

GraefCrystal.com

The Crystal Report on Executive Compensation



Obama's \$500,000 Cap Feels Great, Does Nothing

by Graef Crystal

February 9, 2009

The following article was published by Bloomberg News on Feb. 9, 2009.

I'm in a time warp. I keep hearing Howard Beale from the movie "Network" screaming, "I'm mad as hell, and I'm not going to take it any more." Yet when I open my eyes, I find myself looking not at Beale but at President Barack Obama.

Our new president has worked himself into a lather over the way senior executives have been paid at major financial institutions, particularly those that have received gargantuan government assistance.

Last week the Obama administration issued new regulations designed to curb executive pay while at the same time avoiding unnecessarily risky incentives.

Bottom line: The new rules do neither.

The regulations distinguish between gargantuan borrowers such as American International Group Inc., Bank of America Corp. and Citigroup Inc. and lesser debtors.

Senior executives at the big institutions (probably the top five who appear on proxy statements) can't receive annual compensation (probably salary and bonus) of more than \$500,000 a year.

By itself, that's tough. So tough that my first impulse was to figure out a way to short the New York City real estate market -- and the Hamptons while I was at it.

"But wait," as the gadget hawkers say on TV commercials. Those senior executives can receive as much restricted stock -- free shares -- as their boards want to give them.

Doughnut Diet

This is akin to admonishing a teenager that he has to lose weight and therefore can no longer buy Big Macs and fries, only to turn a blind eye as he consumes endless amounts of pizza and donuts.

So I may have to limit your cash pay at \$500,000, but I can give you \$100 million of free shares.

“But wait.” Those free shares come with a catch. The government has to be paid back before they vest, something that may not occur for years or may never occur.

“But wait.” There’s an escape clause buried in the new regulation. The shares can be allowed to vest “after a specified period according to conditions that consider among other factors the degree a company has satisfied repayment obligations, protected taxpayer interests or met lending and stability standards.” Whatever that means.

Then we have an “earmark” in the regulations, one sponsored by some in the corporate-governance priesthood. It’s a requirement that a company allow shareholders a “say on pay.” The priesthood figures that if shareholders can express their opinion on the subject, boards will pay attention.

No Limits

But these resolutions are non-binding. Lawyers call this arrangement “precatory,” after the Latin word for prayer. You can pray to the Lord, but He might not hear you. In this case, you can pray to your board, and if past behavior is any guide, it definitely won’t hear you.

Then, for companies receiving financial assistance from the government, other than the really big borrowers, there is no limit of \$500,000 in cash and, indeed, no limits at all, provided you disclose everything and the shareholders get their say on pay.

The government has also weighed in on perks. Here’s a further proof of the old maxim: “The generals are always fighting the last war.”

Corporate Jets

Perks -- like flying your wife and children with you on corporate jets as well as elaborate security services, no doubt designed to protect you from your shareholders -- have been much in the news of late. First, we had the Detroit auto chiefs

winging their way to Washington on corporate jets, where they changed into their poverty costumes and marched into a congressional hearing room waving signs that read “Will work for food.” More recently, we have news of Citigroup Inc. about to take delivery of an expensive jet.

And then there’s Sandy Weill, the retired head of Citigroup traveling with his family on a luxury company jet, outfitted with pillows made from Hermes scarves. Maureen Dowd of the New York Times unearthed that one.

So the generals are all over perks, which, at bottom, are small potatoes in the context of the overall senior executive pay package.

“But wait.” You can still give all the perks you want so long as you disclose your perk policy to shareholders and give them a say on pay.

Boom for Lawyers

The government wants companies to avoid really risky incentives, which is why stock options have been taken off the kosher-food pay menu. But who do you think is going to be attracted to a pay package that limits cash compensation to \$500,000 and then offers dazzling numbers of restricted shares that will make one rich, but may also never pay off at all? A risk-taker is who.

There is one good thing about all these regulations. Even before Obama has been given an economic stimulus bill to sign, he has found a creative way to create more jobs -- jobs for lawyers, jobs for accountants and jobs for pay consultants.

I think the president is on to something. The entire U.S. economy may be lifted out of recession simply by creating more and more regulations of this type.

(Graef Crystal is a contributor to Bloomberg News. The opinions expressed are his own.)

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.