

## Investors Can Make Governance Bet On S&P 500-Based Index

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NEW YORK (Dow Jones)--Investors who've long wondered about the financial value of top-notch corporate governance now have a chance to play guinea pig.

Later this year, fund managers and pension plan sponsors will be able to plow their money into a custom-designed version of the Standard & Poor's 500, dubbed the Shareholder Rights Index. The creators of the index reckon that by leaning towards shareholder-friendly companies and lightening up on governance laggards, the returns should be better.

"There's good evidence and reason to believe - and intuition would certainly suggest - that good governance will improve returns over the medium and long terms," said Gregory Taxin, chief executive of Glass, Lewis & Co, a San Francisco proxy advisory firm.

The firm developed the index in collaboration with Harvard law and economics professor Lucian Bebchuk, director of the law school's corporate governance program.

Bebchuk and two fellow researchers carried out a study scoring companies based on whether they embraced any of six corporate governance provisions considered management-entrenching and limiting shareholders' power to make changes.

Among the arrangements are anti-takeover provisions, such as poison pills and staggered three-year board terms - where only a third of the board stands for election each year - weakening shareholders' ability to replace a board in one fell swoop. Other so-called constitutional limits folded into the "entrenchment" score include prohibiting shareholders from amending a company's bylaws and requiring a supermajority, or a high percentage of votes, to approve mergers or amend a corporate charter.

The trio found that from 1990 through 2003, the companies with low scores created more shareholder value than the "entrenched" companies.

In constructing the Shareholder Rights Index, geared for launch in December, Glass Lewis tested those conclusions on the S&P 500 over that same 13 year period by applying heavier weightings to companies which embraced shareholder rights and lowering the weightings of the highly "entrenched" companies. Taxin found this hypothetical index would have outperformed the S&P 500.

S&P, which was hired by Glass Lewis to help calculate the index, is in the process of verifying those results.

## When Is Governance Good?

Corporate governance does figure in some broader indexes, but the Shareholder Rights Index is believed to be the first investable product based solely on governance practices, Taxin said.

The Dow Jones Sustainability Index, for example, includes governance as only one of numerous economic, environmental and social criteria. The DJSI originated as a joint venture between Dow Jones & Co (DJ) and the Sustainable Asset Management Group in Zurich. Dow Jones, which publishes this newswire, no longer has an ownership interest, but licenses the name and helps produce and disseminate the index.

Despite the rush to overhaul companies' governance practices in the wake of the collapse of Enron Corp. (ENRNQ) and other financial scandals, there hasn't been a universal meeting of corporate and academic minds about a direct link between governance and corporate performance.

For one thing, not all studies even agree about what constitutes good governance. So, researchers have isolated different practices and policies, while at the same time examining varying samples and time periods.

A recently published working paper by three accounting professors at the University of Pennsylvania's Wharton School, for example, found scant evidence that a long list of governance factors had a substantive impact on valuation, managerial decisions, class-action lawsuits or restatements.

"I think it's going to be really hard to just look at external data to form an index that's going to be predictive," said Wharton accounting professor David Larcker, one of the study's authors. He questioned whether it was premature to draw commercial applications from current governance research.

Taxin stands by Bebchuk's results, which unlike the Wharton paper, zeroed in on a narrower set of governance practices.

But he acknowledges there's no sure bet: "We have attempted to use the best academic research available to construct an index that will perform better than the S&P 500 by relying on good governance," he said, "But there can be no guarantee that this index would identify the next Enron or in fact that it will outperform the S&P."

Several funds said they would need to take a closer look at the strategy before jumping in.

At the State of Wisconsin Investment Board, which manages \$63 billion of state and local public employee retirement assets, it would fall to investment strategists and portfolio managers to examine the viability of the index, and whether it's a good fit with the fund's strategy, said spokeswoman Vicki Hearing.

But given SWIB's focus on governance, interest appears to be piqued. "It certainly opens up a new dimension," she said. "We are always looking at ways to find added value for our investors. If this would be one of those ways, we would consider it."

The governance data will be updated twice yearly and index weightings as often as the S&P 500 is rebalanced, typically quarterly, Taxin said. Institutions wanting to mimic the index will pay a licensing fee, based on the amount of money invested.

S&P - through its Custom Index Solutions group created earlier this year - will handle the nuts and bolts calculations. But other than being hired by Glass Lewis to serve as a calculation agent, S&P has no other role in the product and isn't endorsing the index, Kevin Shafkowitz, the group's manager stressed, though S&P will receive a percentage of the licensing fees as well.