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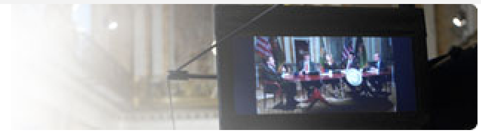

Statement by Treasury Secretary Tim Geithner on Compensation

6/10/2009

TG-163

For the Say on Pay fact sheet, visit link.

For the Providing Compensation Committees New Independence fact sheet, visit link.

WASHINGTON – Our financial system is built on trust and confidence. It requires rules and practices that encourage sound risk management and align the benefits for market participants with long-term growth and value creation – not only at individual firms, but for our financial system and the economy as a whole.

This financial crisis had many significant causes, but executive compensation practices were a contributing factor.   Incentives for short-term gains overwhelmed the checks and balances meant to mitigate against the risk of excess leverage.

Today, I met with SEC Chairwoman Mary Schapiro, Federal Reserve Governor Dan Tarullo, and top experts to examine how we can better align compensation practices – particularly in the financial sector – with sound risk management and long-term growth.

In considering these reforms, we start with a set of broad-based principles that – with the help of experts like those we assembled today – we expect to evolve over time. By outlining these principles now, we begin the process of bringing compensation practices more tightly in line with the interests of shareholders and reinforcing the stability of firms and the financial system.

First, compensation plans should properly measure and reward performance.

Compensation should be tied to performance in order to link the incentives of executives and other employees with long-term value creation. Incentive-based pay can be undermined by compensation practices that set the performance bar too low, or that rely on benchmarks that trigger bonuses even when a firm's performance is subpar relative to its peers.

To align with long-term value creation, performance based-pay should be conditioned on a wide range of internal and external metrics, not just stock price. Various measurements can be used to distinguish a firm's results relative to its peers, while taking into account the performance of an individual, a particular business unit and the firm at large.

Second, compensation should be structured to account for the time horizon of risks.

Some of the decisions that contributed to this crisis occurred when people were able to earn immediate gains without their compensation reflecting the long-term risks they were taking for their companies and their shareholders. Financial firms, in particular, developed and sold complex financial instruments that yielded large gains in the short-term, but still presented the risk of major losses.

Companies should seek to pay top executives in ways that are tightly aligned with the long-term value and soundness of the firm. Asking executives to hold stock for a longer period of time may be the most effective means of doing this, but directors and experts should have the flexibility to determine how best to align incentives in different settings and industries. Compensation conditioned on longer-term performance will automatically lose value if positive results one year are followed by poor performance in another, obviating the need for explicit clawbacks. In addition, firms should carefully consider how incentives that match the time horizon of risks can extend beyond top executives to those involved at different levels in designing, selling and packaging both simple and complex financial instruments.

Third, compensation practices should be aligned with sound risk management.

At many firms, compensation design unintentionally encouraged excessive risk-taking, providing incentives that ultimately put the health of the company in danger. Meanwhile, risk managers too often lacked the stature or the authority necessary to impose a check on these activities.

Compensation committees should conduct and publish risk assessments of pay packages to ensure that they do not encourage imprudent risk-taking. At the same time, firms should explore how they can provide risk managers with the appropriate tools and authority to improve their effectiveness at managing the complex relationship between incentives and risk-taking.

Fourth, we should reexamine whether golden parachutes and supplemental retirement packages align the interests of executives and shareholders.

Golden parachutes were originally designed to align executives' interests with those of shareholders when a company is the potential target of an acquisition. Often, they have been expanded beyond that purpose to provide severance packages that do not enhance the long-term value of the firm. Likewise, supplemental executive retirement benefits can make it more difficult for shareholders to readily ascertain the full amount of pay due a top executive upon leaving the firm.

We should reexamine how well these golden parachutes and supplemental retirement packages are aligned with shareholders' interests, whether they truly incentivize performance, and whether they reward top executives even if their shareholders lose value.

Finally, we should promote transparency and accountability in the process of setting compensation.

Many of the compensation practices that encouraged excessive risk-taking might have been more closely scrutinized if compensation committees had greater independence and shareholders had more clarity. In too many cases, compensation committees were not sufficiently independent of management, while companies were not fully transparent in explaining their compensation packages to shareholders. In addition, existing disclosures typically failed to make clear in a single place the total amount of "walkaway" pay due a top executive, including severance, pensions, and deferred compensation.

We intend to work with Congress to pass legislation in two specific areas. First of all, we will support efforts in Congress to pass "say on pay" legislation, giving the SEC authority to require companies to give shareholders a non-binding vote on executive compensation packages. "Say on pay" – which has already become the norm for several of our major trading partners, and which President Obama supported while in the Senate – would encourage boards to ensure that compensation packages are closely aligned with the interest of shareholders.

Secondly, we will propose legislation giving the SEC the power to ensure that compensation committees are more independent, adhering to standards similar to those in place for audit committees as part of the Sarbanes-Oxley Act. At the same time, compensation committees would be given the responsibility and the resources to hire their own independent compensation consultants and outside counsel.

Beyond legislation, I also want to emphasize the importance of the efforts being taken by Chairman Bernanke and the bank supervisors to lay out broad standards on compensation that will be more fully integrated into the supervisory process. These efforts recognize that an important component of risk management is getting incentives right, and we will support the Fed and the other regulators as they work to ensure executive and employee compensation practices do not create unnecessary risk.

Finally, I want to be clear on what we are not doing. We are not capping pay. We are not setting forth precise prescriptions for how companies should set compensation, which can often be counterproductive. Instead, we will continue to work to develop standards that reward innovation and prudent risk-taking, without creating misaligned incentives.

As we seek to strike this balance, the President's Working Group on Financial Markets will provide an annual review of compensation practices to monitor whether they are creating excessive risks. And we will encourage experts in the field – academics, business leaders and shareholders – to conduct their own reviews to identify best practices, emerging positive and negative trends and call attention to risks that might otherwise go unseen.

Many leaders in the financial sector have acknowledged the problems posed by past compensation schemes, and have already begun implementing reforms.   But we have more to do to address this challenge, and we look forward to continuing this conversation with a wide range of stakeholders in the weeks and months ahead.

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REPORTS

- Providing Compensation Committees New Independence fact sheet
- Say on Pay fact sheet