

GOVERNANCE RATINGS

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Companies Must Seek to Avoid the “Junk” Governance Rating

by *Matthew Brown*

As we know too well, the past year has been marked by the collapse of numerous high-profile public companies that were rocked by accounting scandals. These developments resulted in the passage of the Sarbanes-Oxley Act of 2002 as well as the Securities and Exchange Commission's (SEC's) and stock exchange's conducting rulemakings that require companies to review and improve their corporate governance practices. These events have increased the interest of investors in corporate governance issues and have led journalists to report more on actual or apparent cases of corporate governance weakness. This increasing investor focus on governance also is now resulting in a proliferation of published rating systems or metrics that rank, analyze, and compare the relative corporate governance practices of public companies.

With these developments, it is appropriate to take stock of the available ratings programs and examine the criteria they use. Recent developments in this area include:

- Nearly two years ago, Institutional Shareholder Services (ISS) began developing a metric for measuring and comparing the corporate governance structures of public companies. In January 2003, ISS updated its corporate governance metric by providing broader ratings criteria and company coverage, making a commitment to offer more frequent scoring updates and several other enhancements.
- In April 2000, GovernanceMetrics International (GMI) designed a new ratings system that creates a metric to compare companies' corporate governance characteristics.
- In December 2002, The Corporate Library (TCL) devised a proprietary system for rating board effectiveness, which TCL believes is an important indicator of potential investment risk. TCL will begin issuing ratings by the end of the 2003 proxy season.
- In July 2002, Standard and Poor's (S&P) released a detailed white paper outlining its criteria and method-

ology used in preparation of their new corporate governance scoring system.

- Recently, large institutional investors such as TIAA-CREF have assembled their own internal resources to rate governance and numerous other rating agencies and shareholder rights advocate organizations are also entering the governance rating business.
- Other debt ratings agencies and shareholder and investor advisory groups are considering comparable ratings services, such as Moody's and Fitch.

It is unclear (1) exactly how accurate the ratings are, (2) to what extent investors will value a company's corporate governance framework when making investment decisions, and (3) whether a good corporate governance score will translate into a higher valuation for a company. What is clear, however, is that regardless of whether these ratings are empirically sound or intrinsically valuable, corporate investor and media relations teams must now actively consider their governance ratings and press reports on their governance matters. The numerous occasions of erroneous or incomplete governance ratings or media reports demonstrates the increasing importance of companies actively monitoring the data being used by these systems, if only to avoid potential negative publicity.

An increased focus on governance ratings also may be warranted due to other investor considerations. Some available data points may well suggest that companies with better corporate governance records will, over time, create greater shareholder value and be more attractive investments than companies with relatively poorer governance.¹ Some investor surveys and research studies have shown that corporate governance could become an important element of investor decisions.²

This potential correlation of improved stakeholder value with strong corporate governance, together with fiduciary duty concerns and other public relations issues that could result from investing in companies with relatively weak corporate governance, may cause institutional investors to increasingly make governance ratings part of their investment decisions. If that is the case, then

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companies should understand the factors being considered by the various corporate governance ratings services and may wish to implement or modify their governance practices to improve their ratings.

The following addresses the ISS metric, the GMI metric, the S&P scoring system, and the TCL “Board Analyst” service.

ISS

ISS historically has provided research and advisory services to assist institutional investors in evaluating proxy proposals and casting votes that protect and enhance shareholder value. ISS develops policy guidelines and proxy analyses, provides consulting services to clients who vote proxies, and offers voting agent services. The ISS services are available by subscription and include a weekly informational newsletter and annual updates to the *ISS Proxy Voting Guide*. The *ISS Proxy Voting Guide* is a reference manual designed to provide recommendations to institutional shareholders, especially ERISA managers, on how to satisfy their obligations as shareholders and vote their stock to enhance long-term portfolio value.

The Corporate Governance Quotient Rating

Recently, ISS established a new Corporate Governance Quotient (CGQ) ratings system. The CGQ ratings are relative and are reported on a percentile basis ranging from zero to 100 percent. A company’s CGQ ratings will appear on the first page of each ISS proxy analysis. Each company receives two CGQ ratings:

- The first score compares the company’s corporate governance practices with a relevant index, such as the S&P 500, the S&P (mid-cap) 400, the S&P (small-cap) 600, or the Russell 3000.
- The second score compares the company’s corporate governance practices with its industry peers using S&P’s 23 sector groupings.

The CGQ ratings comprise eight core topics (with 61 sub-issues):

1. Board structure and composition;
2. Charter and bylaw provisions;
3. Laws of the state of incorporation;
4. Executive and director compensation;

5. Quantitative factors such as financial performance;
6. Director and officer stock ownership;
7. Director education; and
8. Audit.

The score for each core topic reflects a set of governance variables. The eight core topics currently include 61 ratings variables.³

Data Gathering

ISS will gather some of the data for the CGQ ratings from publicly available disclosure documents, such as proxy statements, annual reports, and prospectuses. In its most recent update, ISS indicated that it also will look for corporate governance data by reviewing press releases, news articles, and disclosures made on covered companies’ Web sites. ISS also might ask corporate secretaries to supplement the filings with additional data concerning the company’s corporate governance practices.

Companies also may (1) visit the CGQ Web site at <http://www.isscgq.com> at any time to review the list of ratings criteria and submit data to ISS; (2) sign up at the CGQ site for an email Corporate Issuer Review and provide ISS with corrections or updates, which will be verified by ISS within two business days before the database is updated and the “score” is recalculated and included on an ISS proxy analysis; and (3) subscribe to a fee-based subscription service that allows companies to learn how to improve their ratings and to benchmark their corporate governance practices against a self-selected peer group.

The CGQ Subscription Service

Only companies that subscribe to the CGQ subscription service may preview the ISS data used to calculate the company’s ratings, learn how to improve the CGQ ratings by improving the score among the governance variables, and view governance ratings data for peer companies.⁴

There is no charge for a company to submit its corporate governance data to ISS. If differences are noted between the company’s data and the ISS data points, ISS will contact the company to resolve the differences. However, companies that do not subscribe to the ISS CGQ service will not know their CGQ ratings until they are released by ISS on a proxy analysis. Non-subscriber

companies will not be able to preview their ratings among the governance variables and will not be able to view their CGQ ratings as compared with peer companies and the indexes.

Reasons for the Corporate Governance Ratings System

The CGQ ratings system is a new development that creates a metric that identifies the relative performance of companies regarding corporate governance. ISS views the CGQ as a new tool to monitor and compare the corporate governance structures of public companies. The CGQ ratings will appear on the front page of each ISS proxy analysis along with some information that provides some context for the rating.

A table on the second page of the ISS proxy analysis will provide details about the key factors that drive the CGQ ratings. *ProxyMaster.com*, ISS's electronic platform for delivering research to institutional investors, allows its users to screen portfolio companies on the basis of their CGQ ratings. ISS has set this system up for investors to use corporate governance as a distinguishing issue when making investment decisions. Additionally, Salomon Smith Barney and Goldman Sachs have purchased access to the ISS CGQ database and will be including a company's CGQ rating in their research reports.

Companies may consider subscribing to the CGQ ratings service for at least one year to maximize their potential CGQ ratings. Although the CGQ ratings are computed relative to peer companies, after the first year of subscription to the service it may not be possible to materially increase a company's CGQ rating. Since there is no fee or subscription required, public companies should annually submit their corporate governance data points to ISS for comparison to the internally generated ISS information and resolve any discrepancies.

GovernanceMetrics International

GovernanceMetrics International (GMI) is a company formed in April 2000 that has designed a new ratings system that creates a metric to compare companies' corporate governance characteristics. The GMI ratings system incorporates more than 600 data points across seven categories, including:

1. Board accountability;

2. Financial disclosure and internal controls;
3. Executive compensation;
4. Market for control;
5. Ownership base and potential dilution;
6. Reputational and SRI (socially responsible investment) issues; and
7. Shareholder rights.

GMI Methodology

The GMI ratings criteria are based on securities regulations, stock exchange listing requirements, and various corporate governance codes and principles disseminated by the Organisation for Economic Cooperation and Development (OECD), the Commonwealth Association for Corporate Governance, the International Corporate Governance Network, and the Business Roundtable.⁵ In addition, GMI solicited the views of various corporate governance and legal advisors, institutional investors, corporate officers, and company directors and used the combined experience of its founding partners.

According to GMI, this produces a set of more than 600 metrics structured in a manner that can only produce "yes," "no," or "not disclosed" answers. In this way, GMI attempts to eliminate a large degree of subjectivity in answering the metrics from official company filings with securities regulators and stock exchanges.

GMI's research process begins with a review of all pertinent public data, including regulatory filings, company Web sites, news services, and other specialized Web sites. In addition, certain data is provided by Aon Consulting's eComp Database, Dow Jones Global Industry Classification System, the Investor Responsibility Research Center (IRRC), and TrueCourse, Inc. All data collected by GMI are entered into a relational database. Once the research template answers have been compiled and have been subjected to various quality control checks, data entry reports are sent to each company in the GMI "universe" for a final accuracy check.

After company adjustments are made, the GMI data are set, and GMI then runs a scoring model that calculates and assigns ratings to each company. Companies are scored on a scale of 1 (lowest) to 10 (highest). GMI scores are relative, and each company is scored against the GMI universe of companies measured and also

against all those in the same country of domicile. Initially, companies are assigned eight ratings in all, an overall GMI rating and one for each category of analysis.

Scoring Algorithm

GMI has developed a proprietary scoring algorithm to produce its ratings. The GMI research template is divided into seven broad categories of analysis. These categories are further divided into subsections. Each individual metric has a numerical value, and each subsection and research category is weighted according to investor interest. GMI looks at the individual metric scores as building blocks that when tallied demonstrate a company's governance architecture. No one indicator is a litmus test of the governance profile of a company.

GMI's system uses asymmetric geometric scoring (AGS), which in effect magnifies the record of "outliers." This includes both those with the very best practices, who are then rewarded more, or those with the worst, who are penalized.

Company Updates and the GMI Rating Cycle

GMI plans to re-rate all companies in its universe approximately every six months once it establishes a baseline global universe. In between these ratings runs, GMI monitors each company in its research universe on a daily basis and will post company updates in order to keep subscribers apprised of new governance developments at the companies covered by GMI.

If a company has gone through a major restructuring or governance overhaul in between these planned ratings runs, GMI will consider updating the company's profile and rating it as a one-off.

Basic Ratings

GMI offers two levels of ratings: basic and comprehensive. Every company in its universe (currently only the S&P 500) undergoes a basic rating, which entails a review of public information available for each company in order to answer the GMI metrics. The data are gathered from the company's regulatory filings, what it publishes about itself, and by GMI's screening of other data sources. There are no costs to the company for the basic rating.

Each rating report includes a summary of the company's overall governance profile and commentary on

each of the seven broad categories of analysis. In addition to an overall GMI rating, each of the seven research categories receives a separate rating. These are meant to help subscribers see where a company is particularly strong or weak. As an additional tool, GMI will provide a red-flag service to alert subscribers about a governance issue that it thinks has the potential to affect shareholder value and warrants immediate attention.

Comprehensive Ratings

A comprehensive rating is a more detailed analysis of the governance practices at a company. This level of review is possible only at the invitation of the company, which is required to pay a fee to GMI. A comprehensive rating starts with the basic rating process but is further supplemented. GMI undertakes a review of company policies and documents. GMI reviews the company's litigation and regulatory infringement record. Following the document review, GMI will meet with members of the board and appropriate senior management. In these interviews the company will answer a more detailed set of questions about the company's governance philosophy and practices.

If a company retains GMI to conduct a comprehensive rating, the rating must be published. Further, while GMI will allow a company to review its analysis prior to publication, GMI has final editorial discretion. To allow for additional comments, companies will be able to provide their own statements to amplify or rebut the GMI work as part of the overall GMI report. GMI believes that a company undergoing a comprehensive rating is in many ways subjecting itself to a form of non-financial due diligence.

The Corporate Library

Nell Minnow and Robert A.G. Monks, co-founders of Institutional Shareholders Services, founded TCL in summer 1999. Serving as a central repository for research, study, and critical thinking about the nature of the modern global corporation, TCL focuses on corporate governance and the relationship among company management, their boards, and shareholders.

Recently, TCL developed "Board Analyst," a system for rating board effectiveness, which provides general coverage of more than 1,500 US companies.⁶ Available data include each firm's CEO compensation numbers and all directors and their committee assignments.

Individual director information is cross-referenced against multiple board appointments and includes tenure, compliance with meeting attendance standards, and shares held for each directorship, plus age, gender and current number of directorships. In addition, a “Director Interlocks” research tool, which tracks multiple director interlocks across multiple boards, is offered as an add-on.

In addition, TCL has devised a proprietary system for rating board effectiveness, which TCL believes is an important indicator of potential investment risk. The ratings system is available as an add-on module for investment-oriented subscribers and is comprised of six key areas:

1. CEO Employment Contracts and Compensation Practices;
2. Outside Director Shareholdings;
3. Board Structure and Make-up (do the directors provide an appropriate range of skills?);
4. Ownership;
5. Accounting and Audit Oversight; and
6. Board Decision-making.

Individual scores in each area are combined to provide an overall board effectiveness rating for each board. TCL states in its marketing materials that, if it is “given two firms with similar earnings and commercial prospects, the one with the stronger board will be the better choice for most investors.”

S&P

Known traditionally for its credit and debt ratings of large-cap companies, S&P recently launched a Governance Services Department that will provide investors with corporate governance scores, evaluations, and customized research services and that will help corporations benchmark and communicate their internal governance practices to the marketplace. The S&P Corporate Governance Scoring Service is a diagnostic for companies that wish to identify strengths and weaknesses in their corporate governance process. Designed to help senior managers and directors benchmark their existing governance practices to corporate governance standards on a global basis, S&P Corporate Governance Customized Research is specific research into corporate governance that can be carried out on behalf of investors, intermediaries, companies, regulators, exchanges, and multilateral organizations.⁷

While there exist many different benchmarks and codes of best practices, S&P has identified specific standards that can apply across the broad spectrum of economic, legal, and political environments. With this in mind, S&P’s Business Sector Advisory Group on Corporate Governance to the OECD has articulated a set of core principles of corporate governance practices that are relevant to a range of jurisdictions. The core principles are *fairness, transparency, accountability, and responsibility*. S&P uses these principles as the basis of its corporate governance scoring methodology for individual companies and emphasizes that this methodology can be used to analyze governance both at country and company levels.

S&P also uses the OECD Principles of Corporate Governance (1999) to form the basis of its scoring methodology. The OECD principles represent attempts to establish overarching indicators of the status of corporate governance in different countries. In addition to the four core principles and the OECD principles, S&P also consulted the governance work of the World Bank, TIAA-CREF, Commonwealth Association for Corporate Governance Guidelines, European Association of Securities Dealers, and selected international companies.

Process and Structure of Corporate Governance Scores

S&P’s Corporate Governance Score (CGS) assesses a company’s corporate governance practices and policies and the extent to which these serve the interests of the company’s financial stakeholders, with a particular emphasis on shareholders’ interests.⁸ The creation of the CGS encompasses the interactions among a company’s management, the board of directors, shareholders, and other financial stakeholders. Reflecting the premise that the quality of a company’s governance process can affect its ability to honor contractual financial obligations to creditors and to maximize equity value, financial stakeholders include both a company’s shareholders and creditors.

Typically, analysts from S&P’s Corporate Governance Services and S&P’s affiliates, local law firms, and other professionals in corporate governance (the committee), as appropriate, will visit with the company being evaluated to discuss the company’s corporate governance process. The committee will inspect relevant

documentation prior to meeting with management and other officials. The committee will examine company documents, including: company annual and intra year reports; company charter and by-laws; filings with government regulatory agencies; records of recent shareholder meetings (past three years), general and extraordinary; minutes of recent board meetings (past three years); disclosure of new share issuance (including options) at the company or the subsidiary level; identification of key shareholders and creditors; records of any penalties, fines or other violations relating to abuse of shareholder rights on public record, including pending items; disclosure of board structure and composition; disclosure of company auditor; disclosure of major scale transactions in past three years (more than 10 percent of company net assets); and identification of share registrar.

Typical interviewees include the chief executive, finance director, corporate counsel/company secretary, board of directors (in particular the chairman and independent directors), shareholder relations' personnel, key shareholders and creditors, and the company's auditor. These individuals may be provided with questions in advance. The scoring process then begins as analysts are guided by more than 100 standardized observation prompts, which reveal the quality of corporate governance arrangements and minimize jurisdictional influences to the greatest extent possible.

A CGS is then assigned on a scale from 1 (lowest) to 10 (highest). A score of zero will be awarded when a company is unable or unwilling to provide enough information for a meaningful analysis. Additionally, scores from 1 to 10 are awarded to the four individual components that contribute to the overall CGS. These components are:

1. Ownership structure and influence;
2. Financial stakeholder rights and relations;
3. Financial transparency and information disclosure; and
4. Board structure and process.

Ownership Structure

Ownership structure, notably when there is a known majority holder or a large number of nominee shareholders, may make the analysis of the concentration of share ownership difficult. S&P suggests that, while the presence of a majority shareholder is not necessarily a

negative governance issue, the relationship of any stockholder to another shareholder's interests will be thoroughly scrutinized as part of the ownership structure analysis.

With respect to transparency of ownership, S&P recommends that there should be adequate public information on the company's ownership structure, including, when relevant, information on beneficial ownership behind corporate nominee holdings. The company's actual ownership structure should be transparent, not obscured by cross-holdings or management-controlled holdings. S&P will examine the breakdown of shareholdings, substantial and majority holders, director shareholdings, management shareholdings, and evidence of indirect shareholdings.

With respect to concentration and influence of ownership, S&P recommends that, if large stockholders exist, these should not exert influence that is detrimental to the interests of other stakeholders. The concentration of economic interest and influence of controlling shareholders of the parent company on independent board/management action should not occur through block holdings of key operating subsidiaries and through effective control of key customers and suppliers.

In sum, a CGS would be adversely affected if shareholders were placed at a disadvantage by management or other insider shareholders who are protected from accountability. The committee will examine shareholder affiliations; commercial arrangements between the company and affiliates; corporate structure; outside holdings of major shareholders; terms of key contracts and licenses; the company's internal financial and operational control system; management shareholding and voting control; and contracts with directors and management.

Financial Stakeholder Rights and Relations

The CGS also reflects the extent to which a company's corporate governance practices serve the interests of the company's financial stakeholders, with an emphasis on shareholders' interests. In this respect, the committee examines voting and shareholder meeting procedures; ownership rights and financial rights; and takeover defenses and corporate control issues.

A CGS criterion is that shareholders holding an appropriate percentage of voting rights should be able to call a special meeting and have the opportunity to ask questions of the board during the meeting and to place

items on the agenda beforehand. S&P favors an assembly of shareholders' being able to control appropriate decisions through processes that ensure participation by all shareholders. Here, the committee will conduct a thorough examination of notices of meetings, documents sent to shareholders, charter provisions on the convening of meetings, arrangements for shareholder participation at meetings, previous meeting minutes, shareholder information on voting procedures, proxy arrangements, and shareholder attendance records.

With respect to ownership and financial rights, there should be secure methods of ownership of shares and full transferability of shares. S&P prefers that a shareholders' assembly to be able to exercise decision rights in key areas and that the company have procedures in place that ensure that minority shareholders are protected against possible dilution. Here, the committee will look at charter provisions; classes and rights of common and preferred shares; shareholder agreements; dividend history; and examples of share repurchases and swaps.

S&P also will look at takeover defenses and corporate control issues in creating its CGS on financial stakeholder rights. The CGS takes into account that a company should be open to changes in management and ownership that provide increased shareholder value. In this analysis, takeover defenses are not necessarily considered negative; rather, they are viewed against the current ownership structure to determine how the board intends to use them to increase shareholder value. Here, the committee will look at charter provisions, arrangements disclosed in regulatory filings, annual reports, resolution records, notices of meetings, proxy materials, and interviews with the board secretary.

Financial Transparency and Information Disclosure

Transparency covers the timely disclosure of adequate information concerning a company's operating and financial performance and its corporate governance practices. In arriving at the financial transparency CGS, S&P examines the quality, content, and timing of public disclosure and the independence and effectiveness of the audit process.

Financial reporting and disclosure should be clearly articulated and compared to a high standard. Because public disclosure is a function of internal transparency and internal control policies, one CGS criterion is that all information that can be publicly disclosed should be publicly disclosed. The company's by-laws and articles

of incorporation should be readily accessible to shareholders. The company also should maintain a Web site and make company reports available to the public. Here, the committee will scrutinize the comprehensiveness of financial statements and reports and the quality of non-financial information; the timeliness of filing financial and other statements with regulatory bodies; procedures for disclosure of market-sensitive information; and the availability of records to all shareholders at the company's headquarters.

One CGS criterion is that auditors should be independent of the board and management in all material respects and should be "reputable." There also should be procedures in place to maintain outside auditor independence. Here, the committee will look at the audit contract, finance and control systems, the audit committee process, applicable charter provisions, and audit reports.

Board Structure and Process

Board structure and process addresses the board's ability to provide independent oversight of management and hold management accountable to all stakeholders. A board with high accountability often includes independent directors that look after all stakeholders, regardless of size. The CGS takes into account that a board should be structured to ensure that the interests of all the shareholders are represented fairly and objectively. Here, the committee will look at the audit committee, compensation committee, the nominating/governance committee, board size, composition, and board leadership.

Good governance practices requires the board to bear overall accountability for the performance of the company and to be ultimately responsible for the system of internal risk control at the company. Here, the committee will look at board-level processes for identifying, evaluating, managing, and mitigating risks faced by the company.

According to S&P, an appropriate proportion of the non-employed directors should be truly independent. Independent or outside directors should ensure that the long-term interests of all shareholders, regardless of size, are taken into account. Here, the committee will examine relationships between outside board members and senior management; control committee independence and activity; the specific role of outside directors; and director election procedures.

Board and executive compensation also play an integral role in the CGS for board structure and process. Directors and executives should be fairly compensated and motivated to ensure the long-term success of the company. There should be a clearly articulated performance evaluation and succession plans for employed directors of the company. Here, the committee will evaluate the level and form of compensation; the extent to which pay is connected to financial or other performance measures; performance evaluation criteria; independence and integrity of compensation setting process; and succession planning.

Company Report Format

Following the company meeting, the committee will prepare a detailed report covering the main elements of the analysis and will also articulate the CGS and individual scores for each of the four components. The report will include an executive summary that presents the aggregate governance score with a rationale together with summaries of key features of component scores. It also includes a company report, containing basic operating, financial, management, and ownership information.

Country Considerations

Consideration of a country's legal, regulatory, and market environment is a key element in final analysis of the risks associated with the governance practices of an individual company. For instance, two companies with the same company scores, but domiciled in countries with different legal, regulatory, and market standards present a different risk profile to an investor. If the governance standards at a particular company diminish, stakeholders are likely to receive better protection in a country with stronger laws and regulations. Further, governance standards practiced by individual companies may reflect compliance with externally imposed governance standards. In a country with a particularly weak external environment, individual company practices will likely reflect the extent to which internal company governance discipline may or may not offset the weaker external infrastructure.

S&P does not currently score individual countries but plans to develop a more formal country governance evaluation and classification. While the CGS focuses on a company's internal processes, then, a country governance classification would focus on how external forces

at the macro level can influence the quality of a company's governance.

Conclusion

It is unclear what importance corporate governance ratings will ultimately be to investors. In the short term, as a result of the Sarbanes-Oxley Act and corporate governance rule proposals submitted by the NYSE and NASDAQ, governance compliance is being given considerable media and management attention. It is expected that eventually there will be a leveling of corporate governance practices among public companies. As these practices are mandated and/or instituted at public companies, there will be a more equal footing among companies in the corporate governance area. However, if investors begin to use governance ratings as important factors in investment decisions, factors that help or hurt these ratings could become increasingly important to investor sponsorship, particularly while companies are generally transitioning to better corporate governance practices.

Management or the board should consider the various criteria described that affect a governance rating positively or negatively and may want to consider implementing or changing some practices to improve the company's rating. Some of these criteria may be easy to improve because they are relatively cosmetic and innocuous and have no practical cost to implement. Others may be more serious and present fundamental business considerations that, depending on the particular situation, may or may not ultimately be advisable. Additionally, it is our hope that alerting our clients to these criteria will help them to assure that their ratings and published governance reports are accurate and free of errors and as strong as they desire.

Notes

1. For example, the July 2002 McKinsey Global Investor Opinion Survey suggests that corporate governance will be on par with financial indicators in making investment decisions and that investors will be willing to pay a premium for companies that exhibit high governance standards. Also, Rutgers University professors of human resource management Joseph Biasi and Douglas Kruse examined stock option grants and shareholder returns at the 1,500 largest US companies from 1992 to 2001 and found that companies dispensing significantly larger-than-average stock option grants to their top five executives produced lower total returns to shareholders over the period than those dispensing fewer options. Additionally, S&P's October 2002 Transparency and Disclosure Study suggests that companies that voluntarily disclose

more in their annual reports than is required may command a higher stock price and that such additional disclosure may be a best practice.

2. Having been generally criticized for its failure to recognize audit issues at Enron and other recent notable corporate meltdowns, S&P has now said in an October 2002 article that the linkages between credit quality and corporate governance can be extensive, with weak corporate governance potentially undermining credit-worthiness in several ways and should serve as a red flag to credit analysts. *See* Clifford M. Griep and Solomon S. Samson, "The Evolving Role of Corporate Governance in Credit Rating Analysis," October 10, 2002.

3. A current list of the ratings variables and their distribution among the eight core topics is available at <http://www.isscgq.com/RatingCriteria.htm>. A demonstration of the CGQ ratings is available at <http://www.isscgq.com/demo>.

4. The annual fees for companies to subscribe to the CGQ subscription service range from \$10,000 to \$17,000.

5. Annual subscriptions for GMI's US research universe start at \$18,000 per year. The cost of a comprehensive rating is \$50,000.

6. Board Analyst is a subscription service that ranges in price from \$8,000 to \$35,000, depending on the number of users and add-ons. Fearing potential conflicts of interest, TCL does not accept fees from companies it covers.

7. S&P's Web site contains a corporate governance link on <http://www.standardandpoors.com>. In July 2002, S&P's Governance Services Department prepared a white paper that outlined its criteria and methodology in the creation of corporate governance scores. This white paper was supplemented by S&P's October 2002 Transparency and Disclosure Study, which suggested a correlation between disclosure and corporate valuation.

8. The entire CGS service ranges from \$75,000 for small-cap companies to \$200,000 for large-cap companies.

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