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Bailout triggers exec pay worries

By Peter Page

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Attorneys specializing in executive compensation are hearing from banking and finance executives forced to sign waivers of any right to challenge reductions in pay or benefits required when banks accept federal bailout money.

"People affected by the new rules are very skittish," said Stephen Zweig, a New York partner who is head of the employee benefits group at Ford & Harrison.

The rules affecting executive pay are a condition of selling stock to the U.S. Treasury Department's Troubled Asset Relief Program (TARP).

According to the Treasury Department's Office of Financial Stability, as of the end of 2008 nearly 200 banks have received a total of $187.5 billion from TARP's capital purchase program. TARP also administers separate programs for the $40 billion invested in American International Group Inc., $19.4 billion invested in automakers Chrysler Corp. and General Motors Corp., and $20 billion invested in Citigroup Inc.

The rules vary somewhat in the separate programs, such as mandates that only automakers sell their private jets, but all prohibit incentives that encourage "unnecessary and excessive risks"; mandate "clawback" provisions for repayment of any bonus based on bookkeeping later proven to be inaccurate; and forbid "golden parachute" severance packages.

Broad participation

Robert Wild, a partner in the corporate practice in Katten Muchin Rosenman's Chicago office, expects that nearly all U.S. banks will ultimately accept the government money and the restrictions on executive pay. "The boards [of directors] find it is too good to pass up," Wild said.

The Treasury Department, in a report to Congress in December, conceded that it has no process for ensuring compliance with the compensation restrictions that apply to the top five paid executives at banks that accept TARP money.

Wild said banks are nonetheless complying, noting that senior executives risk criminal penalties if they don't. President-elect Barack Obama in recent remarks promised closer oversight, and Representative Barney Frank, D-Mass., chairman of the House Financial Services Committee, on Jan. 9 introduced a bill that would write TARP regulations into law.

Wild believes that some institutions are considering applying the restrictions more broadly than required.

"If I am a top five guy because I make ten thousand more than the next guy, and I have to sign waivers and be subject to clawback, that isn't fair," Wild said. "The idea is spreading that this ought to be applied throughout the ranks."

No bank contacted had a comment on executive pay restrictions, nor did the National Bankers Association.

Alan Levine, a partner in the executive compensation group at Morrison Cohen in New York, has heard from executives who want a legal opinion before signing the federally required waiver.

"They call us to find out what is the story, what are they giving up," Levine said. "At the end of the day, people don't have a lot of choice."

Levine said many publicly traded companies are beginning to disclose in proxy statements executive compensation that rewards risk.

"I think voluntary disclosure will become a best practice," Levine said.

Robert Stone, counsel to the executive compensation practice at Clifford Chance, said there is little guidance on what constitutes "excessive risk."

"There is not much guidance on what is excessive risk, so this regulation could have the adverse effect of quieting innovation," Stone said. "It is a tricky thing."

Brigen Winters, a principal at Groom Law Group in Washington, said restrictions on executive pay were first written into the Sarbanes-Oxley Act of 2002 in response to the Enron scandal and tightened further with the IRS 409A rule for payment of deferred compensation.

"The TARP restrictions did not come out of nowhere," Winters said. "409A creates all sorts of hoops to jump through and, unlike the TARP restrictions, it is not just the top five people."

Zweig of Ford & Harrison said he is hearing from executives nearing retirement who are shell shocked by the collapse of financial giants such as Lehman Brothers Holdings Inc. "A lot of executives have nonqualified deferred compensation plans that are just a promise [and] only as good as the institution standing behind it," he said.