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SJ(5/14) It's Wait-And-See Over US Pay Overhaul

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(From THE WALL STREET JOURNAL)
By Aaron Lucchetti

Wall Street reacted cautiously to talks by the Obama administration to overhaul pay practices at financial companies, worried about the specter of micromanagement but reluctant to fight back while the effort is at an early stage.

Few companies that would be affected by a federal crackdown on compensation would publicly discuss the options being considered by administration and regulatory officials, which include trying to more closely match pay with long-term performance. The wait-and-see response also reflects nervousness about openly challenging the Obama administration on an issue that has become a flashpoint for anger over Wall Street's culpability for the financial crisis and recession.

But some firms suggested on Wednesday that they are open to government guidance on what to pay traders, investment bankers and other employees, and might not fiercely resist the Obama administration's push if it results in principles to follow, instead of specific guidelines that give Wall Street little or no leeway.

Pay cuts are likely to wash across Wall Street no matter what happens in Washington, given the rocky financial markets and reined-in risk-taking at many firms. Ariell Reshef, an economics professor at the University of Virginia, predicts that financial-industry wages likely will decline relative to other industries, reversing an upward trend coinciding with a deregulation wave that began in 1980 and with the bull market.

"When there's a lot of credit risk, innovation and initial public offerings, you have to pay" more to financial professionals, says Mr. Reshef, who has studied the industry's pay over the past century with New York University Prof. Thomas Philippon.

In 2006, the last year included in the study, financial-industry wages exceeded nonfarm private-sector wages by 72%, according to their research.

Regulations passed in connection with the economic-stimulus plan and Troubled Asset Relief Program already are forcing cuts in Wall Street pay. It isn't clear how much further the Obama administration or Congress wants to go beyond that. 7

At Morgan Stanley, overall compensation was $2 billion in the first quarter, down 46% from a year earlier but still excessive to critics who want to see bonuses shrink or disappear until TARP recipients repay the government.

One of the most controversial ideas is whether the government should get leverage on pay practices at companies that haven't taken TARP funds. "For institutions that have ended up on the public dole, the policy issue becomes very important, but for those that aren't, it's an issue between the company and its shareholders," said Thomas Kloet, chief executive of Toronto Stock Exchange operator TMX Group.

John Benson, CEO at eFinancialCareers.com, said regulators should try "to limit banks from overextending themselves," but wading into compensation mightn't be the best strategy. In a recent survey by the financial-jobs Web site, 40% of respondents considering leaving Wall Street said that their primary concern is that "the smaller pay isn't worth the hours."

Several officials at Wall Street firms said they are adopting some of the guidelines being discussed by the federal government, such as tying pay to long-term performance and penalizing employees who put a firm's profits or reputation at risk.

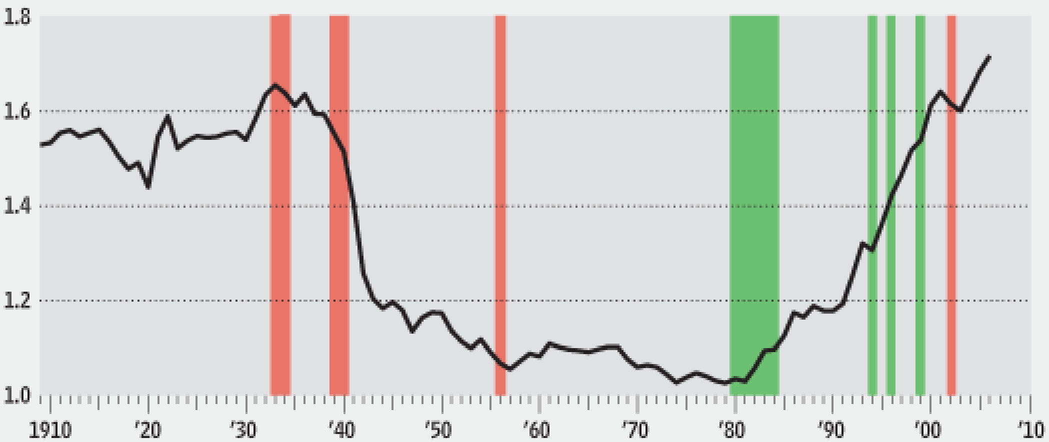
Some analysts predict that aggressive intervention on pay could raise constitutional concerns about whether the government is overstepping its powers. "This is a very bad trend," said Yale Law School Prof. Jonathan Macey. "The government doesn't know risk-taking" is excessive "until its too late."

"Any time you work against a priority" of a presidential administration or Congress, "it needs to be done delicately," said Sam Geduldig, partner at lobbying firm Clark Lytle & Geduldig.

Firms also must wrestle with the possibility that opposing pay changes in Washington could have an impact on other issues affecting the financial industry.

The Long Bull Market for Wall Street Pay

The rise of deregulation helped fuel financial-industry pay, which rose faster than overall wages.
Ratio of financial-sector wages to nonfarm private-sector wages, through 2006



Regulatory legislation

- **1933** Glass-Steagall Act
- **1933** Securities Act
- **1934** Securities Exchange Act
- **1939** Trust Indenture Act
- **1940** Investment Advisers Act
- **1940** Investment Company Act
- **1956** Banking Holding Company Act

Deregulatory legislation

- **1980-1984** Removed interest-rate ceilings (from Glass-Steagall Act)
- **1994** Riegle-Neal Interstate Banking & Branching Efficiency Act (repeals parts of Bank Holding Co. Act)
- **1996** Investment Advisers Act amended
- **1999** Graham-Leach-Bliley Act (repealed Glass-Steagall & parts of Bank Holding Co. Act)

Regulatory legislation

- **2002** Sarbanes-Oxley Act

2008 Economic Stimulus Act

2008 Housing and Economic Recovery Act

2008 Emergency Economic Stabilization Act (TARP)

2009 American Recovery and Reinvestment Act

Source: Ariell Reshef of the University of Virginia and Thomas Philippon of New York University