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VIEWPOINTS

On Compensation, Bankers Don't Get It

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Bankers today are experiencing extreme outrage from rank-and-file folks who are fed up with what they perceive as dramatic excess in the pay senior executives take home.

The hostility is fueled by the belief that while bankers are getting paid handsomely, regular folks are losing their homes.

We bankers, much like the American International Group and Merrill Lynch executives, seem to have a tin ear for the public relations issues surrounding our industry.

We should also not be surprised that the government bailout money and new capital in our banks come with heavy strings attached. And we should certainly not be surprised that the toughest strings are attached to executive compensation.

Bank boards and their executive compensation committees must take immediate action to deal with the new rules being written for us in the halls of Congress. We must navigate the sea of outrage and hostility today and make some attempt to mitigate and differentiate our real compensation practices from the salacious stories that describe a scant few.

As an industry, we are best served by devising our own solutions to the current criticism — and doing it now. The faster compensation committees tackle these issues, the more likely we are to get good solutions, not legislated rules that do not work.

Here a few actions that a board compensation committee can take immediately. These tasks are more likely to be helpful to banks with assets of under $50 billion.

Re-examine your compensation philosophy, as stated in the bank's proxy. In the rapidly changing business climate, nearly all banks are restating their business strategies. Board compensation committees should immediately rethink the compensation strategy statements and correlate these principles with the redefined business direction. This process should produce the lead statement in next year's proxy and demonstrate the bank's commitment to responsible compensation practices.

Inventory all cash and noncash compensation for the top five executives, and then extend the list to the next 25. Proxy information is available for the top five, and data collection for the next group should follow the same pattern. This exercise will reveal where the pay gaps exist among the senior managers and force a discussion of whether the differences are appropriate.

Debate the rationale of your short- and long-term incentives to determine whether performance measurements are defensible and sufficiently challenging. Goals that are too easy to achieve will draw legitimate criticism, and those that are too hard will drive executives away from your bank. In the new world, the link between goals and risky behavior is a big concern. If we get it wrong too often, we can expect an outside force, such as a regulator, to begin setting not only the pay levels, but also the required goals and measurements — and we are mighty close to that happening right now.

Listen to the investor and regulator constituents. In today's environment, the PR value of our actions may be as important as compliance with whatever rules are ultimately given to us. A pay package that puts significant emphasis on long-term stock incentives appears to be the model the government favors. The negative backlash is most felt when all elements of pay seem to hit the jackpot at the same time — a big salary, a bigger annual bonus and an enormous stock award.

Review all executive contracts today, and rethink what is "reasonable and fair" for the bank and the executive in these troubled times. Even among those banks that do not take TARP money, there is an immediate need to face reality on what constitutes "competitive" in today's market. The bank that continues to defend a three-year protection for senior executives may discover stiff shareholder resistance as votes are taken at next year's annual meetings — and perhaps at this year's, as well.

The payout of disproportionate severance packages to executives who failed or appear to have failed will garner instant criticism, so don't do it.

Designate a reputational risk officer to be paired with the board's executive committee. We must re-establish our good names if we are going to regain the public's confidence in the financial system. We are talking about survival. Actions that managers were allowed to take in the past but are poorly perceived today should be stopped before they occur. We bankers must wake up to reality. We should be fired without any payouts if we underperform, and we should have money taken back if our compensation is based on a misleading balance sheet. Conversely, we should be paid when we do a good job.

We have got to make our compensation practices a lot more transparent, or the guys like Chris Dodd and Barney Frank are going to start telling us how much we can pay, what performance measurements we can use and whether we can pay severance to anyone. Oh, sorry — they are already trying to do that.

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