Governance Committee

Administrator Evaluation

Materials were provided by Ron O'Keefe by email on April 15, 2010 to all qualified Directors for discussion during Executive Session. Please insert them here.

EXCERPTS FROM SEC DISCUSSION OF AMENDMENTS TO RULE 33-9089 PROXY STATEMENT REQUIREMENTS

C. New Disclosure about Board Leadership Structure and the Board's Role in Risk Oversight

We proposed a new disclosure requirement to Item 407 of Regulation S-K and a corresponding amendment to Item 7 of Schedule 14A to require disclosure of the company's leadership structure and why the company believes it is the most appropriate structure for it at the time of the filing. The proposal also required disclosure about the board's role in the company's risk management process. We are adopting the proposals with some changes.

1. Proposed Amendments

Under the proposed amendments, companies would be required to disclose their leadership structure and the reasons why they believe that it is an appropriate structure for the company. As part of this proposed disclosure, companies would be required to disclose whether and why they have chosen to combine or separate the principal executive officer and board chair positions. In addition, in some companies the role of principal executive officer and board chairman are combined, and a lead independent director is designated to chair meetings of the independent directors. For these companies, the proposed amendments would require disclosure of whether and why the company has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company. In proposing this requirement, we noted that different leadership structures may be suitable for different companies depending on factors such as the size of a company, the nature of a company's business, or internal control considerations, among other things. Irrespective of the type of leadership structure selected by a company, the proposed requirements were intended to provide investors with insights about why the company has chosen that particular leadership structure.

We also proposed to require additional disclosure in proxy and information statements about the board's role in the company's risk management process. Disclosure about the board's approach to risk oversight might address questions such as whether the persons who oversee risk management report directly to the board as whole, to a committee, such as the audit committee, or to one of the other standing committees of the board; and whether and how the board, or board committee, monitors risk.

We also proposed that funds provide the new Item 407 disclosure about leadership structure and the board's role in the risk management process in proxy and information statements and similar disclosure as part of registration statements on Forms N-1A, N-2 and N-3. The proposed amendments were tailored to require that a fund disclose whether the board chair is an "interested person" of the fund, as defined in Section 2(a)(19) of the Investment Company Act. We proposed that if the board chair is an interested person, a fund would be required to disclose whether it has a lead independent director and what specific role the lead independent director plays in the leadership of the fund.

2. Comments on the Proposed Amendments

Comments were mostly supportive of the proposals.[120] Commenters believed the disclosure regarding a company's leadership structure and the board's role in risk management

[120] See, e.g., letters from AFL-CIO, Chairmen's Forum, Calvert, CII, CalSTRS, the General Board of Pension and Health Benefits of the United Methodist Church, Hermes, Norges Bank, Pfizer, RiskMetrics, and SEIU.

process would provide useful information to investors and improve investor understanding of the role of the board in a company's risk management practices.[121] Some commenters opposed the disclosures. Many of these commenters believed that the proposed amendments were too vague and would likely elicit boilerplate descriptions of a company's management hierarchy and risk management that would not provide significant insight or meaning to investors.[122]

Many commenters suggested revisions to the proposed disclosure requirements. For instance, several commenters recommended that we use the phrase "board leadership structure" rather than "company leadership structure" and noted that the discussion of the board leadership structure and the board's role in risk management are two separate disclosure items.[123] These commenters believed that the use of the phrase "company leadership structure" could be misinterpreted to require a discussion of a company's management leadership structures. Other commenters suggested that we replace the phrase "risk management" with "risk oversight" because the board's role is to oversee management, which is responsible for the day-to-day issues of risk management.[124]

Several commenters believed disclosure of the board's role in risk management would be more effective as part of a comprehensive discussion of a company's risk management processes, rather than as stand-alone disclosure.[125] They suggested that companies be allowed to provide the required disclosure in the MD&A discussion included in the Form l0-K, and to incorporate

[121] See, e.g., letters from CII, the General Board of Pension and Health Benefits of the United Methodist Church, IGS, and RIMS. [122] See, e.g., letters from Cleary Gottlieb, S&C and Theragenics. [123] See, e.g., letters from Business Roundtable and Honeywell. [124] See, e.g., letters from GovernanceMetrics and PLC. [125] See, e.g., letters from ABA and JPMorgan.

by reference this information in the proxy statement rather than repeat the information.

With respect to funds, commenters addressing the issue generally supported the proposal that funds disclose whether the board chair is an "interested person" as defined under the Investment Company Act.[126] In addition, commenters noted the importance of fund board oversight of risk management,[127] but commenters were split regarding whether we should require disclosure about fund board oversight of risk management.[128]

3. Final Rule

After consideration of the comments, we are adopting the proposals substantially as proposed with a few technical revisions in response to comments. We believe that, in making voting and investment decisions, investors should be provided with meaningful information about the corporate governance practices of companies.[129] As we noted in the Proposing Release, one important aspect of a company's corporate governance practices is its board's leadership structure. Disclosure of a company's board leadership structure and the reasons the company believes that its board leadership structure is appropriate will increase the transparency for investors as to how the board functions.

As stated above, the amendments were designed to provide shareholders with disclosure of, and the reasons for, the leadership structure of a company's board concerning the principal

[126] See, e.g., letters from Independent Directors Council ("IDC") and Mutual Fund Directors Forum ("MFDF").

[127] See, e.g., letters from IDC and MFDF.

[128] See letters from Calvert and MFDF (supporting disclosure). But see letters from the Investment Company Institute and IDC (opposing disclosure).

[129] See, e.g., National Association of Corporate Directors, Key Agreed Principles to Strengthen Corporate Governance for U.S. Publicly Traded Companies, (Mar. 2009) ("Every board should explain, in proxy materials and other communications with shareholders, why the governance structures and practices it has developed are best suited to the company.").

executive officer, the board chairman position and, where applicable, the lead independent director position. We agree with commenters that the phrase "board leadership structure" instead of "company leadership structure" would avoid potential misunderstanding that the amendments require a discussion of the structure of a company's management leadership.[130] We also agree with commenters that the phrase "risk oversight" instead of "risk management" would be more appropriate in describing the board's responsibilities in this area.[131]

Under the amendments, a company is required to disclose whether and why it has chosen to combine or separate the principal executive officer and board chairman positions, and the reasons why the company believes that this board leadership structure is the most appropriate structure for the company at the time of the filing. In addition, in some companies the role of principal executive officer and board chairman are combined, and a lead independent director is designated to chair meetings of the independent directors. In these circumstances, the amendments will require disclosure of whether and why the company has a lead independent director, as well as the specific role the lead independent director plays in the leadership of the company. As we previously stated in the Proposing Release, these amendments are intended to provide investors with more transparency about the company's corporate governance, but are not intended to influence a company's decision regarding its board leadership structure.

The final rules also require companies to describe the board's role in the oversight of risk. We were persuaded by commenters who noted that risk oversight is a key competence of the board, and that additional disclosures would improve investor and shareholder understanding of

[130] See letter from Honeywell. [131] See, e.g., letters from Ameriprise Financial and Protective Life Corporation.

the role of the board in the organization's risk management practices.[132] Companies face a variety of risks, including credit risk, liquidity risk, and operational risk. As we noted in the Proposing Release, similar to disclosure about the leadership structure of a board, disclosure about the board's involvement in the oversight of the risk management process should provide important information to investors about how a company perceives the role of its board and the relationship between the board and senior management in managing the material risks facing the company. This disclosure requirement gives companies the flexibility to describe how the board administers its risk oversight function, such as through the whole board, or through a separate risk committee or the audit committee, for example. Where relevant, companies may want to address whether the individuals who supervise the day-to-day risk management responsibilities report directly to the board as a whole or to a board committee or how the board or committee otherwise receives information from such individuals.

The final rules also require funds to provide disclosure about the board's role in risk oversight. Funds face a number of risks, including investment risk, compliance, and valuation; and we agree with commenters who favored disclosure of board risk oversight by funds.[133] As with corporate issuers, we believe that additional disclosures would improve investor understanding of the role of the board in the fund's risk management practices. Furthermore, the disclosure should provide important information to investors about how a fund perceives the role of its board and the relationship between the board and its advisor in managing material risks facing the fund.

[132] See, e.g., letters from Norges Bank and RIMS.

[133] See letters from Calvert and MFDF.

Who's Minding Risk?

Some experts say audit committees take on too many risk-management duties. The SEC's new proxy-disclosure rule should shed more light on the issue.

Sarah Johnson - CFO.com | US

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Monday-morning quarterbacks pinned the blame for the financial crisis largely on excessive risk taking, particularly at large financial institutions. Subsequent calls for regulatory reform have increasingly included nonfinancial companies and their boards, which critics accuse of having been lax in overseeing risk management. Now, the Securities and Exchange Commission is requiring companies to describe in their proxy statements how the supervision of risk is distributed among their boards and board-level committees. Approved in December and effective on February 28, the rule is part of a package of rules intended to improve disclosures regarding executive compensation that may foster risky behavior.

By prompting companies to define their board members' responsibilities for overseeing risk, the disclosure could reveal inefficiencies. You could have a situation where the compensation committee, the audit committee, and potentially a risk committee are all addressing similar areas related to risk, says Mark Plichta, a partner at Foley & Lardner. "[Board members] need to understand the boundaries of who is doing what. There are a lot of gray areas and areas for overlap."
But the disclosure could also show, as a recent survey suggests, that some companies delegate responsibility for overall risk management to the audit committee. That duty, some experts maintain, should be reserved for the board of directors.

Because audit committees tend to straddle the line between overseeing financial-risk management and process, they are sometimes pressed to look at other types of risks as well. (The New York Stock Exchange requires listed companies' audit committees to periodically review the processes for handling risk exposures.) According to a survey of board members and senior executives by KPMG's Audit Committee Institute, 18% of audit committees are primarily responsible for overseeing strategic risk, and 58% oversee IT security and privacy risks.

That kind of data may be troubling to those who believe a broad overview of risk should remain in the board of directors' purview. "There's been some confusion about the role of the audit committees that is sorting itself out," says J. Michael Cook, a former chairman and CEO of Deloitte & Touche who has served on various audit committees and currently chairs Comcast's audit committee. "The audit

committee's reason for existing is to address one very significant enterprise risk: that you will issue inaccurate, or misleading, or fraudulent financial statements." Corporate-governance experts say the perception that audit committees have specialized expertise and knowledge has turned them into a dumping ground for risk-oversight responsibilities. "There is a tendency at a lot of boards to make the audit committee a repository of governance issues," said Alan Beller, a partner at Cleary Gottlieb Steen & Hamilton and former director of the SEC's Division of Corporation Finance, at a recent conference for corporate attorneys sponsored by the Practising Law Institute.

Some of that push-down appears to come from third parties, such as politicians and media outlets, say observers. "It's easy to theorize what should be done in the governance world, but until you have to sit down and do these things, you don't really have to deal with the impracticalities of some of these suggestions," says Cook.

To be sure, directors themselves are torn about how best to allocate the supervision of risk management. In interviews with board members, Jay Lorsch, a human-relations professor at Harvard Business School, encountered disagreement over who should be responsible for risk management. At least one director told Lorsch that all risks, including broad business risks, should fall under the audit committee's umbrella. "Some people believe that [overseeing] risk management [is] the job of the CEO and the management team, and others say the boards should be worried about that but not the audit committee," says Lorsch. "Then others thought it was a natural thing for the audit committee to do."

What's largely agreed on is that audit committees will be preoccupied with risk this year. Charles Noski, a former CFO at AT&T who sits on four boards and chairs the audit committees at Microsoft and Morgan Stanley, says he found consensus among participants at a recent audit-committee conference that "risk management [is] probably the number-one issue and number-one topic that will be addressed by audit committees in 2010."

The financial crisis, notes Noski, "heightened the level of interest and time that is being devoted to the topic." Audit committees have moved on from the complexities of the first few years of Sarbanes-Oxley implementation and are shifting part of their focus to the broader business-risk issues facing the enterprise, he says.

At Fortune Brands, a consumer-brands company, CFO Craig Omtvedt says he will discuss with his audit committee this week various issues surrounding the company's risk-management program, including how risks are identified and reviewed. The company was one of the first to file a proxy statement under the new disclosure rules.

In its latest proxy statement, Fortune Brands explained that its board is responsible for overseeing the company's management of risk, and its individual committees manage risks within their respective areas. The audit committee oversees the management of financial risks and keeps tabs on the company's overall risk-management program from a process standpoint, Omtvedt says.

Omtvedt doesn't object to the new disclosure rule. "It's reasonable to request that people take more time and be more formal in communicating how they deal with risks that are inherent to their business," he says. What's more, the rule may aid companies in deflecting calls for more-serious reforms of corporate risk-management policies. For instance, a provision in a shareholder-rights bill, introduced by Sen. Charles Schumer (D-N.Y.) last spring, would have required large companies to establish risk committees. Now, the bill appears unlikely to get past the committee stage.

12-Month Governance Committee Calendar

Date	April 2010	NOTES
4/29/2010	1. Launch Administrator Review	
	2. New SEC rule: Board's Role in Risk Oversight	
Date	**May 2010**	
5/27/2010	1. Launch Board and Committee Self-assessment	
	2. Governance Guideline change: catastrophic coverage policy approval process subject to follow-up approval of financial commitment by Board and Audit Committee chairs.	
	3. Membership for Governance and Medical Services & Safety Committees	
Date	**June 2010**	
6/17/2010	1. Finalize Board and Committee Self-assessment	
	2. Committee membership recommendations	
	3. Develop Education Plan	
	4. Administrator's Objectives for FY 11	
Date	**July 2010**	
7/29/2010		
Date	**August 2010**	
8/26/2010		
Date	**September 2010**	
9/23/2010	1. Governance Guidelines (1st read)	
	2. Committee Charters (1st read)	
Date	**October 2010**	
10/21/2010		
Date	**November 2010**	
11/18/2010	1. Governance Guidelines (2nd read)	
	2. Committee Charters (2nd read)	
Date	**December 2010**	
12/15/2010		
	2011 Tentative Agenda Topics	
Date	**January 2011**	
TBD	1. Administrator Performance Review and Action Items to date	
	2. Board Self-assessment and Action Items to date	

12-Month Governance Committee Calendar

Date	February 2011	NOTES
TBD		
Date	**March 2011**	
TBD		
Date	**April 2011**	
TBD	1. Launch Administrator Review	
Date	**May 2011**	
TBD	1. Launch Board and Committee Self-assessment	
Date	**June 2011**	
TBD	1. Finalize Board and Committee Self-assessment	
	2. Committee membership recommendations	
	3. Develop Education Plan	
	4. Administrator's Objectives for FY 12	