Bonuses for Wall Street’s top executives should be tied to a basket of the firm’s securities, including bonds and stocks, to align managers with all stakeholders and discourage excess leverage and risk, Harvard Law School Professor Lucian Bebchuk said.

Under current stock-based compensation arrangements, executives are “not exposed to the potential negative consequences that large losses could impose on other contributors to the capital structure, like preferred shareholders, bondholders and depositors,” Bebchuk said in a conference call with reporters yesterday.

Wall Street chief executive officers including Goldman Sachs Group Inc.’s Lloyd Blankfein and JPMorgan Chase & Co.’s Jamie Dimon continue to receive pay awards that are made up of restricted stock. Because banks carry more debt than equity, a better compensation system would also link executives’ pay to the performance of bonds and preferred stock, Bebchuk said.

“We could tie the payoffs to executives not just to the value of common shares but to the long-term value of a broader basket of securities,” Bebchuk said. “So, for example, instead of giving executives 3 percent of the value of the firm’s common shares, you could give them, say, 1 percent of the aggregate value of the common shares, preferred shares and bonds.”

Goldman Sachs, which paid Blankfein a $9 million all-stock bonus for 2009, carried about $64 billion in common equity at the end of December compared with $230 billion in preferred stock and short- and long-term unsecured debt, according to a company filing.

‘Wages of Failure’

JPMorgan, which paid Dimon $17 million of restricted stock units and options for 2009, had $157 billion in common equity compared with $330 billion in preferred stock, long-term debt and other borrowed funds, a company filing showed.

Bebchuk has been a vocal critic of Wall Street pay practices. His “Wages of Failure” paper last year showed that top officials at Lehman Brothers Holdings Inc. and Bear Stearns Cos cashed in $2.5 billion in the eight years before their firms collapsed in 2008. Bebchuk said the study helped counter the “standard narrative” that compensation didn’t contribute to the financial crisis because the executives’ finances were tied to their firms’ fortunes.

He made his remarks yesterday on a call hosted by the Investor Responsibility Research Center Institute, a four-year-old New York-based not-for-profit organization that funds environmental, social and corporate governance research. He spoke about three papers he has helped write about executive compensation in the financial industry.
European Proposals

In March, the European Parliament’s top financial lawmaker made a similar recommendation when she advocated paying bankers’ bonuses in subordinated debt rather than shares or cash to limit the type of risk-taking that contributed to the financial crisis. Sharon Bowles, chairwoman of the assembly’s Economic and Monetary Affairs Committee, said bonuses would be held for five years in a pool that the bank could use as capital to absorb losses.

Bankers’ bonuses should be capped at 50 percent of their pay, lawmakers on the EU committee said yesterday, as they voted on tougher capital and remuneration rules for banks. The plan will be voted on by the whole EU Parliament in July.