House set to vote on curbs for executive pay

The bill, which could come to a vote Friday, would give shareholders more say over how much money top executives make.

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By Mark Trumbull
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Congress is moving this week toward a vote on one of the most politically charged questions arising from the financial crisis – whether new rules are needed to guide executive pay in America.

Many financial experts say that poorly designed pay incentives were an important cause of the recent banking crisis.

The House of Representatives may vote Friday on a “compensation fairness” bill. Senate lawmakers sought guidance on similar legislation from an expert panel Wednesday.

Don’t expect a populist revolt by elected officials wielding pitchforks. The bills won’t set a cap on CEO pay, for example, or try to claw back the controversial bonuses granted at firms like AIG, which were receiving government money.

But the proposals under review could have a broad impact on executive pay and the way US corporations are governed.

The House bill would:

• Give shareholders an advisory “say on pay” vote for top executives annually, a move supported by President Obama and many shareholder-rights advocates.

• Require that the compensation committees within corporate boards, which set the pay for top executives, be composed entirely of outside directors rather than by executives who also sit on the corporation’s board.

• Require financial firms to disclose their incentive pay structures, and require federal regulators to ban imprudently risky pay practices as part of their effort to promote the solvency of financial institutions. (Firms with fewer than $1 billion in assets would be exempt from these provisions.)

These ideas are heading toward a vote at a time of considerable doubt about whether US businesses – long a model for the world – are governing themselves effectively. First came the collapse of giants such Enron and WorldCom early this decade. Then last year came of a succession of banking failures and government rescues.

Meanwhile, executive pay has been rising steadily. In the early 1990s, total pay for the top five executives typically equalled about 5 percent of corporate profits, according to research by Lucian Bebchuk of Harvard University and Yaniv Grinstein of Cornell University. By early in this decade, that percentage had roughly doubled, they found.

A major challenge for policymakers is how to curb harmful practices while not doing additional harm in unintended ways.

Before the crisis, many banks “provided executives and employees with incentives to take excessive risks that were not consistent with the long-term health of the organization,” Scott Alvarez, general counsel at the Federal Reserve, told House lawmakers at a hearing last month.

He said federal bank supervisors must do more nudge banks toward better compensation practices – as part of the regulatory effort to ensure a safe banking system.

But he warned against overdoing it. “Regulation that is too severe and that does not recognize that the market for quality employees is global,” Mr. Alvarez said, “will threaten more harm than it will do good.”

At this week’s Senate hearing, one expert drew a distinction between policy toward financial and nonfinancial firms.

For corporate America in general, moves to empower shareholders may serve a broad public interest, said John Coates of Harvard Law School. It would help ensure that corporate boards don’t act as captives of top management.

But in the financial sector, Mr. Coates said, the interest of shareholders may be for the firms to take greater risk. The taxpayer interest may call for a more conservative path, because it’s taxpayers who end up paying for bailouts during a financial crisis.