Agencies Must Toughen Up Banker Pay Rules, Senate Panel Hears

By Evan Weinberger

New York (February 15, 2012, 6:19 PM ET)—Advocates of restricted compensation for bankers told a U.S. Senate panel Wednesday that current proposals put forward by regulatory agencies do not go far enough to tie pay to performance for employees throughout major financial companies.

In testimony before the Senate Banking Subcommittee on Financial Institutions and Consumer Protection, Columbia Law School professor Robert J. Jackson Jr. said rules put forward by the Federal Deposit Insurance Corp., the Board of Governors of the Federal Reserve System and other banking regulators do not force banks to provide enough information about the compensation for lower-level executives that could bring down a major financial institution.

“The rules provide little hope that regulators will actually oversee or address the incentives of employees, like those who worked at AIG Financial Products Corp., who make decisions with critical consequences for the safety and soundness of our financial system,” Jackson said, referencing the unit whose derivative investments nearly destroyed American International Group Inc., requiring $182 billion in bailout funds to survive.

Under Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Fed, the FDIC, the U.S. Securities and Exchange Commission, and other regulators were required to put forward rules mandating that major financial institutions disclose the structure of incentive-based compensation packages for executives.

Regulators could prohibit any pay package thatrewarded executives for taking risks.

Subcommittee Chairman Sherrod Brown, D-Ohio, said in his opening statement that between the provisions of Section 956 as well as a section of Dodd-Frank giving the Fed authority to impose risk or other prudential standards for complex financial institutions, Congress had provided regulators with sufficient tools to bring banker pay in line with bank performance.

“It appears that significant tools exist for regulators to put an end to runaway pay and 'heads I win, tails the taxpayer loses' compensation packages,” Brown said.

But Jackson noted that the rules the regulators put forward last spring only require essentially an essay outlining the pay packages, and not a detailed accounting of compensation for top
executives.

The professor also said that focusing on the compensation of top executives at a bank holding company or major insurer would not necessarily prevent other, lower-level executives from taking a company down.

Pointing to the experience of AIG, where members of its infamous financial products unit would not have been covered by Section 956 and who were well-paid for taking on risks, Kurt Hyde, the deputy special inspector general for the Troubled Asset Relief Program, said there was a need for more disclosure from more employees at big financial companies.

“We've got to get further down into the bowels of the corporation,” he said.

Lucian Bebchuk, a Harvard Law School professor who specializes in executive compensation issues, told the Senate panel that federal regulators should only set standards on executive pay for companies that have an implicit government guarantee, like major banks that are federally insured.

Bebchuk added that bank executives should be blocked from cashing out their stock options — the going currency in banker pay — for significant periods, and that those executives subject to pay restrictions should be barred from hedging against losses to company stock.

“There is really no good reason ... why any company should allow general freedom for executives to hedge and engage in derivative transactions,” Bebchuk said, adding that hedges could provide a conflict of interest for top executives.

But many of the country's top financial companies have already adopted changes to their compensation structures, and in many ways are going beyond what the government wants them to do, said Michael Melbinger of Winston & Strawn LLP, who testified on behalf of industry group the Financial Services Roundtable.

Compensation for top executives at the group's members is down since the 2008 financial crisis, he said, and the majority of major financial services companies have already put in place clawbacks, maximum pay caps and other compensation controls.

“Financial institutions have led the way in designing plans with reduced risks attributable to incentive compensation, greater transparency, better correlation between pay and performance, and just plain lower compensation,” Melbinger said.