and investment management boards, to exercise their proxy rights, where available, to compel corporations which they own to report the cost of stock option grants in the same year as they are granted.

Approved this 7th Day of September 2003 by
the National Association of State Treasurers

Brian K. Krolicki,
NAST President and Nevada State Treasurer