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Turning the Tables: RiskMetrics's Head Faces His Day of Shareholder Judgment

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Ethan Berman runs RiskMetrics Group Inc., which makes money by judging others. Now, the chief executive is preparing to be judged himself.

RiskMetrics owns ISS Governance Services, which exerts tremendous clout in advising institutional investors on proxy fights, director elections and shareholder resolutions. Critics say ISS judges firms on criteria best understood by buying its consulting services.

Following its January initial public offering of stock, New York-based RiskMetrics has public shareholders of its own. Those investors will meet for the first time Wednesday, and some may complain that RiskMetrics doesn't meet its own standards for corporate governance. "I am a little bit worried," Mr. Berman admits. A reputation for good governance is "crucial to the success of the company."



Ethan Berman

The biggest concerns: Mr. Berman's dual roles as CEO and chairman as well as RiskMetrics' heavy reliance on subjective factors, such as "exemplifying our corporate values," in paying top executives other than Mr. Berman. ISS generally favors separating the chairman and CEO roles and encourages companies to judge executives by objective factors, such as financial results and share performance.

"RiskMetrics is taking positions on several governance issues that are at odds with what it recommends for other public companies," says Cary Klafter, corporate secretary at chip maker Intel Corp. "Many business leaders would consider all this to be a bit ironic."

This week's meeting will be a new experience for Mr. Berman. The 46-year-old playwright-turned-bond-trader has never attended a shareholder meeting of a public company.

Mr. Berman has led RiskMetrics since its 1998 spinoff from J.P. Morgan and has long favored freewheeling transparency. For years, he convened staffers every Friday to share financial results and seek consensus about key decisions.

In preparing for the IPO, he promised shareholders similar transparency and unusual access to inner workings. The company will let investors cast an advisory vote on executive pay, approve the CEO's 2008 compensation objectives and easily nominate board members. Its proxy statement divulges the 24 ratings from Mr. Berman's 2007 performance review; directors rated him 2.5 on a

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one-to-five scale for expanding client relationships, for example.

In other ways though, Mr. Berman has found it hard to live up to his ideals while running a public company. For a road show last winter, he drafted a slide that described RiskMetrics' flat hierarchy, lack of internal titles, employees' sizable stock ownership, entrepreneurial environment and annual "fun day." He also intended to disclose specific earnings and revenue targets for 2008.

Outside investment bankers and lawyers nixed the ideas. "I have never caved in on more issues in 10 years," Mr. Berman lamented in late December, slamming a conference table.

In September, he stopped divulging financial figures during companywide meetings -- and began scrutinizing regulatory filings before signing them. He asks his executive assistant to put pink stickers on forms covering "something I could go to jail for." A 2002 corporate-reform law imposes severe penalties if high-level executives sign false financial statements.

Mr. Berman signed a November prospectus where he and eight fellow directors pledged to strip his chairman's title soon after RiskMetrics went public. After the IPO, Mr. Berman urged the board to divide the roles this spring. But the other directors wanted to defer the split until at least next year.

"We have performed well historically with Ethan as chairman and CEO," says Christopher Mitchell, a board member and managing director of Spectrum Equity Investors, which holds a 17.9% stake in RiskMetrics. The firm posted a 20% rise in first-quarter net income. Its shares, which went public at \$17.50, are at \$20.73 on the New York Stock Exchange.

Mr. Berman then asked the board to publicly commit to dividing his roles by 2009. But on April 3, its nominating and corporate-governance committee rejected that alternative, too.

That irks Robert A.G. Monks, a veteran corporate-governance activist and founder of ISS who is an old friend of Mr. Berman's father.

The refusal of RiskMetrics directors to endorse naming an independent chairman within a year "is a very serious matter [because] this is a company with vast impact," Mr. Monks says. He owns 15,770 RiskMetrics shares through his stake in ISS, and says he may attend the annual meeting.

"The right chairman would add enormously to the value of the enterprise," he says.

RiskMetrics' criteria for paying executives also are drawing flak. Egan-Jones Proxy Services, an ISS rival, suggests that shareholders reject a resolution endorsing management's pay philosophy because annual bonuses for top officers besides Mr. Berman largely reflect subjective factors.

In its proxy, RiskMetrics directors said they "believe no other company knows how to compensate our people better than do we." That attitude bothers some corporate executives. "I have never seen this kind of holier-than-thou approach to executive compensation," says Karl Barnickol, a retired general counsel and corporate secretary for chemical company Solutia Inc. who is now a partner at Husch Blackwell Sanders, a law firm in St. Louis.

"The company has clearly lived up to its responsibility about being transparent," replies Mr. Mitchell, a member of the board's compensation committee.

Mr. Berman also has been trying to mollify ISS's corporate critics, who say its governance guidelines are vague and encourage companies to buy its consulting services. It is a "heads-you-lose, tails-you-lose kind of environment," says David Hirschmann, a senior vice president of the U.S. Chamber of Commerce.

So far, though, Mr. Berman's efforts have produced mixed results. An advisory council mainly formed to air corporate complaints about ISS has met only twice, with little effect.

The slow start irked director Arthur Levitt, a former Securities and Exchange Commission chairman who championed the panel's formation. Mr. Levitt calls a protracted effort to expand its size and mission "unnecessarily bureaucratic," though things now seem to be "on the right track."

Mr. Hirschmann remains unconvinced. "We do expect a lot more transparency, fairness and clarity around how they set their policies," he says.

When Mr. Berman takes the annual-meeting dais, he will read scripted replies to anticipated questions about RiskMetrics' governance, such as his dual role.

"I feel awkward having to give a prepared answer about the separate chairmanship, especially since I can't commit RiskMetrics to a firm date for a split," he says.

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