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DENISE L. NAPPIER

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Nappier Calls on Wall Street to Consider Corporate Governance Practices for Leading Market Indexes; Asks Major Institutional Investors to Support Initiatives Establishing "Second Tier" of Corporate Reforms

Treasurer Urges Connecticut Companies to Become "Model" by Expensing Options

Connecticut State Treasurer Denise L. Nappier is calling on Wall Street's major index providers to consider the corporate governance policies of companies that are included in leading investment indexes, and is urging institutional investors to support the effort as part of a "second tier" of corporate responsibility reforms.

Nappier said the very nature of index funds – in which investors are virtually locked-in to individual stocks as long as the stocks remain included in the index – make consideration of corporate governance policies essential. She is asking firms that establish the indexes – stock portfolios designed to match the performance of the market as a whole -- to take corporate governance into account when determining which stocks to include. The indexes are created by firms such as Standard and Poors (S&P), the Frank Russell Company (Russell 1000, 2000, and 3000).

"This is an important issue not only for major institutional investors, but for tens of thousands of individual investors who hold mutual funds, many of which have investments that mirror index funds and include many of the same companies," Nappier said.

Nappier, principal fiduciary of the Connecticut Retirement Plans and Trust Funds, said the recent reforms approved by Congress, the Securities and Exchange Commission and the New York Stock Exchange form the "first tier" of regulatory and industry response to the recent corporate scandals. "Now we must build on this newly laid foundation and construct what I call the second tier of corporate responsibility reforms," Nappier said.

Among the corporate governance issues that should be considered, Nappier said, are: the composition, selection process and operating procedures for boards of directors and key board committees; executive compensation policy (including policy on expensing and re-pricing of stock options), corporate structure that affects shareholder rights, and strength of financial oversight.

"It's very important that the corporate governance policies and track-record of firms be considered if they are to be included in an equity index. If investors have less flexibility to quickly remove bad apples, then the apples need to be checked very carefully before they're placed in the barrel," Nappier said.

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In addition to corporate governance standards for equity indexes, included in Nappier's "second-tier of corporate governance reforms" are adoption of investor protection principles, expensing of stock options, more closely linking executive compensation plans to long term financial performance of company, strengthening auditor independence, audit committee oversight and training for audit committee members.

"As an industry, we're on our way but we're not there yet. We must do more if we are to fully restore public and investor confidence," Nappier said. The Nappier plan includes:

1. **Establishing standards of corporate governance and accountability for all companies included in investment indexes.**
   The public companies included on investment indexes are subject to varying standards of corporate accountability, based on the exchanges they are listed on. The nature of an index fund is that a stock is held by the investor as long as it is included in the index – regardless of indications of corporate malfeasance or bad corporate behavior.

   The Treasurer noted that as a major holder in index funds, Connecticut, like virtually all institutional investors, has a vested interest in the corporate governance standards of companies listed included in the indexes. She went on to say that the majority of people who invest in the financial markets own stock in the companies included on indexes, and this would be an extremely valuable reform measure for shareholders everywhere.

2. **Expensing of stock options, with Connecticut firms as a "model."**
   Treasurer Nappier is urging corporations, both in Connecticut and nationwide, to add their names to the growing list of firms that expense their stock options. Doing so will show investors how this form of compensation affects earnings and will provide a more accurate picture of the financial status of a company for its shareholders. As State Treasurer, Nappier is specifically calling on Connecticut companies to collectively become "a model for America's business community" in changing their method of accounting for stock options. A number of prominent Connecticut-based global corporations have recently announced such plans, and Nappier is urging others to follow suit.

3. **Strengthening financial accountability through auditor independence, audit committee oversight, and assurance of adequate resources and training.**
   Treasurer Nappier called on audit committees to aggressively and fully implement the provisions of the Sarbanes-Oxley Act, recently signed into law. '"How these new provisions will be implemented is as important as their passage in the first place," Nappier said. The law allows companies discretion in how they interpret and implement certain provisions, and "as investors we must insist that this does not allow companies to do anything less than the comprehensive and effective reforms that were intended." Nappier is calling on companies to clearly lay out for shareholders -- in revised audit committee charters -- how they intend to meet these new requirements, explain precisely how terms such as "consulting" and "independent" will be defined in practice, and detail the ongoing education and training that will be provided to audit committee members.

4. **More closely linking executive compensation plans to long-term financial performance of the company.**
   During the 1990s executive compensation increased out of proportion to the true long-term value that executives added to the company – much of it due to stock options. "Certain stock option plans tempted some executives to manage earnings in a way that increased the short-term value of their own stock options - to the detriment of the long term financial health of the company," Nappier said. "Compensation Committees should

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develop and implement executive compensation plans that tie compensation to the long-term financial performance of the company."

5. **Implementation of Investor Protection Principles by institutional investors.** Institutional investors from around the country are working together to eliminate conflicts of interest in investment management firms and restore integrity to the financial markets by implementing the principles developed, in part, by New York State Attorney General Eliot Spitzer in a settlement with Merrill Lynch. Nappier's office joined 16 other states and the District of Columbia treasurers and other public pension managers last month to endorse these principles. Nappier is in the process of putting these principles in place for Connecticut's investment and debt managers, and is urging other public pension funds, including state and municipal funds, to do the same.

6. **Passage of federal legislation to bar companies from reincorporating to countries where shareholder rights would be diminished.** The Treasurer's Office recently worked with Connecticut's Attorney General to prevent The Stanley Works from following through on plans for a Bermuda reincorporation that would have substantially weakened shareholder rights. Nappier is calling on public funds to urge Congress to end the financial incentives for American corporations to make "paper moves" overseas to avoid U.S. taxes and undermine investor and consumer confidence.

"I do not believe that the measures adopted so far by legislators, the stock exchanges and regulators are sufficient to make the necessary changes in publicly owned companies and restore confidence across the board," Nappier said. "Quite simply, our work is not done. We must do more."

"Creating a corporate governance hurdle for inclusion in equity indexes, and taking the additional steps I've outlined, will clearly demonstrate that the financial industry and institutional investors are serious about expecting good corporate behavior and responsiveness to shareholders," Nappier said.

Treasurer Nappier has long been a proponent of high standards for corporate governance and corporate accountability. When she took office she developed and proposed a comprehensive series of proxy voting policies, which were endorsed by the state's Investment Advisory Council. Proxy voting is a method that allows investors to hold companies accountable for the business decisions they make. These guidelines re-established Connecticut as a responsible institutional investor for the first time since 1995, and are now in place to ensure that these critical responsibilities are performed consistent with state law and the obligations of the State Treasurer.

In addition, Treasurer Nappier is a major proponent of shareholder rights, and has been a leader in shareholder resolutions at companies with policies inconsistent with the Connecticut Treasury's standards on corporate governance issues, which include executive compensation, independence of board members, methods for electing board members, severance benefits for executives and corporate environmental policies.

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