RPT-Novel ideas surface for U.S. banks' executive pay

Reuters
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NEW YORK/WASHINGTON, May 24 (Reuters) - As the Obama administration looks for ways to reform executive pay in the banking industry, novel ideas are surfacing on how to move away from stock options as a key component of compensation.

Treasury Secretary Timothy Geithner is expected to issue rules as early as next week on how bailed-out banks must limit their executives' pay. He is also working on ways to reform the compensation practices of the entire banking industry to discourage a focus on short-term gains and undue risk-taking. [ID:nN13420447]

Lucian Bebchuk, a professor at Harvard Law School, and colleague Holger Spamann argue that a banker's pay should be tied to all of the bank's assets, not just to equity, which they say accounts for only about 5 percent of overall assets.

"Banking regulators should monitor executive pay in banks, and prevent arrangements that incentivize top bankers to focus only on the bank's equity, which ... can gain through strategies that are detrimental to the other 95 percent," they write in a forthcoming paper.

Bebchuk and Spamann suggest top bankers should be paid on a "broader set of claims, including deposits and junior debt," which would prod them "to place much greater weight on possible losses in their choice of strategy."

President Barack Obama has argued that Wall Street's pay practices pushed banks to take excessive risks, helping sow the seeds of a financial crisis that is now punishing the U.S. economy with a severe recession.

Exactly how Geithner, Obama's top economic lieutenant, will tackle the problem is not yet clear, but many ideas are circulating on how bank pay could be brought back to earth.

BONUSES BASED ON RATINGS

Susan O'Donnell, a Boston-based managing director at compensation consultant Pearl Meyer & Partners, said stock incentives can be structured in a way to reward long-term thinking.

Instead of stock options, whose value depends on how much a stock rises, companies could simply award shares, tying the award to performance goals or vesting that takes place over several years, she said.

Performance measures are likely to become more balanced and not tied to any single item like a stock price, O'Donnell added. "I do think we're going to see more measures on things like

liquidity and capital, things that in the past weren't as big an issue but are an issue now," she said.

Companies seeking new ideas for pay practices could also take a look at National Rural Utilities Cooperative Finance Corp, a non-profit cooperative based in Herndon, Virginia, based that ties employee bonuses to the company's credit rating.

National Rural, which provides financing for rural utilities, chose ratings as a yardstick for bonuses because the company depends on capital markets and low interest costs.

"I don't think anybody has questioned the value of the goal, especially given what has happened in the financial markets," said Andrew Don, vice president of capital market relations at the company. "If we were not a highly rated company, we would have had more difficulty raising capital."

BUCKS RATING DOWNGRADE TREND

While the credit crisis forced scores of financial firms to seek government bailouts as their debt ratings went into a tailspin, National Rural Utility's rating has held steady, triggering bonuses every year since 2005, when the first payouts were made, spokesmen said.

Bonuses are awarded if the company keeps at least an A-plus rating on its senior secured debt from the three major rating agencies. The cooperative also offers a short-term incentive bonus based on its annual performance.

Public fury over executive pay came to a head after bailout recipient American International Group (AIG.N) paid out millions of dollars in bonuses to managers at the helm when the insurer nearly collapsed.

Mark Kiesel, managing director and global head of the corporate bond portfolio management team at Pacific Investment Management Co, said he would be in favor of compensation tied to credit quality.

"A healthy company and a strong balance sheet is in the interest of shareholders too," Kiesel said. "You will not get a sustained rebound in the stock market without companies' credit concerns being addressed."

(Additional reporting by John Parry and Kevin Drawbaugh; Editing by Leslie Adler)