Solving a $122 Billion Problem

Improved disclosure goes only part of the way towards curbing excessive CEO pay.

Fortune Magazine
By Marc Gunther
January 17, 2006

NEW YORK (FORTUNE) - The Securities and Exchange Commission and Christopher Cox, its straight-talking chairman, have begun taking steps that could curb excessive CEO pay. But they have only just begun.

The SEC proposed rules on Tuesday that, if adopted, would require companies to more fully and clearly disclose what they are paying top executives. The disclosure rules will go a long way to exposing so-called stealth forms of pay such as deferred compensation, retirement benefits, severance deals, tax payments and perquisites.

Remember, for example, the luxury apartment, sports tickets and fresh flowers that General Electric awarded to its former CEO, Jack Welch? Shareholders learned about Welch's perks, not from GE (Research), but from his divorce proceedings. These rules attempt to change that.

"We want investors to have better information -- including one number, a single bottom line figure for total amount of annual compensation," said Cox, a former Republican congressman who has emerged as an effective investor advocate since joining the SEC last year.

A strong believer in free markets, Cox said it's not the government's job to decide how much companies should pay CEOs, or whether pay should be linked to performance. But he also said that, if markets are to work, investors need "comprehensive but also comprehensible information" about the amount and structure of executive pay. These rules represent the first major changes in pay disclosure since 1992.

Here's the problem, though -- improved disclosure will only go so far toward fixing the problem of overpaid CEOS. Accountability, as well as transparency, is required.
'Necessary, but not sufficient'

"The rules are necessary but not sufficient," says Richard Ferlauto, the director of pension and benefit policy for AFSCME, the public employees' union. AFSCME has pushed to fix corporate governance because its members' pensions depend on a healthy, growing stock market.

Paul Hodgson, a compensation expert with The Corporate Library, which analyzes boards of directors, says better disclosure will improve the quality of the debate over pay. But, he says, real change will only come when institutional shareholders lobby directors to tie pay to meaningful performance hurdles.

Other shareholder advocates say more fundamental changes in governance are needed. In particular, they say, shareholders should be able to vote out directors who pay top executives too much.

Just how much pay is too much pay is debatable, of course. But there's no question that CEO pay has been soaring. In 2004, total compensation for CEOs increased by an average of 30 percent, according to a survey of 1,500 CEOs by The Corporate Library. The year before, total pay grew by about 15 percent. By contrast, average household income, when adjusted for inflation, has remained stagnant or dropped slightly in every year since 2000, even as the economy has grown.

What's more, new research by Lucien Bebchuk, a Harvard Business School professor who studies executive pay, indicates that pay as a proportion of earnings is growing. From 1999 to 2003, the top five execs at the 1,500 largest public companies, as a group, took home $122 billion in salary, bonus and stock. That's not chump change.

While the SEC awaits public comment on its new rules this spring, shareholders soon will have their own opportunities to be heard on the issue of CEO pay.

At Home Depot (Research), AFSCME has submitted a proposal that would allow shareholders to vote each year on executive pay packages. (The vote would be non-binding.) CEO Bob Nardelli has been criticized for his pay, which added up to about $14 million in 2004, most of it not tied to performance.

The union also has filed pay-related proxy resolutions at Countrywide Financial (Research), where CEO Angelo Mozillo took home compensation of $20 million in 2004, and at Citigroup, where CEO Charles O. "Chuck" Prince collected more than $10 million.

Other activists want to hold boards accountable for their decisions on pay by asking companies to adopt a "majority vote" requirement for directors. While the concept is not quite as simple as it sounds, the idea is to remove from corporate boards those directors who fail to win a majority of votes cast by shareholders in director elections. Right now, most directors run unopposed and need only one vote to be elected.

The SEC, for its part, can give shareholders more power by allowing them to nominate their own candidates for director and, under certain circumstances, get their nominees onto the proxy ballots. Corporate groups have opposed the idea of giving shareholders access to the proxy.

But Cox has shown himself to be an independent thinker, and by no means an apologist for overpaid CEOs or ineffective boards. He may just decide that the owners of companies have a right to meaningful elections of boards the directors who run them. That's hardly a radical idea. ■

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