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Frank to hold hearing on regulation of Wall Street pay practices

By Zachary A. Goldfarb
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Rep. Barney Frank, chairman of the House Financial Services Committee, said Tuesday that he will hold a hearing this fall to examine whether regulators are being tough enough in curbing pay practices at Wall Street firms that can lead to excessively risky practices.

The overhaul of financial regulations enacted this summer gives federal banking regulators new powers to dictate how Wall Street firms compensate their employees. Regulators have decided to issue general principles that banks must follow in setting pay but not stricter rules that would detail how banks must structure pay packages.

"When you get into new areas that can be somewhat controversial and run into resistance, you want to strengthen the regulators' resolve," Frank (D-Mass.) said in an interview Tuesday.

Many analysts, academics and government officials have blamed compensation plans that prevailed on Wall Street for contributing to the financial crisis. These plans tied pay to short-term profits and increases in stock prices.

Under the new law, officials have until April to set new pay rules. Regulators will have the authority to make pay decisions not only at banks but also at brokerages, credit unions, investment advisers, Fannie Mae and Freddie Mac, and other financial firms with $1 billion or more in assets.

Frank said that he's not prepared to endorse a specific approach to structuring executive pay but that he plans to ask regulators whether they think they need more authority. He said he is not convinced that all regulators favor more restrictive pay practices. "I think some do and some don't," he said.

Frank hasn't been impressed with how Wall Street executives have restrained themselves.

"They've done a terrible job, because they're getting all that money," he said. "There are not institutional checks on excessive expenditures."

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Frank said the hearing - which he plans to schedule for next month or October - would take up pay proposals developed by the Squam Lake Group, 15 economists who developed ideas about financial changes over the past year.

The group has argued against setting dollar caps on salaries, arguing that making millions in annual pay can be effective in rewarding "particularly talented financial employees." The group also concluded that capping pay would have unintended consequences such as pushing top executives to work for unregulated firms or work in other countries.

Still, the Squam Lake Group urges regulators to force banks to restructure the way they pay employees to ensure that executives bear in mind long-term risks.

"[I]f a significant portion of senior management's compensation is deferred and contingent on the firm surviving without extraordinary government assistance, managers will be less inclined to pursue risky strategies," the group wrote.

The group wrote that firms might be required to withhold one-fifth of an executive's compensation for five years. Executives would receive that pay if their firm has not declared bankruptcy or has not received a taxpayer bailout.

Other academics have suggested that pay be linked to the value of a company's debt or other measures that give a better indication of the value of a firm.

Federal banking regulators notified financial firms in June that their pay plans must reward long-term performance rather than excessive risk-taking. The banks are also required to take account of compensation when watching for risks, and boards must play a larger role in monitoring compensation practices.

The new financial-overhaul law contains additional measures to address compensation at financial firms and other companies. These include provisions that require boards to be more rigorous in their oversight of pay and that allow shareholders to register an advisory opinion on pay.

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