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U.S. Fed plans to review bank pay

Janet Whitman, Financial Post

Looking to thwart a return to the reckless behaviour that led the United States into its worst financial meltdown since the Great Depression, the U. S. Federal Reserve is considering a plan to curb compensation at big banks.

As part of the proposal, the Fed plans to review banker pay packages and possibly order more money be paid in longer-term restricted stock and also allow for "clawbacks" that would force executives to return bonuses that proved unwarranted.

The draft plan being mulled by the Fed is far less onerous than the original US\$500,000 pay cap for top bank executives proposed by the Obama administration at the height of the financial crisis.

"The feeling is that boards of directors at many of these banks haven't been very effective at [setting compensation], so now they're getting some sort of referee," said Roy Smith, a professor of finance at New York University and a former partner at Goldman Sachs. "Banks will benefit from having best practices imposed on them...They aren't really going to object to the restrictions. It will keep them from hurting themselves."

If approved, the plan would mark the first time the Fed would step in to oversee compensation policies at banks.

The proposal comes as excessive compensation is set to be a front-burner issue at the Group of 20 nations meeting next week in Pittsburgh.

With financial reform being pushed aside in the U. S. as the Obama administration focuses on a healthcare overhaul, Europe has picked up the torch for a crackdown on compensation.

At the G-20 meeting, European Union leaders are expected to push for binding worldwide rules on pay for bankers and for new controls on bonuses, arguing that excessive risk-taking by bankers that contributed to the financial crisis was encouraged by huge bonuses.

Some industry observers speculated the Fed's move could be calculated to get a step ahead of European leaders.

"The fact that the Fed is, on a preliminary basis at least, showing sympathy with Europe's position, may help prevent a more radical turn," said Marc Chandler, global head of currency strategy at Brown Brothers Harriman & Co. "At the same time, if such issues are not coordinated, it could lead to a competitive disadvantage to the first mover."

Other industry observers worried about an uneven playing field if the Fed doesn't work out a coordinated global effort.

"Do you try to tell the Royal Bank of Canada what to pay their senior executives working here in the United States?" said Dennis Nason, a former banker, who's now chief executive of Nason & Nason, an executive search firm specializing in banking and finance. "If you told Deutsche Bank that, maybe they would have their senior bankers work out of London."

Similarly, Mr. Nason added, it's unclear whether a company like American International Group, the insurance giant that was bailed out by Washington after threatening to bring down the global financial system, would fall under the rules.

"Do you reach out to regulate companies like them too?" asked Mr. Nason.

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