Ken Feinberg's Lame Report on Wall Street Pay Shows We're Back to Square One

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Ken Feinberg's final report as the Obama Administration's pay "czar" is good for only one thing — reminding us that the controversy over sky-high pay on Wall Street will be with us for a loooong time. He comes to the entirely unremarkable conclusion that big financial firms in 2009 rewarded executives with huge bonuses even as taxpayers were saving their pinstriped hides. Ya don't say.

Wait a sec, though. Doesn't the newly passed Dodd-Frank Wall Street Reform and Consumer Protection Act tackle banker pay? Not really. The law merely gives the issue a trim, in the form of more stringent compensation disclosure requirements for financial firms. But it leaves it to financial regulators to come up more substantive rules.

The legislation does give investors "say on pay," allowing shareholders to vote every three years whether to approve a company's executive comp. The catch? The vote is nonbinding. That leaves investors in the same position as Feinberg — pleading with corporate directors to be taken seriously. As a result, writes University of Illinois law professor Christine Hurt:

> [T]he corporation is going to spend a lot of shareholder money hiring lots of compensation experts and legal experts to create these executive compensation packages and disclose them in proxy materials, just so the same shareholders can vote on the packages, a vote which has only signaling value.

Not that giving shareholders say on pay isn't a good idea — it is. Although management isn't required to listen, it's bad PR for troubled companies to summarily ignore investor complaints about the CEO's platinum trash can. The problem is that this deterrent works poorly in financial services. And that's because, when it comes to risk-taking, bank execs are different than you and I.

Here's the bottom line on why bankers have a tendency to let it ride: They're paid to. Under a typical comp package on Wall Street, a banker can make gobs of money when a company is doing well. But there's no commensurate downside risk when the company does poorly. You can get rich by rolling the dice, in other words, but you're not likely to get poor. If the stock tanks, it is preferred shareholders and bondholders that will feel the pain. And if things really head south, taxpayers have your back.

Common shareholders in banks tend to be equally thrill-seeking, studies show, and for similar reasons. The more risk a company takes, the more money they can make. That's why say-on-pay doesn't work in banking. Because when both bankers and investors benefit the more risk a company takes, giving shareholders a voice over how those bankers should be compensated

merely reinforces the firm's taste for action. As Harvard's Lucian Bebchuk, a leading corporate governance expert, has written:

> [S]imply because shareholders of bank holding companies voted in favor of a pay structure, and those pay structures might consequently be set with the prospect of such a vote, does not indicate that pay structures will avoid incentives that encourage excessive risk-taking.

Just ask the Brits. Investors in the U.K. have had say-on-pay for years, yet bankers in the City received the same outlandish rewards and displayed the same gambler's mentality as did their counterparts on the Street.

Dodd-Frank isn't completely toothless. Expanding on Sarbanes-Oxley, the new law requires executive officers at publicly listed financial firms that have to restate earnings to return whatever incentive-based comp they earned up to three years before the restatement. The SEC is also asked to require firms to disclose a CEO's total annual pay; the median annual total comp of all other employees; and the ratio of rank-and-file employees' pay versus what the CEO earns.

These regs will force financial firms to become more transparent. But they won't do much to discourage bankers from acting recklessly. On that score, the law leaves it up to financial regulators to come up with a solution. Among other things, Dodd-Frank requires bank supervisors to prohibit any incentive-based compensation in cases where a banker's pay is adjudged "excessive" and that led the person to take "inappropriate" risks.

The only trouble with that, as Hurt tartly notes, is how the hell can you tell if someone's pay is excessive and when risk is inappropriate? Next stop, square one.

Or almost. Although Wall Street is back in the habit of dishing out alarmingly large bonuses to top earners, since the financial crisis there is at least a growing weight of opinion that regulators must more actively monitor banker pay. The mindset is changing.

"To the extent that, particularly in the finance sector, where the entire system and broader economy can be threatened by pay that rewards risky short-term behavior, it makes sense to impose external standards or incentives," Jennifer Taub, an expert in corporate law and governance at the U. of Massachusetts, told me by email.

The FDIC is doing just that. The banking agency plans to charge higher deposit-insurance premiums for banks it determines have risky pay practices. "I believe this is an important step toward steering clear of financial instability," Taub said.

Let's hope the SEC and other bank regulators believe that, too.