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## SEC to Examine Boards' Role in Financial Crisis

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Securities and Exchange Commission Chairman Mary Schapiro plans to look into whether the boards of banks and other financial firms conducted effective oversight leading up to the financial crisis, according to SEC officials, part of efforts to intensify scrutiny of the top levels of management and give new powers to shareholders to shape boards.

As she examines what went wrong, Schapiro is also considering asking boards to disclose more about directors' backgrounds and skills, specifically how much they know about managing risk, said the officials, who spoke on condition of anonymity because no policy initiative has been launched.

Having led the agency for just three weeks, Schapiro hasn't had the chance to move forward on these initiatives, though that will probably be one of her first tasks. Schapiro has said that Wall Street must repair itself after the financial crisis and that one way to do so is by "giving shareholders a greater say on who serves on corporate boards, and how company executives are paid."

With few exceptions, boards have received little media attention as the country has sought explanations for financial firms' taking on such perilous risks. These boards -- which typically consist of a dozen or more well-known executives, politicians and other influential people -- were ultimately responsible for the decisions of the Wall Street companies, housing firms and banks at the heart of the crisis.

The boards signed off on the risks the companies took and the compensation packages awarded to top executives. But many corporate watchdogs say the boards of top financial firms had characteristics that promoted risky business practices and harmed shareholders.

"Corporate governance is about managing risk. It's about incentive compensation. It's about corporate strategy and sustainability. And all of those things are what the boards failed to do," said Nell Minow, a co-founder of the Corporate Library and an advocate of reforming corporate boards.

The Obama administration and Congress have already taken steps to limit the type of board behavior that may have contributed to the crisis. The stimulus legislation includes limits on compensation at companies receiving tax dollars as well as provisions that give shareholders an advisory vote on executive compensation, known as "say on pay."

Most boards have committees to oversee risk and compensation, and corporate watchdogs say their biggest failure was allowing executives to be paid in exchange for the quantity of business rather than the quality. This often promoted short-term risk-taking at the expense of long-term gains.

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"Management and traders are compensated on booking profits. It didn't take a long time to figure out if you undertake very risky activities, you get higher bonuses," said Ivo Welch, professor of finance and economics at Brown University. "There's nobody to say this is not in the interest of shareholders or the United States overall."

Watchdogs point to flawed boards at many firms -- including Countrywide, [American International Group](#) and [Wachovia](#) -- involved in the crisis. Minow points out that at Bear Stearns, the compensation committee had nine criteria to decide on the chief executive's compensation, such as total return to shareholders and earnings per share. But in the end, it could choose to award the maximum compensation to the chief executive based on only one of the criteria.

Over five years at Bear Stearns, chief executive James E. Cayne took home \$155 million, according to Forbes. A few months after Cayne stepped down as chief, a collapsing Bear Stearns was snapped up by J.P. Morgan in a federally engineered fire sale in which shareholders lost most of their investment.

The Bear Stearns board had other characteristics that corporate governance advocates found problematic. For example, several directors served on the boards of four public companies, raising questions about whether they had the time to oversee a complex financial firm.

During part of the tenure of former [Merrill Lynch](#) chief executive E. Stanley O'Neal, who took home \$161.5 million as he left the firm, the Wall Street investment bank loaded up on investments derived from subprime mortgages and other risky loans. O'Neal was also chairman of the Merrill board -- meaning he was both the overseer and the overseen.

Watchdogs say the [Citigroup](#) board also exhibited poor practices. Three of the firm's directors also were serving as chief executives at other companies.

Other Citigroup directors had multiple roles at the firm. Robert Hernández Ramírez was both a board director and chairman of the bank's Mexican subsidiary. Former Treasury secretary Robert E. Rubin was both a board director and a top adviser to the firm, a role that earned him more than \$100 million. Rubin recently retired, and Hernández announced he was stepping down this week, though Citigroup said he would retain access to aircraft on the company's dime.

Some business insiders say that boards shouldn't be held culpable for a financial crisis that just about everyone missed.

"The universe of people who misread the risks in what some of these firms were doing is very broad. You could extend it to the rating agencies, to managements, to regulators," said David Hirschmann, president of the Center for Capital Markets Competitiveness at the U.S. Chamber of Commerce.

The inquiry into what went wrong at the board level comes as the SEC's Schapiro plans a broader review of policies governing how much shareholders can influence boards. She previously has expressed support for proxy access, which would make it easier for shareholders to propose new directors. Many public companies oppose proxy access, in part because it enables activist shareholders, such as from labor or environmental groups, to try to seek influence on boards.

Schapiro recently hired Kayla J. Gillan, a longtime shareholder advocate, as a senior adviser. Another one of Schapiro's close associates, SEC Commissioner Elisse B. Walter, has also spoken favorably about enhancing shareholders' influence. "To me, the fundamental question is: 'Should shareholders have a real say in determining who will oversee management of the companies that they own?' I believe

strongly that the answer is yes," Walter said this week.

Earlier this month, the SEC rejected a request by Birmingham, Ala.-based [Regions Financial](#) to ban a shareholder proposal to set strict pay limits at the firm, according to RiskMetrics Group. Just months earlier, the SEC approved a request by [SunTrust Banks](#) to ban a similar shareholder proposal.

Some investors aren't convinced the shift is real. Money manager John Harrington tried to propose new board committees at [Bank of America](#), Citigroup and [Goldman Sachs](#) that would ensure that the companies take steps to support U.S. economic interests.

Bank of America and Citigroup wrote letters to the SEC asking for permission to disallow the proposal. The SEC told Citigroup it had the authority to do so, Harrington said. "It's shameful that the SEC is still supporting corporate management right down the line," he said.

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