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Wall Street, Meet Ken Feinberg, the Pay Czar

By Stephen Gandel

Ken Feinberg is a close talker. Feinberg, a lawyer who in June was named the Treasury Department's special master for executive compensation, starts his sentences about 18 inches from your face and, with a thick Boston accent, leans in to make his point.

It's an unusual trait for a guy who has to deliver the type of news that most of us would prefer to dispense from across the room or, better yet, by e-mail from a do-not-reply address. On Oct. 22, he told 136 top executives of seven bailed-out firms that effective immediately, he was cutting their total compensation 50% from what they received a year ago. Feinberg's previous public position was the administrator of the September 11th Victim Compensation Fund. In that job, he had to put a price tag on the dead.

"Dollars are a surrogate for worth," says Feinberg, leaning back in his chair before bouncing forward again on the next sentence. "So when you start talking about dollars, what people hear is a ruling on their overall integrity and value to society. It gets difficult."

Feinberg, 64, holds a unique position in American society. He decides what people — their pain as well as their day-to-day roles — are worth. Appointed 25 years ago to distribute about \$200 million to Vietnam vets poisoned by the herbicide Agent Orange, he has become the Solomon of settlement. As head of the 9/11 fund, he held town-hall meetings and met one on one with countless grieving relatives to explain his bottom line on the lost years of mothers and fathers and daughters and sons. "He recognized the astounding amount of sensitivity of the assignment," says former Senator Charles Hagel, who supported Feinberg for the position. "By all the different assessments you can take of these things — victims' reactions, cost to the taxpayer, political issues — he did a great job with the 9/11 fund."

His current task may be even more complex. Feinberg's mid-October report reassessed not only what the top 25 executives of each of the seven firms that received the most government assistance should be paid but also how. Unlike his job with the 9/11 fund, Feinberg's position as pay czar is not one that inspires sympathy. Some think his meddling has made the firms over which he has sway less competitive. Others say he didn't cut enough. But as Wall Street prepares to hand out eye-popping year-end bonuses, the larger question is this: Just how much does it matter what people are paid? "Where is the empirical evidence that by doing what Feinberg is doing, we'll solve the problems that caused the financial crisis?" asks Ohio State University

finance professor René Stulz, who has looked at whether excessive CEO pay caused the credit crunch. "I don't see it."

The Job at Hand

The Treasury established Feinberg's position after Congress passed the American Recovery and Reinvestment Act in February. Feinberg has jurisdiction over the 100 highest-paid employees at the seven firms that the government deemed "exceptional assistance recipients": insurer AIG, financial firms Bank of America and Citigroup, auto companies Chrysler and General Motors and their former finance arms Chrysler Financial and GMAC.

That's just the start. Feinberg will oversee the pay at the firms until each has repaid the government — or until he quits, and he has no plans to do so anytime soon. Having established a set of principles on which to base compensation for these execs, Feinberg says it will be easier to pass judgment on next year's pay packages, a process he pledges to start in January.

So how does one man evaluate the worth of 700 others? Feinberg asked each company to submit pay proposals for their top 25 executives. Officials at six of the seven asked him to approve base-salary raises for their top guns. He was stunned. "What I learned in this job already is that the gap between what Wall Street thinks is a reasonable paycheck and what Main Street thinks these officials should get is not a gap. It's a chasm," he says.

Feinberg had the seven firms disclose what the executives in question earned in the past two years. He then collected data on top executives' salaries in the auto and financial industries. None of those at the bailed-out firms, in Feinberg's view, should receive more than the average pay for that position in their industry. Then he got feedback from within the firms on how well each individual did his job.

He says in general, the companies have cooperated. But there has been tension. Feinberg asked all the firms to report how much stock each of their executives held, a point that a number of execs said might call into question their loyalty to their firm. AIG and a number of its top earners refused to give back past bonuses or rewrite contracts that guarantee multimillion-dollar bonuses at the insurer next year. And a number of companies insisted that his plan would hurt their ability to attract and retain talent.

Cutting the Check

In the end, he made more changes to the way executives get paid than to how much. That has disappointed some critics. Feinberg ended up boosting many of the executives' base salaries from last year's, though not as much as the firms requested. Total compensation dropped, but to most people, it will look like Wall Street pay as usual. Eight of the 12 highest-paid executives at Bank of America will get more than \$5 million for their work in 2009. At Citigroup, 14 execs will get at least that much.

Feinberg's big changes are in the form of payment, particularly on Wall Street. Gone are year-end payouts and AIG-style guaranteed retention awards. Instead, he devised a method of compensating executives: something he calls salary stock. Each pay period, the executives at Bank of America, GM and the other firms will get awards of stock along with their regular

paychecks. The checks can be cashed immediately, but the executives may not sell the stock for up to four years. Also, bonuses are paid in restricted stock, which must be held for at least three years and may be sold only after the firm has repaid what it owes taxpayers. The result is that in most cases, much of what the executives will get paid — in some instances, nearly 95% — will be in long-term stock grants. For the most part, Feinberg has kept cash salaries to \$500,000 or less.

Many people have praised him for his emphasis on long-term compensation. But a number of pay consultants say Feinberg might have gone too far in curbing year-end bonuses. "It is fair to say that some of the pay schemes promoted bad behavior and led to excessive risk, but you still need some sort of short-term incentive," says top-pay consultant Don Delves. "People do stuff for money, and they tend to be more motivated by money they can get in the next year [than by] money they may not see for three or five years."

But the real problem with Feinberg's scheme may be its reliance on the market. If we have learned anything from the financial crisis, it should be that the market can get things very, very wrong. So paying more people mostly in stock may result not in his stated goal of pay for performance but in pay for randomness. Feinberg is probably correct that his compensation structure won't hurt these firms' ability to retain top talent. Wall Streeters love to let it ride. The question is whether more people hell-bent on boosting their stock price will produce a better outcome for the economy as a whole. What Feinberg is likely to find after five months of studying executive comp is that there is no great way to pay people gobs of money. The superrich have relatively less at stake and more reason to gamble than you or I.

"Are these pay packages fair? I had to balance the need for these companies to pay back what they owe taxpayers," says Feinberg. "Others may have balanced things differently, but I did what I thought was right."