The Big Wall Street Pay Days That Ken Feinberg Missed

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You can almost hear Ken Feinberg telling his grandchildren about this one: The big pay days that got away.

As the pay czar reviews bonuses paid out to Wall Street firms that received Troubled Asset Relief Program funding, it is worth remembering the big pay days that preceded the federal bailout and some might say helped create the need for one.

We are talking about stock sales by Bear Stearns and Lehman Brothers Holding executives. A trio of Harvard researchers, including Lucian Bebchuk, recently calculated that the top five executives at Bear and Lehman cashed out $1.1 billion and $850 million, respectively, from 2000 to 2008.

"During this period….executives regularly took large amounts of money off the table by unloading shares and options,'' according to the February study. "We find that during the years preceding the firms' collapse, each of the teams sold more shares than they held when the music stopped in 2008."

The Harvard study (which doesn't include the multimillion dollar cash pay and bonuses that were collected during the boom years by Bear CEO Jimmy Cayne, Lehman chief Dick Fuld and others) says the stock sales at Bear and Lehman were driven by "incentives to seek improvements in short-term results even at the cost of an excessive elevation of the risk of large losses."

Those thoughts are echoed by the U.S. Bankruptcy Court Examiner's report on Lehman Brothers.

The examiner said Lehman had policies that theoretically tied compensation to long-term performance, including a "compensation scorecard,'' the measured such things as return on risk investment when determining compensation. "But in practice,'' the report states, "Lehman rewarded its employees based upon revenue with minimal attention to risk factors in setting compensation. None of these risk-related adjustments was applied rigorously or consistently."

For example, Lehman included in its compensation pool "revenue not yet recognized, but recorded on a mark-to-market basis….In theory, therefore, traders and business units were incented to enter into transactions for short-term profits, even if those transactions created long-term risks for the firm."

The conventional wisdom is that Wall Street executives who are paid in stock lose out when their firm's suffer. But as the Harvard study points out the top executives at Bear and Lehman were able to collect more money during the good years than they lost when their firms ran into trouble.

Feinberg has spent the past year implementing compensation guidelines at Wall Street firms which are meant to reduce risk taking incentives. But as the Lehman report show, it is how these firms actually use these guidelines “in practice” that really matters.