The New York Times

Executives Kept Wealth as Firms Failed, Study Says

By LOUISE STORY
November 22, 2009

Bear Stearns and Lehman Brothers paid their executives largely in stock, and that stock lost most or all of its value when those companies collapsed.

Many people on Wall Street say these examples help make the case that pay incentives were not what caused executives at these fallen firms to take excessive risks.

But three professors at Harvard are disputing that logic in a new study, saying it is an urban myth that executives at Bear and Lehman were wiped out along with their companies.

Though the chiefs at both investment banks lost more than $900 million in their stock holdings, the professors argue that it is important to also consider all the riches the bankers took off the table in the years preceding the crisis.

At Lehman, the top five executives received cash bonuses and proceeds from stock sales totaling $1 billion between 2000 and 2008, and at Bear, the top five received more than $1.4 billion, according to the study, which was released on Sunday night on the Web site of the Program on Corporate Governance at Harvard Law School.

The payouts came in the form of cash bonuses as well as thousands of shares of stock that the executives sold as the share prices of their companies soared. Most of the executives sold far more shares during that period than the number they held when their companies hit bottom.

“There’s no question they would have done massively better had their firms not collapsed,” said Lucian Bebchuk, one of the study’s authors. “But the wealth of those top executives was hardly wiped out. The idea that they were devastated financially has kind of colored the picture people have about what payoffs they were facing.”

Many of the solutions that policy makers and regulators are considering for Wall Street pay are tactics that were already in place at Lehman and Bear. Both firms required executives to wait several years before selling their stock. Both firms paid heavily in stock.

Critics of compensation reform have pointed to these two firms as examples of why change in pay practices may not make a difference and have said the focus should be on things like risk management and regulatory oversight.

However, the Harvard study says the executives may have had reason to focus on the short-term prices they could attain with stock selling.

Mr. Bebchuk has been advising the Treasury Department on compensation at bailed-out companies. He advocates locking up stock compensation for longer periods as well as pay clawback provisions for years later.

James E. Cayne, the former Bear chief executive, stands out for selling fewer shares over the years than he held at the firm’s demise. Mr. Cayne sold 2,720,845 shares for $289 million over eight years, beginning in 2000. He was still holding 5,685,591 shares at the start of 2008.

The other Bear executives sold nearly five times as many shares in the years leading up to the firm’s collapse as they held in 2008, and at Lehman, the executives sold about 1.3 times the shares they owned at the end.

The study does not take into account that the executives might have sold shares in part to pay hefty tax bills. Shares of stock are not taxed until they transfer in ownership to executives, which was a period of multiple years at both investment banks. At that time, some executives sold the number of shares needed to pay the tax bill on the shares they still held.

Some compensation experts said over the weekend that the study did not seem to prove that compensation caused the crisis and that it instead just pointed out that the bankers were wealthy.

“I don’t think anybody would question that they were well compensated,” said René Stulz, a professor at Ohio State University who has studied bank compensation. “It’s certainly true that the incentive effects are different if you’re already very wealthy, but that does not mean that the incentive effects are not there.”

Executives at companies that were bailed out by the government have in many cases had their stock holdings recover in value in the last year, and that might have been the case at Bear or Lehman if they had received the same treatment.

Shortly after Bear collapsed, Richard S. Fuld Jr., the chief executive at Lehman, called Peter J. Solomon, an investment banker who used to work at Lehman.

“He reiterated the fact that when firms like Bear Stearns fold and if Lehman Brothers got into trouble, the executives own so much stock that they were losing a lot,” Mr. Solomon recalled over the weekend.

But Mr. Solomon, who has been critical of pay levels and of the fact that investment banks are publicly traded, said the executives who presided over Wall Street's collapse have suffered, despite the money they retained.

"There's not one person involved in the demise of Lehman Brothers, Bear or even the troubles that have fallen on Citigroup who thinks they're living happily ever after," Mr. Solomon said, "because their reputations have been tarnished, and what do you have at the end of the day but your reputation?"

Through intermediaries, several of the executives examined in the study declined to comment. The other authors of the study were Alma Cohen, a professor visiting Harvard from Tel Aviv University, and Holger Spamann, a lecturer at Harvard.