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Clawbacks Are In Place And Ineffective

By Tara Weiss



(October 29, 2008) Long before the brouhaha started in Washington and on Main Street over highly paid Wall Streeters taking excessive risks that jeopardized their companies, some of America's biggest public companies—including financials that have now become household names--were already putting financial disincentives in the path of top bosses to discourage them from betting the bank.

These are clawbacks, clauses in compensation packages that let a company recoup salary and bonuses from leaders accused of misconduct or fraudulent accounting, much the same that many in Congress are now advocating be made mandatory.

Clearly clawbacks don't always work.

A new study by Equilar, an executive-compensation research firm, names a long list of large public companies that have already voluntarily introduced clawbacks. They include the government-bailed-out insurer AIG, which introduced them in 2005, and troubled mortgage companies Fannie Mae and Freddie Mac, which brought them in 2006.

"A clawback policy at best is just one element in the toolkit that a company might employ to curb extensive risk-taking," says Alex Cwirko-Godycki, Equilar's research manager who co-authored the study. "It's not the catchall solution."

Among the 95 U.S. companies with the largest annual revenues, clawbacks are increasingly common. In 2006, 17% of these companies had them; that number rose to 42% in 2007 and today it's 64%, according to the study.

One problem is that they are rarely enforced. "The bar is so high that legally it's hard for the company to get those payments," says David Larcker, co-director of the Rock Center for Corporate Governance at Stanford.

Another is that, as Equilar's Cwirko-Godycki points out, "the definition of what qualifies a bad act varies from company to company and it's not always a slam-dunk case."

So why have them?

"If you do things that are bad from a compliance and corporate governance standpoint, we'll clawback your pay," says Richard Cellini, senior vice president, business and legal affairs at Integrity, which helps companies implement corporate governance. "Nothing gets [senior executives] to listen like that."

Any company that wants to participate in the Treasury's \$250 billion recapitalization program must agree to a clawback. Several of those who have signed on already had clawbacks, according to the survey. They include Bank of America, Citigroup, Goldman Sachs, Wells Fargo and JPMorgan Chase.

Clawbacks were originally designed as part of the Sarbanes-Oxley Act in 2002 as a measure to hold chief executives and chief financial officers responsible for accounting fraud.

As public scrutiny of executive compensation and the quest to squash corporate malfeasance intensifies, boards have expanded the reach of clawbacks. Many apply them to at least the top five executives; some go even further down the line, and broaden the trigger to general misconduct. Some companies impose clawbacks if an executive goes to a competitor.

This diffusion of the focus of clawbacks is one reason that they are a symptom rather than a cure. "The question is much greater than just clawbacks," says Susan Schultz, president The Board Institute, which benchmarks corporate governance. "Compensation packages have gotten to be inappropriate and out of order. A bonus by definition is a reward for exceptional performance. Now executives are awarded as a matter of course."

http://www.forbes.com/leadership/compensation/2008/10/29/executive-compensation-clawbacks-lead-compensation-cx_tw_1029ethics.html