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There is more corporate fraud, accounting fraud, and Wall Street fraud than there used to be.

Why? People are not more evil than they used to be. Human nature doesn't change.

There is more fraud because people have *correctly* figured out that *it pays*. Corporate, accounting and financial-services fraud have huge upsides and few downsides.

Why? Because our investor-protecting laws and regulations have been worn down by years of special-interest lobbying. Because decades of loophole finding have paid off better than a lottery. And because *companies* are punished rather than the *people* who commit fraud. That does not deter, it punishes victims and the innocent and lets wrongdoers profit.

The point is this. People will behave badly if they are rewarded for it and risk little. That is the current state of our investor-protection laws. Enron, Global Crossing and others happen because *we let them*. Our safety nets—outside auditors, boards of directors, rating agencies, analysts, the stock exchanges, the SEC and prosecutors—are all failing us at one level or another.

The most important safety net, however, is investors themselves. People will take care of their property unless laws prevent them. We shareholders want to stop those who fleece us by fraud. But we can't. The rules that govern us prevent us.

I have provided examples of these laws in my written remarks. They make for lively reading. But what I want to focus on here is **executive compensation. It is a critical contributor to corporate, accounting and financial-services fraud.** And it is in your jurisdiction.

First, executive compensation is an excellent <u>diagnostic tool</u>. When we see executives paid way <u>too much</u>, or paid <u>more to leave than to work</u>, or paid for <u>failure</u>, or paid for <u>fraud</u>, we know something is wrong. That may seem obvious, but it is important. Most people tell you our markets don't need fixing. But rising executive compensation abuse tells us they do. The reasons are summarized in my written remarks.

Executive compensation is also <u>*the* critical enabler</u> for corporate fraudsters. And stock options are fraudsters' best safe-cracking tools. Without stock options, fraudsters could not turn companies into Ponzi schemes. They could not suck out enough money before the company collapsed to be worth it. Stock options can be printed up as easily as the government mint prints money, so they can be abused more easily than cash, which a company has to have before an executive can take it. <u>Stock options are not bad; they can be good; but they are like a dangerous drug that can cure or become addictive and harmful.</u>

So if you want to crack down on fraud you need to do a few things about executive compensation. First, you need to make sure all CEO and board compensation is disclosed, clearly and immediately. Executives should not be able to dump stock today and tell us tomorrow—or next year. And we shouldn't have to be CFAs to figure out what the packages are worth. The SEC has proposed a few disclosure improvements but I encourage you to watch these efforts to make sure the result in the needed reforms.

Second, shareholders must have the right to vote on all stock option plans. Executives should not be able to print up corporate money to pay themselves without shareholders, who foot the bill, approving. Compensation committees of independent directors are simply *not* enough.

Third, you need to charge options to earnings, even though they are a slightly awkward fit. Options have value, they transfer that value directly from shareholders to the option holders, bypassing the company. Options are a cost of production. They substitute for cash the company might otherwise pay. A charge reflects that substitution. And a charge is an important check on the rampant abuse of options and an accurate reflection of what is left over for shareholders.

The arguments I hear against charging options are the closest thing to humor in the accounting world. **Options don't have value?** Right. Then why are CEOs lobbying you like desperate cocaine addicts fearing withdrawal? **Options value can't be estimated?** An executive who can't work with estimates as concrete as stock option estimates should be in another job. And they sure seem to be able to estimate them for tax purposes. Executives routinely estimate pension and depreciation numbers. Heck, accounting is full of estimates. **Executives won't work without options?** Then those are executives with bad attitudes we'd be lucky to lose—funny that entrepreneurs work the world over without options—they even work at Boeing, which charges its options. **Options charging would cause market collapse?** Pfft. We're talking about an accounting treatment here, not a change in the real world.

There are many ways to tie executives' interests to the long-term success of companies. Options are one way, though not an essential way—boards could do it the old fashioned way and perform a proper annual review, taking stock price and everything else into account, and pay cash. A real evaluation by human beings can assess variables that no formula can capture.

So, do not be taken in by the hype. The difficulty is not in the issue itself but in the pressure you are getting. I do understand that that pressure is tremendous—so I understand that it will take remarkable courage for any of you to support this change. I keep thinking that if we could harness the pressure executives are applying to you *not* to charge options to earnings and direct it, say, at finding Osama Bin Laden, he'd be sitting here today. I wish the same energy would be directed at employees' and shareholders' interests.

Those of you supporting Senators Levin and McCain deserve our respect. You are profiles in courage, and I thank you. You are clearly in good company—Warren Buffett, Alan Greenspan, TIAA-CREF and the Council's many members back you. You seem to understand what others are missing--the fact that we've had a good run of it the past 200 years doesn't guarantee our future. Only you can do that. If we coast, we slow down. We can't do it without clean markets and we won't have clean markets without leaders with courage.