SHAREHOLDER COMMUNICATIONS AND EXECUTIVE COMPENSATION

OPENING STATEMENT

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AT THE OPEN MEETING OF THE COMMISSION

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Few issues at the SEC have aroused the level of public commentary as our efforts to modernize the proxy rules governing shareholder voting and to create clear and comprehensible disclosure concerning the executive compensation practices of America's public corporations. We have received more public comments than on any other issue in memory as part of a careful study of the current federal system of proxy voting and the dynamics of corporate governance in America.

The U.S. economy has the broadest dispersion of ownership of any major country. More than 50 million individuals have invested in stocks. Those investors range from schoolteachers, farmers and the people next door to professional investors, and together they own just under 50% of our total equity capital. Indirectly through their pension plans, America's citizens own most of the rest of our economy. We have truly democratized corporate <u>ownership</u>, though of course we could benefit from much higher levels of private investment in our economic base.

While we have democratized ownership, we have not done so well in creating reasonable management accountability to those owners. Our most common managerial structure is the single "Chairman and CEO." For most companies at most times, this system works well. However, in recent years we have seen more than one case of a once-strong American corporation that endured a prolonged decline under a single CEO.

We have also seen cases in which the CEO, in spite of widespread losses to shareholders or massive employee layoffs, received immense and increasing compensation. In other cases corporations have performed well -- or even very well -- but the compensation awards of the company have been so large that they are not possible to square with a normal person's sense of right and wrong.

Our system of corporate democracy depends on an informed and independent board of directors. The directors have the job of stepping in to protect the interests of the shareholders and employees in a strong and profitable company. Without a strong board that insists on high performance standards, any company could run into trouble.

In reviewing the current proxy system, one fact is overwhelmingly clear. A system that was supposed to protect

shareholders sometimes works to insulate management in problem cases from accountability to their shareholders.

The proxy system has legitimate objectives. We seek to prevent people from obtaining proxy voting authority based on false, misleading or incomplete representations. However, in pursuing these goals we have created a system in which it takes the permission of the federal government, teams of lawyers and millions of dollars for shareholders to discuss the future of the company they own in a newspaper op-ed or on a radio talk show.

If the current proxy rules for corporate elections applied to our national political elections, then every time citizens wanted to discuss their views of President Bush, Bill Clinton or Ross Perot, they would have to file a description of themselves and their views with the SEC. Discussing tonight's debate in the newspaper or on television would require mailing a proxy statement to every registered voter in the country.

We have considered many questions in our review process. But one question came up over and over again: "Does the government really need to restrain shareholders from expressing their views?" By making discussion and debate vastly more difficult and costly for "disinterested" shareholders, we reduce the vigor and the quality of our system. We also weaken the accountability of managers and directors to the shareholders who own the company.

The new rules will include a series of steps designed to enable shareholders to communicate with each other and the board without unnecessary interference or costs. Those who are not soliciting proxies for themselves, and who do not have any other special interest in the election, will be exempt from the proxy rules except for a simple prohibition against fraud. Shareholders will be completely free to publish their views in the press or the media without the SEC's permission. Small shareholders will also be completely free to communicate directly with one another. Shareholders with more than $5 million invested in the company will simply send a copy of any written material that they circulate widely to the SEC. At minimal cost, this will help keep other shareholders informed of such communications. Oral communications will not require any notice or filing whatsoever.

We will also take several steps to improve the elections process. The new rules will give shareholders a line-item vote. They will end the current system in which voting for a minority slate of independent candidates for the board requires shareholders to forfeit part of their votes.

The best protection against abuses in executive compensation is a simple weapon -- the cleansing power of sunlight and the power of an informed shareholder base. The new compensation disclosure rules will do away with impenetrable legalistic narratives that

often obscure the bottom line without the aid of a battery of analysts and a Cray supercomputer. Instead of the legal boilerplate will be a series of tables expressly designed to inform shareholders of exactly what is being done at their expense.

The most important of these tables is a new "summary table" that will capture all forms of compensation over a three-year period on a single page. This table will bring all the bottom-line information together for shareholders in one easy format to read. A second very important new table will disclose the number of stock options granted, together with either the present value at the date of grant of these options or a presentation of hypothetical gains that could result. This will allow shareholders to see the size of awards that are being handed out as options or restricted stock.

Last year one company awarded its CEO 10-year options to buy 2,750,000 shares of stock. This single grant for one year will be worth $219 million if the company's stock growth simply matches the rate of return of a ten-year Treasury. If the company's stock rises by the same percentage during the term of the option as it did in the last 10 years, these options will be worth more than $1.1 billion. This "mega-grant" is merely the latest and largest in an increasing and quite disturbing trend.

Aside from questions regarding their absolute size, some mega options make mini-sense for shareholders. It shouldn't be up to the SEC to decide whether a mega-grant of options for any particular company is justified. However, shareholders are entitled to expect the directors who make those awards to have an affirmative reason for every award and its pricing. Presumably the company's performance has justified the CEO's compensation award. Under the new rules, the members of the Compensation Committee will describe the performance factors on which they based their decision. That report to shareholders will appear -- before the annual election of directors -- over the names of the people who actually made the decision. Then, judging the appropriateness of the directors' decision should be up to the shareholders, not the government. Armed with information and empowered to act on that information, market forces should hopefully restore a better sense of balance to America's boardrooms.

The new rules also require a table comparing the performance of the particular company with both a broad-based stock index, such as the S&P 500, and a narrower index or a group of peer companies. This will allow shareholders to compare the company's relative performance with the broader market and with competitors.

Finally, the new rules contain special provisions and transitions for small business. Many of the comments expressed concern that the rules were unnecessarily complex for smaller

businesses: we have attempted to respond to those comments by permanently exempting small businesses from many of the new rules.

There are indications that the new rules, even as proposals, have already helped to encourage directors to listen more closely to shareholders. At General Motors and Sears in the last year, directors have stepped in to require major changes in the company. Whether or not these specific board decisions were correct will only tell with time. However, what we know now is that those decisions came from exactly the body that has the information, the power and the responsibility to act in the company's best long-term interests. This is a good trend, and I hope that our efforts contribute to more boards acting vigorously to promote corporate success.

The new rules maintain many corporate governance traditions. However, they represent a large step to restore accountability to the system -- something that is absolutely essential to a healthy market and a productive economy. By requiring clear and complete information and allowing vigorous and informed discussion, we can hopefully make sure that we remember who pays for the economic party -- America's shareholders.