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Bill Poole: Fed “Deluding Itself” On Bank Compensation

William Poole was an outspoken central banker when he led the Federal Reserve Bank of St. Louis (until March 2008). Now, as a senior fellow at the Cato Institute, he’s an outspoken *former* central banker. Among his targets when he delivered a lecture at the Shadow Open Market Committee’s meeting on Wednesday: the Fed’s planned regulation of banks’ compensation practices.

Poole said the government cannot design compensation practices better than the private sector can. If regulators try to bear down hard on those practices, “companies can evade compensation controls with a wink and nod.” The effect: Managements would just draft more vague policies to provide room to pay what’s necessary to keep the most productive employees, he says. “Banks will not sit back and permit key employees to be bid away by outside offers.”

That was about the government in general. Then he got to the Fed: “The Federal Reserve is deluding itself if it believes it can influence compensation practices over the long run by making compensation policies subject to Fed approval. The formal policies will indeed be written in a fashion that satisfies regulators. To understand implementation of these policies, however, the Fed will have to conduct detailed studies of how actual compensation fits within the policies. The exercise will either descend to detailed regulation of compensation employee by employee or become merely another bureaucratic hurdle banks must jump over.”

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