2011

The Post-TARP Movement to Regulate Banker Pay

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New York University
Review of Employee Benefits
and Executive Compensation—
2011

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New York University Review of Employee Benefits and Executive Compensation—2010 [page #]

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CHAPTER 1B
The Post-TARP Movement
to Regulate Banker Pay
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§ 1B.01 INTRODUCTION

Despite the state-law origins of corporate law, the federal government has attempted to regulate executive compensation for decades. Before the financial crisis, however,

1 See Kathryn J. Kennedy, Excessive Executive Compensation: Prior Federal Attempts to Curb

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these attempts were largely indirect and implemented through the tax and securities laws. The Internal Revenue Code favored some arrangements (e.g., stock options) while disfavoring others (e.g., large fixed salaries) in order to encourage higher levels of executive performance. Using its regulatory power, the Securities Exchange Commission required disclosure of executive pay packages. The SEC remained facially neutral about different types of arrangements, but was clearly motivated by the idea that public disclosure would curtail executive pay.²

Financial firms were, however, singled out and subject to pay caps during the crisis and ensuing bailouts. The Troubled Asset Relief Program (TARP) limited the amount of compensation that TARP recipients could pay and subjected their pay practices to regulatory oversight by a new “pay czar,” Kenneth Feinberg.³ The TARP limits ceased to apply once firms repaid their assistance, which most recipient firms have now done.⁴ Because of the outrage over the crisis and the extravagance of financial-sector compensation, it was inevitable that policymakers would seek more permanent regulation of banker pay.

§ 1B.02 DODD-FRANK’S UNFOCUSED COMPENSATION REFORMS

Just as the collapse of Enron gave birth to Sarbanes-Oxley, the financial crisis spawned its own signature legislation, Dodd-Frank.⁵ The act is enormous in scope and size, running nearly 850 pages in the Statutes at Large⁶ and reforming financial regulation of gargantuan bank holding companies⁷ down to pawn shops and payday lenders.⁸

[1] Corporate Governance Reforms of General Application

Given the widely held view (even inside the industry) that compensation practices played some role in the crisis, one would have expected Congress to devote

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² See id.
³ See Michael S. Melbinger, Executive Compensation & Risk, 14 N.C. BANK. INST. 59 (2010); John W. Lee, Tax TARP Needed for Year One and Year Two Returns of Executive Bonus to TARP Recipient: A Case Study of Year One Rescission/Exclusion From Income and Year Two Deduction Under Section 1341, 1 WM. & MARY BUS. L. REV. 323 (2010).
⁷ See, e.g., Dodd-Frank §§ 161–76, 124 Stat. at 1420–42.
considerable attention to compensation in drafting the act. Dodd-Frank, however, devotes a mere eight pages to compensation practices, many of which are generic provisions applicable to all listed companies:

- Periodic but nonbinding shareholder advisory votes on executive compensation (i.e., "say on pay").
- Independence of compensation committees.
- Disclosures relating executive pay versus performance.
- Recovery of erroneously awarded executive compensation following a restatement of earnings (i.e., "claw-backs").
- Disclosure of company policies on whether executives can hedge against declines in equity compensation (stock or options).

Though some claim ulterior motives, the public-spirited justification for these provisions argues that federal regulation is necessary to align the divergent interests of management and shareholders. Regarding claw-backs, a Committee report said, "The Committee believes it is unfair to shareholders for corporations to allow executives to retain compensation that they were awarded erroneously." Similarly, according to the committee, hedging disclosures "will allow shareholders to know if executives are allowed to purchase financial instruments to effectively avoid compensation restrictions that they hold stock long-term, so that they will receive their compensation even in the case that their firm does not perform."

In the financial sector, however, enhancing shareholder value does not necessarily enhance societal welfare. Shareholders may have the incentive to pursue excessive risks because neither they nor any other stakeholders bear the full costs of systemic

9 Section 951, 124 Stat. at 1899–1900.
10 Section 952, 124 Stat. at 1900–03.
11 Section 953, 124 Stat. at 1903–04.
13 Dodd-Frank § 955, 124 Stat. at 1904–05.
15 See generally Lucian Bebchuk & Jesse Fried, PAY WITHOUT PERFORMANCE (2004).
17 Id.
risk when bank failures rock the entire economy. Moreover, the government socializes the much of the risk of banking by providing a safety net of deposit insurance, emergency lending, and bailouts. Other compensation reforms of Dodd-Frank, discussed next, aim to enhance the safety and soundness of financial firms.

[2] FDIC Clawback Authority

Dodd-Frank gives regulators a powerful new tool to put large, failing financial firms into receivership. This new resolution authority was enacted primarily to avoid a future Lehman—an enormous financial firm going through bankruptcy proceedings considered by many ill-equipped to deal with such size and complexity. Congress clearly views the new resolution authority as supplanting bankruptcy and probably future bailouts as well. Many question whether the Federal Reserve and Treasury Department will swear off bailouts should they consider them appropriate in the future.

As for the mechanics of the new authority, the Treasury, Federal Reserve, and FDIC must jointly decide to place a systemically important financial firm into resolution, based primarily on the determination that the firm is in default or in danger of default. The FDIC conducts the resolution process and has broad powers in deciding which creditors should be paid and in what amounts. Equity compensation should be automatically wiped out during resolution, and the FDIC would surely try to minimize if not repudiate payments to bankers under deferred compensation arrangements.

Moreover, Dodd-Frank authorizes the FDIC to recover all payments made to senior executives two years prior to the start of the resolution process. Both the statute and

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19 See Dodd-Frank Act §§ 201 to 217, 124 Stat. at 1442–1520.
20 But cf. SKEEL, supra note 8, at 31 ("Given the tumultuous environment in which Lehman filed its original bankruptcy petition, the assumption that bankruptcy must have been a disaster is perhaps understandable. But in fact, bankruptcy worked quite well.").
21 Cf. Dodd-Frank Act § 1, 124 Stat. at 1376 (describing the purposes of the Act as “improving accountability and transparency in the financial system, to end 'too big to fail', [and] to protect the American taxpayer by ending bailouts").
22 OFFICE OF THE SPECIAL INSPECTOR GENERAL FOR THE TROUBLED ASSET RELIEF PROGRAM, QUARTERLY REPORT TO CONGRESS 7–10 (January 26, 2011).
23 See Dodd-Frank Act § 203(b), 124 Stat. at 1451; SKEEL, supra note 8, at 121.
24 See SKEEL, supra note 8, at 148.
25 The FDIC has proposed giving such obligations a lower priority than subordinated debt. See 76 Fed. Reg. 16324, 16340 (March 23, 2011).
26 Dodd-Frank Act § 210(s), 124 Stat. at 1514; cf. also 12 C.F.R. § 380.3(a)(2) (defining “senior executive").
proposed regulations allow the “clawback” only when the senior executive is “substantially responsible” for the firm’s failure.27 CEOs and CFOs are presumed substantially responsible but may rebut the presumption by showing they “performed [their] duties with the requisite degree of skill and care required.”28

[3] Regulation at Covered Financial Institutions

Dodd-Frank Act § 957 authorizes federal regulators to regulate compensation structures at “covered financial institutions,” a term that includes important banks among others.29 Federal financial regulators have the authority to issue rules that—

prohibit any types of incentive-based payment arrangement, or any feature of any such arrangement, that the regulators determine encourages inappropriate risks by covered financial institutions—

(1) by providing an executive officer, employee, director, or principal shareholder of the covered financial institution with excessive compensation, fees, or benefits; or

(2) that could lead to material financial loss to the covered financial institution.30

In April 2011, U.S. financial regulators proposed rules implementing section 957.31 Because the details of these proposed rules largely come from the Financial Stability Board, they are discussed in more detail below.32

Section 957 is largely superfluous. Even before the financial crisis, U.S. bank regulators prohibited “excessive compensation” as an “unsafe and unsound practice.”33 Excessive compensation drains bank capital, making the bank more prone to distress or default. The goal of preventing excessive compensation is to protect depositors and the banking system, not bank shareholders. Indeed, from a regulatory perspective, excessive compensation is no more or less harmful than excessive

29 Dodd-Frank § 957, 124 Stat. at 1905–07. Covered financial institutions include depository institutions and their holding companies, broker dealers, investment advisors, credit unions, Freddie Mac, and Fannie Mae. Institutions with under $1 billion in assets are exempt. Dodd-Frank § 957(e)(2), 124 Stat. at 1906.
30 Dodd-Frank § 956, 124 Stat. at 1904.
31 See § 1B.03[4].
32 See id.
dividends, as both deplete bank capital.\textsuperscript{34} A month before Congress passed Dodd-Frank, federal banking regulators issued guidance on compensation at regulated institutions.\textsuperscript{35} Section 957 merely expands the scope of firms whose compensation is regulated\textsuperscript{36} while allowing regulators to rethink their manner of implementing international agreements discussed below.

\textbf{§ 1B.03 THE FINANCIAL STABILITY BOARD (FSB)}

\textbf{[1]} The Cooperative Model of International Financial Regulation

For compensation and benefits lawyer, the movement to regulate banker pay will seem to be come from a strange place. Most of what U.S. and E.U. regulators have done is implement agreements reached by the Financial Stability Board, composed of central bankers and regulators from the wealthier nations and charged with developing policy responses to the financial crisis.\textsuperscript{37} International consensus is the traditional model for banking regulation. Because capital is mobile, bankers and nations have long sought to level the playing field between different jurisdictions. The model for the FSB comes from the Basel Committee on Banking Supervision,\textsuperscript{38} which describes its authority as follows:

The Committee does not possess any formal supranational supervisory authority, and its conclusions do not, and were never intended to, have legal force. Rather, it formulates broad supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements—statutory or otherwise—which are best suited to their own national systems. In this way, the Committee encourages convergence towards common approaches and common standards without attempting detailed harmonisation of member countries' supervisory techniques.\textsuperscript{39}

\textsuperscript{34} Cf. Comptroller of the Currency, Comptroller's Handbook: Capital Accounts and Dividends ("Excessive dividends can weaken a bank's capital position.").


\textsuperscript{36} The June 2010 guidance applies to the most important class of financial firms: banks and bank holding companies. See id. at 36398. Dodd-Frank § 957 extends the regulatory reach to broker dealers, investment advisors, credit unions, Freddie Mac, and Fannie Mae, while exempting institutions with under $1 billion in assets. See Dodd-Frank § 957(e)(2), 124 Stat. at 1906.


\textsuperscript{38} Basel is composed of central bankers from the G-20 and a few other rich countries. The European Union has its own seat at the G-20 but not at Basel. The remaining nineteen nations all participate in Basel, as do Belgium, Hong Kong, Luxembourg, the Netherlands, Singapore, Spain, Sweden, and Switzerland. See generally History of the Basel Committee and its Membership, http://www.bis.org/bcbs/history.htm.

\textsuperscript{39} See supra note 38.
The actual Basel standards of capital regulation\textsuperscript{40} clearly fell short during the financial crisis, prompting newer and tougher standards.\textsuperscript{41} Basel has been successful, however, at achieving harmonization, with most nations adopting some form of the Basel accords.\textsuperscript{42} This success inspired the G20 nations to task a similar body, the Financial Stability Board, with responding to the financial crisis. Mostly the same countries comprise the FSB and the Basel Committee, although the FSB includes financial regulators (like the SEC) and some nongovernmental organizations (like the IMF) in addition to the central bankers who meet on Basel.\textsuperscript{43}

\[\text{[2]} \text{ FSB Principles for Sound Compensation Practices}\]

\[\text{[a]} \text{ The Risk-Management Criticism of Incentive Compensation}\]

Consider the following exaggerated example on risk-seeking incentives. Suppose you could make a bet—with your employer’s money—that the stock market will rise next month. If you are right, your employer makes $1 billion, and you get a nice bonus of $10 million. If you are wrong, your employer loses $1 billion, and you get fired but could probably land a job at a slightly lesser firm. Most people would be willing to bet their jobs on a multimillion-dollar payoff. Bankers (greedy and otherwise) are different because they actually have the chance to do so.

Bank executives have long understood that bonus-seeking employees could take on too much risk and “blow up” the firm. Rogue trader, Nick Leeson, bankrupted Barings, one of England’s oldest and most storied banks in 1995. The 2008 counterpart occurred at the Financial Products Group of AIG. AIG is primarily an insurer, and its Financial Products group sold credit-default swap (CDS) contracts, essentially insurance against the default of some other financial instrument like a bond. AIG, of course, collected a premium for writing each CDS contract. Before the financial crisis, default on the underling bonds was a remote and contingent event, making the


\[\text{\textsuperscript{41} See BASEL COMMITTEE ON BANKING SUPERVISION, BASEL III: A GLOBAL REGULATORY FRAMEWORK FOR MORE RESILIENT BANKS AND BANKING SYSTEMS}\]

\[\text{December 2010 (rev June 2011)}\]


transactions appear very profitable. These profits enriched the Financial Products employees with average compensation of over $1 million per year, giving them every reason to sell more and more CDS. The employees, however, are not on the hook for any losses should the bonds default. Since Financial Products was a small corner of AIG—employing a few hundred of AIGs 100,000 employees—top executives were ill-equipped to control the risks presented by the CDS contracts. Once the financial crisis struck, only a federal bailout of $85 billion saved AIG from bankruptcy.44

Thus, incentive compensation gave Financial Products employees an incentive to pursue risk. Their returns were asymmetric: success gave the employees large bonuses, while failure brought widespread economic loss. Reforming such incentives has become the primary work of the Financial Stability Board.

[b] Alignment of Incentive Compensation with Risk Management

The most influential work on regulating banker pay is the FSB’s Principles for Sound Compensation Practices45 (the “Principles”). In the view of the FSB, incentive compensation contributed to the financial crisis because it was not coordinated with risk management.46 The following example illustrates this failure:

Imagine two employees whose activity generates the same short-run profit for the firm. One is a trader who ends each day with no positions and thus who exposes the firm to losses only during the trading day. Another is an originator of long-term, on-balance-sheet assets that provide substantial fees at origination but that expose the firm to substantial risk of loss over the life of the asset. Many compensation systems would tend to reward the two employees similarly, other things being equal, because there would be no “risk charge” applied to the short-term profits generated by the second employee.47

Risk-management systems did constrain employees before the crisis by disallowing some trades and projects. Risk management was about permission and limited the array of transactions that employees could take on behalf of their firms. Within the set of approved transactions, however, employee compensation was measured by profit without any adjustment for risk. Returning to the FSB example, assume that an employee receives permission to transact as either a short-term trader or a long-term originator. All other things being equal, the employee would pursue transactions as an originator as illiquid, long-term, risky transactions tend to produce higher profits. The

44 See Gretchen Morgenson, Behind Insurer’s Crisis, Blind Eye to a Web of Risk, N.Y. TIMES, Sep. 27, 2008.
45 FIN. STABILITY FORUM, FSB PRINCIPLES FOR SOUND COMPENSATION PRACTICES (2009) [hereinafter FSB PRINCIPLES].
46 FSB PRINCIPLES, supra note 47, at 1.
47 FSB PRINCIPLES, supra note 47, at 8.
Principles aim to correct this employee-level bias by requiring firms to make incentive compensation sensitive to risk.

Thus, the true failure at AIG and elsewhere was that incentive compensation was not adjusted to reflect the risk taken on by employees. The trick, however, is devising an effective way to do so. Quantitative models (like "value at risk" and its variants) exist for many transactions, allowing firms to impose upfront risk charges. These models do not perform well in times of distress, the only time they really matter. Human judgment seems little better at predicting crisis. We need only recall the choir of prominent voices that, before September 2008, downplayed the impact of subprime mortgages, the housing collapse and credit crunch on overall economy.

The soft, standards-based approach of the FSB's Principles would seem to reflect these difficulties. They are flexible and sensible in the abstract. No one could seriously argue against propositions like "Compensation systems should link the size of the bonus pool to the overall performance of the firm. Employees' incentive payments should be linked to the contribution of the individual and business to such performance. Bonuses should diminish or disappear in the event of poor firm, divisional or business unit performance."

The Principles leave implementation up to individual firms. They can use quantitative methods to measure risk taking and bonuses. If these methods are found lacking, firms may defer bonuses or pay them in firm equity to adjust ultimate payouts with ultimate performance. The Principles recognize the limits of these methods, especially with the use of firm equity. Employees may just want to get their equity awards and may realize that their individual risk-taking will have little effect on overall firm performance. Indeed, equity (especially options) offers asymmetric returns that could even encourage risk-taking.

We should note, however, that the goal is not to regulate compensation per se, but to regulate the risk of financial distress. If firms can regulate risk in alternative ways—for example, by holding more capital or by hedging—can they simply ignore compensation? The Principles answer no, holding that compensation reform is necessary to prevent employees from manipulating the quantitative risk management.

48 FSB PRINCIPLES, supra note 47, at 8.
50 Cf., e.g., Austan Goolsbee, 'Irresponsible' Mortgages Have Opened Doors to Many of the Excluded, N.Y. TIMES, March 29, 2007 (arguing that, with subprime lending, "the mortgage market has become more perfect, not more irresponsible.").
51 FSB PRINCIPLES, supra note, 47, at 3.
52 Id. at 10–11.
53 Id. at 8.
Yet, if employees can exploit traditional risk management, however, surely they can exploit flexible standards. Perhaps the FSB believes that their Principles will actually change firms' cultures by ensuring that risk management affects the most salient measure of banker performance—compensation.

[c] Governance by Boards, Regulators, and Stakeholders

The Principles envision compensation structures being overseen by boards, financial regulators, and “stakeholders” (like shareholders). Implicitly, the FSB is responding to the concern that bankers are setting their own pay without oversight from those constituents who will bear the consequences.

The governance standards regulate process, not results, much like the “procedural prudence” required by fiduciary law. Boards of directors, not management, must have primary control over compensation and review compensation structures regularly. The breadth of board oversight extends beyond executive compensation and reaches all employees who could affect firm risk.

While boards must establish and regularly review incentive-compensation programs, they cannot actually administer them. Those who do must have the appropriate authority, independence, and expertise. One fear is that bonus-maximizing bankers will cow risk-managers into altering their judgments. In response, the Principles require that risk-control employees be independent of front office employees. Similarly, the Principles demand that banks hire competent risk managers and pay them appropriately.

In addition to the board, regulators must review compensation. “[W]hen the totality of a firm’s compensation practices are less than sound, supervisors should first exercise suasion on the affected firm, and in the absence of necessary improvement should consider escalation to firmer intervention, which may include increased capital requirements.” Stakeholders—shareholders, counterparties, depositors, auditors and analysts—should receive disclosures about firm compensation. The Principles expect “engagement” with stakeholders without specifying details.

Like the risk-management Principles, the governance Principles are flexible, commonsensical, and unlikely to affect actors determined not to be affected. It is

55 FSB PRINCIPLES, supra note 47, at 2.
56 Id. at 6.
57 Id. at 6.
58 Id. at 14.
59 Id.
unclear how we can even measure their effectiveness as the Principles fail to provide clear vision of whose interests are being safeguarded. They note that the financial crisis “revealed that many firms took actions that were inconsistent with their own goals and externally determined risk appetite.”60 Similarly, the Principles argue for more “oversight and engagement” by “the firm’s stakeholders, particularly shareholders.”61 Elsewhere, the Principles suggest that firms follow some objectively prudent level of risk, referring to the “excessive risk taking”62 that contributed to the financial crisis. There are good reasons to believe that financial regulation cannot serve both the interests of shareholders and society at large. Like bankers themselves, shareholders enjoy limited liability and asymmetric returns. They keep all the gains from risk but have limited exposure to losses. Because of systemic risk, society at large—not stakeholders—bears much if not most of the burdens.63

[3] FSB Implementation Standards

The Principles do not impose pay caps, nor do they require compensation to be paid in any particular form.64 For the most part, they leave firms free to decide for themselves how to align risk management and incentive compensation, although the Principles do specify factors of particular concern. Six months after issuing the Principles, the FSB took a more stringent stance with its Implementation Standards.65

The Implementation Standards require firms to defer between 40 and 60 percent of banker bonuses over at least three years. Firms may use a form of “graded vesting” to pay the deferred bonuses (i.e., 1/3 after one year, 1/2 of the remainder after two years, and the full remainder after three years). Moreover, firms must pay at least 50 percent of bonuses in the form of firm equity, subject to an appropriate retention policy.66

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60 Id. at 5.
61 Id. at 13.
62 See Id. at 1 (“High short-term profits led to generous bonus payments to employees without adequate regard to the longer-term risks they imposed on their firms. These perverse incentives amplified the excessive risk-taking that severely threatened the global financial system.”); id. (“The Principles are intended to reduce incentives towards excessive risk taking that may arise from the structure of compensation schemes.”); id. at 12 (“[T]he asymmetry of bonus practice encourages taking of excessive risk. It also reduces the incentive to draw attention to excessive risk taking by others, since the sensitivity of the employee’s compensation to losses caused by others is reduced.”).
64 FSB PRINCIPLES, supra note 47, at 1 (stating that the Principles are “not intended to prescribe particular designs or levels of individual compensation. One size does not fit all.”).
65 FIN. STABILITY BD., FSB PRINCIPLES FOR SOUND COMPENSATION PRACTICES: IMPLEMENTATION STANDARDS (2009).
66 Id. at 3.
The *Implementation Standards* comprise five scant pages, only one of which is devoted to the deferral and firm-equity requirements. Based on the *Principles*, however, it is clear that the requirements are motivated by the idea of risk management and alignment. Deferred compensation is particularly well suited to ex ante adjustments to reflect individual performance, although such adjustments are not expressly required by the *Implementation Standards*. At least in the U.S., deferred compensation takes the form of an “unsecured promise to pay,” arguably giving senior management the incentive to avoid default at the firm level. Furthermore, equity compensation automatically reflects overall firm performance.


U.S. and E.U. regulators have largely adopted the FSB’s original *Principles*. Thus, incentive compensation must provide incentives that balance risk and reward, be compatible with risk management, and be supported by strong governance and oversight. Acting pursuant to its authority under Dodd-Frank, U.S. regulators have proposed extending their regulation of incentive compensation to bank holding companies, broker dealers, and certain other non-bank financial firms.

The U.S. and E.U. differ, however, on their adoption of the more binding *Implementation Standards* of the FSB. The E.U. has fully adopted them (and perhaps gone even further). E.U. financial firms must pay substantial portions of incentive compensation in both deferred compensation and in employer stock (or similar instruments). Deferral must cover between 40% and 60% of incentive compensation (rising with the level of the employee), and shares must command at least 50% of incentive compensation. The two requirements apply separately. For an executive subject to 60% deferral, every €100 of incentive compensation would be paid (a) €20 in current cash, (b) €20 of current stock, (c) €30 of deferred cash, and (d) €30 of deferred stock. Since the deferral and stock requirements must be satisfied independently, an E.U. firm could pay only 20% to 25% of incentive compensation in current cash.

In contrast, U.S. regulators have watered down the *Implementation Standards*.

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forcing only the top executives at large financial firms$^{71}$ to defer half of all of their incentive-based compensation and not requiring any equity compensation.$^{72}$ Deferral would need to be over at least three years, “with the release of deferred amounts to occur no faster than on a pro rata basis.” For example, an initial deferral of $150,000 could be repaid $50,000 per year.$^{73}$ E.U. regulators have noted the disparity and faulted their U.S. counterparts for failing to implement the full FSB model.$^{74}$

The U.S. proposal contains a vague requirement that the deferral be adjusted “to reflect actual losses or other measures or aspects of performance that are realized or become better known during the deferral period.”$^{75}$ The regulators do not specify whose performance matters, although presumably it is the entire firm’s as deferral targets only senior executives. Thus, the requirement seems to support deferral in the form of phantom equity, arguably increasing the risk-taking incentives that many believe plagues banker pay in the first place.$^{76}$

§ 1B.04 EVALUATION AND CONCLUSION

Like all of the compensation reforms of the past decades, the post-TARP movement to regulate is motivated by the best of intentions. And, as all of the older reforms, we should question whether the new movement will be effective or have unintended consequences. Throughout this paper, I have questioned whether this movement will be able to succeed even on its own terms. Unless firms take compliance to heart and change their own internal goals, the flexible standards of the FSB’s Principles would do little to slow the aggressive pursuit of risk-financed bonuses. Similarly, the mandatory deferrals of the FSB’s Implementation Standards align ultimate payouts to individuals with the results of their firms, not their personal results. Moreover, the incentive to earn bonuses awards—even by pursuing risky trades—will almost certainly swamp any countervailing incentive to protect employers from the remote risk of failure.

So far, however, the criticism is that the post-TARP movement will be ineffective. They may, however, turn out to be pathological. Requiring deferral of a fixed percentage of bonuses may simply encourage firms to “gross up” their bonuses to cover the deferral. Mandatory clawbacks and deferred compensation may also complicate the future resolution or bailout of troubled firms. Bankers will be acutely

$^{71}$ For this purpose, “large” means a bank having assets of at least $50 billion, the same threshold that Dodd-Frank uses in applying the bulk of its important provisions. See id.

$^{72}$ See id.

$^{73}$ Id.

$^{74}$ See Peter Spiegel, EU Warns US to Speed Up Bank Reform, FIN. TIMES, June 1, 2011.

$^{75}$ Id. at 73–74.

$^{76}$ See Bebchuk & Spamman, supra note 19.
aware that they will suffer large financial losses by going through the new Dodd-Frank resolution process. Rather than guiding a troubled firm smoothly into resolution, bankers will have every incentive to double down their bets in the hopes that a win—even if unlikely—will hold off failure. Conversely, should the Federal Reserve and Treasury turn again to bailouts in the future, doing so will almost certainly keep executives whole with respect to any deferred compensation.

It is worth keeping sight of the fact that regulating banker pay works only if it keeps firms out of financial distress or insolvency. Were it not for systemic risk—the society-wide costs of distress—regulators would have no reason to bother. For this reason, we all may be better off if regulators focus more on the activities and leverage of financial firms and less on how they compensate their employees.