Bankers' Bonuses Beat Earnings as Industry Imploded

Report on Pay Fuels Efforts to Rein In Compensation

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NEW YORK, July 30 -- The nation's nine largest banks handed out $32.6 billion in bonuses last year even as they ran up more than $81 billion in losses and accepted billions of dollars in emergency federal aid, New York Attorney General Andrew M. Cuomo says in a report released Thursday.

Cuomo's investigation into pay practices at Wall Street's largest firms found that nearly 4,800 executives and other employees were each awarded at least $1 million. Of those, more than 900 worked for Bank of America and Citigroup, which have been among the largest recipients of government bailout funds.

This latest report about Wall Street bonuses turned up the heat on lawmakers and regulators, who have been weighing how to rein in compensation practices that banking executives themselves admit contributed to the worst financial crisis in decades. The House is set to vote Friday on legislation that would give regulators authority to prohibit pay practices that they deem inappropriate and grant shareholders the right to cast non-binding votes on executive compensation.

Shortly after Cuomo released his findings, Rep. Edolphus Towns (D-N.Y.), chairman of the House Oversight and Government Reform Committee, announced a hearing to examine pay practices, particularly at companies rescued by the federal government.

"A few months ago, they were facing bankruptcy. Then, after being bailed out, they're giving huge bonuses," Towns said. "I think the American people need some answers. With the economy being the way it is, and people suffering . . . how do you still do that?"

Facing the prospect of greater government oversight, some of the biggest banks have been taking steps since late last year to restructure pay incentives as a way of keeping Washington at bay while avoiding some of the business practices that led to the financial sector's tremendous losses.

Several firms have adopted a clawback policy that allows them to reclaim bonuses if corporate or individual business decisions turn out to be costly or improper. Other firms have extended the number of years that employees have to wait before cashing in on stock awards. Still others are discussing ways to further link compensation to long-term performance.

But some prominent pay experts and investor groups question whether the measures go far enough or if any of the more ambitious proposals will ever be implemented.

"The details of design in many cases still fall short of what is necessary," said Lucian Bebchuk, a Harvard law professor who has met with Obama administration officials to discuss pay

principles. "There is substantial distance we need to go before we have effective tying of pay with long-term results."

Lawmakers in Washington also are skeptical and are moving ahead with legislation that would tighten restrictions on pay.

"If I thought they were enough, why would we pass the bill?" said Rep. Barney Frank (D-Mass.), chairman of the House Financial Services Committee, who sponsored the legislation. He said the restrictions should be uniform across companies, adding that he doubted firms would be restructuring pay practices if Congress wasn't moving ahead with legislation.

The bill embodies broad compensation principles similar to those outlined last month by Treasury Secretary Timothy F. Geithner, and its adoption would represent a victory for the Obama administration. The Senate is expected to take up the measure after the August recess.

While some in Congress and the administration have expressed cautious optimism that some banks were taking steps in the right direction, Cuomo's findings did little to boost confidence.

"It's window dressing," Towns said. "It's all basically rhetoric. They're not doing it. When it comes down to final analysis, it's not happening."

According to Cuomo's report, Citigroup and Merrill Lynch each lost more than $27 billion last year but paid out $5.3 billion and $3.6 billion in bonuses, respectively. Together, they have received government bailout funds from the Troubled Assets Relief Program totaling $55 billion.

Three other firms -- Goldman Sachs, Morgan Stanley and J.P. Morgan Chase -- were faulted for each awarding bonuses that totaled much more than their respective 2008 earnings. Goldman made $2.3 billion and paid out $4.8 billion in bonuses. Morgan Stanley earned $1.7 billion and paid $4.5 billion in bonuses. J.P. Morgan Chase made $5.6 billion and paid $8.7 billion in bonuses, the report says. Those firms recently returned their government funds, a combined $45 billion.

The report, titled "No Rhyme or Reason: The 'Heads I Win, Tails You Lose' Bank Bonus Culture," looked at bonuses and earnings at the nine large banks that were the first to receive government funds last year under TARP. Cuomo says a review going back six years shows that pay at Wall Street firms has become "unmoored" from their financial performance.

"When the banks did well, their employees were paid well," he says in the report. "When the banks did poorly, their employees were paid well. And when the banks did very poorly, they were bailed out by taxpayers and their employees were still paid well."

As an example, Cuomo cited pay practices at Merrill Lynch, which he accused of abandoning any effort to link pay to performance. Instead the investment bank, dragged down early in the financial crisis by bad investment decisions, set bonuses based on what it expected competitors to award. Merrill's losses in 2007 and 2008 erased all of its earnings in the preceding four boom

years, evidence that pay practices were based on short-term profits on risky bets that later evaporated, Cuomo said.

Representatives of Bank of America, which earlier this year acquired Merrill Lynch, declined to comment. Other banks named in the report also declined to comment on it or did not return messages.

Wall Street firms have begun taking some steps to try to ward off criticisms, which have rained in from President Obama on down. Late last year, for example, Goldman Sachs increased the holding period for restricted stock awards for all employees from three years to four. Meanwhile, Morgan Stanley introduced a clawback provision that would allow it to roll back a portion of year-end bonuses awarded to traders and other employees if they are deemed to have engaged in activities that prove detrimental to the company, such as triggering major losses or harming its reputation. The clawback can reach as far back as three years. Morgan Stanley's Swiss rivals, UBS and Credit Suisse, have adopted clawbacks.

Some experts who have studied pay practices are reserving judgment.

"They all depend upon implementation by directors," said Stephen M. Davis, a fellow at Yale University's center for corporate governance. "And do we have the right directors installed at these companies? Are they sufficiently independent to put these practices into tough practice? Or will they be more lenient as time goes on?"

Goldman Sachs said it has had a policy that allows it to claw back bonuses of employees who cause significant harm to the firm. But a company official declined to say whether the clawback has ever been triggered.

Among the more hotly debated changes in pay practices are plans to shift compensation from bonuses into higher salaries. Morgan Stanley, Citigroup and J.P. Morgan Chase, along with several foreign competitors, all have carried out or informed employees of plans to increase salaries for many of them. The banks say these raises will not increase total annual compensation. Putting less emphasis on bonuses, some banks argue, would discourage excessive risk-taking. Some executives, however, acknowledged that they are hiking salaries for competitive reasons after rivals awarded pay raises to employees.

Nell Minow, a co-founder of the Corporate Library, said these steps run counter to the efforts banks should be making to tie pay more closely to performance. "Whether you're awarding new stock options to make up for underwater options or raising cash compensation to compensate for more risk-based bonuses, all of that completely undermines the legitimacy of any of the reform efforts," she said.