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Opening Statement of Sen. Chuck Grassley
Committee on Finance Hearing on Corporate Governance and Executive Compensation
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Mr. Chairman, Thank you for holding this hearing on Corporate Governance and Executive Compensation. This is an important area and one which the Senate has not examined for many years. The bankruptcies of Enron and Global Crossing have had huge implications for the nation. In the end, I think we will find that much of the problem had to do with the aggressive use of accounting and tax rules by companies, and failures by accountants and analysts to observe the standards of their professions, to exercise due diligence and to be skeptical of financial information.

Some rank-and-file workers believed in their company so much that they invested most of their retirement in their company stock. They also played by the rules and sacrificed. They saved regularly for their retirement. But they lost large amounts of their savings because of the misrepresentation of the value of the stock. At the same time we have heard allegations that some executives walked off with fairly large deferred compensation benefits. I'm not concluding that. But if we find out that there are problems with the rules affecting executives, we ought to look at what corrective measures are needed.

I hope the hearing is not being used as a way to tax executive compensation to pay for spending programs. During the 1980s pension plans were the "cash cow" for spending programs. The argument was made that we "had to" cut back on the pension plan limits because "rich" people were getting too much in benefits from qualified plans. But cutting back on the wealthy didn't raise much money. So, tax committees cut back retirement benefit plans for middle-class workers. That was the only way to help to raise enough money for big spending programs. That was wrong, and I hope we don't do that again.

Nowadays some people are bothered by the size of executive compensation. But some people are bothered by the size of athletes' compensation or movie stars' compensation. So it is important to keep the issue of the size of compensation packages in perspective. The size of executive compensation packages is determined by boards of directors. Boards of directors should be sensitive to what shareholders think. Shareholders should care about who is getting the most profit out of the company – the executives or the shareholders. If shareholders believe that the directors are not representing their interests, they should vote them out. This is my way of saying that executive compensation – both what it consists of, and the magnitude of the benefit – is a corporate governance issue.

In the past, we have used the Internal Revenue Code to influence corporate governance. Section 162(m) limits deductions for wages to $1 million. That is one example. Another example is Section 280G that governs (and limits) so-called "golden parachute" payments to executives. But Section 162(m) has not limited executive wages beyond the $1 million limit. It has only limited the deduction. This is because a good executive is as valuable as the pitcher for the New York Yankees or some big movie stars. Some movie stars make over $20 million per movie, and I've got to believe that they can make more than one movie per year. Athletes often have high wages and get paid for endorsements that equal millions and millions.)

When we debated the compensation limit proposals in 1993, the late Senator John Chafee used to ask why folks weren't bothered by Wade Boggs' multimillion dollar baseball contract. Today we'd substitute Alex Rodriguez for Wade Boggs. However, I am concerned that some executives and corporations may be taking advantage of outmoded IRS rules to obtain a tax advantage – and the IRS has not been able to keep up with these creative arrangements due to congressional action many years ago. The Revenue Act of 1978 specifically limited the Internal Revenue Service's authority to issue regulations on non-qualified deferred compensation. The language in the Revenue Act of 1978 was enacted in reaction to regulations proposed during the Carter Administration. The House Ways and Means Committee report said:

> The Committee believes that the doctrine of constructive receipt should not be applied to employees as would be provided in the proposed regulations ....the uncertainty surrounding the status of private non-qualified deferred compensation plans caused by the proposed regulations is not desirable and should not be permitted to continue.

That has been the law for the past 24 years. If there are problems with constructive receipt or the economic benefit theory and its application to various non-qualified deferred compensation arrangements, perhaps we should untie the hands of the IRS? Might that approach be preferable to legislation? Next, this hearing will also examine the issue of stock options. Senator Levin's bill has been referred to this committee. He is here to testify in support of his bill, S. 1940. Senator Mike Enzi, the Senate's lone accountant, is here to give the other side.

Senator Levin points out a significant problem. That is, do financial statements accurately reflect stock option expenses? I agree financial statements should be as transparent as possible. That goal, transparency of so-called "book" income, is different from the policy goals of tax treatment of stock options. We in Congress have built into the tax policy favorable tax treatment for stock options. This is because stock options are a unique compensation device. In other words, tax and financial statement treatment should not be conditioned upon one another. They serve different purposes. This is not to say that the current financial accounting rule is proper. In fact, I think that the current rule can and has led to dubious results. Clearly, in some cases, the result is not transparent. The bottom line is that the financial statement treatment is not transparent. The investing public has a right to know what it is buying into. So I support Senator Levin's efforts, but oppose entangling his financial statements rule with the Tax Code.

Two results could come from Senator Levin's bill: (1) Companies would be required to expense their stock options at the time the option is granted or the company would lose the tax deduction; or, (2) alternately, a company would compute a tax deduction at the time a stock option is granted. If that were the case, we could end up with dramatically different results from company to company. Now, Mr. Chairman, I tend to think that stock options are a good thing. An investor's interest is in the price of the stock. Investors like it when senior managers take the same interest in the price of the stock. If not manipulated, stock options are a way to align the direct interests of management and shareholders in the growth of the company. Making compensation commensurate with performance of the company (and its stock value) failed at both Enron and Global Crossing. In those two companies, executives and insiders are alleged to have lined their pockets with gold on the fictitious notion that their stock had value. Unfortunately fictitious stock values can't be resolved in the Tax Code.