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cc: Board, TSL, JTB, DM, Willis

THE WHITE HOUSE

WASHINGTON

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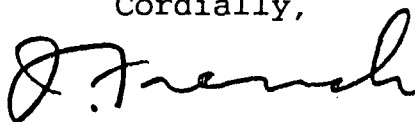
Dear Denny:

Thank you and Joe Anania for taking time to visit with Deputy Secretary Robson, Jay Powell and myself on the critically important FASB projects under way.

We need to keep an open dialogue on financial issues of mutual concern. I look forward to a more detailed discussion in the future on the accounting for incentive stock options. I have included a copy of John Robson's recent speech on that subject.

Best personal regards.

Cordially,



J. French Hill
Special Assistant to the President

Enclosure

Mr. Dennis R. Beresford
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

TREASURY NEWS



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Contact: Anne Kelly Williams
202-622-2960

REMARKS BY
DEPUTY SECRETARY OF THE TREASURY JOHN E. ROBSON
INDUSTRIAL BIOTECHNOLOGY ASSOCIATION
EMERGING COMPANY CONFERENCE
NEW YORK, NEW YORK
JUNE 10, 1992

Good evening. I am very pleased to be here with you tonight. Pleased, because I look back with great satisfaction on my previous personal involvements in biotechnology as a pharmaceutical company executive and a director of a prominent biotech firm. And pleased because American biotechnology is the envy of the world and a fabulous success story of Yankee scientific creativity and leadership. So I am proud to be here among you who work daily to unlock the secrets to new products and new processes that may save lives or dramatically improve product quality or manufacturing productivity.

Certainly the importance of biotechnology has been recognized in a number of actions by the Bush Administration. These include the revision of biotechnology regulatory guidelines, advocacy in the President's 1993 budget of a permanent research and development tax credit and a record \$4 billion Federal investment in biotechnology, changes in the FDA's drug approval process, and a steadfast insistence on protecting intellectual property rights in trade and investment agreements. Even at this moment, the Administration is resisting a global biodiversity treaty at the environmental summit in Rio because we believe it jeopardizes important U.S. biotechnology interests and threatens American jobs.

Tonight I would like to consider with you some issues which I believe can strongly influence, not only the future environment for biotechnology, but our future standard of living, America's competitive position in the global marketplace, and the kind of economy and society we have for ourselves and our descendants.

Let's begin by addressing the contentious matter of executive compensation and, in particular, the treatment of stock options.

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All of us can look disapprovingly on instances where senior corporate executives appear to have been grossly overcompensated in relation to the performance of their companies. But where does the correction of these disconnects between pay and performance lie? Does it lie in better informing the shareholders, who pay for these bad executive compensation decisions, and in a more effective system for holding corporate directors accountable for these decisions, including their removal from office? Or is it time for government to intervene in these corporate compensation decisions? To me, the choice is obvious. These are decisions to be left to the marketplace, not to legislators and bureaucrats.

Others disagree with me. And today we are facing a number of Congressional proposals to limit executive compensation by denying tax deductibility to compensation expenses exceeding certain dollar levels or to cap executive compensation at some fixed multiple of the pay of the company's entry level workers. This is pernicious legislation and ought to be vigorously opposed.

Indeed, it is a supreme irony, after we have spent the years since the Berlin Wall fell weaning the former Iron Curtain countries away from economic systems where every wage was determined by government, that we now propose to adopt the very practice we demand they abandon.

And who are to be the determiners of company "performance" and "correct" compensation? These are not simple questions. For example, all of you in this room know that businesses which depend on scientific research require continuous and substantial investment in R&D if a stream of profitable new products and innovations is to be maintained over time. But we also know that this R&D investment will reduce current earnings and that the results of any R&D investment are seldom predictable.

Is a company performing well during periods when it incurs large R&D expenses to produce uncertain profits that may be a decade in the future? Should the executives of such a company be diminished in compensation if the stock doesn't happen to perform during this period as well as some other firm's in the same industry or against some stock market index? And should the successors of these executives be rewarded in their compensation because they were fortunate enough to be there when the fruits of the earlier R&D investment were realized? These same issues are raised for any management contemplating investments to achieve long-term strategic and shareholder value objectives at the price of diminished short term results.

And what should someone be paid as CEO of a global corporation with a hundred thousand or more employees -- just for being the person where the buck stops -- even if the company isn't doing spectacularly? For that matter, what should Michael Jackson, Michael Jordan, Meryl Streep, Bill Cosby or Madonna get paid? Or Stephen Jobs who started Apple Computer from scratch? Or a Sam Walton?

Frankly, I don't know. But I do know that these decisions are highly complex, situation specific, and that they must be left to the marketplace and the normal vehicles of corporate governance. Government shouldn't even think of messing around with this stuff. And, even those who seek only improved and uniform public disclosure of executive compensation data to shareholders better be extremely careful about how they undertake to "simplify" these data in neat little box scores and charts. It just ain't that simple, and each executive compensation situation is different and is affected by a myriad of factors.

Now there's another compensation matter being debated that is of equal concern to the future of biotechnology, innovation and entrepreneurship in this country. That is employee stock options.

I know something about stock options. I have held and exercised them, granted them to my company's employees, and seen them operate as a powerful incentive for motivating, attracting and retaining employees. By and large they put the employee stock option holder in the same shoes as the company's shareholders and, of course, stock option plans must be approved by the shareholders. I believe stock options are an important and unique tool for providing incentives, stimulating innovation, and improving the energy and quality of management. And I strongly oppose actions now being considered that will diminish the utility of stock options.

I have already spoken about various proposals to generally limit executive compensation. These would, of course, negatively impact stock options as well as other forms of compensation. But there are some notions afoot in the accounting world that would also have a negative effect. I refer specifically to the idea, now being considered by the Financial Accounting Standards Board, the SEC, and at least one U.S. Senator, to require companies to record the "expense" of stock options as a charge against income. Although there is not a consensus as to what point in time the accounting expense ought to be recorded -- that is, when an option is granted, becomes vested, or is exercised -- the deterrent on using stock options will be significant.

This deterrent will be particularly harmful to start-up firms and smaller companies which are the typical model for biotechnology and other high-tech businesses. Stock options are liberally employed in these businesses to provide the reward potential to scientific entrepreneurs, and the means to attract and retain the necessary scientific and management talent, in circumstances where the company has insufficient resources to pay significant cash compensation. But this isn't only a small company issue. Employee stock options operate as an important incentive device for firms of all sizes.

There is also the question of how to value options for earnings statement accounting purposes. Some valuation formulas require an entirely speculative look into the future. And, depending on when the option is required to be run through a company's earning statement, you have the potentially perverse result that the more successful a venture becomes, and the more its stock therefore increases in value, the greater will be the hit to its earnings.

Bear in mind, too, that under current law and regulations, stock option plans and option grants are required to be fully disclosed to the shareholders and the public. The number of optioned shares and the exercise price are completely divulged in proxy statements and SEC form 10K. So no one is hiding the stock option pea under the walnut shell.

So why are FASB, members of Congress, and even some at the SEC considering this accounting change for stock options that will deter their use? Because, they say, these stock options have value, and technically sound financial accounting scorekeeping requires us to reflect that value as a compensation expense in the company's profit and loss statement.

Well, I don't agree that these technocrats are right. But, suppose, as a matter of textbook accounting, they were right. Who is injured by the current stock option system? Why would you want to damage a useful incentive that produces innovation, motivation, jobs, and economic growth for the sake of an arcane accounting principle? That strikes me as a very bad trade and a total surrender of good economic practice to the technical theology of accounting. We should not permit an important compensation vehicle like employee stock options, that affects real people and real business, to fall prey to the metaphysics of accounting.

And so I specifically and most strongly urge FASB, the SEC, and the Congress to focus on what is important in the real world and abandon their pursuit of these accounting changes for stock options that will have the inevitable effect of discouraging their use.

But beyond employee stock options, I worry that we are seeing too many instances of bean-counter mentality and preoccupation with technical niceties instead of the substance of things. For example, there are those who advocate mark-to-market accounting applied to the investment accounts of financial institutions, even though it would lead to unnecessary and unnatural volatility in their earnings or capital and contribute further to the credit crunch. And Congressional tax experts manifest a similar technical myopia in calculating that capital gains tax cuts reduce revenues instead of increasing them.

Another area of debate where American competitive opportunity and accounting issues intersect, is whether large, well established foreign companies can list their stock on U.S. exchanges without fully conforming to the U.S. accounting system. It is profoundly in our interest to attract world class foreign firms to raise capital and trade their shares in U.S. financial markets. Admittedly, considerations of fairness to other listed firms and disclosure to investors complicate the issue. But I hope that the regulators and the accounting community keep their eye on the big picture, and do not needlessly sacrifice this economic growth opportunity on the altar of technical convention.

Why do we miss the important point so often? And why do we do these harmful things to ourselves? I believe these are symptoms of a greater and ultimately more threatening force. And that is that we have become too much a nation mesmerized and drained by process, paper shuffling, technical detail, and constricting regulation. More and more we are slipping into the clutches of a green eyeshade mentality.

We have too many lawyers, too many lawsuits, too many accountants, too many forms and too many other burdensome complexities. We have created a two-foot thick tax law that is underpinned by regulations twenty times that massive. In a system based on voluntary tax compliance, nearly half the taxpayers cannot fill out their own income tax returns. Our economic and social systems have become baroque. And some day the accumulated silt of all these lawyers, accountants, regulations, regulators, actuaries and other experts will choke the rivers of commerce and entrepreneurship.

It is not my purpose to condemn lawyers, accountants or any others as professionals or individuals. But I do condemn the system that spawns their overwhelming presence and cannot seem to operate without them. It is costly.

How costly? In the last three decades the number of lawyers in America tripled. One academic study finds a direct correlation between economic growth and the number of lawyers in the workforce, estimating that each attorney reduces GNP by \$2.5 million a year. And, according to surveys, excessive litigation costs create employee layoffs and product withdrawals. But, not just to pick on the lawyers, the same kinds of costs can, I am sure, be traced to accountants and other professionals. I think we all know this intuitively.

Just a week ago in Warsaw, I sat with the economic leaders of Poland. One of the bright spots in Poland's transition to a free market economy has been the explosive growth of its small entrepreneurial private sector which the government has by and large freed to do its own thing. I noted this and urged my Polish colleagues, who are starting with a clean slate, to avoid the mistake of creating complex, overregulated systems that would smother entrepreneurship.

So, too, can we take steps to liberate innovation and entrepreneurship and avoid stifling and short-changing our economic future. Certainly we can try to find and promote appropriate incentives for individual performance and economic growth -- such as stock options -- not defeat them.

And, in a variety of actions and proposals, the Bush Administration has begun the process of creating incentives and more open space for economic creativity and growth, legal system reform, the regulatory moratorium, payroll tax simplification, uniformity among the multiple bank regulators, a capital gains tax reduction, and in the work of the Council on Competitiveness. But this is an undertaking that requires the zeal and participation of all Americans.

We do not need to leave to our children and grandchildren a nation where accountants, lawyers and legions of experts are the arbiters of the incentives for economic growth. With resolution, we can restore more elbow room for entrepreneurs and innovators.

I know that the biotechnology industry shares that view. And it is appropriate here and now that we dedicate our mutual efforts to that end.

Thank you.

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