New Pay Guidelines Raise Questions

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By Cari Tuna and Joann S. Lublin
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The Obama administration outlined its new approach to executive pay Wednesday, with tough restrictions on firms receiving large amounts of government aid, but only suggested guidelines for most other companies.

Compensation consultants said the moves may prompt sighs of relief from many executives, but also could leave them frustrated by the lack of specifics.

"While they represent admirable goals … how do you actually translate these principles into workable programs?" asked Mark Borges, a principal at Compensia Inc., a pay consulting boutique in San Jose, Calif.

He and others said the guidelines, which aim to encourage companies to base pay on long-term value creation rather than stock price, are likely to intensify a debate about how to motivate executives and what constitutes "excessive" risk.

Mr. Borges says companies' – and regulators' – understanding of the relationship between compensation and excessive risk-taking remains fuzzy. "The government today is really saying that [risk] needs to be part of the equation," he says. "We just don't have a whole lot of data … [or] experience yet."
What do top CEO's make?

* WSJ.com/ExecutivePay: News, pay data, more

The new approach is "a win for most affected businesses," predicted Steve Hall, a managing director of Steven Hall & Partners, an executive-pay consultancy in New York. "They're going to be able to attract and retain talent without artificial limits on how they pay people."

He expects financial-service firms to continue offering executives restricted shares without performance triggers, a popular industry practice. Mr. Hall expects fewer companies to provide "golden parachutes" or supplemental pensions for departing executives. But he said some companies dropping supplemental pensions may grant executives extra cash or stock "to make up for the difference."

Mr. Hall and others expect the seven companies receiving "exceptional assistance" from the government to face big challenges recruiting and retaining executives. Kenneth Feinberg, the administration's new pay czar, will have authority to review, reject and even set pay for the top 100 earners at those companies: American International Group Inc., Bank of America Corp., Citigroup Inc., General Motors Corp., GMAC LLC, Chrysler LLC and Chrysler Financial.

Among other things, Mr. Hall anticipates many of these companies will eliminate retention bonuses and exit packages. More top executives "will be pushed out with no severance," and

others will quit because "they aren't used to this level of oversight [and] limitations on their pay," he suggested.

Don Delves, a Chicago-based compensation consultant, said the rules encourage recipients of government aid to repay it as quickly as possible, to escape the tough compensation restrictions.

"The only thing you can pay people for is paying back the government," he said.

But Mr. Delves said the Obama administration's guidelines may be felt far from the financial sector. "The rest of the business community is going to read this and take notice," he says. "I promise you that compensation committees around the country are going to look at these and say, 'Gee, these are interesting.'"

Mr. Delves said the guidelines will prompt more boards to discuss risk management in compensation packages and eliminate rich severance packages and golden parachutes.

Some union shareholder activists applauded the broad principles – as long as the administration's related legislative initiatives become law. "With greater investor power and greater authority within the [Securities and Exchange] Commission, the principles are appropriate and will be effective," said Richard Ferlauto, director of corporate governance and pension investment at the American Federation of State, County and Municipal Employees union.

Mr. Ferlauto also praised the administration's proposed legislation to give the SEC power to require advisory votes on executive pay as well as greater independence of board compensation committees. Together, such legislated requirements "will go a long way toward moderating pay," he said.

Treating bank executives' pay in a vacuum will not cure the problem of excessive risk-taking – and may prove counterproductive, says Lucian A. Bebchuk, a Harvard Law School professor and director of its corporate-governance program. He says the highly levered structure of financial-services firms gives executives the possibility for big gains, without much risk. Mr. Bebchuk said encouraging grants of restricted stock and shareholder votes on compensation packages may exacerbate the problem.

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