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The Crystal Report on Executive Compensation



We Might As Well Nationalize the Banks!

by Graef Crystal

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Let's get it over with and proceed with the nationalization of this country's banks. After all, the Congress just paved the way by creating a senior executive pay environment in which only a GS-15 could be comfortable.

The rules of the pay game seem to be changing almost every week, to the point where I expect to see a preview of the next set whenever I go to the movies.

Apparently, President Obama is not too keen about what Rep. Barney Frank (D-MA) and Senator Chris Dodd (D-CT) have wrought. So maybe it will be changed in a few weeks.

In the movie that was running until last Friday, senior executives at TARP institutions could be paid cash up to \$500,000 a year. And they could be given unlimited numbers of restricted shares, so long as those shares didn't vest until the government was repaid (although there seemed to be some wiggle room on the vesting issue).

In this week's movie, the \$500,000 cap has been eliminated. But any incentives – which must come in the form of restricted stock – are limited to one-third of cash compensation.

So fasten your seatbelts for a \$20 million base salary.

Most likely, none of the TARP banks will go that far, for fear of waking up the Honorable Rep. Frank and the Honorable Sen. Dodd and watching them gird their loins (not particularly pleasant to see, I would imagine) for another battle in the executive compensation war.

I just love how the two of them, who, to my knowledge, have never done one day's work in the private sector, are able to project themselves as experts in executive compensation.

To them, there will be no problem holding on to the bankers, because times being so bad as they are, where are they going anyway?

And if they do leave, it will be no problem recruiting talent from non-TARP companies, because there are plenty of people out there who will apply for jobs – especially unemployed executives many of whom didn't have the moxie to keep their jobs.

Lost in all this is that a talented banking executive or a talented bond salesperson or a talented broker can go to a non-TARP company. A lot of banking skills are readily transferable to, say, a pharmaceutical company's finance department.

And if you want to get some talent into a TARP company to help turn things around, who, with any credentials, is going to want to work for a piddling cash sum and an even more piddling puddle of restricted stock that may not ever vest? There are, after all, only so many masochists out there.

But a GS-15 might be available.

And with a GS-15 running things, TARP companies can begin to learn how to emulate the vaunted efficiency of the Federal government.

What a horrorshow!

Lest my readers think that I am delighting in trashing Democrats, they should know that I have also trashed Republicans – like Richard Nixon who put in even dumber pay controls that affected the entire U.S. economy.

I am not an apologist for high pay. But I am for free markets. And I am a fervent apostle of high pay for high performance, as well as its corollary, low pay for low performance.

I am also dubious about the value of the "Say on Pay" that has been pushed into the new legislation by certain priests and priestesses of the corporate governance church. Resolutions of this type are non-binding and being non-binding can be fairly easily ignored.

True Corrective Actions

For my part, I think there are three things that could be done that, while they won't solve anything really fast, should do the trick in the long run. And they all come under the notion of making the market for executive pay truly free.

First, require that a director receive a majority of all votes cast to be elected or re-elected. That way, if shareholders don't like, say, the chairman of the comp committee, they can send him packing. Nothing non-binding about that.

Second, force the CalPERS's of the world to represent the fiduciary interests of their beneficiaries by selling the stock of companies that have abusive pay levels or pay practices. The money from the sale can be re-invested in companies that are model citizens when it comes to executive pay.

If institutional investors stopped talking about executive pay and did something about it, a turnaround in attitudes would not be long in coming. Selling shares has the effect of depressing prices, which causes the following side effects:

- The value of restricted stock grants drops.
- The value of stock option shares plummets.
- And before long, the CEO is out in the street.

Third, the IRS should be empowered to deny the tax deduction of any pay package that is wildly excessive and should do so in a most public way, so that the lawyers can use the IRS position as backup for damage claims in civil actions.

The IRS code says compensation is deductible to a corporation so long as it is “ordinary, necessary and reasonable”. Cover your eyes and read the letters in the last word: R-E-A-S-O-N-A-B-L-E.

I'm not talking here about going after a company that is paying, say, 50 percent more than a market rate of pay. I am talking here about going after companies that are paying, say, 300 percent or more above a reasonable standard of pay, after taking into account such relevant factors as the company's size, its performance and the degree of risk imbedded in the pay package.

But I doubt that Rep. Frank or Sen. Dodd really want to go that way. Remember that not all wealthy campaign contributors are fervent Republicans.

Got to serve our constituents!

2009 marks GRAEF Crystal's 50th anniversary in the executive compensation field. He has been a director of compensation for General Dynamics and Pfizer, worked as a consultant for Booz, Allen & Hamilton, served as worldwide practice director at Towers Perrin, was a professor at the University of California at Berkeley's Haas School of Business for 10 years and a syndicated columnist for Bloomberg News for almost nine years. He has written six books and more than 1,600 articles on executive pay. He is now teaching a course in executive compensation at the University of California at Berkeley's Boalt School of Law.