SUNDAY
FEBRUARY 22, 2009
HOUSTON CHRONICLE
chron.com/opinion

OUTLOOK

E

COMING MONDAY
■ Houston's pro-growth policies are helping the city withstand the economic downturn better than most other places around the country.

EDITORIALS | COMMENTARY | OPINION | LETTERS TO THE EDITOR | POLITICAL CARTOONS | VOICES

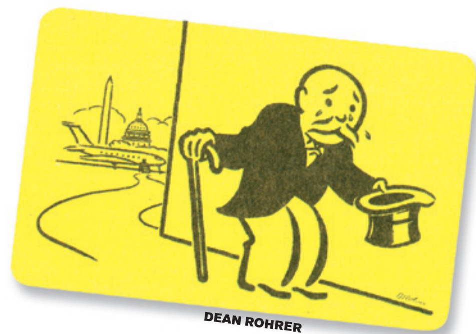
EXECUTIVE PAY

# Capping compensation won't solve bank crisis

## Boards must step up and set sensible salaries

By KAREN KANE

With the stroke of a pen at the eleventh hour, Democratic Sen. Christopher Dodd of Connecticut added a provision to the stimulus bill to strictly limit the pay of bankers whose firms receive federal cash. It seems that everyone in Washington wants a say on pay — if only to gain bragging rights that they will not tolerate the excesses that brought about the financial crisis. Yet, even the Obama administration that had earlier imposed restrictions on executive compensation has begun to worry that such moves may have unintended consequences. Legislating compensation programs from on high, unilaterally, does little to solve the crisis. What Dodd and the House Financial Services Committee revealed was the hubris that they could fix the economy by managing compensation. Not only is it more complicated, but the compensation discussion is already occurring inside boardrooms of companies untouched by the bailout. Directors have been hearing loud and clear that pay for performance is acceptable but pay for failure is not.



DEAN ROHRER

In the midst of the terrible downturn that has gripped the world economy, it's more than a little satisfying for a politician to call out the bad behavior of the Wall Street bankers who rewarded themselves with $18 billion in bonuses as the economy was imploding. It would be wrong to tar all executives and their boards with the same brush. The current situation demands that boards do a better job explaining how they provide oversight and how they evaluate and reward company leadership, two key elements of corporate governance.

Studies suggest that high pay on Wall Street is episodic and highest in bull markets. While the compensation cap is historic, it pertains only to those firms getting exceptional help; that is, excessive amounts of taxpayer money. The Obama administration is not signaling that it will try to manage executive compensation but it has changed the context. It is now up to boards of directors, charged with company oversight to use common sense.

As Chronicle columnist Loren Steffy pointed out in his column, "Let Boards of Directors Police Pay," Obama could change corporate governance by revising company bylaws to require directors to stand for annual election and to let shareholders vote against directors rather than simply withhold their vote. That would give teeth to the concept that directors serve to protect the interest of shareholders.

There was a time when boards were little more than rubber stamps, the friends of management, golf buddies who served on multiple boards. But since Sarbanes Oxley and shareholder activism, boards have evolved to operate at a higher level. Strong boards have no more than two directors who are current or former company executives. The audit, compensation and nominating committees now are made up solely of independent directors. More companies require directors to have an equity stake in the company, investing alongside shareholders. The quality of board membership has improved with at least one independent director experienced in the company's core business. Companies set standards about board attendance as well as director evaluation.

That doesn't mean they always get it right. In the economic meltdown, boards have received their share of the blame. Some boards have found it easier to reward executives and leave the explanation to compensation formulas and legalese. Today, directors recognize that data is just a tool and they are required to bring their best judgment to the task. Boards understand that shareholders expect to pay for outstanding performance but they are loathe to pay for failure.

It's been popular for companies to adopt the mantra of creating long-term shareholder value as a mission. However, the purpose of the company is not shareholder return, according to Paul Volcker. "The purpose of the company is really to provide goods and services at the best possible price, at the highest level of productivity, and in a way that serves society and communities." It is management's job to ensure that the company is ethical and successful. Corporate boards provide oversight.

Examples of poor oversight are an affront to investors. Certainly, in the aftermath of the dotcom meltdown and the disgraces of Enron, WorldCom and Tyco, most boards chose discretion as the better part of valor, continuing to operate quietly behind closed doors. Unfortunately, the boards that have saved companies from crisis and scandal have gone unrecognized and unheralded. In the best circumstances, CEOs turn to boards for strategic advice and guidance.

*A board with a strategic communication plan can use transparency and communication as effective risk management tools. Conversely, a board with its head in the sand pretending tat no one is looking is courting disaster or shareholder mistrust.*

In the current climate, boards are learning that they must tell the story of the work they do in carrying out their fiduciary responsibilities to shareholders or detractors will. A board with a strategic communication plan can use transparency and communication as effective risk management tools. Conversely, a board with its head in the sand pretending that no one is looking is courting disaster or shareholder mistrust.

Boards need to convey to shareholders that their contributions are significant in providing the necessary oversight and direction to management. Further, they need to convey that they are taking their responsibility very seriously. The truth is that boards are spending more high-impact time on the company's complex issues. At the same time, boards need to use every communication vehicle at their disposal — their Web sites, annual meetings, the proxy's compensation discussion and analysis to convey the thought and time they are putting into these issues.

Boards should continue to manage compensation as part of their oversight responsibilities. If they are not effective, the shareholders should vote them out. It's time for effective boards to communicate their understanding of shareholder concerns and how seriously they take their responsibility.

*Kane, formerly senior vice president of corporate affairs and board secretary for the Federal Reserve Bank of Chicago, served as communication officer for the Bank and the Federal Reserve System. She provides independent communication counsel to corporate boards. She can be reached at karen@karenkaneconsulting.com.*