





Commission Calls for Major Compensation Reforms

Sept. 17, 2002

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The Conference Board's Blue-Ribbon Commission on Public Trust and Private Enterprise today proposed a wide-ranging series of reforms to strengthen corporate compensation practices and restore trust in America's corporations and capital markets.

The twelve person Blue Ribbon Conference Board Commission on Public Trust and Private Enterprise is comprised of major business leaders, major investors, former senior government and regulatory officials as well as a university professor of business ethics. The work of the Commission is supported by the Pew Charitable Trusts.

This report ([download](#)), the first in a series of three reports, focuses on executive compensation. Subsequent reports will deal with reforms on other areas of corporate governance as well as accounting and auditing issues.

The Conference Board Commission on Public Trust and Private Enterprise said, "it shares the anger at the misconduct leading to the breakdown in public trust." Commission Co-Chair Pete Peterson, Chairman of The Blackstone Group, noted the "lack of fairness" of the unprecedented level of executive compensation, particularly the compensation of certain executives, even as their companies and the retirement savings of their employees have collapsed. Co-Chair John W. ... Chairman, CSX Corporation, added, in referring to the malfeasance at Enron, WorldCom and other companies: "these egregious failures evidence a clear breach of the basic contract that underpins corporate capitalism." The Commission proposed wide ranging reforms on executive compensation including:

- Retention and direction of compensation experts by compensation committees - not management.
- Compensation committees setting comp not by ratcheting up industry averages.
- Uniformly expensing stock options.
- Substantial director and top management stock ownership for extended holding periods.
- Avoiding "special purpose entity" comp to executives.
- Greater disclosure of equity dilution and employment agreements.
- Shareholder approval of option repricing.

- Advanced notice of executive stock sales.

Snow emphasized there needs to be a vigorous role for compensation committees. He said: "Compensation Committees of the boards need to act more independently of management, hire their own consultants, and hold executive sessions without management to avoid the potential conflict of interest that can arise when management is making recommendations about its own incentive packages."

'Excessive Use' of Stock Options

Peterson stated: "The excessive use of stock options – especially fixed-price options – was encouraged by the fact that they did not result in a charge to earnings while providing substantial tax deductions. The quantity of such stock options resulted in an enormous incentive to manage companies for short-term stock price gains and the unprecedented bull market led to massive unanticipated gains in options unrelated to management's operating performance." The report declares that: "Executive compensation has become too 'delinked' from long-term performance in many corporations. There is an imbalance between unprecedented levels of executive compensation, with little apparent financial downside risk or relationship of this compensation to long-term company performance."

Four Guiding Compensation Principles

The Committee suggested a series of recommended principles as well as a series of specific practices. The principles include:

1. Focus on a much **tighter linkage between executive operating performance and executive compensation**, rather than simply on the ups and downs of the stock market, which are not closely related to the executive's contribution to the long-term value of the enterprise.
2. Focus on a **fully independent, accountable, and vigorous compensation committee** with the primary responsibility of all aspects of executive compensation including employment, retention, and severance agreements.
3. Focus on **accounting neutrality** so as to avoid bias and favor of any one form of equity compensation, and, at the same time, facilitate comparability of results as between companies.
4. Focus on **full disclosure** of all material information on an understandable and timely basis, in particular, to reassure the public that management is not involved in stock transactions that require advanced knowledge of material information not available to the public at that time.

Recommended Best Practices

1. The Compensation Committee should retain any outside consultants who advise it, and any outside consultants should report solely to the Committee.
2. The Compensation Committee should be unconstrained by industry averages and standards by the company's past compensation practices and levels, which, in certain companies, have been excessive.
3. Stock options should be expensed on a uniform and broadly accepted basis. This will reduce the accounting treatment that makes stock options so desirable to companies at the expense of more performance-oriented forms of compensation including cash, and equity

compensation.

4. Senior management and directors should: 1) be required to own a meaningful amount of company stock on a long-term basis; and 2) be subject to substantial minimum holding periods for equity received as compensation, in each case in order to align the interests of management with those of the corporation. Holding periods for senior executives and directors should generally not be less than the holding periods for other employees.
5. Companies should avoid the use of special purpose entities to compensate or enrich executives.
6. There should be a strengthening of requirements for conspicuous disclosure of all major impacts of stock options and other compensation arrangements, including overall cost-of-living and earnings dilution effects, as well as disclosure of all employment agreements for top executives, including severance arrangements.
7. Shareholders should approve modification of existing equity compensation arrangements, including repricing options or any actions that could dilute their holdings.
8. Executive officers should be required to give advanced public notice of their intention to sell stock.

Commission will Launch New National Effort

The Commission applauded the new Sarbanes-Oxley Act and new stock exchange rules as a way to curb further abuses. The Commission will launch a national effort to encourage corporations and investors to take their own corrective actions by installing a series of recommended best practices that thus avoid additional legislation on executive compensation. As an example of the unintended consequences of such legislation, the Commission pointed to earlier tax legislation and the intention to limit executive pay by disallowing tax deductions in excess of \$1 million. Instead of accomplishing its intended purpose, this legislation contributed to fixed-price options becoming the dominant form of executive compensation.

Members of The Conference Board's Commission on Public Trust and Private Enterprise in

Co-Chairs

- **Peter G. Peterson**, Chairman of The Blackstone Group, former Secretary of Commerce, former Chairman of the Federal Reserve Bank of New York
- **John W. Snow**, Chairman, CSX Corporation and former Chairman, Business Roundtable
- **John H. Biggs**, Chairman, President and CEO, TIAA-CREF
- **John C. Bogle**, Founder and former Chairman, Vanguard Group, Inc.
- **Charles A. Bowsher**, former Comptroller General
- **Peter M. Gilbert**, Chief Investment Officer, State Employees' Retirement System, Commonwealth of Pennsylvania
- **Andrew S. Grove**, Chairman of Intel Corporation
- **Ralph S. Larsen**, former Chairman and CEO of Johnson & Johnson, former Chairman of the Business Council
- **Arthur Levitt Jr.**, former SEC Chairman and former Chairman of the American Business Conference
- Professor **Lynn Sharp Paine**, John G. McLean Professor of Business Administration at Harvard Business School

Business School

- Former Senator **Warren B. Rudman**, Paul, Weiss, Rifkind, Wharton & Garrison
- **Paul A. Volcker**, former Chairman of the Board of Governors, Federal Reserve System

[Download the Commission's first report.](#)

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