



Jesse Brill Responds to TARP Regulations

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The following was written by Jesse Brill, who is one of the country's top experts on executive compensation.

One key aspect of the new \$500,000 cap that has not gotten sufficient attention is the unlimited amount of restricted stock and stock options that still can be granted under the latest "restrictions." Equity compensation is the pay component that has gotten most out-of-line over the past 20 years. It (as well as severance/retirement/ golden parachutes) has caused the greatest disparity between CEO compensation and that of the next tier of executives (and employees generally).

The new \$500,000 cap provision does prevent executives from realizing the gains in their equity compensation until after the government is paid back. But there are two major problems with how this applies:

1. It does not apply to past equity compensation. Warren Buffet imposed a similar cap on Goldman Sachs' executives, but his restriction applies to all the equity held by the top executives. It is not limited just to future grants, as is the case with the new government restriction. So Buffett's provision wisely requires that the key decision-makers keep all their "skin in the game" until he gets paid off.
2. Although it may help protect the government's investment, it is short-sighted and fails to protect the shareholders' best long term interests. The holding period should be the longer of age 65 or two years following retirement. That will ensure that the key executives make decisions that truly are in the long-term best interests of the company (as opposed to decisions aimed at a shorter period - after which an executive could depart, taking all his marbles with him). Note that holding-through-retirement also addresses the major concern about top executives' unnecessary risk taking.

Holding equity compensation through retirement is perhaps the single most important—and fundamental - fix to getting executive compensation back on track because it also addresses all

the past outstanding excessive option and restricted stock grants. And, by requiring CEOs to keep their skin in the game for the long term, it will go a long way to restoring public trust in our companies and our market, which is so important to restoring stability to the markets.

Needless to say, the fundamental hold-through-retirement fix should apply to all companies - not just TARP financial institutions—and can be adopted at the same time that Congress adopts say-on-pay legislation (which everyone assumes will happen in the coming weeks. It will have much greater impact and do more good than say-on-pay.

Here are three additional points about the \$500,000 cap:

1. Just as the \$1 million cap was a major cause for the runaway increase in equity compensation over the past decade, the new unlimited opening for restricted stock will further exacerbate the problem. As an example, the typical time vested restricted stock grant does not qualify for the \$1 million cap "performance-based" compensation exemption, thus more companies and shareholders will suffer the cost of the lost tax deductions as these very large amounts vest. (So, once again the top executives will benefit at the expense of shareholders.)
2. One reasonable fix to the tax deductibility problem would be to require real performance conditions (in addition to time vesting) upon the vesting of the equity.
3. To address the "unlimited" new grants problem, do not permit additional grants in situations where the CEO's total accumulated equity grants exceed the company's own historic internal pay equity ratios compared to the next tiers of executives within the company.

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A complimentary copy of the November-December 2008 issue of *The Corporate Executive*, which Mr. Brill edits and publishes, may be obtained by going to <http://www.compensationstandards.com>.