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Hearing on
Pay for Performance: Incentive Compensation at Large Financial Institutions

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Thank you, Chairman Brown and Ranking Member Corker, for the opportunity to testify before you about incentive compensation at America's largest financial institutions. Hard experience has taught us that bankers' pay can be a source of concern for all Americans, so I welcome your invitation and look forward to participating in this hearing. As a researcher at Columbia Law School who writes on, among other matters, bankers' incentives, I am pleased to have the opportunity to testify on this important issue.[1]

The financial crisis of 2008 brought the potential dangers associated with bankers' incentives into sharp relief. In 2010, Congress responded with the Dodd-Frank Wall Street Reform and Consumer Protection Act, which included several important new rules that now govern executive pay at large public companies. For example, one provision proposed by the Administration and included in Dodd-Frank now requires large public companies to give shareholders a vote on executive pay. Boards of directors initially resisted federally mandated "say-on-pay" votes, arguing that they might compromise the board's longstanding freedom to use its business judgment in setting executive pay. While it is too soon to know how say-on-pay will affect executive compensation in the long run, preliminary study of results from the first year of votes suggests that say-on-pay has facilitated important dialogue between directors and shareholders on pay while leaving the ultimate decision to the sound judgment of the board.[2]

Say-on-pay has been the subject of considerable political debate and media scrutiny. But Dodd-Frank's broadest compensated-related provision has received much less attention. That

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[1] My institutional affiliation is given for identification purposes only. Further, from 2009 to 2010 I served at the Department of the Treasury as an advisor to senior officials on executive compensation and in the Office of the Special Master for TARP Executive Compensation. The views set forth here are solely my own and should not be attributed to the Treasury. This testimony expands upon comments I submitted to federal regulators in May 2011, *see* Robert J. Jackson, Jr., Ltr. to the Board of Governors of the Federal Reserve System, *available at* http://www.law.columbia.edu/null/download?&exclusive=filemgr.download&file_id=6035.

[2] *See, e.g.*, COUNCIL OF INSTITUTIONAL INVESTORS, SAY ON PAY: IDENTIFYING INVESTOR CONCERNS (Sept. 2011), at 20 (concluding, following empirical study of the shareholder votes cast during the 2011 proxy season, that "[i]nvestors by and large agree that they do not want to dictate executive pay arrangements").

provision, Section 956, gives nine federal agencies, including the Federal Reserve, the Federal Deposit Insurance Corporation and the Securities and Exchange Commission, extraordinarily expansive authority to ensure that bonus practices at our largest banks never again endanger financial stability. Section 956 gives the agencies two key powers in regulating banker bonuses. First, the agencies must "prohibit *any*" bonus arrangement that gives bankers excessive pay or could lead to material financial loss. Second, the agencies must require banks to disclose "the structures of *all*" bonus arrangements to regulators so that those who oversee our financial institutions can identify incentive structures that could lead bankers to take excessive risks.[3] In Section 956, Congress and the Administration gave federal regulators the expansive powers they will need to ensure that bonus practices do not threaten the safety and soundness of America's financial system. The agencies jointly issued proposed rules under Section 956 last April, and these rules are scheduled to be finalized later this year.[4]

Unfortunately, the agencies' proposals fall far short of the rigorous oversight of banker pay that Congress authorized in Section 956. In this testimony, I will provide three reasons why Congress should not expect these rules to change bonus practices at America's largest banks, and describe three principles for reform that would help ensure that incentive structures give bankers reason to pursue long-term value rather than the illusory, short-term profits that led to the crisis.

First, the rules focus their attention on the few top executives who lead America's banks. But bank executives' incentives have for many years been the subject of extensive disclosure rules and media scrutiny. That is not to say that top executives' incentives are unimportant. But

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 956(a-b), 124 Stat. 1376, 1905 (2010) (emphases added).

[4] Office of the Comptroller of the Currency et al., Incentive-Based Compensation Arrangements, 76 Fed. Reg. 21,170 (April 14, 2011). Although the agencies initially expressed hope that the rules would be finalized in the first six months of 2012, they recently signaled that final rules will not be issued until the second half of this year, *see* SEC, Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act—Upcoming Activity, *available at* http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml#07-12-12.

for two reasons the rules governing bankers' incentives should apply beyond this limited group. First, one of the clearest lessons of the crisis was that bankers outside the executive suite can cause a great deal of systemic damage. None of the employees at American International Group's Financial Products division, the unit that contributed to the system's collapse in September 2008, was an executive. If that division were still operating today, the agencies' most stringent rules under Section 956 would not apply to bonuses paid to its employees. Second, because executives' incentives have long been scrutinized by investors and the public, rules governing their bonuses may be redundant to existing practices. Indeed, as I explain below, the agencies' most rigorous rule under Section 956 is redundant to pay practices that were in place at many large banks years before the crisis. Accordingly, I argue that ***rules governing bankers' bonuses should not be limited to the group of executives, and regulation of executives' incentives should go beyond longstanding industry pay practices.***

Second, the rules provide little hope that regulators will actually oversee or address the incentives of employees, like those who worked at AIG Financial Products, who make decisions with critical consequences for the safety and soundness of our financial system. The rules require only that banks identify these employees using a vague standard—and then have the bank's own board of directors approve the employees' pay. For two reasons, we should not expect these rules to address bonus structures that encourage bankers to take excessive risk. First, because there is no clear standard for identifying these employees, there is little hope that the rule will apply to all of the risktakers whose decisions might threaten systemic stability. In 2008 alone, just six of our largest banks collectively had more than 1.3 million employees, more than 4,500 of whom received bonuses of more than $1 million each. A vague standard applied by the banks themselves is hardly likely to lead to the identification of the few employees in that large group whose incentives warrant special attention. Second, even if banks do identify the appropriate group of employees, the rule is unlikely to eliminate bonuses for those employees that encourage them to pursue short-term profits at the expense of systemic stability. Because directors, as a matter of law, owe their allegiance to shareholders rather than to financial stability, there is no reason to think that requiring the board to approve bonuses will eliminate incentives for excessive risktaking. Thus, regulators should ***provide clear rules for identifying significant risktakers at large banks and require bonus structures for these risktakers to be reviewed by regulators rather than the boards of directors of the banks themselves.***

Third, while there can and should be debate about how regulation should influence bonus practices, there is no question that regulators need detailed information about those practices to do their work under Section 956. Congress and the Administration understood as much; that is why the broadest language in Section 956 is reserved for the requirement that banks disclose detailed information about incentives to regulators. But the agencies' proposal requires only that banks provide qualitative, general descriptions of their policies on pay. These reports will be redundant to disclosure long required by securities rules. And, more importantly, because they will consist of qualitative reports rather than clear, quantitative data, they have very little chance of giving regulators the information they need to identify bonus practices that could lead bankers to take the kinds of excessive risks that contributed to the financial crisis. Instead, I argue, the agencies should ***require banks to provide meaningful quantitative disclosure of bankers' incentives*** rather than the duplicative qualitative reporting that the agencies have proposed.

Despite the sweeping authority Congress granted federal regulators in Section 956, the agencies' proposal likely leaves bonuses completely unregulated for many significant risktakers at our largest banks. Below I explain why—and what might be done about it.

I. Regulation of Executives' Incentives

Consistent with Section 956's command that regulators prohibit incentive-pay arrangements that encourage bankers to take inappropriate risks, the agencies' proposal requires that, at large financial institutions, at least 50% of each executive's incentive pay be deferred for at least three years. Many have debated whether a 50% deferral requirement is likely to give bankers optimal risk-taking incentives. I agree with the agencies that deferrals can be useful in structuring incentives—because, as the agencies have explained, deferral "allows a period of time for risks not previously discerned" "to ultimately materialize," and for bankers' pay to be adjusted for those risks. But for two reasons, the agencies' decision to apply this rule only to executives means that the deferral requirement will have little effect on bankers' incentives.

First, one of the few clear lessons from the financial crisis is that employees outside the group of executives frequently make decisions that affect systemic stability. None of the employees at American International Group's Financial Products division was an executive; nor was the Citigroup banker who earned more than $100 million in annual bonuses trading energy futures in the years leading up to the crisis.[5] Congress and the Administration understood well that, even though they are not executives, these employees' incentives demand scrutiny. That is why both Congress's rules and the Treasury Department's oversight for bonuses at recipients of financial assistance under the Troubled Asset Relief Program apply beyond the group of executives,[6] and that is why the language of Section 956 itself specifies that it applies not only

[5] *See* American International Group, Inc., Form 10-K (filed Feb. 2, 2008), at 15 (listing AIG's executives, including its general counsel and chief human resources officer—but excluding employees at Financial Products). *Compare* Michael Sinconolfi & Ann Davis, *Citi in $100 Million Pay Clash*, WALL ST. J. (July 25, 2009), at A1 (describing the trader, who was an employee of Citigroup's energy-trading unit, Phibro) *with* Citigroup, Inc., Form 10-K (filed Feb. 22, 2008), at 129, 201 (listing Citigroup's executives, including its general counsel and vice chairmen but excluding this trader—even though Phibro earned $843 million in trading revenues in 2007 alone).

[6] Congress placed limits on bonuses for employees of TARP recipients that applied, for most large banks, to the senior executive officers and 25 most highly paid employees of each firm, see American Recovery and Reinvestment Act, Pub. L. No, 111-5 § 7001, 123 Stat. 115 (2009). For seven significant recipients of TARP

to payments to any "executive" but also to any other "employee." That is also why international standards on banker pay require that mandatory-deferral rules apply to employees outside the executive suite.[7] But the agencies' deferral rules under Section 956 apply only to executives, excluding many employees whose decisions can have important systemic implications.

Second, because bank executives' pay has long been subject to disclosure and public scrutiny, the proposed deferral rule is redundant to longstanding pay practices at America's largest banks. Figure I below describes the percentage of executives' incentive pay that was deferred at six of America's largest banks in the years leading up to the financial crisis:

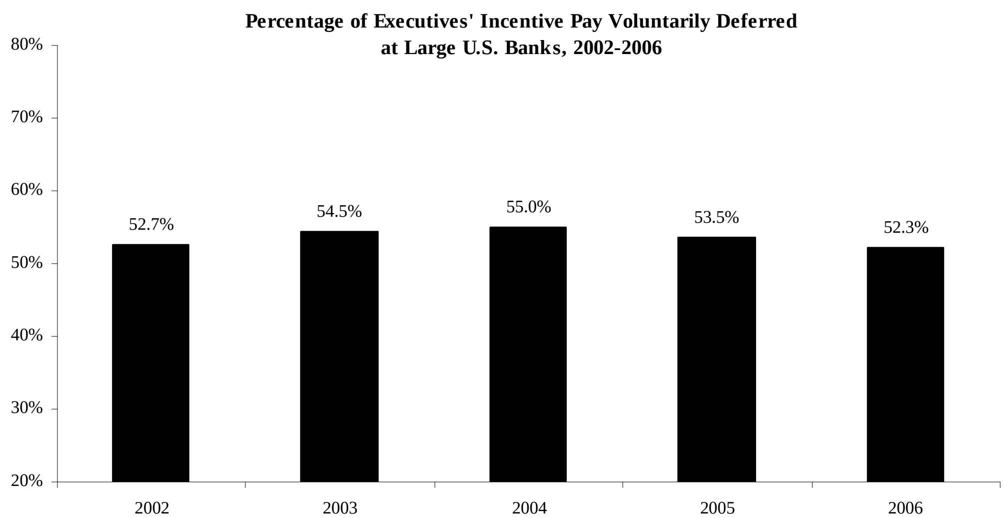

Figure I: Deferral Practices for Executive Incentives at Large Banks Before the Financial Crisis[8]

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assistance, the Treasury Department went even further, requiring review by the Special Master for TARP Executive Compensation of compensation structures for both executives and the 100 most highly paid employees, Department of the Treasury, TARP Standards for Compensation and Corporate Governance, 74 Fed. Reg. 28,394 (2009).

[7] For example, standards on banker pay adopted by the Financial Stability Board state clearly that incentive pay should be deferred for "senior executives *as well as other employees whose actions have a material impact on the risk exposure of the firm*." FINANCIAL STABILITY BOARD, PRINCIPLES FOR SOUND COMPENSATION PRACTICES: IMPLEMENTATION STANDARDS 3, Basel, Switzerland (Sept. 2009) (emphasis added). Similarly, deferral rules recently adopted by the European Parliament expressly apply "at least" to "senior management, risk takers, . . . and any employee whose [pay] takes them into the same [pay] bracket as senior managers and risk takers." EUROPEAN PARLIAMENT, Directive 2010/76/EU (Dec. 14, 2010) at ¶ 3.

[8] The data reflected in Figure I include incentive payments disclosed for the top five executives at Bank of America, Citigroup, Goldman Sachs, J.P. Morgan Chase, Morgan Stanley, and Wells Fargo, in each case drawn from the ExecuComp dataset. *See* COMPUSTAT EXECUTIVE COMPENSATION DATASET, WHARTON RESEARCH DATA SERVICES, *available at* http://wrds-web.wharton.upenn.edu/wrds/index.cfm (last accessed February 11, 2012). Figure I assumes that payments under long-term incentive programs and in the form of options or stock are

As Figure I shows, the largest U.S. banks deferred more than 50% of their executives' incentive pay for years prior to the financial crisis. Moreover, in the years immediately following the crisis, the banks voluntarily agreed to defer even larger proportions of executives' incentives even before Congress enacted Section 956.[9] Because the proposed rules are redundant to longstanding industry practices on executive pay, we should not expect that the agencies' proposed rules will meaningfully change bankers' incentives.[10]

The agencies' most stringent rules on incentives do not apply to bankers who take significant risk—and are redundant with respect to the few executives to whom they do apply. To the extent that Congress and the agencies seek to ensure that bonus structures do not give bankers incentives to pursue excessive risk, ***rules governing bankers' bonuses should not be limited to the group of executives, and regulation of executives' bonuses should go beyond longstanding industry practices on executive pay.***[11]

"deferred" for purposes of the agencies' proposal, because a standard term of those programs is that amounts paid vest over several years on a pro rata basis. *Compare* Morgan Stanley, Schedule 14A (filed February 24, 2006), at 22 (noting that stock awards granted to executives vested 50% on the third anniversary of the grant date and 50% on the fourth anniversary of the grant date) *with* Office of the Comptroller of the Currency et al., *supra* note 4, at 21,194 (explaining that the agencies' proposal under Section 956 requires deferrals "over a period of no less than three years, with the release of deferred amounts to occur no faster than on a pro rata basis").

[9] See, e.g., GOLDMAN SACHS GRP., GOLDMAN SACHS COMPENSATION PRACTICES 12 (March 2010) (noting that all of Goldman's executives, as well as other officials who are members of the firm's Management Committee, received 100% of their incentive pay in stock that was not transferable for five years pursuant to policies voluntarily adopted months before the passage of Dodd-Frank).

[10] In addition to the deferral requirement, the agencies' proposal also requires that, during the deferral period, incentives paid to executives be subject to a clawback, or "look-back" provision, that would require incentives to be "adjusted downward to reflect actual losses." Office of the Comptroller of the Currency et al., *supra* note 4, at 21,198. This requirement, too, is redundant to existing executive pay practices at large U.S. banks. *See, e.g.*, GOLDMAN SACHS GRP., *supra* note 9, at 12 (describing the adoption of such a clawback); Morgan Stanley, Schedule 14A (filed April 14, 2010), at 18 (same).

[11] Indeed, in many respects the agencies' proposal lags prevailing industry practices on executive pay. For example, the proposal would not prohibit executives from hedging—that is, from using derivatives and similar instruments to undermine the incentives created by stock compensation. Office of the Comptroller of the Currency et al., *supra* note 4, at 21,183 (requesting comment on whether hedging should be prohibited). Many large U.S. banks have prohibited executives from hedging for years, *see, e.g.*, Goldman Sachs Grp., Schedule 14A (filed March 7, 2008) at 21 ("Our [executives] are prohibited from hedging . . . their equity-based awards."), and academics long ago provided evidence that hedging is used to undermine the incentives provided by stock-based pay, see J. Carr Bettis et al., *Managerial Ownership, Incentive Contracting, and the Use of Zero-Cost Collars and Equity Swaps by Corporate Insiders*, 36 J. FIN. & QUANT. ANALYSIS 345, 346 (2001) (finding that executives "use [hedging transactions] to cover a significant proportion of their holdings of the firm's stock"). Hank Greenberg, the CEO of

II. Regulating the Incentives of Significant Risktakers

As I have noted, the agencies' proposed deferral requirement applies only to executives. With respect to all other employees, including significant risktakers, the proposal requires only that the board of directors of the bank identify employees who "individually have the ability" to cause losses "that are substantial in relation to the institution's size"; for these employees, the board must approve their incentive pay as "appropriately balanced." This approach is unlikely to allow regulators or banks to identify the employees whose incentives deserve special scrutiny. More importantly, even if those employees are identified, it is doubtful that the proposal will ensure that their incentives are consistent with systemic stability.

At a large financial institution, thousands of risktakers are spread throughout the firm. Although it is difficult to know how many of these employees take systemically important risk, pay levels may serve as a helpful means of identifying those who bear substantial organizational responsibility. Table I below describes the number of employees at six large U.S. banks—and the number of bankers who received bonuses of more than $1 million—in 2008:

Financial Institution	Total Number of Employees	Employees Receiving Incentive Pay of More than $1 Million
Bank of America	243,000	263
Citigroup	322,800	1,102
Goldman Sachs	30,067	1,407
J.P. Morgan Chase	224,961	1,826
Morgan Stanley	28,475	55
Wells Fargo	281,000	89
Totals	**1,130,303**	**4,742**

Table I. Bankers Receiving Incentive Pay of More Than $1 Million in 2008[12]

AIG, provided perhaps the most prominent example, hedging approximately $300 million worth of AIG stock in 2005 and avoiding $280 million in losses when the firm collapsed in 2008. *Id.* at 347. The Office of the Special Master for TARP Executive Compensation has prohibited hedging for all of the employees at all of the firms subject to its jurisdiction. Kenneth R. Feinberg, U.S. Dept. of the Treasury, Ltr. to Bob Benmoche (Oct. 22, 2009), at 3.

[12] *See* Andrew M. Cuomo, *No Rhyme or Reason: The "Heads I Win, Tails You Lose" Bank Bonus Culture*, *available at* http://www.oag.state.ny.us/media_center/2009/july/pdfs/Bonus%20Report%20Final%207.30.09.pdf.

At the height of the crisis these six firms alone had more than 1.1 million employees, more than 4,500 of whom received bonuses of more than $1 million in 2008—a year in which performance suffered considerably. Identifying the key risktakers among a group of this size and scope requires a careful assessment of the relationship between employees' activities and the firm's exposures against a clear set of rules. One might expect, for example, that the agencies would require that the group of significant risktakers include the employees who, according to the regulators' risk models, are responsible for the firm's most significant exposures. Instead, however, the agencies' proposal provides only a vague standard under which the banks themselves are responsible for identifying these critical employees. This approach is likely to lead either to an overinclusive group, with too little attention given to each risktaker's incentives, or an underinclusive analysis that excludes significant risktakers from regulators' reach.

More importantly, even if the group of significant risktakers is properly identified, incentives for these employees to take excessive risk will likely remain in place. That is because the agencies' proposal requires only that the board of directors of the bank itself approve the compensation of significant risktakers. The problem with this approach is that, as a matter of law, the board owes its duties strictly to the shareholders of the bank. And it is now well-accepted that shareholders in large banks prefer that the bank take excessive risk. That is because shareholders capture the full upside from such risktaking, while some of the downside of bank failures is borne by the government, both as an insurer of deposits and as a provider of bailout financing.[13] Thus, even if the board of directors identifies employees with incentives to take excessive risk, their legal obligations will not necessarily lead them to eliminate those incentives. Considerations regarding the socially appropriate level of risktaking are not within the purview,

[13] *See generally* Lucian A. Bebchuk & Holger Spamann, Regulating Bankers' Pay, 98 GEO. L.J. 247, 284-85 (2010).

or expertise, of banks' boards of directors. Those considerations are more appropriately addressed by bank regulators, which is why Section 956 requires those regulators to "prohibit *all*" bonus structures that could someday lead to material losses—even if those structures are in the short-term interests of shareholders.

The proposed rules under Section 956 would permit large banks to identify their most significant risktakers under a vague standard. Once these risktakers are identified, the proposal requires only that the bankers' bonuses be approved by the bank's own board of directors—whose duties are to shareholders, not systemic stability. This approach is unlikely to provide needed scrutiny for the incentives of all of the risktakers whose decisions have implications for the safety and soundness of our financial system—and, even if it does, that scrutiny will be applied by directors with no duty to pursue systemic stability rather than short-term profits. To the extent that Congress and banking regulators want to ensure that the incentive structures of significant risktakers are subject to meaningful oversight, ***clear, uniform rules for identifying significant risktakers are needed—and bonus structures for these risktakers should be reviewed by banking regulators rather than the banks' own boards of directors.***

III. Providing Meaningful Quantitative Disclosure of Bankers' Incentives

Section 956 requires "enhanced disclosure and reporting of compensation" at financial institutions, including disclosure on the "structures of *all* incentive-based compensation arrangements." This broad language empowers, and indeed directs, regulators to obtain detailed information from large banks about their employees' incentives. The agencies' proposal would require that each financial institution provide a "clear narrative description" of its incentive-pay arrangements; a "succinct description of [the bank's] policies and procedures" on incentive pay;

and "specific reasons why the [bank] believes the structure of its [incentive pay] does not encourage inappropriate risks." For two reasons, these disclosures are inadequate to carry out both the purpose of Section 956 and the agencies' policy mandate.

First, most large banks are public companies subject to securities rules that have long required qualitative disclosure of exactly the kind required by the proposal.[14] In Section 956, Congress gave the agencies sweeping authority to obtain "*enhanced* disclosure and reporting" on bankers' incentives. Congress's purpose is hardly met by requiring banks to provide duplicative reports identical to those that banks already must provide under securities law.

Second, and more importantly, qualitative reports are unlikely to give regulators the information they need to supervise banker incentives. Importantly, the securities rules that require qualitative discussion of pay policies are accompanied by clear, quantitative tables describing the amount and structure of the compensation to be paid.[15] Unlike those rules, the agencies' proposal requires only generalized essays that will be difficult to compare either to each other or to prevailing best practices.[16] It is hard to see how regulators will be able to use these reports to identify bonus practices at large banks that could threaten financial stability.

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[14] *See, e.g.*, 17 C.F.R. § 229.402(b)(2)(i) (requiring a qualitative description of the company's "policies for allocating between long-term and currently paid out compensation"); *see also id.* § 229.402(e)(1)(i-iv) (requiring a "narrative description" of incentive pay). The proposal's language on this reporting requirement is nearly identical to the language that has governed securities-law disclosure requirements since 2006. Financial institutions and their counsel have generally concluded that the agencies' proposal allows them to use identical reports to comply with identical language in the agencies' proposal under Section 956 and longstanding securities rules. This might explain why comments from the Financial Services Roundtable and Chamber of Commerce, among others, although critical of some aspects of the agencies' proposal, offered only "applau[se]" in response to the "streamlined" nature of the reporting rules. Letter from Center on Executive Compensation et al. to Elizabeth M. Murphy, Sec'y, SEC (May 25, 2011), at 10.

[15] 17 C.F.R. § 229.402(c).

[16] Recently the Federal Reserve, upon the conclusion of its "horizontal review" of bonus practices at 25 large banks, indicated that its staff "intends to implement" disclosure requirements on banker pay recently promulgated by the Basel Committee. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, INCENTIVE COMPENSATION PRACTICES: A REPORT ON THE HORIZONTAL REVIEW OF PRACTICES AT LARGE BANKING ORGANIZATIONS (Oct. 2011), at 3, *at* http://www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf (citing BANK OF INTERNATIONAL SETTLEMENTS, PILLAR 3 DISCLOSURE REQUIREMENTS ON REMUNERATION ISSUED BY THE BASEL COMMITTEE, at http://www.bis.org/publ/bcbs197.pdf (July 2011)). The Basel standards appear to require disclosure of some quantitative information on bonus structures,

Indeed, qualitative descriptions, in the absence of quantitative data, may well give regulators misleading information about bankers' incentives. Suppose, for example, that a large bank qualitatively describes its pay practices as requiring that its employees' bonuses be paid in stock. Regulators might well conclude that these bankers have strong incentives to increase the value of the firm because the bankers will suffer personal losses if the bank's stock price falls. But this assumes that the bankers have not "unloaded" their shares—that is, sold a sufficient number of shares to eliminate the incentives created by the stock-based bonus. Empirical study has shown that unloading is common at the largest U.S. banks—both for executives and for other significant risktakers.[17] Without quantitative detail on unloading, qualitative disclosures will give regulators no way to distinguish between a banker whose pay is actually tied to the long-term future of her firm—and the banker who has unloaded, taking advantage of short-term increases in value before the systemic consequences of her risktaking can be known.[18]

In sum, the reporting provisions of the agencies' proposal will give regulators no new information on bonus compensation at America's largest banks. As proposed, the rules will leave regulators unable to identify which bankers have incentives to take excessive risk. These rules are inconsistent with the sweeping authority that Congress provided in Section 956 and the

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see BANK OF INTERNATIONAL SETTLEMENTS, *supra*, at 4. Those standards were promulgated in July 2011, however, and the agencies have not yet indicated that U.S. banks are required to provide that information to their regulators. Thus, it remains to be seen whether banks will be required to disclose meaningful quantitative information on their bonus practices under Section 956. Moreover, even the Basel standards would not provide regulators with all of the information they need to have a full picture of bankers' incentives. *See infra* note 18.

[17] *See, e.g.*, Lucian Bebchuk et al., *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000—2008*, 27 YALE J. ON REG. 257 (2010) (documenting unloading prior to the collapse at Bear Stearns and Lehman Brothers); Robert J. Jackson, Jr., *Stock Unloading and Banker Incentives*, 112 COLUM. L. REV. ____ (forthcoming 2012) (documenting unloading by the partners of Goldman Sachs).

[18] More generally, the financial-economics literature on managerial incentives has shown that equity ownership in the firm provides a far stronger pay-performance link than standard incentive payments like cash bonuses. *See, e.g.*, Michael C. Jensen & Kevin J. Murphy, *Performance Pay and Top-Management Incentives*, 98 J. POL. ECON. 225, 226 (1990). More recent research has suggested that substantial equity stakes may lead bankers to pursue levels of risktaking that is socially excessive. *See, e.g.*, Bebchuk & Spamann, *supra* note 13, at 284. All agree, however, that bankers' equity ownership in their firms is a critical determinant of their incentives. Yet under the agencies' proposal and the Basel standards, federal regulators would have no quantitative data from America's largest banks about the equity ownership of their employees—even those who take systemically significant risk.

agencies' objective of ensuring that incentive-pay practices do not threaten the safety and soundness of these institutions. Rather than the duplicative qualitative reports required by the agencies' proposal, the rules under Section 956 should ***require large banks to provide the agencies with clear quantitative data on the structure of incentive compensation for all employees who take significant risk.***

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Bankers' incentives remain a significant concern for all Americans who rely upon the safety and soundness of our financial system. In Section 956, Congress and the Administration provided federal regulators with the sweeping authority they will need to ensure that bankers do not have incentives to pursue short-term gains that could compromise systemic stability. The agencies' proposed rules on banker incentives are, however, inadequate to the regulators' critical task. Further diligence from Congress, from the Administration and from the regulators themselves is needed to make certain that the agencies use this new authority to ensure that banker incentives are aligned with all Americans' interest in a safe and secure financial system.

Thank you once again for the opportunity to testify about this important issue. This statement concludes my formal testimony; I will of course be pleased to answer any questions you or your staff may have.