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Feds to slash bankers' pay, spurs debate

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The government moved in a sweeping and unprecedented way Thursday to curb the pay of executives at banks and Wall Street firms that contributed to last year's global economic crisis.

In simultaneous announcements, the Federal Reserve and the Treasury Department prescribed the pay limits to quiet public anger over the regulators' failure to restrain multimillion-dollar bonuses and other exotic pay schemes on Wall Street. The moves stirred a debate between people who saw the actions as long overdue and others who viewed the intervention as excessive.

Supporters said the effort would go a long way toward ending the incentives for short-term profits and bonuses that helped cause last year's financial meltdown and left taxpayers footing the bill. Opponents worried that the new regulations go too far, exceed the government's authority and attempt to dictate what for centuries in the United States have been the private decisions of executives and boards of directors.

The cuts ordered by Treasury pay czar Kenneth Feinberg target three of the largest culprits in the crisis - Citigroup, Bank of America and American International Group - as long as they continue to rely on government bailout funds. But the Fed took on a much broader group in announcing that it would regulate pay at the 28 largest banks as well as thousands of community banks. Its rules potentially will have a more lasting effect in limiting pay throughout the financial sector.

The Fed's targeting of the largest bank holding companies ensures that unsound pay practices of executives and traders at all the major Wall Street players in the crisis are reviewed, including Goldman Sachs Group Inc., JPMorgan Chase and Co. and Morgan Stanley - companies that have already announced generous bonuses for employees this year

after paying off their obligations to the government to free themselves from the Treasury's restrictions.

Fed Chairman Ben S. Bernanke, who has been nominated for a second term and faces strong criticism from some quarters in Congress, has been under the gun for not using the Fed's sweeping powers over banks and Wall Street firms to curb risky practices in the past. The Fed and Treasury also were compelled to act to comply with international agreements to curb excessive pay adopted at recent meetings of the Group of 20 economic powers.

After conducting a comprehensive review of major banks and directing changes in their pay practices, the Fed said it intends to use its regular supervisory reviews to track and curb potentially risky practices that could lead either to the collapse of the bank or create instability in the broader financial system. While not detailing how it will curb pay, the Fed is citing its authority to regulate for "safety and soundness" of banks as well as its authority to ensure the stability of the broader financial system.

Smaller, community banks also regulated by the Fed - most of which played no part in the financial crisis - will receive lighter reviews and recommendations from the central bank. The Fed is among the most powerful bank regulators and, under the threat of enforcement action, banks are expected to quickly adopt any changes the Fed deems necessary.

"Compensation practices at some banking organizations have led to misaligned incentives and excessive risk-taking, contributing to bank losses and financial instability," Mr. Bernanke said. "The Federal Reserve is working to ensure compensation packages appropriately tie rewards to longer-term performance and do not create undue risk for the firm or financial system."

The Fed's move came as the Treasury's Mr. Feinberg announced cash pay cuts of as much as 90 percent for the top 25 executives at the seven corporations that received the most government aid, starting next month. The slashed compensation will serve as the basis for salaries next year, and for as long as the firms benefit from government bailouts, he said.

Cash salaries were limited to $500,000 for more than 90 percent of relevant employees, and average total compensation was down by more than 50 percent from last year under Mr. Feinberg's plans, which were worked out in negotiations with each company. General Motors, Chrysler and their financial subsidiaries also are subject to the pay restrictions.

President Obama said the bailed-out executives are reaping what they sowed.

"It does offend our values when executives of big financial firms that are struggling pay

themselves huge bonuses even as they rely on extraordinary assistance to stay afloat."

Mr. Feinberg said he is "extremely sensitive to the public outrage," and his goal is to replace cash compensation as much as possible with stock grants that align the interests of executives with the long-term interests of stock holders. The executives would not be allowed to cash in their stock compensation to make a quick killing on quarterly changes in profits and revenues.

Mr. Feinberg said he hopes the drastic changes in compensation he is ordering at top financial firms set an example for other firms on Wall Street. But there is little evidence that is the case. Goldman Sachs, JP Morgan and other big firms paid off their obligations to the government earlier this year precisely so they could continue to offer huge bonuses and awards to their most productive employees.

How those Wall Street firms will be affected by the Fed's restrictions remains to be seen.

Treasury Secretary Timothy F. Geithner suggested that one of the goals of the stiff cuts ordered by Mr. Feinberg is to prompt the most heavily indebted companies to quickly repay the government. Bank of America already has stated its hopes to do so, but GM, Chrysler, Citigroup and AIG are considered a long way from being able to repay the more than $300 billion of bailout cash they received.

"We all share an interest in seeing these companies return taxpayer dollars as soon as possible, and Ken today has helped bring that day a little bit closer," Mr. Geithner said.

Stephen Lerner, special assistant at the Service Employees International Union, called Mr. Feinberg's pay cuts "a pretty good start" but said "it should not be limited to the seven companies." He said the government should attempt to recover the large sums of money Goldman Sachs and other Wall Street executives made during the financial crisis.

The Fed and Treasury actions "combined are the beginning of a change to the idea that the masters of the universe cannot be held accountable," Mr. Lerner said. "It's bad business, morally bankrupt and bad for the economy."

But Mark A. Calabria, analyst at the Cato Institute, said it sets a bad precedent of government interference in the market.

"I am a little concerned about where this will go in the long run. As a taxpayer I want my money back, but you don't want to set up a system in which you scare off the best talent," he said.

A Bank of America spokesman said the Feinberg restrictions already are hurting the bank.

"Competitors not subject to the pay restrictions already are exploiting this situation by identifying our top performers and using pay concerns to recruit them away," spokesman Scott Silvestri said.

The Securities Industry and Financial Markets Association indicated it would resist the Fed proposal through the regulatory process. The Fed has allotted 30 days for public comment on its pay guidelines before they take effect.

"These proposed rules will likely affect compensation for hundreds if not thousands of professionals working in our industry," said the association's president, Timothy Ryan.

Charles G. Tharp, an executive vice president at the Center On Executive Compensation, said Mr. Feinberg's focus on aligning compensation with shareholders' interest is commendable, but the severity of the curbs may make it difficult for firms hit hardest by the crisis to attract the talent needed to restore their financial health.

"We also have significant concern about the governments intrusion into the boards authority to structure pay," he said.

Joe Weber contributed to this report.

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