Lawmakers Divided Over Exec Comp Bill

The Deal
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Republican and Democrat lawmakers clashed Thursday, March 8, over legislation introduced by House Financial Services Committee Chairman Barney Frank that would give shareholders a greater voice in executive pay packages.

"The collective wisdom of the stock market is a very good place to make decisions," said Frank, D-Mass. "I don't believe that the collective wisdom of investors disappears when it comes to overseeing a CEO pay package."

Frank's bill would require all public companies to submit their executives' salaries, bonuses and pensions to a nonbinding vote of their shareholders. Companies would also be required to allow nonbinding votes when golden-parachute packages for executives are negotiated as part of a merger or sale of the business.

Currently "advisory" proposals on pay packages are carried out only if shareholders take the initiative and demand them.

So far, shareholders have introduced advisory vote proposals at 47 companies this year, according to proxy advisory firm Institutional Shareholder Services Inc.Investors also have shareholder measures seeking to link CEO pay with performance at an additional 48 companies. A number of other proposals target retirement plans, option grant practices and bonuses.

Companies are not required to implement changes to their executives' pay in situations where the majority of voting shareholders oppose the CEO compensation. But despite that, the effect of the advisory proposals can be large. A major shareholder vote of no-confidence on a CEO's pay often can embarrass corporate directors into making adjustments to the packages.

Throughout the debate, Democratic lawmakers expressed concern about executives that continued receiving high pay and severance packages despite reigning over poorly performing companies. Most Republican lawmakers expressed opposition to requiring such a vote, arguing that Congress should wait and see if new Securities and Exchange Commission executive compensation disclosure rules have a dampening impact on pay packages before taking any further steps to alter CEO pay. They worried that any additional regulatory pressure on CEOs will force many of the most talented leaders to leave the public markets and take jobs at private equity firms or hedge funds.

Rep. Scott Garrett, R-N.J., said the SEC's disclosure rules should be given a chance to work, while Rep. Melvin L. Watt, D-N.C., said the system of pay and performance was broken.

Some Republicans did express concern about executive compensation, but they didn't go so far as to support Frank's proposal.

"I wonder whether when you consider the larger percentage of our revenues we pay to CEOs, compared to other countries, if in the long run it hurts our ability to compete effectively?" asked House Financial Services Committee ranking member, Spencer Bachus, R-Ala.

Another Republican, Delaware Rep. Mike Castle said he wasn't sure if he, as a CEO, would be good at judging pay packages. But Castle added that he was concerned about severance packages. "I don't think we ought to be paying someone to walk away from a company that has failed under his oversight," Castle said.

Witnesses expressed diverging opinions on the incentive that pay packages provide CEOs to instigate mergers that may not be in the best interest of shareholders or corporations. In an interview, Harvard Law School professor Lucian Bebchuk said that in the past CEOs' interest in keeping their jobs may have led them to avoid value-creating transactions. But severance packages now are so large that executives routinely agree to transactions that don't make sense.

But Steven Kaplan, finance professor at the University of Chicago, pointed out that golden parachutes are critical to give CEOs the motivation to sell when it makes sense. He added that in cases where poorly designed severances are negotiated as part of transactions, investors will launch public campaigns to oppose deals. Kaplan said there is a mechanism in the market, through activist hedge fund managers and institutional investors that publicly oppose poorly thought-out transactions, to deal with problematic severance packages. Kaplan added that the SEC's new compensation disclosure rules will aid those investors in their oversight of deals.

"Look at all the hedge fund managers," Kaplan said.

It was unclear whether a required advisory vote would increase costs and take director and executive attention away from their primary roles at the company. John Castellani, president of CEO lobby group Business Roundtable, said he believed the measure would create huge costs to companies, in part because of the price of the public political campaigns and the cost of lost time and energy for insiders that otherwise would be focusing on business operations such as research and development. But Stephen Davis, a fellow at Yale University School of Management, argued the costs of the advisory vote are minimal because it would only lead to additional collaboration between shareholders and executives in behind-the-scenes conversations. He pointed out that in the U.K. shareholders can call an advisory vote but they typically don't because companies agree to changes in private conversations.

"It would mean a few more phone calls and some meetings," Davis said.

So far, the bill, H.R.1257, has 21 Democratic co-sponsors and no Republican supporters. Frank has scheduled a vote on the bill for March 21.