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April 10, 2006

The Honorable Christopher Cox
Chairman
Securities and Exchange Commission
Washington, DC 20002

RE: File Number S7-03-06
Executive Compensation and Related Party Disclosure

Dear Chairman Cox:

I commend you and your staff for taking steps to improve the disclosure of executive compensation arrangements and strongly support the proposed rule.

As you know, executive compensation has skyrocketed in recent years. In 1991, the average large-company CEO received approximately 140 times the pay of an average worker; in 2003, the ratio was about 500:1.[1] The amounts have risen so far so fast, that they can no longer be explained by traditional valuations (e.g., even when adjusting for other variables like company size, performance, industry classification, and inflation, studies find executive compensation is far higher today than in the early 1990s).[2]

While these numbers are themselves concerning, they also reflect real costs to shareholders and the economy. In 1993, the aggregate compensation paid to the top five executives of U.S. public companies represented 4.8% of company profits; by 2003 the ratio had more than doubled to 10.3% and the total amount paid to these executives during this period is roughly $290 billion.[3]

Although this amount alone concerns many, as a policy maker I am particularly concerned over the perverse incentives created by this system. For example, by tying compensation to short term results or "wall street expectations" some compensation schemes may actually encourage executives to shirk their fiduciary duty to shareholders by managing earnings or engaging in unprofitable mergers. In what seems a strange irony, in some cases it appears that shareholders are unintentionally paying executives to manipulate financial results and undermine the company's long-term profitability. Unfortunately, the story only gets worse as it unfolds: when problems are found and

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[1] Lucian Bebchuk, Pay Without Performance (2004).
[2] Lucian Bebchuk and Yaniv Grinstein, "The Growth in Executive Pay" (Discussion Draft, 2005) (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=648682).
[3] Id.

senior executives resign, the executives often receive *additional* compensation. Pay for performance has, in some cases turned into pay for failure.

Finalizing the proposed rule will certainly help. Knowing that their decisions will face public and shareholder scrutiny, greater transparency of executive compensation will give boards and compensation committees pause before agreeing to monumental packages. As Justice Brandies said, "[p]ublicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."

Suggested Improvements

Although I believe the proposed rule is excellent, I would suggest the following:

Requiring Greater Disclosure of Performance Targets. In H.R. 4291, the "Protection Against Executive Compensation Abuse Act" we decided that shareholders could best judge the effectiveness of their board – and the appropriateness of the compensation scheme – if shareholders had access to the performance measures used to determine executive pay and information regarding whether those measures were met in the preceding year. This disclosure would help make compensation committees more accountable should they decide to provide bonuses/incentive pay even when performance targets are not met. Unfortunately, the proposed rule would maintain a "safe harbor" within which companies could withhold targets and thresholds. Although I understand companies have expressed concerns that disclosing these targets may have competitive costs, I am unconvinced. First, because competitors would also be required to publish their information, the "competitive" costs should equalize. Second, it appears that "everyone" except shareholders, already has access to this information (particularly compensation consultants).

To the extent the Commission remains concerned by competitive impacts of this disclosure, I believe these concerns could be addressed by a compromise approach offered by the Council of Institutional Investors. The Council has suggested that the Commission *generally* require that companies disclose performance targets when they are established but, in cases where companies believe that this information is competitively sensitive, would permit firms to postpone the disclosure of the targets until a future date (e.g., when the performance related to the award is measured). To benefit from the delay, the company would have to disclose that it is taking advantage of the exemption and provide its basis for doing so. Although this would not provide "real-time" disclosure, the delay would solve the competitiveness concerns *and* still provide shareholders with the information needed to review performance measures and independently verify that they were met. Knowing that their decision will be reviewed *eventually* may also discourage compensation committees from rewarding failure. To the extent a middle ground is necessary, this appears to be a workable approach that would address competitiveness concerns without providing a broad-based exception to disclosure that, over time, could mask abuses.

Requiring Full Disclosure of Perquisites. In H.R. 4291 we also decided that the best way to disclose the value of perquisites and other benefits was by disclosing their estimated "market value" – not just their "incremental cost" to the company. By relying on "incremental cost" the proposal not only runs the risk of underestimating the value of these benefits, it may create perverse incentives for senior executives to misallocate company funds.

For example, a senior executive could reasonably determine that purchasing a corporate jet makes good business sense (e.g., to reduce travel time and improve business relationships) – and this same executive could also reasonably determine that it makes sense to compensate executives by permitting them to use the jet for personal use when it is not being used for business purposes. Because the company now owns, fuels and hires pilots for the jet, the "incremental cost" to the company for executives' personal use might be quite small even when the "market value" of the benefit is large – thereby underestimating the compensation.

In addition, because the full cost is not disclosed, the "incremental cost" test may actually give the executives (who often make decisions using company funds) a perverse incentive to approve the use of company funds for purchases (like corporate jets, box seats or luxury company apartments), in part, because they can also be used by the executive with only "incremental cost" disclosure.

The "market value" approach mitigates this perverse incentive because the personal use of the company's plane would result in the full disclosure of the benefit. Hence the board and shareholders would be better informed of the full compensation provided to these executives. Seeing how often the plane is used for personal use (and the market value of that use) may also give the board a better sense for whether the company plane is actually necessary. Please keep in mind, however, that this is still only a disclosure. The board is still free to compensate executives however it sees fit.

Given the importance of the issue, I hope the Commission will continue to move quickly to consider comments, make revisions and implement the rule for the 2007 proxy season.

Going Forward

I believe the proposed rule is an excellent first step, and I hope we can work together to ensure that shareholders have the tools needed to address executive compensation and corporate governance *as they see fit*. For a market to work, however, participants require information; *and* choice. This proposed rule would give shareholders valuable information relating to executive compensation, but does not give them much hope for doing anything about it. Short of shaming boards into holding executives accountable, the proposed rule does not ensure that shareholders can effectively change compensation practices.

To address this issue, H.R.4291 would ensure that shareholders can vote on a company's executive compensation plan. I believe this mechanism would work well with your disclosure requirements and ensure that these owners (shareholders) can pay their employees (management) as they best see fit.

Thank you for your efforts and I hope you will work with me on this next step.

BARNEY FRANK