Study finds surge in director pay following Sarbanes-Oxley Act

By Sam Fahmy *(BS '97)*

A new study co-authored by Terry finance professors Jeff Netter and Jim Linck and former doctoral student Tina Yang finds that the landmark Sarbanes-Oxley Act of 2002 — as well as related rule changes at major stock exchanges — have dramatically altered the makeup of corporate boards, making them larger and more independent. The legislation also had the unintended effect of increasing director pay by 54 percent.

"Post Sarbanes-Oxley, the demand for directors is up and the supply is down because the job is harder," says Netter. "So what do you find? Pay is up — way up."

The Sarbanes-Oxley Act was passed with near unanimous congressional approval following scandals that brought down companies such as Enron and WorldCom. In conjunction with changes imposed by NYSE and Nasdaq, the act sought to enhance corporate governance by promoting board independence and imposing greater responsibility and accountability on board members.

In their paper, the authors label Sarbanes-Oxley "the most dramatic change to securities laws regulating corporate governance since the Great Depression." Previous laws set disclosure requirements, they explain, but Sarbanes-Oxley sets specific rules for how corporations should be governed.

To gauge the impact of the law, the researchers examined data on more than 8,000 firms of various sizes from 1989-2005. Median pay per director rose from $52,495 in 2001 to $80,646 in 2004, an increase of more than 50 percent. Data also showed that higher costs of director pay are disproportionately borne by small firms; they paid $3.19 in director fees per $1,000 of net sales in 2004, which is 81 cents per $1,000 more than they paid in 2001. Large firms, on the other hand, paid 32 cents in director fees per $1,000 of net sales, a mere seven cents more than in 2001.

Director workload also increased in the aftermath of SOX. Audit committees met roughly twice as often, from an average of 2.6 meetings per year for small firms in 2001 to 5.1 meetings per year in 2004. Audit committees of large firms met 4.5 times per year in 2001 versus 8.2 times in 2004.

Under Sarbanes-Oxley, corporate directors now face more legal liability for corporate malfeasance, and their director and officer insurance premiums have increased sharply as a consequence. In a sample of firms incorporated in New York, D&O premiums rose from a median of $143,000 in 2001 to $360,000 in 2004, an increase of 152 percent. For a sample of S&P 500 firms, D&O premiums rose from $826,000 in 2001 to $3.0 million in 2004, an increase of more than 264 percent.

"Members of the audit committee must work harder post-SOX and are much more accountable," says Linck. "Some firms even pay additional fees to members of the audit committee, which was rare before SOX."

Linck and Netter acknowledge that the changes in director pay and board makeup weren't caused by SOX alone. The legislation coincided with a large drop in stock prices, the start of a recession, and a series of corporate scandals. Sarbanes-Oxley coincided with rule changes at the NYSE and Nasdaq. But the authors see SOX as a turning point, and their data supports the idea that firms are making substantial changes in response to it.

The researchers say the question of whether Sarbanes-Oxley has improved corporate performance or reduced malfeasance is beyond the scope of their study. Data suggests that more companies went private after Sarbanes-Oxley and more went dark, meaning they filed paperwork with the SEC that allows them to function as a private company. The authors note that foreign companies appear to be shifting their fundraising from the U.S. to other nations.

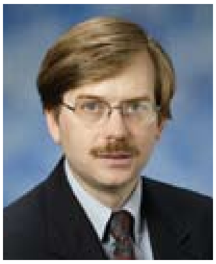
"As recently as 2000, nine out of every 10 dollars raised by foreign companies through equity offerings were raised in New York instead of London or Luxembourg," says Linck. "However, the reverse is true by 2005. That's a pretty major shift in terms of where firms are going public, and a lot of people argue that it's because it has become so expensive to be public in the U.S." ■

Sam Fahmy (BS '97) is a science writer in the UGA News Service.

Federal charters could save life insurers $5.7 billion annually

By Kent Hannon

The American Council of Life Insurers recently contracted with Steven Pottier, a Terry College professor of risk management and insurance, to conduct a research study related to the proposed Optional Federal Charter, which is an offshoot of the National Insurance Act of 2006. If implemented, OFC would issue federal charters and licenses to insurers that currently must obtain a license for each state where they do business — or form a separate company that is domiciled and licensed in each state where they do business.



POTTIER

Pottier's assignment was to determine whether the proposed federal system would be more efficient and cost effective than the current system wherein multi-state insurers face multiple regulatory bodies and multiple sets of regulations. Under the proposed OFC, an Office of National Insurance would be established to issue federal charters and licenses to insurers, with the goal of providing financial relief from the multi-state licensing scenario that currently exists.

The study provides results on 284 life insurance entities with combined assets of $3.8 trillion. Of those 284, 74 are national insurers licensed in every state and the District of Columbia.

"The principal findings suggest that a life insurer's cost efficiency declines significantly as the number of states licensed or domiciled increases — but increases with the insurer's size," says Pottier. "Based on parameter estimates from cost efficiency regressions, the potential savings related to a 'single regulator' — similar to what would be the case under the proposed Optional Federal Charter — exceed $5.7 billion, about 1.25 percent of net premiums annually."

Pottier notes that the current regulatory financial reporting system does not specifically identify or separate regulatory compliance costs from other costs that might be inherent to expansion into new states. He also notes that this study did not attempt to estimate other potential benefits of the Optional Federal Charter, such as increased competition and improved speed bringing new products to market.

In an interview with *Dow Jones Newswire*, Pottier echoed industry claims that cost savings would be passed along to customers. "Just like they are passing the additional (regulatory) costs along (now)," said Pottier, "in a competitive environment they would be able to pass along cost savings to consumers."

Not surprisingly, given Pottier's $5.7 billion savings figure, large multi-state insurers hailed the study's findings.

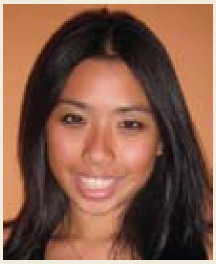
"Dr. Pottier's thorough analysis reinforces what we have said all along, which is that consumers would be the true beneficiaries of an optional federal charter system for insurers," said Frank Keating of the American Council of Life Insurers, which represents national companies like Prudential and State Farm. OFC was included as part of the National Insurance Act of 2007 co-sponsored this past May by Sen. John Sununu (R-N.H.) and Sen. Tim Johnson (D-S.D.).

"If approved by Congress," says Pottier, "OFC will probably be the most substantive change in insurer regulation in more than 60 years." ■

CURO enables Terry students to pursue research interests

Twenty-seven UGA undergraduates are spending the summer investigating local, national, and international research topics. These students are participants in the summer research fellowship program sponsored by UGA's Center for Undergraduate Research Opportunities (CURO), and Terry students Karen Wong and Jessica Van Parys are among them.

Wong, a rising senior international business major from Wilmington, Del., says her participation in CURO for the last two years has led her to pursue research that not only complements her major, but also delves more deeply into her other interests such as philanthropy and business.



WONG

Under the guidance of Andrew Whitford, a professor of public administration and policy, Wong is investigating possible foundations for environmental sustainability as measured across countries with varying social, economic, political and geographic characteristics. She hopes her paper will be published in *Political Research Quarterly*, a peer-reviewed political science journal.

Wong also will be working on finishing a second paper about global transfer pricing policy practices, which refers to the pricing of goods and services among divisions of multi-national corporations. She and Whitford presented the first draft of that paper at the Midwest Political Science Association meeting in Chicago in the spring.

VAN PARYS

"I think the summer fellows program will be an incredibly positive experience," says Wong, who would like to pursue an MBA in the future. "By having research as my main focus this summer, Dr. Whitford and I can achieve our research goals and I can gain an in-depth understanding of global business regulation."

Van Parys, a rising senior in the Honors Program, is a double major in political science and economics from Suwanee. Her faculty mentor is Terry College economics professor David Mustard, and she is investigating whether scores on the new writing section of the Scholastic Aptitude Test accurately predict academic success of incoming college freshman. She hopes to present her findings at both the CURO symposium and at an education policy conference in spring 2008. After graduation, she hopes to pursue a Ph.D. in either public policy or economics. Her CURO summer research fellowship is funded by the UGA Alumni Association. ■

— Joelle Walls (MMC '01)

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