



THOR'S U.S. ECONOMIC REVITALIZATION AND CORPORATE RESPONSIBILITY PLAN

INTRODUCTION

To say that we are in unusual times is an understatement. The stock market has fallen by more than 40% during the past year, the real estate market is frozen as home prices are collapsing, unemployment is rising and fear is rampant among investors and consumers, causing them to hoard their money in cash and short-term Treasury Notes. We agree with President-elect Obama that changes need to be made in order to spark our economy and provide relief for state and local governments. This position paper offers a simple, yet effective, approach that will, in our opinion, help improve the overall economy, the stock market, local and state governments, employment and average worker pay. Our approach will also significantly reduce excessive executive pay. Whether one is a liberal, a conservative or an independent, we believe that new ideas need to be brought forth that will provide long-term sustainable growth and stewardship of our public companies. Although there are many company boards and company executives that look out for the best interest of shareholders, there are too many that do not. Moreover, stories of excessive executive compensation and executive malfeasance have soured investors' confidence in the market. The era of executives and corporate boards using public companies as their own personal piggy banks while destroying shareholder value needs to end.

The premise of this paper is this: **if companies agree to new executive and corporate board compensation guidelines, those companies would be subject to a flat corporate tax rate of 15%.** A lower corporate tax rate is good for the stock market and the economy as a whole. The plan uses a "carrot" approach in that the plan is optional. It is similar to how allowing mortgage interest to be deducted on one's income taxes sparked higher home ownership in America. Companies that believe it is worth paying higher salaries and benefits to just a few executives can keep paying these salaries, but they will continue to be subject to the current higher corporate tax rates. The shareholders will ultimately decide if the executives are worth paying higher corporate taxes. We believe they would decide otherwise and changes would be made to enhance shareholder value, not executive net worth.

This plan is intended for publicly-traded companies only. The reason for this is that publicly-traded companies are owned by the public – this includes not only individuals, but state and local pension plans, union health and retirement plans, teacher retirement plans, endowment funds and foundations ("Investors") to name a few. Data collected by the Center for Retirement Research at Boston College back in 2006 on 109 state and 87 local pension plans showed that these plans had over \$2.6 trillion in combined assets. In addition, those plans had, on average, 58.6% of those assets invested in stocks.¹ This equates to approximately \$1.52 trillion invested in stocks. With a 40% drop in stock values, state and local government pension plans have lost \$609 billion dollars in value. Regaining those losses

¹ Lucas, Deborah J. and Stephen P. Zeldes. "How Should Public Pension Plans Invest?" AEAweb. 1 Jan 2009. American Economic Association < <http://www.aeaweb.org/assa/2009/retrieve.php?pdfid=489>>



would substantially help state and local governments meet their pension obligations and provide more than 60% of the \$1 trillion dollars now being requested by state governors.² We believe a lower tax rate on public companies is justified given that they are owned by the Investors, all of whom have an impact on the general well-being of the entire country. Even those people on public assistance will benefit as less funds are needed to fund public pension plans. If these plans are funded by contributions instead of rising asset values, it would mean higher taxes, higher product prices and fewer services for all.

In addition to U.S. companies receiving this lower tax rate, foreign-owned publicly-traded companies that are doing business in the U.S. and abide by these guidelines would also qualify for this lower tax rate. The Investors have a significant portion of their assets invested in foreign stocks for diversification purposes. The top 50 U.S. foundations currently have 20% of their total assets invested in foreign stocks.³ In many cases, foreign companies would already qualify for the lower corporate tax rate since most foreign company executives earn much less than their U.S. counterparts. More importantly, the favorable tax rate would create an incentive for foreign companies to invest in the United States.

WHY IT IS IMPORTANT FOR THE STOCK MARKET TO RISE

The stock market has been tarnished by a few executives who have abused the public trust with excessive pay and poor stewardship of the companies they oversee. Some say that all of corporate America needs to suffer and pay even more taxes because of the sins of a few over-indulgent executives. This punitive approach, however, would hurt all shareholders as stock prices would fall to reflect these higher tax rates. The stock market matters to everyone: Warren Buffett, retirees, state and local governments, taxpayers and even those on public assistance. Why does the stock market matter to everyone? Because most state and local governments have defined benefit pension plans with a significant portion of those portfolios invested in the stock market. As of 2006, only 60% of those pension plans were 80% or more funded.⁴ This was prior to 2008's 40% drop in the stock market! This recent fall only deepens the pension plans unfunded status. State and local governments have these obligations which will need to be paid either through cash contributions or appreciation of asset values. If the market stays at current levels, most states and localities will have to add more funds to their pension plans. That means less money for other services – including public assistance. In order to provide some relief, some governors like John Corzine of New Jersey are allowing local governments to defer pension contributions. This is after the New Jersey pension plan lost some \$23 billion in value through the first week of December, 2008.⁵ Deferring the problem to a future generation is not the long-term answer. Increasing the asset values of the plans investments is the best solution.

² Hurdle, Jon. "U.S. governors seek \$1 trillion federal assistance." Reuters. 2 Jan 2009. <<http://www.reuters.com/article/newsOne/idUSTRE5014F120090102>>

³ The Commonfund Institute. "Foundation Spending." Pensions & Investments. 22 Dec 2008. p. 20.

⁴ Bovbjerg, Barbara J. "State and Local Government Pension Plans." United States Government Accountability Office. 10 July 2008. United States Government Accountability Office <<http://www.gao.gov/new.items/d08983t.pdf>>

⁵ Clary, Isabelle. "Now playing: pension woes in New Jersey." Pensions & Investments. 8 Dec 2008. p. 8.



Curing the stock market fall would also go a long way to restoring our economy, not only psychologically, but in true and meaningful ways. For example, if the Dow rose to 16,000, the pension deficits (state, local, company and union) would change from being underfunded to being fully funded because of appreciation in asset values. Consumers would have more money to spend on goods, services and housing. The federal government would benefit from higher revenue from both capital gains and higher required distributions from retiree IRA accounts. Because states and localities would need to spend less of their funds on pension contributions, they would be able to not only keep the services they provide, but provide additional services as tax revenues increase with a rebounding economy.

As previously mentioned, even the neediest in our country will benefit from a rising stock market. The underprivileged would benefit from state and local governments having more funds to spend from a rising stock market, but also from charitable foundations. At the end of 2007, the average exposure to stocks for the top 50 U.S. foundations was just above 50%.⁶ These foundations will have less money this year to provide for their causes. A robust stock market will allow them to spend additional money which will help fund services to our most downtrodden citizens and, in turn, reduce the burden on state and local governments. In addition, as the net worth of citizens rises along with the stock market, the amount that they donate to charitable causes will increase. This is why even those on public assistance need the stock market to rise. If the stock market remains where it is or falls further, they will receive fewer benefits.

HOW A LOWER CORPORATE TAX RATE WOULD BENEFIT THE STOCK MARKET AND THE ENTIRE ECONOMY

A reduction in corporate income tax rates for companies that opt to participate in the plan would not only be beneficial to the recipient corporations, but would have a stimulating effect upon the economy as a whole. The current American corporate income tax rates are not globally competitive. Consider that:

“The U.S. continues to have the second-highest combined federal-state corporate tax rate among industrialized countries at 39.3 percent. Only Japan has a higher overall corporate tax rate at 39.5 percent. By contrast, the average corporate tax rate among OECD (Organization for Economic Co-operation and Development) countries has fallen a full percentage point in the past year, from 27.6 percent to 26.6 percent. Ireland’s 12.5 percent corporate tax rate remains the lowest among OECD nations.”⁷

While other nations have cut or are cutting their corporate tax rates to boost global competitiveness, the United States has maintained the same high rate for many years. Over the last sixteen years, there

⁶ The Commonfund Institute. “Foundation Spending.” Pensions & Investments. 22 Dec 2008. p. 20.

⁷ Hodge, Scott A. “U.S. Corporate Taxes Now 50 Percent Higher than OECD Average.” The Tax Foundation. 13 Aug 2008. <www.taxfoundation.org/research/printer/23470.html>



has been no change in the federal corporate tax rate.⁸ Continued high rates of corporate taxes will almost certainly cut the global competitiveness of the United States and continue to weaken the economic growth of the country. On the other hand, reducing the corporate tax rate to a level below the OECD average would enhance American global competitiveness and strengthen domestic economic growth.

For example, consider paths taken by the two extremes of the OECD in corporate taxation, Japan and Ireland. In the period between 1989 and 2004, high-tax Japan experienced average per capita GDP growth of 3.0% per year, whereas low-tax Ireland experienced average per capita GDP growth of 7.3% per year (all measured in 2004 U.S. dollars).⁹ Ireland's growth was so spectacular that it went from having a per capita GDP that was 62.3% of Japan's in 1989 to 114.7% of Japan's in 2004. Although other factors (such as Ireland's open access to the EU market) were certainly in play, the positive effect of low corporate taxes upon the Irish economy is unmistakable. The CEO of the Industrial Development Agency Ireland, Barry O'Leary, stated that, among other factors, "the fact that we have a very strong corporation tax regime, a very very low tax rate" helped make Ireland competitive and keep it competitive, especially for attracting foreign direct investment ("FDI").¹⁰

FDI was critical to fueling Irish economic growth, and it was not nearly as present in Japan. Since FDI is so important in fueling economic growth, enacting policies that would make the U.S. more competitive for businesses would be excellent from the perspective of fueling growth and employment. A 15% corporate tax rate would make the U.S. a more attractive place to invest capital for both foreign and domestic companies. For the average American, this greater incentive to invest domestically would mean that more high-paying jobs would remain at home, and the median real income would certainly rise as it did in Ireland.

Companies already have a strong incentive to invest in the United States, despite the fact that labor costs in the U.S. are higher than in many parts of the world. The United States overwhelmingly has the world's largest economy with a GDP of \$13.1 trillion in 2006 (this is larger than the combined economies of Brazil, Russia, India, China, Germany and Japan).¹¹ Companies that invest in the United States gain more competitive access to the world's largest consumer economy because of reduced shipping costs and avoidance of trade barriers. Furthermore, the United States is a great location for high-paying, cutting-edge industries because of its highly-educated, hardworking labor force. Reducing the costs of doing business in the U.S. would make the U.S. even more attractive to invest in than it is today. Because of the sheer size of the U.S. economy, economic events in the United States often transmit globally. If the United States recovers from the current market downturn, the benefits

⁸ Taylor, Jack. "Corporation Income Tax Brackets and Rates, 1909-2002." Internal Revenue Service. Ed. Beth Kilss. <<http://www.irs.gov/pub/irs-soi/02corate.pdf>>

⁹ Alan Heston, Robert Summers and Bettina Aten, Penn World Table Version 6.2, Center for International Comparisons of Production, Income and Prices at the University of Pennsylvania, September 2006. <http://pwt.econ.upenn.edu/php_site/pwt62/pwt62_form.php>

¹⁰ O'Leary, Barry. "Thoughts from The Economist Conference's First Roundtable with the Government of Ireland." Ireland on Business. 2008. IDA Ireland. <http://www.idaireland.com/uploads/documents/transcript_economist.doc>

¹¹ "Biggest Economies." Economist.com Rankings. 18 Dec 2008. The Economist. <http://www.economist.com/markets/rankings/pocketworldinfigures/displaystory.cfm?story_id=12758678>



would be transmitted globally. If, on the other hand, the United States continues to stagnate, then the global economy will almost certainly continue to stagnate.

The benefits from lowering the corporate tax rate are multifarious. The change would go a long way to curing the current economic downturn by freeing up more money for businesses to invest in themselves and making investing in business a more attractive option because business profits should rise. As America becomes a more competitive place to invest, employment and median income will rise. GDP will grow more rapidly as the gains from reduced taxes are reinvested. The faster pace of GDP growth will increase the attractiveness of the United States for foreign and domestic investments.

Furthermore, over the long run, the likely effect of implementing this plan would be more tax receipts for the government. The reduction in the federal corporate tax rate in the 1980's from 46% to 34% actually increased corporate tax revenue from 1.4% of GDP to 1.8% of GDP.¹² This increase as a percent of GDP does not include the positive effect that the tax cut had on GDP. Although a temporary short-term reduction in government revenue is possible, over the long run, history suggests that the government's coffers would increase from the tax reduction.

NEED TO GET PEOPLE TO INVEST

This plan is clearly logical from the Keynesian perspective. Within Keynes' economic theory, downturns will be prolonged if people hold onto cash instead of investing it or purchasing goods with it. When people become fearful about the future, they demand higher returns before they will part with their cash.¹³

The change in the corporate tax rate and pay structure would lead to a stock market rebound. This rebound would transpire because, with lower tax rates, corporate profitability would go up. As stocks are a residual claim on a company's profits, greater corporate profitability would mean that the value of such claims would increase, driving up the stock market. Higher returns in the stock market would lead people to invest rather than hoard cash. Furthermore, the new policies would increase confidence in the market in the long-term. Shareholders would recognize that the companies in which they are invested would be managed with an eye toward long-term viability. This shift removes the incentive for executives to gamble on high risk business propositions, which would make another crisis similar to the current sub-prime crisis unlikely. Shareholders would have greater faith that in the new structure, company's assets would not be pilfered by managers. The combination of greater confidence in the market and greater expected returns would lead to an economic revival. The benefits of this rise in stock prices would be felt by everyone.

¹² "2008 Federal Revenue and Spending Book of Charts." The Heritage Foundation. 2008. Heritage Foundation. <<http://www.heritage.org/research/features/budgetchartbook/fed-rev-spend-2008-boc-T2-Corporate-Income-Tax-Receipts.html>>

¹³ Keynes, John Maynard. General Theory of Employment, Interest, and Money. New York: Harcourt, Brace and Company, 1936.



When the stock market goes up, government funded retirement plans stand to benefit. Many state and local public retirement programs are funded in some part through investments in public companies. If these investments go up, then it would reduce the amount of tax funding they would need to cover these programs, freeing funds for other government programs.

The increase in the value of the stock market would be accompanied by an increase in investment volume because more investors would have greater confidence in the market. The combination of increased share prices and volume would lead to significant increases in revenue from capital gains taxes.

There also would be a multiplier effect, as the gains from the stock market rebound are spent in the general economy. A portion of this additional cash circulating in the economy would be reapportioned toward investment. The feedback would lead to increases in both consumption and investment, fueling the present economy and also providing the necessary investment for future growth.

SUMMARY OF BENEFITS OF LOWER CORPORATE TAX RATE

A lower tax rate on corporations would have a dramatic, positive impact on the U.S economy. It would spark an economic recovery and have the following benefits:

1. Federal tax receipts will increase as the economy recovers and grows.
2. Employment will rise as the U.S. becomes among the **most** competitive places to invest.
3. Payroll taxes will rise as employment rises.
4. Unemployment costs to the federal government will fall as employment rises.
5. Faster GDP growth as benefits of lower taxes are reinvested in companies or paid out in dividends.
6. U.S. companies will repatriate foreign earnings back for investment in the U.S.
7. Companies will have more money to invest in infrastructure and employees.
8. Using debt as a source of funding will be less attractive since companies get a higher tax benefit from using debt financing with a higher tax rate than a lower tax rate.
9. As the U.S. grows faster, foreign companies will invest more money in the U.S. economy.
10. Net effect to government would be higher revenues that could be used for debt reduction and/or additional programs.

EXECUTIVE COMPENSATION

HISTORY

Executive compensation continues to be a hot topic as executives walk away from failing companies with tens of millions of dollars while the “average Joe” falls behind. There are many studies that compare executive pay to average worker pay and these studies differ in the amount executives are paid over and above the average worker. The trend in executive pay, however, is indisputable. A



study by the Hay Group and Wall Street Journal shows that back in 1979 the average CEO pay was 35 times the average worker pay. This rose to 71 times in 1989 and to 126 times in 1993.¹⁴ It was at this time that Congress passed the Revenue Reconciliation Act (“RRA”) of 1993.

RRA attempted to reduce executive pay in two ways. First, it capped the income tax deduction for a corporation for executive pay at \$1 million dollars, and second, it required companies to disclose the compensation of its top executives in its financial statements. The reason they had pay disclosure rules was to shame executives into accepting lower executive compensation.¹⁵ The act was a noble, but unsuccessful attempt to curb executive pay. Executive pay has more than doubled since 1993. In 1993, executive compensation was 126 times average worker pay while in 2007 it was 275 times.¹⁶ Why? In place of giving direct pay through salaries, companies changed compensation packages to include stock options and “performance based” compensation, both of which are deductible for income tax purposes. Hence, executive pay was not reduced, only the form of compensation was changed. In addition, executives demanded more pay in order to “keep up with the Jones’.” This same phenomenon occurs in sports. For example, Star #1 believes he is the best player in professional basketball. If he sees that Star #2 is making \$2 million more a year in salary, Star #1 will demand more. Executives act in a similar fashion. At the end of the day, RRA had the exact opposite effect of its intended purpose.

CURRENT PAY DISCONNECT

Executive compensation’s disconnect from reality can be illustrated by the fact that many executives earn lavish pay and/or severance for their work at failing corporations. For example, Rick Wagoner, CEO of General Motors, earned \$9.3 million in 2006 in overall compensation while the company he was charged with managing began to flounder. Ford’s CEO Alan Mulally earned \$27.8 million in 2006 working less than a year. This stands in contrast to the pay package of their better managed Japanese counterpart Toyota. Toyota’s top executive Hiroshi Okuda’s estimated annual compensation was \$903,000 in 2006. In fact, the total salary of Toyota’s top 37 executives was \$21.6 million that same year.¹⁷ It makes no sense whatsoever that Ford’s CEO should earn more “performance based” compensation than all of the top executives combined of a better managed company! This illustrates that so called “performance based” compensation is not very well tied to performance.

¹⁴ Mishel, Lawrence, Jared Bernstein and Heidi Shierholz. “Executive Pay.” *The State of Working America 2008/2009*. Jan 2009. The Economic Policy Institute. p. 220-223. <http://www.stateofworkingamerica.org/swa08-exec_pay.pdf>

¹⁵ Markham, Jerry W. “Regulating Excessive Executive Compensation –Why Bother?” *Digital Commons*. 2006 - *The Fall and Rise of Federal Corporation Law*. University of Maryland School of Law. p. 1
<http://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1008&context=blc_2006>

¹⁶ Mishel, Lawrence, Jared Bernstein and Heidi Shierholz. “Executive Pay.” *The State of Working America 2008/2009*. Jan 2009. The Economic Policy Institute. p. 220-223. <http://www.stateofworkingamerica.org/swa08-exec_pay.pdf>

¹⁷ Carty, Sharon Silke. “Union questions auto execs’ pay packages.” *USA Today Online*. 10 Oct 2007.
<http://www.usatoday.com/money/autos/2007-10-09-auto-exec-pay_N.htm>



The disconnect from reality is also readily apparent in the financial industry. “Banks that are getting taxpayer bailouts awarded their top executives nearly \$1.6 billion” in overall compensation.¹⁸ These compensation packages for executives of bailed-out firms included Merrill Lynch CEO John Thain’s \$83 million in 2007 as the company was headed for failure. The top five executives at Goldman Sachs earned a total of \$242 million dollars in 2007, while the company this year needed \$10 billion in bailout money. Not only is the sheer amount of money received ludicrous, the incentive structure for these companies encouraged the risk-taking that contributed to the current economic mess.

CHANGES IN ORDER TO QUALIFY FOR THE 15% CORPORATE TAX RATE

Most people are disgusted with the outrageous amount of money some executives are awarded. This year provided enough ammunition to demonstrate that executive pay (especially for companies like Merrill Lynch and Goldman Sachs) is disconnected from the long-term performance of the companies themselves. It is excessive and leaves shareholders and workers disenchanted. On the other hand, shareholders want to make sure they get the best management possible for the long-term success of the company. The problem is, some executives care only about the short-term success of the company. Short-term success leads to higher option value which in turn allows the executives to maximize their options when they cash them in. In our opinion, this is why we have seen failures of such stalwart institutions as Fannie Mae and Merrill Lynch. Just prior to these institutions failing, their executives (Harold Raines at Fannie Mae and E. Stanley O’Neal at Merrill Lynch) left with obscene amounts of money for themselves. The short-term focus of CEOs is not in the best interest of shareholders and needs to end. In order for a company to get the reduced tax rate of 15%, the company must agree to the following:

1. Tie executive pay to “average worker” pay.
2. Eliminate all options, deferred compensation plans and special executive retirement plans for the top executives.
3. Eliminate “golden parachutes” or make them company wide.
4. Make a significant portion of executive pay be in the form of restricted stock.
5. Restricted stock must be held for five years for preferred tax treatment.
6. Restricted stock would be subject to disgorgement if the executive is found guilty of corporate malfeasance.

1. TIE EXECUTIVE PAY TO “AVERAGE WORKER” PAY

Past attempts to limit executive pay have failed to reduce executive pay or increase pay for the average worker. This plan would do both. In 2007, the average executive pay was 275 times that of the average worker. The average annual executive pay was \$12.3 million in 2007 while the average annual production/nonsupervisory worker’s pay was just over \$44,700.¹⁹ We understand that large

¹⁸ Bass, Frank and Rita Beamish. “Bailed-out bank execs got \$1.6B, study finds.” MontgomeryAdvertiser.com. 22 Dec 2008 <www.montgomeryadvertiser.com/apps/pbcs.dll/article?AID=/20081222/BUSINESS>

¹⁹ Mishel, Lawrence, Jared Bernstein and Heidi Shierholz. “Executive Pay.” [The State of Working America 2008/2009](http://TheStateofWorkingAmerica.org). Jan 2009. The Economic Policy Institute. p. 220-223. <http://www.stateofworkingamerica.org/swa08-exec_pay.pdf>



publicly-traded companies require more from their executives than smaller publicly-traded companies. Therefore, a tiered system on executive pay should be employed. The initial amount of executive pay also would be tied to the average compensation of all workers and future compensation would be tied to the percentage change in the pay of the average worker of that company. It should be tied to the percentage change in pay of that specific company because it would be unfair for executives of companies that have lower skilled or lower paid workers (such as McDonalds) to be paid significantly lower than executives at companies with higher skilled or higher paid workers (such as Google).

Initial executive pay not to exceed the following (based on company sales)

	Less than <u>\$250 million</u>	Greater than		
Times Avg. Worker	15x	<u>\$250 Million</u>	<u>\$1 Billion</u>	<u>\$5 Billion</u>
		30x	50x	100x
Or	\$670,000	\$1,340,000	\$2,235,000	\$4,470,000

This is based on the average worker pay of \$44,700 per year.

Please note that a significant portion of this pay would come in the form of restricted stock that, if held for 5 years, would have significant tax benefits for the executives (see paragraph 5 below).

Pay for executives in following years

After the initial year, executive pay would be tied to pay changes of the “average worker” of their specific company. This is done in order to give an incentive for executives to pay higher salaries to their work force. Increase in pay for executives would be tied to the average pay of the bottom 80% of full-time wage earners at their company. If those bottom workers pay increases by 5%, executive pay would increase by 5%. The average pay would include pay from the company’s operations worldwide, not just in the United States. Thus, an executive would have to take into account the impact on his or her own pay if the company was considering moving its operations to a lower wage country like Mexico. Below is a simplified example showing how this would work for a company with over \$5 billion in sales:

End of Year 1

Assumptions:

- Paid executive maximum amount allowed \$4,470,000
- Bottom 80% of work force had a 3% **increase** in pay

Maximum salary allowed for year two would be: $\$4,470,000 \times 1.03 = \$4,604,100$



End of Year 2

Assumptions:

- Paid executive maximum allowed of \$4,604,100
- Company restructured and moved a significant amount of production overseas and the bottom 80% pay **decreased** by 15%.

Maximum salary allowed for year three would be: \$4,604,100 x .85 (1-.15 reduction in bottom 80% average salary pay) = \$3,913,485

Executives would have countervailing incentives in that their salaries would be lower in Year 3 by moving jobs overseas, but share price could rise because of reduced costs. This ensures that executives are managing the firm for the best interest of shareholders, while also keeping higher paying jobs in the U.S.

2. ELIMINATE ALL OPTIONS, DEFERRED COMPENSATION PLANS AND SPECIAL EXECUTIVE RETIREMENT PLANS FOR TOP EXECUTIVES

Many executive compensation programs have become so convoluted that most shareholders don't understand them. They are short-term in nature, and don't provide enough incentive for long-term appreciation of shareholder value. For example, look at any proxy that allows shareholders to vote on executive compensation plans and read through the 30+ pages to try and uncover what it means. Allowing shareholders to vote on executive compensation is ineffective since it has become so confusing. A large portion of that compensation is in the form of deferred compensation, special retirement plans, questionable performance based bonuses and the most detrimental part to shareholders - options. These payment schemes would be eliminated and replaced with direct ownership in restricted stock.

3. ELIMINATE GOLDEN PARACHUTES AND SEVERANCE PACKAGES FOR EXECUTIVES

Golden parachutes packages benefit only executives, not shareholders or employees. Executives put these in place in order to provide themselves a big pay day. This mentality of self-interest, rather than shareholder interest, must change. Executives will once again become stewards of these publicly traded companies, and will stop using them as their own personal piggy bank. In changing this mentality, executives must realize that they are first and foremost employees of the company. As such, they should receive the same severance package as all other employees. Why should only they cash in when they leave? There is no justification for Alan Fishman getting a \$13 million severance package for working at Washington Mutual for only three weeks.²⁰ Likewise, if the company is bought out, the executives should not be treated any differently than the other employees. Most companies pay severance packages based on salary and time served working at the company. It should be the same

²⁰ Jones, Kathy and Katie Paul. "What They Got Away With." *Newsweek*. < <http://www.newsweek.com/id/159439>>



for executives. If a company wants to institute a “golden parachute,” it must include all employees (and base it on same multiple of average pay) in order to get the 15% tax rate.

4. MAKE A SIGNIFICANT PORTION OF THE EXECUTIVE PAY BE IN THE FORM OF RESTRICTED STOCK

Not only is it important to tie executive pay to the average worker salary, but to the shareholders as well. Therefore, a significant portion of executive pay would be in the form of restricted stock. In order to benefit from the 15% corporate tax rate, a minimum of 25% up to a maximum of 75% of pay must come in the form of restricted stock. By holding stock, the executive’s interest would be tied directly to shareholders interest. Unlike options, the restricted stock would have special tax treatment if held for a longer time horizon (paragraph 5 below).

5. RESTRICTED STOCK MUST BE HELD FOR FIVE YEARS FOR PREFERRED TAX TREATMENT

Since some executives would initially be taking a pay cut, there should be special tax treatment for their restricted shares in order to incentivize executives to accept lower pay. First, the amount paid in restricted shares would not be subject to federal or state income tax. Any payroll taxes associated with the restricted shares would be paid by the company, be deductible for income tax purposes by the company and would not be considered pay to the executive for purposes of the maximum pay calculation. The restricted stock must be held for a minimum of five years. If it is, it would be subject to the long-term capital gains tax rate when sold. If the restricted stock is sold prior to the 5 year time period, the proceeds would be **taxed as ordinary income plus a 15% penalty**. The restricted stock would be restricted even after an executive leaves or retires. If this rule was in place, many of the executives of Fannie Mae would have thought twice about taking on more sub-prime loans. Perhaps E. Stanley O’Neal and his executive team at Merrill Lynch would not have weakened risk control measures by removing longstanding employees that “walked the floor” monitoring the risk the firm was taking on.²¹ We believe if this provision were in place when O’Neal became CEO and Chairman in 2003, Merrill Lynch may have survived. Most of O’Neal’s net worth would still be in Merrill Lynch restricted shares today and he would have thought long and hard about taking on excessive risk that would hurt the long-term success of the firm. His desire for short term profits benefitted him, not the long-term employees and shareholders of Merrill Lynch.

6. RESTRICTED STOCK SUBJECT TO DISGORGEMENT IF EXECUTIVE FOUND GUILTY OF CORPORATE MALFEASANCE

One of the problems we have seen recently by a few executives has been to “cook the books” in order to juice up short-term profits (i.e., Fannie Mae) to the detriment of long-term shareholders. Under this plan, any executive found guilty of corporate malfeasance would forfeit their restricted stock. This would create a disincentive for executives to engage in any unethical or illegal practices.

²¹ Mongenson, Gretchen. “How the Thundering Herd Faltered and Fell.” The New York Times. 9 Nov 2008. <www.nytimes.com>



SARBANES-OXLEY RELIEF

Sarbanes-Oxley Act was enacted in response to the Enron and MCI bankruptcies in 2002. This law was put into place to hold companies and executives accountable. The problem with the law is that it is too cumbersome and costly for many small companies to comply with. Moreover, it doesn't appear to have stopped corporate malfeasance. Under the plan, this law will no longer be needed for those companies that adhere to this plan because executive pay is in restricted stock and subject to disgorgement if found guilty of corporate malfeasance. We believe that this personal incentive eliminates the need for Sarbanes-Oxley. Sarbanes-Oxley would still apply to those publicly traded companies that decide not to adhere to this plan.

BOARD MEMBER COMPENSATION

Unfortunately, sitting on a corporate board these days is viewed as an avenue to self-aggrandizement and financial benefit, rather than as a position that carries with it the responsibility of looking out for the best interest of shareholders. Nothing demonstrates this more than Illinois Governor Rod Blagojevich attempting to exchange a U.S. Senate seat for a corporate board seat for his wife.²² We doubt that her experience would be the type of top notch experience and wisdom that is needed to oversee a publicly traded company. Of course, as with executives, not all board members fall in to this category. However, in too many instances, board members have become too friendly to executives with a "you rub my back, I'll rub yours" mentality. The excessive pay packages that boards have approved bring the objectivity of all boards into question. The board's role is to oversee the activities of the corporate executives and to ensure that their corporate decisions are in the **best interest of the shareholders, not themselves or the executives**. We believe, therefore, that members of a corporate board should be compensated in a fashion similar to that of corporate executives.

- 1) Eliminate all options and deferred compensation programs for board members.
- 2) Board member pay will be tiered in a fashion similar to executives with the maximum pay ranging from 1x the average worker pay to 4x the average worker pay depending on annual sales of the organization.
- 3) Any increase in board member pay is tied to the increase in average pay of the lowest paid 80% of the workers in the corporation and adjusted in a similar fashion as executive pay.
- 4) Since board members are there to protect shareholder interests, a higher percentage of that pay must be in the form of restricted stock than the executives. Under this plan, a minimum of 50% of board member pay must be in restricted stock and taxed in a fashion similar to executives. This forces boards to make long-term decisions that are in the best interest of shareholders.

²² Shinkle, Kirk. "FBI: Blagojevich Wanted Corporate Board Bribe." U.S. News and World Report. 9 Dec 2008. <<http://www.usnews.com/blogs/the-ticker/2008/12/9/fbi-bлагоjevich-wanted-corporate-board-bribe.html>>



CONCLUSION

We believe the most effective way to revitalize the country and rebuild investor confidence is through the use of the tax code. The tax code has been used throughout American history to affect behavior - either positively or negatively. This plan is no different. It uses the tax code to bring about greater corporate responsibility and accountability while sparking economic growth.

During the Great Depression, the stock market was mainly the playground of wealthy individuals. In 2009, everyone is tied to the stock market in some fashion. The impact on the economy of this recent market downturn demonstrates how intertwined the stock market is with the overall economy. By lowering corporate income tax rates, along with inducing true change in corporate responsibility, the economy and stock market would rise as confidence is restored. The beauty of this plan is that it is voluntary. Those companies that choose a lower tax rate will expect more accountability from their executives and boards. Those that choose not to accept the lower tax rate will be judged by the market.

It is key that this plan be approved before the stock market recovers. We are sure that there are some executives licking their lips at this golden opportunity - loading up on stock options when the stock price is depressed. We have seen this before in recent history when the stock market recovered in 2003. It would be criminal to let this cycle continue where executives load up on options for themselves and benefit when the stock price goes back up to where it was before the market's fall. At the same time that they benefit from this windfall, shareholders only recoup their losses. All shareholders (states, unions, foundations, endowments and individuals) are tired of executives using corporations as their personal piggy bank. It is time to use the tax code to change this behavior. Good behavior would be rewarded with lower taxes and a better economy.



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