USC Marshall Professor Testifies in D.C.

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By Anne Bergman
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With U.S. taxpayer outrage still simmering over the big bonuses Merrill Lynch and AIG paid to employees after receiving federal bailout money, USC Marshall School of Business professor Kevin Murphy appeared before the House Financial Services Committee on June 11 to discuss executive compensation, his field of expertise.

Murphy, who holds the Kenneth L. Treffitzs Chair in Finance and teaches in USC Marshall's department of finance and business economics, is the author of more than 40 articles, cases, books or book chapters relating to compensation and incentives in organizations.

Murphy agreed to appear at the hearing on "Compensation Structure and Systemic Risk" to discuss regulating executive compensation because he was already in Washington, D.C., meeting with the Federal Reserve to discuss the very same issue.

"If executive pay is regulated, the Federal Reserve will do it, as they're the regulatory body," Murphy said.

As Murphy testified in front of Congress, his opinion is "that regulating compensation in financial services more broadly will cripple one of our nation's most important and historically most productive industries."

The Treasury Department's counselor Gene Sperling, Harvard Law School's Lucien Bebchuk and Nell Minnow of The Corporate Library were among the panelists who also testified in front of the committee, which is chaired by Massachusetts Rep. Barney Frank, who's seeking new laws on compensation structures.

One of Murphy's concerns is that to base pay on objective assessments of an individual's performance is impossible and "part of why we're in this mess in the first place." For example, Murphy testified, "consider mortgage brokers paid for writing a large number of loans rather than writing loans that the borrowers will actually pay back.

"A solution to this performance-measurement problem is to pay people to write 'good loans' and penalize them for writing 'bad loans," Murphy said.

He advised that companies not reward short-term results and avoid "paying bonuses all at once. Pay them over a period of time to make sure the performance is real."

Overall, Murphy argued it's not "in the taxpayers' interest to eliminate bonuses or limit the top pay of executives. Banks are losing their best people who are starting their own hedge funds. These are precisely the people who understand the complex interests that got us into trouble. If they leave, there's no one there who understands what the risks really are."

After his testimony, Murphy met with the Obama administration's new pay czar, Kenneth Feinberg.

As for the public outrage over executive salaries, Murphy acknowledged, "The anger is understandable. But we shouldn't make policy decisions when we're angry."