Will Sharpened Clawback Provisions at J.P. Morgan Chase, Bank of America Corp., and Morgan Stanley Quiet Populist Rage?

American Banking News
January 28, 2010

The big banks continue to respond to the growing outrage focused on their compensation practices. The Wall Street Journal reports that many banks including J.P. Morgan Chase (JPM), Bank of America Corp. (BAC), and Morgan Stanley (MS) have announced enhanced provisions that will allow them to seize bonus compensation for employees whose bets or other actions do not pan out, and expose the company to excessive risk.

These provisions, called clawback provisions, have been attached to executive compensation for years. However the new provisions reach down to include employees at all levels.

J.P. Morgan Chase, for example, has expanded their provisions to include any employee who receives company stock as compensation. And, the firm can now reclaim stock awards from any employee who is found to have taken excessive risks, or who didn't blow the whistle on bad risk-taking.

"This year in particular, we tried to find the right balance between paying for performance and being competitive and showing the right balance and degree of restraint given the economy and political realities facing Wall Street," said Jes Staley, who runs J.P. Morgan's investment bank. "Increasing the bank's ability to claw back equity awards was one of the measures we took."

Morgan Stanley announced new clawback provisions that allow it to "reclaim compensation for up to three years after it is awarded" if the company "realizes losses on certain trading positions, investments, or holdings." In addition, top executives could lose deferred cash compensation.

Bank of America compensation packages will introduce new provisions that include deferred compensation being subject to a performance-based clawback if profit projections fall short.

However, the bank stopped short of disclosing how steep losses would have to be to trigger the clawback rules or which trades and assets are subject to tighter provisions.

The firm also added teeth to its definition of "detrimental conduct" allowing the bank to retrieve compensation if an employee is found to have disregarded company policies.

"This is part of a program to more tightly connect our associates to long-term shareholder interests," said spokesman Robert Stickler.

Compensation experts applauded the toughened provisions as a good first step, but were wary of the actual substance.

“Firms have not been providing outsiders with the information that is necessary to assess whether the clawbacks are meaningful and effective or merely cosmetic,” remarks Lucian Bebchuk, a Harvard University law professor who runs the college’s corporate-governance program.

Skeptics note that clawbacks have a mixed track record. For example, many traders and bankers made bets in the housing market that, when undertaken, did not expose the firm to much risk. Would those trades, many of which subsequently blew up be subject to clawback provisions? It’s unclear.

Furthermore, firms could have a hard time seizing compensation once an employee pays taxes on it.

And finally, should the provisions apply to the trader or also his superiors?

These are all questions which don’t lend themselves to easy answers, particularly when many of these clawback provisions will not take effect for several years.

But in this highly charged atmosphere, even a symbolic gesture should be welcomed.