SEC Historical Society
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Diane Sanger Memorial Lecture

CARLA ROSATI: Good afternoon and welcome to the inaugural Diane Sanger Memorial Lecture, broadcast live from the Columbus School of Law, The Catholic University of America and worldwide on www.sechistorical.org. I am Carla Rosati, Executive Director of the Securities and Exchange Commission Historical Society, host for today's program.

The SEC Historical Society, through our unique virtual museum and archive at www.sechistorical.org, opens the door to the history of financial regulation from the 20th century to the present. All of us have a stake in the financial regulatory system. As investors, we want to be sure that Federal, state, municipal and international regulators are making possible, safe and fair capital markets for everyone.

Our museum and archive provides you with firsthand resources on how the regulatory system has evolved over the years. You can be an eyewitness to history by accessing the words, voices and images of the people who made the regulatory process what it is today.

For it is the people, not just the laws and statutes, who make our system of financial regulation work. Today, we recognize one such person, Diane Sanger. In her brief life and career, Diane shared her keen intellect, commitment to justice and mentoring spirit to the cause of protecting investors and ensuring fairness in the capital markets. A top graduate of Massachusetts Institute of Technology and the Boston University School of Law, she began her career at the U.S. Securities and Exchange Commission in the Office of the General Counsel in 1979.

Except for a brief time as visiting staff to U.S. Senator Alphonse D'Amato on the Subcommittee on Securities of the Senate Banking Committee, Diane devoted her career to the SEC, rising to the position of Associate General Counsel for Counseling and Regulatory Policy. The SEC recognized Diane's accomplishment in 1992 with the Philip A. Loomis, Jr. Award given to the individual "who displays the qualities of outstanding legal scholarship, analysis and draftsmanship; the legal counselor's ability to reconcile opposing viewpoints and create workable solutions to difficult legal and policy issues; and the highest caliber of personal and professional integrity." In 1994, Diane received the Distinguished Service Award, the SEC's highest award, recognizing outstanding contributions to the work of the Commission and the administration of the Federal securities laws.

SEC Commissioner Elisse Walter, a former colleague, regrets that she could not be with us today but wants to share her thoughts of Diane. "I had the pleasure of working with Diane for a number of years. For two of them, she worked for me or, more accurately, I worked for her. Diane had rigorous standards and was a tough critic. She was insightful, brilliant and devoted to her work. Perhaps, even more important, she had a wicked sense of humor and was the most loyal of friends. I miss her very much. I am pleased that this event will be an annual celebration of a fabulous person and I will see all of you next year."

The SEC Historical Society is honored to present the first of a series of annual Diane Sanger Memorial Lectures, recognizing the values that Diane supported throughout her life and career. Each lecture will offer reasoned discourse on the policies and practices needed to promote regulatory reform and the fairness of capital markets. We would like to thank Columbus School of Law, The Catholic University of America for joining with us to present today's program. David Lipton, Professor of Law and Director of the Securities Law Program, will speak on behalf of the school.

DAVID LIPTON: Well, I don't have to tell you who I am because I have been introduced already. But I do want to thank all of you in the audience for making the effort to be here today. I see so many of our alumni, many folks who I know from the SEC, the MSRB, some of our adjunct professors and even one of the directors of the Division of Enforcement, not so long ago. It's a real thrill to have you here and it's a thrill for us to be sponsoring this program. I think that this is an extraordinary confluence of people and institutions that each have a singular or had a singular devotion toward both securities regulation and some basic decency qualities, both in terms of society and the profession and the way that they deal with people. The SEC Historical Society is devoted to memorializing and preserving the good work that has been done by an agency which since I have been in this town which is now about 32 years, has had the distinguished reputation of being the agency with perhaps the highest commitment to integrity, quality and concern about society and in this instance, investors.

I am proud that the Historical Society has chosen the law school to initiate this program at and I think it is fitting because the law school also has a similar commitment. Carla mentioned Commissioner Walter, a moment ago. Ten days ago Commissioner Walter was at this microphone. This law school and my securities program had the honor of working with the SEC, the CFTC, FINRA, SIFMA, MSRB and 16 law firms in putting together a program to enhance recruitment of minorities in the securities industry. That's the kind of work that we do and the kind of commitment that we have. I have also had the pleasure of having Nell Minow speak at the school about 13 years ago, I am revealing too much about my age, at our 100th anniversary. Nell, I wasn't here at the beginning. And we all know Nell's commitment to corporate responsibility, shareholder activism and as of late a new passion which is looking after the cinematic interest of the youth of this country. Finally, I was at the Commission. I was a visiting attorney fellow and I was there when Diane Sanger was there. I did not know her well but I did know her and I know that she was part and parcel, extraordinarily so, of the very good work that was done by the Commission and the very solid commitment to the community, to the financial markets and to the investors. With that, I want to turn the mike back to Carla and I want to again thank you all for being here. Please stay around for the reception afterwards and hopefully I would get to know each one of you personally. Thank you.

CARLA ROSATI: The SEC Historical Society thanks the generosity of the family of Diane Sanger for making possible today's lecture. We welcome the members of her family who have joined with us today and are seated in the jury box. Bryna Sanger, Diane's sister, will speak on behalf of the family.

BYRNA SANGER: Hi, I am Bryna Sanger, Diane's sister and I am delighted to say a few words on this, the first Diane Sanger Memorial Lecture, on behalf of my family, my sister Liz and her husband Murray Zang, Gail Sanger and Al Fenster and my husband, Harry Katz.

First, we are very grateful to Carla Rosati from the SEC Historical Society for helping us during a time really of deep loss, find a fitting way to honor our sister, further her deepest commitments, and advance a productive policy discourse about financial regulation and consumer protection. We are especially delighted to have Nell Minow as an inaugural speaker, someone in whom Diane would have found a kindred spirit, I suspect, perhaps not in her role as a movie mom, however, because Diane was a film critic of singular eccentricities. We also like to thank David Lipton and the Columbus Law School for serving such gracious hosts on the occasion.

As Carla mentioned, Diane was really a remarkable person, a highly principled, fiercely independent and intellectually gifted person. Her life was short and it was hard. But even so, she was remarkable and she leaves behind an impressive legacy. She was recognized and honored, as Carla mentioned, throughout her career for lasting contributions to investor protection. But perhaps, her most important contribution will come through the dozens of young lawyers she trained and the community of colleagues at the SEC that shared her passion for creative and rigorous work to advance consumer protection. At a time of great national challenges, these are talents that are in short supply. The professional and personal friendships that she forged in this community of committed public stewards were a great source of pride for her and to us as well. This lecture serves as a recognition of the importance of the public responsibility Diane and her colleagues undertake on behalf of us all. We are very touched to see so many friends here today to honor her memory, in a way that we hope also continues to advance her most deeply held values. Thank you very much for coming.

CARLA ROSATI: When the Sanger family made its generous commitment last fall, we could not think of a better person to present the inaugural lecture than Nell Minow of The Corporate Library. Nell has been titled the Queen of Good Corporate Governance by Business Week Online. She is an expert in the fields of shareholder rights, proxy votes, investor protection and corporate social responsibility. In the words of Professor Lipton, she is such a joyful, upbeat, funny, knowledgeable person that it is a delight to listen to her. Let's welcome Nell Minow.

NELL MINOW: Thank you very much and thanks to Carla for that wonderful introduction and to David for his kind remarks. It is a special honor to be here to inaugurate what I know will be a vibrant and important series of lectures in memory of Diane Sanger and I am very, very, very honored to be here. And it's great to be back after only 13 years -- what took you so long -- back at the Columbus Law School.

Since I am here to speak on behalf of the SEC Historical Society, I want to begin with a little bit of history. There isn't a lot that Karl Marx and Adam Smith had in common but they did have one thing in common which they shared with Benjamin Franklin, Andrew Carnegie and a lot of other people and that is a great suspicion of the power of the corporation, a great concern that there would be agency costs that would be destructive to the interests of society. In fact both Adam Smith and Karl Marx thought that was an unsolvable problem. But the industrial revolution came about, modern communication came about. We needed larger, more complex organizations and so we tried to figure out a way to handle that problem of agency costs and who do we decide should handle it? The Securities and Exchange Commission. As you know, the first chairman of the SEC was Joseph Kennedy, the father of President Kennedy. And when Franklin Roosevelt was criticized for appointing a guy from Wall Street - does this all sound familiar? A guy from Wall Street - Franklin Roosevelt replied that it takes a thief to catch a thief. I am not sure that everybody would say that about anybody at the SEC today, but it's not a bad idea.

I want to talk a little bit about those early days. Now, we are almost 100 years later. Lewis Gilbert first attended an annual shareholder meeting in 1932 and management refused to answer any of his questions and he was furious. So he and his younger brother John - and I was privileged to meet and spend time with both of them - they spent the rest of the 20^{th} century going to annual meetings, as many as a 100 a year, to challenge corporate directors and executives on behalf of the shareholders. The Gilberts are responsible for most of the rights shareholders have now and those rights are largely ignored, unfortunately. They persuaded the then brand new SEC to allow shareholders to circulate their criticism of management at company expense by submitting shareholder proposals that would have to be included on the company's proxy. The Gilbert brothers fought for shareholder approval of auditors, confidential voting to protect shareholders from coercion, cumulative voting, to give minority shareholders the ability to elect a director and annual meetings to be held in cities that were conveniently located. I was involved with one case where the company decided to have their annual meeting in Sri Lanka. I was involved in another case where a company called MAXXAM moved their annual meeting from Houston, a city you can fly to, to a small city in Texas, Huntsville, that is impossible to reach. They also set the meeting for 8 in the morning and bought up all of the hotel rooms in town. And then they had the chutzpah to put in the proxy, "We look forward to seeing as many of you as possible at the annual meeting." So, the Gilberts were really on to something there.

But it's easy to understand why so few investors followed their lead. Individual investors face the collective choice problem. Almost any form of activism will cost them more in time, hassle and money than the return they will get by giving the other shareholders a free ride. And institutional investors which the Gilberts could never even have thought of, really, back in the 1930s, they hold as much as 70% of the stock of most publicly traded companies. They do have the time, the resources, the analytic power and the sheer amount of money at risk to monitor accounting tricks and executive compensation abuses. But they are leery of troublemaking and they are subject of conflicts of interests. Activism requires upsetting people that you might do business with. A fund manager might not want to upset a portfolio company if he's hoping to get their 401k business. And it's hard to imagine that General Motors pension fund filing a shareholder resolution objecting to the CEO compensation at Exxon. Institutional investors are happy to reap the benefits of activism but there are very few of them that are willing to engage.

And what is the result? Well, I think it's fair to say that part of the result was the last set of meltdowns. Remember those, just a few years ago, Enron, Worldcom, Global Crossing, et cetera and the recent set of meltdowns. It seems to me that the whole idea of the corporation, very much like the checks and balances that you are taught about in social studies class. The idea of the checks and balances between the shareholders, management and the board has really been undermined in a very fundamental way. I would argue that all of corporate governance in the 20^{th} century really rested on the distance between the fiction that there was some kind of accountability to shareholders, this Panglossian ideal that if the shareholders don't like they can sell the stock, that will send a message. If the shareholders don't like it they can just elect a new board. Yeah, that's going to happen. There's this ideal that we have that legitimates the system because we have this level of accountability and then there is the reality.

Just to give you an idea, when my business partner Bob Monks and I decided to run him for one seat on the Board of Sears, the company sued us. Why did they sue us? Because we had the temerity to ask for a shareholders list. And they said that it was a publicity stunt, we had a new book out and we were going to promote our book. I don't know, perhaps they thought we would send out a direct mail to shareholders. I don't know what it was. But the point is, they had access to the company treasury. They, according to their SEC filing, budgeted one-seventh of the store's revenues of the year to fight us from getting one seat on the Board.

Now, I will tell you my all time favorite corporate governance story. For those of you who don't know, Bob is a very big guy, he's six six, and he's a big six six, he's not like a retiring six six. He's a very big guy. And so for that reason we used to have him be the good cop when we would meet with the corporate executives because they were so freaked out by how big he was that they wouldn't listen. So, I had to say the bad things because I am not intimidating, Bob would say the nice things. But anyway, Bob went out to meet with Sears to talk about our problems with Sears, like the fact that they had been promising a 10% ROE for 10 years and had never met it. And the fact that the same guy was the CEO, the chairman of the board, the CEO of the largest and the worst performing division. He served on the nominating committee, so he was picking all his own directors, several of whom had worked for him. And this is my favorite, he was a trustee of the 17% of the stock that was held on behalf of the employees. So, that would be like taking the President of the United States and making him the Chief Justice, Speaker of the House and the head of NSA. It was just crazy. Bob went out to meet with them and he went to the Sears Tower and which you know, is a very, very, very tall building, extremely tall building. It was at one time the tallest building in the world. And the CFO came to meet him in the lobby and take him up to the 78th floor. Now, when you have to go up 78 floors even in a super fancy building, it's a long ride, especially if you don't really have anything to say to each other and don't really like each other. So, the two guys are in the elevator, both standing there with their arms folded, looking down at the floor, listening to the bad music as they are going up and up and up and up and up, Bob being his intimidating six foot six self. And finally the CFO looked at him and he said, "You know, this is the first time bad news has gone above the seventy-second floor." To me, that's what corporate governance is all about. Its making sure the bad news goes up above the seventy-second floor and if you got the same guy as the CEO, the chairman of the board, the CEO of the largest and the worst performing division, et cetera, et cetera, et cetera, that's not going to happen.

So, what can we do to address this issue of making sure that we do have these checks and balances system, this idea that really does legitimate the whole idea of capitalism? Well, right now we have got investors who for several reasons really are not able to take advantage of these rights that they theoretically have. One is, as I said, the conflicts of interest, another one is that we don't really have any kind of enforcement mechanism even though institutional investors are fiduciaries, none of them ever have been sued for voting their proxies in a way that enables bad behavior overwhelmingly and we produce a report with Rich Ferlauto's former group, who asked me, "Will you produce a report every year on sort of our naughty nice list on which mutual funds vote in favor of insane pay packages and which do not?" And really, nobody picks their mutual fund based on whether they vote their proxies effectively although I would argue that they should. Other than that, an index fund is an index fund, the fees are the same and everything's the same, where is the big difference, whether your report is on blue paper or white paper or whether they vote proxies intelligently or not. But people are not really at the point of making that, their decisions on that basis. So, what can we do to make sure that institutional investors who really are the majority investors right now and big enough and smart enough, as I said, can do a better job? Well, there are a couple of things. One is, that the Internet has all of a sudden made a lot of information available in a way that it didn't used to be. As you can tell from looking at me, I am not an old person, I haven't been around that long but I remember the days when you had to physically get up and drive over to the SEC and go and look in a big room and read through actual pieces of paper that had ink on them. That was how you read filings. And there were industries involved that made a lot of money by being the people who would go and pick up those filings for you and take it to your office. But now, I could be on the beach with a laptop and call up EDGAR and read whatever I wanted to read. So, that's a tremendous advance and I think the SEC has almost done a really good job of taking advantage of that. It's also made it possible for groups like the shareholder's education network, Moxy Vote and others to put their ideas about how to vote proxy on line. So if you were voting your proxy, you get your proxy in the mail and you want to vote in an intelligent way and not just vote for management all the time, you can go online and share your thoughts.

But I think that they can do better and I am going to talk about two key areas, where I think the SEC can and will do a better job to enable shareholders to play that key oversight role. And both of them really are all about the same thing, which is, who is on the board? At the end of the day, shareholder proposals are nice but they are non-binding, in 99.9% of the cases. What really matters is who is on the board. So, both of the issues I am going to talk about have to do with who is on the board.

The first issue is, what I consider to be the key issue in corporate governance. The key indicator of conflicts of interest, the key indicator of board effectiveness and oversight, the key predictor of litigation, liability and investment risk and is of course CEO compensation. Compensation is both a symptom and a cause of the financial meltdown. I believe that compensation should and will be seen as an essential element in securities analysis just like cash flows, return on investment, we are getting there. Compensation that misaligns pay with performance is always the fault of the board of directors and the single most important indicator of a failed board. If they can't get compensation right, they are a bad board. Compensation is only one way to look at it and they will tell you a lot of different measuring sticks to use on compensation, ignore them. There is only one that matters and that is, just like any other asset allocation made by the company, what is the return on investment of every dollar spent on CEO pay? That is your question, not what is that guy over there is making but what are we getting for every dollar we put into it.

I recommend to you with enthusiasm the book by Professor Rakesh Khurana of the Harvard Business School, 'In Search of a Corporate Savior,' where he documents with excruciating exactitude that the return on investment for most CEO pay packages is less than a piggy bank. So, we have simply got to do better. Let me give some examples. We rate boards of directors at the Corporate Library. We rate them A through F and we have found through back testing many, many, many different indicators that pay is the single most compelling one. So, we gave bad grades, D's and F's and one C to all of the companies that were later bailed out for two and three years before they were bailed out. And I will give you an example. At one of these companies, the pay package said that bonuses will be based on nine metrics and they listed the metrics. And that sounds good. It has a number nine and it has the word metrics, which sounds very mathematical. So, so far, so good. Second sentence, however and if you are in law school, you know to look out for the howevers. However, it is within the discretion of the board to award all of the bonus for the achievement of any of the metrics. Okay, so that's your basic, 'throw the dart at the wall, draw the target around a pay plan.' That company was Bear Stearns and if you had looked at that pay plan three years ago, you would have known that they were in for a lot of trouble.

We noted problems at another financial institution where the CEO's pay was as large as CEO's salaries at firms exponentially larger. It included a $260,000 one-time initiation fee to a country club. The thing that slays me is that people who are paid more than anybody else on the planet can't pay for their own expenses. If you are going to subsidize $260,000, shouldn't it be for somebody who doesn't have any money? But all right, so they paid $260,000 for the country club, they paid his taxes. I love this, very, very popular in the wacky world of CEO pay. They paid for financial planning advice. Trust me, if a CEO cannot do financial planning, he probably shouldn't be the CEO. Okay, why should the shareholders be paying for the CEO's taxes and his financial planning and his country club? That bank was IndyMac, which became the second largest bank failure in history. So, I think you are getting where I am going with this. The sub-prime crisis in part was caused by pay plans that rewarded the people granting the loans based on the number of transactions rather than the quality of transactions. So, think, Professor Lipton, if you were grading your students based on the number of words in their essays, rather than the quality of words on their essays, you would get very, very long papers. But they wouldn't necessarily be any good. And if we don't have clawbacks, then we are essentially paying everybody that way. We are essentially saying to you, "We will pay you based on what the numbers look like today and if it turns out that you have made mistakes that we won't discover for another couple of years, that's on us. We are going to subsidize you on that." That's ridiculous.

I once got into an argument with someone who said that my attitude on clawbacks was punitive. And what I said was, "If you are at the store and the clerk gives you a dollar too much change and you have to give it back, that's not punitive." It was never your money. And the same thing is true with bonuses that are awarded on numbers that turn out to be phony. Angelo Mozilo got paid $600 million while the stock price went down 75% and took the American economy down with it basically. Countrywide was ground zero for the sub-prime crisis. But I got to say my other favorite thing about Mozilo, is that, he and I testified together before a Congressional committee, Barney Frank's committee and it was at that committee that I found out for the first time that there was a flurry of emails from Angelo Mozilo, remember the guy who made $600 million. Well, he felt strongly that his wife should not have to fly commercially. Now, if I had $600 million and I felt strongly that way, I think I would have some options. There are a lot of things that you could do but the ones that occurred to me did not occur to him. He felt very strongly that his wife should fly on the corporate jet. So, the HR department said, "Well, certainly Mr. Mozilo, you will need to reimburse us at the lowest commercial rate." And which he should have said, "That's a great deal for me." The lowest commercial rate to anywhere is about a $100. But, okay, sure, fine, great. He didn't like that. He said, "No, I don't really want to. I don't really want to pay for anything. I want her to fly free." And they said, "Okay, no problem, Mr. Mozilo. That does however mean that you are going to have imputed income and you are going to have to pay taxes on that." And he should have said, "Great, I am getting a wonderful deal here. Thank you very much." Did he say that? No, he did not. He said, "I don't really want to pay the taxes on that." So, yes, the shareholders of Countrywide paid the taxes on the imputed income of his wife's travel on the corporate jet. What does that tell you about the Board of Directors? I think it tells you that they are incapable of saying no to the CEO, that's always a bad sign.

So, we don't ask Wall Street to be humanitarians, we don't ask them to set public policy. That's our job here in Washington. We just ask them to do one thing. We just want them to do math. That's it. We just want them to know how to do math. And we understand that sometimes they are not going to get it right. But when they don't get it right, they shouldn't get it paid like they did get it right and that's what happens. I am so sick of hearing the Wall Street people say that it wasn't their fault that we had the financial meltdown, it was monetary policy. You know monetary policy is 'my dog ate it' of Wall Street. Their job on Wall Street is to follow monetary policy, to predict monetary policy and to respond to monetary policy. I get it that they are going to get it wrong once in a while but it's as I said, they shouldn't get paid as though they got it right. So, executive compensation is the core problem or the manifestation of the problem.

What are we going to do about that? Well, I think we need better disclosure. For example, it used to be, the idea was you will get information about the five highest paid people at the company. But the companies didn't like that. They had what they called the Katie Couric problem. What if you have an employee who is making a lot of money? But, it's really the trading desk problem. It's the guys on the trading desk that they don't want us to know how much they make. You know why we wouldn't want to know how much they make. So, I believe that we should have for anyone who gets more than half of his or her pay in a performance related bonus, we should get aggregate data about that those pay plans and we should get the criteria because I think its really, really important for investors to know whether these are all upside plans, whether they have upsides and downsides. And I think also and this is really my key point today, shareholders have to be able to get rid of directors. Did you know that over 80 directors are currently serving, who did not majority support of the shareholders? So, the majority of the shareholders said, we don't want these people in the boardroom and they are still serving. Now, I have argued to our director and officer liability clients that they shouldn't insure these people because if I were the Delaware Court, I wouldn't give any deference to them under the business judgment rule. After all, the shareholders hadn't delegated anything to them but there they are. So shareholders must be able to remove directors and we must require majority vote. Now, is that the SEC's problem? I would argue that it is and I would argue that it can be done through a listing standard without any kind of a legal problem and I think that's what the SEC should do.

All right, that brings me to my second issue which is Citizens United. As you know, the Citizens United decision issued earlier this year by the Supreme Court was a bit of a surprise. What we have from people who purport to be non-activists was quite an activist and far reaching decision, that gives corporations an unfettered right of freedom of speech and what are we going to do about that? Well, I don't anticipate amending the Constitution any time soon and I wouldn't expect that we should. However, I do think that if corporations are going to be given the right of freedom of speech, we better make darned sure that they are reflecting the interests and the opinions of the people who own the corporations, not the people who have access to the corporate treasury. So, what are we going to do about that? Well, I think there are several problems there. The first problem is the lack of disclosure. We don't know how much money corporations are spending on political contributions or political speech in the larger term. For example, you can go to opensecrets.org, I highly recommend it, and you can find out that the financial services industry spent $600 million or one Angelo Mozilo pay plan to get rid of many of the rules that could have prevented or mitigated the damage from the meltdown. So, that was obviously worth it to them but do we know who spent it or how much they spent or where it went? No, we don't. So, we must have better disclosure. If investors are going to be able to send some kind of a market reaction to this political speech by corporations, we have to have better disclosure. We are currently facing a situation where some companies are taking public positions in favor of one thing and then finally money to intermediary groups to oppose it. We can't have that any more. So, we need better disclosure about the contributions and other kinds of political speech pay, that is paid out.

Problem number two. Even if shareholders do know how their money is being spent and what positions it's being used to support, there is no way for them to respond effectively. It's even difficult for shareholders to have limited non-binding resolutions saying to the companies, could we please get some more information. That's simply got to stop. If this is going to be such an important issue, the SEC has simply got to allow shareholder resolutions on it and companies have to disclose every penny that is spent for political speech on their own behalf or with the intermediaries.

That brings me to my next issue. This is really the most important one, is the problem of intermediaries. The Chamber of Commerce likes to say that they have three million members but was revealed that they only have 300,000 members. So, they were overstating by Enronian standards. They get a third of their budget from only 19 companies. They have announced, they are spending a $100 million of some shareholder's money but we don't exactly whose, to defeat any meaningful financial reform. If you go to the Huffington Post today, if you go to pretty much any political place on the Internet, you will see ads from them basically saying that it's the end of the world, as we know it, if any financial reform goes through. In my opinion, the Chamber of Commerce has hijacked its focus to represent the interests of corporate managers, not businesses and they are doing that because corporate managers give them their money not businesses and we need to address that. So, this issue of these intermediaries, whether you are talking about the Chamber of Commerce or these fake astro-turf organizations that are called things like Citizens United, need to be disclosed.

The fourth problem is making sure that we remove the obstacles to exercising shareholder rights. So, once we have the rights to remove directors, we need to remove the conflicts of interests and other impediments. The largest category of shareholders is within the corporations themselves, pension funds, covered by ERISA with more than $6.3 trillion in assets, much of it invested in equities. But they have conflicts of interests and the Department of Labor has never once said to a fund, "Explain to us how this vote is in the interest of your plan participants." We need to do a better job on that.

Almost a 100 years ago, Justice Louis Brandeis famously wrote in Harper's Magazine, "Sunlight is said to be the best of disinfectants, electric light the most efficient policeman." He was writing about corporate abuse, exact same set of problems we are looking at today. These days he might say that the best police officer is the Internet and tagging, maybe Twitter, so it is up to us to make sure that the cop is on the beat.

Now Professor Lipton's students have given me a couple of questions to answer. So, I am going to go through those while you think of the questions that you want to ask because that's my favorite part.

Jonathan Carraher asks, what impediments to shareholder response do I recommend removing? Well, it wasn't that long ago, since we are speaking about history, when I first got into this business that there were only two areas of written communication that Uncle Sam had to approve before you could circulate it -- nuclear secrets and conversations about proxies. You know that is ridiculous. There are still a lot of inhibitions right now on shareholders communicating with each other, even though they now can communicate without getting it approved by the SEC first. There are still a lot of inhibitions, a lot of blocks to shareholders finding each other and communicating with each other and that needs to be removed. We have seen some progress as I said. On the Internet., the Yahoo message board became the equity committee in a bankruptcy as a result of shareholders meeting each other on the Internet. And I think we will see more of that. But its really the conflicts of interests that is the problem and for that we really need enforcement from the SEC with regard to mutual funds from the Labor Department with regard to ERISA funds from the banking agencies, with regard to bank trust departments and endowments to make sure that they vote their proxies, that they know that somebody is watching how they vote their proxies. We need proxy access which would mean shareholders having access to the proxy to nominate their own candidate. I think that's an excellent idea and I would not be at all surprised if we see some of the same names of people who are currently serving on boards. But the very fact that they are nominated by investors and not by management I think will have a tremendously salutary effect on reminding them. After all, it's human nature to dance with the one who brings you to the party. And it's important for directors to remember that it's the shareholders who bring him to the party.

James Catano asks, what is my position with regard to client directed voting? With regard to client directed voting, I think the best way to do that is for us to pay more attention to mutual funds and the way that they vote. I would rather make that as a market based test rather than saying having individual shareholders say to mutual funds, "I want to vote my shares this way or that way." So, what we want to do is, I hope have a Morningstar rating at some point for mutual funds based on how they vote their shares. I have also got a question, do I feel that discussions related to environmental, social and governance disclosures fail to effectively realize the potential unintended consequences associated with such disclosures? I really recommend the Global Reporting Initiative. I think that they have done probably a better job than anybody else at walking that tightrope and in balancing what should and should not be disclosed. But certainly ESG is the way of the future. With regard to environmental, once a topic goes from the category of 'wouldn't it be nice to know' to the category of 'how are they doing on risk management', it really becomes material and I think that it should be addressed that way.

Justin Nazari asks about Senator Dodd's proposed compromise for the consumer financial regulator to be placed within the Federal Reserve. I have mixed feelings about that. It's really important to me that the legislation gets passed and that's a compromise that I am cautiously optimistic about. How's that? But as far as I am concerned the best way to handle any problem is to have Elizabeth Warren and Paul Volcker run everything.

Gerald O'Hara asks about Judge Rakoff, another one of my heroes, about his rejection of the SEC's initial settlement offer in Bank of America. Does the SEC need broader statutory authority to more effectively deter and punish officers and directors? I don't think that is the problem. I don't think the regulatory authority is the problem. I think it is more the resources for enforcement. Is the New York State Martin Act too broadly written giving the New York State Attorney General's Office the ability to force settlements? Not at all. I thank Eliot Spitzer who has an excellent article in Slate magazine this week, by the way, about Citizens United and very much echoes a lot of the points I just made. I can say he echoes them because I made them last week before Congress and so I am assuming that he read my comments.

William Troost says, after the financial crisis of 2008, do you see the need to completely rework the structure of our financial institutions? I do not think that is necessary. I think what we need to do is, as I said, empower shareholders, give more resources to the SEC. But I think the basic statutory frameworks are right and I think we need to reravel some of the unraveled rules that led to these problems, particularly the capital requirements.

Any questions out there?

AUDIENCE MEMBER: Thank you very much. The question is the employee in SEC and whether you have any place if you want to give the SEC about how to perhaps be more active…

NELL MINOW: Thank you. I have a lot of respect for the SEC. I have a huge respect for the staff. As Professor Lipton said, they are well known throughout the Federal government as best in class. When I was at OMB, I was proud to be the SEC desk officer for a while and it was always a pleasure to work with the people at the SEC, and I do feel their pain. I understand that they are under a tremendous amount of pressure in the current situation. But the last time I was over at the SEC, I had a meeting to talk about what I really have to say was a very, very fine tuning, simple, easy fixes with regard to making the accessibility of some of that information that has to be turned in about how mutual funds or proxies, just making accessibility a little bit better, so that instead of basically taking them off of cuneiform tablets we could just download them. And the response that we got was sympathetic but unenthusiastic and so that's the kind of thing that concerns me. I don't think the SEC has devoted enough attention to ways of making the information that they are collecting accessible. I think that we have to kind of think of financial disclosure as a big, big, big, big wikipedia, that has to be available to everyone so it can be corrected and acted on by everyone. We can't the SEC to do it all. So, I think that would be where I would put my focus. That and as I said, really enforcing fiduciary obligation of institutional investor voting. Thank you. I always like to give my wish list.

AUDIENCE MEMBER: Thanks again now for coming. I am Molly DuBelle. I am in second year here at Catholic and an actor, as you know, who is looking forward to your critique on the Wall Street movie remake. It's timely. I had questions because prior to CUA I worked at the World Bank and I have done the private sector with hedge funds, all too familiar with the whole Enron, Madoff kind of trail in that one direction. But during my MBA, I was the one asking why. We would go through the accounting and go through the numbers and learn the math. But I was the one asking, ethically speaking but why this? And we had this issue of, 'In the news, what's the matter of incompetence?' It's a matter of people not knowing their job, how they get their job. But its not incompetence, its more of, 'You are well savvy of what you are doing with your numbers'. This is intentional malfeasance and the issue is coming down to, 'There aren't a lack of whistle blowers or maybe there and, they are afraid.' But people are living in their loopholes of their math that they do have. So, what kind of advice would you have about possibly fixing the foundation of, you know, call it human nature but call it a greed that is native to the society itself, as far as possible continuing learning education akin to lawyering for MBAs.

NELL MINOW: I thought it was very interesting that the report on Lehman revealed that the whistle blower was fired, it seems to be a lesson that we need to learn over and over again. And I remember once, I was a presenter for the movie 'Enron', the documentary about Enron which I highly recommend to all of you. I have a whole list of good corporate governance movies if you want to hear it. And after it was over during the Q&A, somebody said, "Isn't this really an indictment of the American character?" And I said, "Let me think, greed, gluttony, lust, I think those were around even before America." That's kind of an indictment of the human character.

When I think about this living in the loopholes that you have so accurately described, I think about this argument that comes up all the time about principals-based or rules-based systems. And each one has its advantages and its disadvantages. And there is also kind of a merger because when you have a principles-based system, everybody wants certainty and safe harbors and so you start filling in all the rules around the principles. When you have a rules-based, people want to know what goes on in between and so they fill in the principles. This is honest to goodness, the reason that I got involved in being a movie critic because I really felt that by the time people got to the place where I was dealing with them, it was too late to try to explain to them about integrity and its not about what you can get away with, its about what you can be proud of. And the better thing for me to do, would be to help parents teach their children about values by looking at the lesson that are in movies. That reminds me, I will tell you one movie that I recommend to all of you that I bet you have not seen. It's called 'Owning Mahoney', starring Philip Seymour Hoffman and it is based on the true story of the largest bank embezzlement in the history of Canada. Someone stole $20 million and lost every penny gambling in the United States. And what I love about the movie, aside from the great performances by Minnie Driver and Philip Seymour Hoffman is that the movie makes it clear that everybody from the bank loan officers at the beginning through the Royal Canadian Mounted Police at the end, everyone is assessing risks at every point, even the manager of the gambling casino, who is letting someone bet who clearly does not have that money. But everybody is assessing risk and it's about how they assess risk. The other thing I love in it is that it's very Canadian because the bank examiner comes in and he says to the bank vice-president, "There is a discrepancy." And Philip Seymour Hoffman says, "Oh, that guy was in this morning, he brought in bearer bonds" and the auditor says okay. So, it's a good cautionary tale for everybody.

AUDIENCE MEMBER: But do you always think its disclosure or do you think perhaps in those instances or some others there is a need for more information on the actual face of the financial statements? Could I just say that as a former standards setter you always need a majority to pass a rule and the typical situation when you can't get the majority is, "Let's do a disclosure." So, I just wonder if that's not strong enough then have you thought about… do you ever think that, that isn't the only answer and there's more need for information actually on the face of the statements?

NELL MINOW: Certainly but, that's really a kind of disclosure itself, isn't it? So, no question about it but as a general matter, I am a great believer in the marketplace, the marketplace of ideas and the marketplace of money. I just don't like one of them to tape the other one.

AUDIENCE MEMBER: You made several points of that, how the shareholder rights system really isn't effective. Do you have a feeling about the failure of the Delaware Supreme Court to just draw one in the sand and say, "Can't pay people this much money, it's corporate waste"?

NELL MINOW: I do have strong feelings about the Delaware Courts. On the one hand, I tremendously admire their expertise, I don't think there is a better tribunal in the world than the people on the Delaware courts for understanding the intricacies of financial dealings and the ability to respond very quickly. On the other hand, they themselves have a conflict of interest. They have a strong vested interest in keeping Delaware as the state of incorporation and therefore what we get is a lot of great dicta, a lot of rhetoric about the importance of shareholder rights and shareholders oversight. And there's always some reason that in this particular case it doesn't apply. And what I strongly recommend, because I am all about market based solutions, I did go to the University of Chicago, is that shareholders should have the right to determine the state of incorporation. That would create, instead of a race to the bottom, a race to the top as companies would have to be incorporated in the states that their shareholders pick. And states would have an incentive to come up with shareholder friendly laws instead of corporate friendly laws. So, I would like to see that. I think that that would give Delaware the nudge that it would need to make some changes and keep all these cases in their jurisdiction.

AUDIENCE MEMBER: Thanks. Nell, I wanted you to come back to the question of personality of societies, personality and whether or not what we have seen, particularly in the most… the two most recent financial disorders, the 2000 and the 2007, 2008. If there hadn't really been a sea change of our values between let's say in the 1950s when the executive to average worker salary was something like a 101 to the 2000 period where it had gone to 400. That of course doesn't reflect inflation because we are maintaining a proportion there or we are accelerating a proportion. There was a time I would say in some of our life periods when an attorney's word was his bond, when an investment banker's word was his bond, when a rating agency's word was his bond and we seem to have lost that. We seem to be all going for the hourly rate. When we think about the egregious salary that you mentioned for Countrywide's CEO, that's not unusual. Maybe it was unusual with Mike Milken's returns in the mid-80s but that's not so unheard of anymore. And if there has been indeed a real change in our values, in our standards of what we should be seeking in life, is there any way other than regulations to offset that, to counter it?

NELL MINOW: Just I think there is, I will tell you that there are two indispensable elements of a pay plan that I think are essential for credibility. And I believe that if we could get the shareholder community to insist on those two elements you would see a lot more sanity in the area of pay. But before I tell you what they are, I have to say one great big loophole the SEC needs to address immediately is hedge funds. Because one of the big problems is that CEOs see what the hedge fund guys are getting paid, what the private equity guys are getting paid, what investment bankers are getting paid and they say, "Wait a minute, I am a titan of industry. I am more important than they are. I have more people working for me than they do, I should get paid that much." So, I think that, that is an anomaly in terms of disclosure that needs to be addressed. But the two indispensable elements of every pay plan that I think that would bring sanity into the process, one is absolute clawbacks. Any change whatsoever in the numbers, any time you have to give the money back, period, that's it, the end. No fuzzy stuff, no if, maybe, appropriate, no if there is bad intent, no nothing. If the numbers are changed you give the money back. The biggest reaction that I get from that is what I call the Barbie defense. Remember when Barbie got in trouble for saying, "Math is hard"? All of a sudden, they can do Gaussian copula formulas when it comes to sub-prime loans but they can't figure out how much money to give back when they change their reporting numbers. Come on, give me a break. So, that's absolutely indispensable.

The second one is that all option and stock grants need to be performance based. You can't just shovel them out the door and say, we are going to give this number of them. All option and stock grants need to be indexed to the peer group, if possible or to the market as a whole. If that's not possible, if it's a big conglomerate, can make sure that we are paying people for their own performance and not the performance of the market. And I see huge abuses going on right now. Huge, huge new stock and option grants going on right now. Let's assume we are at the bottom of the market and its going to come back, these people are going to make insane amounts of money that they did not earn, up to 70% of option gains are attributable to the overall market. There is no way on earth we should pay them. So again if we stop looking at what that guy is making as a way of figuring out what this guy should make and look at it in terms of return in investment and keep those two elements in the pay plan, I think that will solve the problem in a much more market-based way than regulation.

AUDIENCE MEMBER: Do you believe that the clawbacks of executive bonuses should be conducted by companies themselves or by a government agency or something else?

NELL MINOW: I believe that the clawbacks should be conducted by the companies themselves under the supervision of the board of directors. And there are a number of ways of going about that without making it too onerous including bonus banking. Thank you all very, very much. Its been a real honor to be here.

CARLA ROSATI: Diane Sanger exemplified the best of what we expect from our financial regulatory system. As we conclude today's lecture, we would like to share another remembrance of Diane, this from Professor J. Robert Brown of the University of Denver Sturm College of Law. "Back in the 1980s I worked in the counseling side of the General Counsel's Office at the SEC. My boss was Diane Sanger, then an Assistant General Counsel. She was one of if not the smartest person I knew at the Commission and tough as nails, not something that earned her kudos with everyone in the agency. When we talked about pretty much every legal issue – and this was the 1980s with the era of takeovers, insider trading and the disclosure of merger negotiations - she would profess to wonder why corporate disclosure was such a tough issue. She would sum it up by saying, 'Just tell the truth'."

We hope that today's lecture helps us to remember and reflect on Diane Sanger's contributions to effective and fair financial regulation. It is now permanently preserved in our virtual museum and archive at www.sechistorical.org for access at any time. We hope also that today's program recognizes all those currently working in the regulation of the capital markets and serves as an inspiration to those who are considering such a career. Thank you for being with us today.