zEthics

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U.S. Securities and Exchange Commission
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Washington, DC 20549

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DODD-FRANK ACT
Title IX Investor Protections
Subtitle G—Strengthening Corporate Governance
SEC. 971. PROXY ACCESS

Inclusion of a standard measure for corporate culture in proxy solicitation materials to give shareholders a better understanding of risks specific to the company and its operations

I am writing on behalf of zEthics, Inc. and the Business Integrity Alliance. The Business Integrity Alliance is one of eleven (11) firms selected to participate in the California Public Employees' Retirement System (CalPERS) Corporate Governance Research Spring-Fed Pool.

The zEthics technology platform provides a structured process for employees to anonymously disclose comprehensive and timely information about the impact on soft controls that are essential to manage the corporate culture. In addition, the zEthics technology platform provides the corporate entity an opportunity to take corrective actions and implement preventative measures to remedy non-conformances with the company's mission, goals, strategies, and objectives.

The Corporate Culture Index is an innovative new tool that measures the integrity of the corporate culture, verifies the tone-at-the-top, and protects shareholders and stakeholders by providing an early warning against corruption, fraud and management misconduct. The Corporate Culture Index provides a quantitative tool to measure the tone of the corporate culture at the Company level, Business Unit level, and Management level.

The zEthics corporate culture surveys and reports provide the organization the knowledge and power to validate and continually improve the integrity of the most important part of the internal control system – the people.

PROPOSED RULE/REGULATION

In the interests of shareholders and for the protection of investors, the Commission is requested to adopt a standard measure of an issuer's corporate culture to be included in proxy solicitation materials, as it allows shareholders to better understand risks specific to the company and its operations.

SUPPORTING ARGUMENT

Corporate culture is a profound driver of any business. Leadership and corporate culture excellence are essential to company performance and organizational well being. The "tone at the top" shapes corporate culture and pervades a company's internal and external relationships.

All the soft controls in an organization together constitute its corporate culture. The corporate culture will drive the success or failure of an issuer as the corporate culture is the most powerful control in any organization. It influences every employee's behavior.

Evaluating soft controls — tone at the top, the organization's ethical climate, and management's philosophy and operating style — and reporting weaknesses to those accountable is perhaps the greatest challenge faced by an issuer.

Evaluating the soft controls makes it possible for representatives from the legal, finance, and investor-relations departments to specifically quantify the various risks affecting their company, their potential impact, and whether that impact warrants disclosure. Including a standard measure of the issuer's corporate culture in proxy solicitation materials makes it possible for shareholders to better understand risks specific to the company and its operations.

Jonathan F. Foster, managing director of Current Capital, explains that while splitting the leadership of a company and its board generally improves governance, the quality of the people is the key factor for success. "The reality is that even the worthiest regulatory fixes and policy enhancements are not nearly as significant as the quality of the people involved."

Monitoring the soft controls is necessary to provide 1) an early warning of problems; 2) extended visibility into the organization to correct problems; and, 3) serve as a check and balance to ensure that the organization is optimized to drive business returns with integrity, transparency, accountability and comprehensive risk oversight.

Shareholders and investors want to know where the high risks are. All stakeholders want assurance that the issuer will not be the next highly publicized failure. To give them that assurance, the issuer must identify the potential causes of such failures: weaknesses in the corporate culture.

In a recent study, Sean Griffith and Tom Baker examined how liability insurers transmit and transform the content of corporate and securities law. The findings suggest that what matters in corporate governance are deep governance variables such as culture and character, rather than the formal governance structures that are typically studied.

Adopting a standard measure for corporate culture addresses current shortcomings in the marketplace for stakeholder due diligence, including:

1) Credit rating agencies that evaluate a company's creditworthiness
    a. Ratings have proven to be unreliable
    b. Ratings are impossible to measure
2) Outside auditors who provide independent assurance that the company's financial condition is portrayed fairly
    a. The audit report — which is the sole communication between auditors and investors on a particular company — explain the auditors' role and their limitations in finding fraud
    b. The disclosure of financial problems tends to come after the fact
    c. Auditors don't examine every transaction and event, so there is no guarantee that all material misstatements, whether caused by error or fraud, will be detected
3) Securities analysts who assess the company's business prospects are not independent
    a. Loyal to investment banks that are allowed to trade ahead of the rest of the market
    b. Have proven to be unreliable, biased and sometimes misleading
4) According to Chairman Mary Schapiro, "Both companies and investors have raised concerns that proxy advisory firms may be subject to undisclosed conflicts of interest, may fail to conduct adequate research or may base recommendations on erroneous or incomplete facts."

In the issuer's boardroom there can be problems when there is an apparent disconnect between strategy and risk. Most of the key risk factors impacting a company relate to the company's strategy. Yet many directors seem not to fully understand the strategy, nor have they been engaged in strategy development and review in a way that would give them a good understanding of some of the risks that may emanate from that strategy. Notably, in the 2009 NACD public company governance study, strategic planning and oversight was rated the top issue of importance to board governance, yet less than 20% of respondents ranked their boards as highly effective in this area.

It is apparent to most experts that the internal audit method of managing risk failed on a colossal scale. The rating agencies are amending their processes to ensure that risk management is being practiced enterprise wide, and that boards have a fiduciary responsibility to ensure that the issuer has a risk management identification and mitigation program in place.

The board has a responsibility to serve as "keeper" of the corporate culture — which is increasingly critical as a board duty — and it must ensure the right culture for its management to operate in. A lax culture permits employees to take myriad shortcuts and unacceptable risks. In practically any corporate scandal that allows malfeasance or misguided judgments to happen, the question arises, "Where was the board?"

The most crucial item for boards to keep in mind is to recognize that there are risks outside the processes, procedures and guidelines that are part of an organizations structure, and it is incumbent upon the board to try to identify and manage those risks. The only practical way to accomplish this is to provide the board access to a standard measure for corporate culture through an independent evaluation of the issuer's soft controls.

COST

The cost of acquiring a standard measure of the corporate culture through an independent evaluation of the issuer's soft controls is not considered burdensome. The cost is estimated to be between $50,000 and $100,000 annually for the majority of issuers, with an estimated rate of return between two (2x) to ten (10x) times through improved economic performance.

CONCLUSION

In the interests of shareholders and for the protection of investors, a standard measure for corporate culture is the single most important disclosure that can be made by issuers. The corporate culture discloses the truth-value of the issuer, and provides stakeholders a level of confidence in the financial disclosures that are audited, and earnings releases that are not audited. Independent monitoring of the soft controls makes it possible to readily identify inappropriate risks that can lead to material financial loss to issuers.

The issuer's boards of directors need to trust but verify what the executive leadership team is doing. Trust is a soft control that constitutes the issuer's corporate culture, along with competence, shared values, leadership, expectations, openness and high ethical standards.

Nell Minow, editor of the Corporate Library, an independent research firm focusing on corporate governance, was quoted recently, "What we have learned from the financial crisis is that boards of directors have failed miserably in their No. 1 task of risk management."

Including a standard measure of the issuer's corporate culture in proxy solicitation materials makes it possible for shareholders to better understand risks specific to the company and its operations.

Shareholders must have a clear understanding of the issuer's corporate culture in order to nominate qualified directors that can interact effectively with other board members to manage risk for the long-term benefit of shareholders. It is clear that the effectiveness of corporate boards will not be measured simply by a regulatory checklist, but by the ability of institutional investors to see evidence of proactive corporate initiatives that improve business performance. Evidence is best gained by a standard measure of corporate culture.

Thank you for considering our comments and your robust, dynamic and transparent approach to regulation. If you would like to discuss any of the following points, please do not hesitate to contact me directly at (602) 358-9586 or Michael Brozzetti at (215)-687-7376.

Yours sincerely,

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Attachments:

A) Dodd Frank Act, Title IX, Subtitle E, Section 956
B) References

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ATTACHMENT A
DODD-FRANK ACT

Subtitle G—Strengthening Corporate Governance
SEC. 971. PROXY ACCESS.
(a) PROXY ACCESS.—Section 14(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78n(a)) is amended—
(1) by inserting ‘‘(1)’’ after ‘‘(a)’’; and
(2) by adding at the end the following: ‘‘(2) The rules and regulations prescribed by the Commission under paragraph (1) may include—
‘‘(A) a requirement that a solicitation of proxy, consent, or authorization by (or on behalf of) an issuer include a nominee submitted by a shareholder to serve on the board of directors of the issuer; and
‘‘(B) a requirement that an issuer follow a certain procedure in relation to a solicitation described in subparagraph (A).’’.
(b) REGULATIONS.—The Commission may issue rules permitting the use by a shareholder of proxy solicitation materials supplied by an issuer of securities for the purpose of nominating individuals to membership on the board of directors of the issuer, under such terms and conditions as the Commission determines are in the interests of shareholders and for the protection of investors.

ATTACHMENT B
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