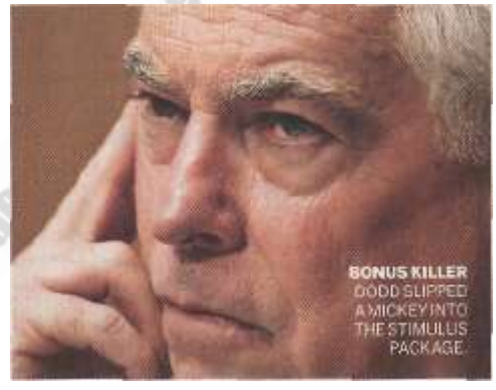
BY GEOFF COLVIN

Chris Dodd Wants to Scrap Your Bonus

The stimulus package *may turn bonus babies into time servers.*

WHEN SENATOR CHRIS DODD, (D-Connecticut) crammed what he dubbed "tough new limits" on "lavish Wall Street bonuses" into the stimulus package, he may have created a bigger problem for the economy than the one he was trying to solve. The reason? His plan inadvertently rewards nonperformance and will drive talented financiers away from the companies that need them most. "There will be a flood of top performers leaving for positions that have no restrictions/' says Richard Smith of the Sibson compensation consulting firm. The pay rules "will slow the only financial engine that can pull the economy out of this mess."

Senator Dodd tacked n pages of pay restrictions onto the stimulus bill at the last minute. (Dodd's office didn't return a call seeking comment.) The main reason they'll backfire is that they make pay for performance, otherwise known as bonuses, illegal beyond a modest allowance, yet they permit unlimited pay for nonperformance. An executive may be paid a guaranteed base salary of any size but may not receive a bonus exceeding one-third of total pay. And even that minor bonus cannot be based on profits; the rules prohibit any pay plan "that would encourage manipulation of the reported earnings" of the firm, which is of course what any plan based on profits would encourage. So paying top executives in any sensible way is forbidden.



Think of it this way: You want your kids to clean their room, but they know you're taking them to the movies regardless. You can still threaten not to buy them the giant box of Gumrni Worms—but the decision must not be based on whether their room is clean. Will this plan work?

Another consequence of the new legislation is that it will drive the craftiest financial minds away from the most troubled institutions. The new rules apply to the five highest-paid executives, plus at least the next 20 highest-paid employees at the largest firms getting TARP funds—"at least" the next 20 because the Treasury-Secretary can extend the rules to cover even more employees.

Let's think this through: Imagine a guy running a foreign-exchange trading desk at Morgan Stanley or Goldman Sachs. He has never been anywhere near toxic assets. Let's suppose he's good at his job and made $100 million for the firm last year—money that strengthens the firm and reduces its need for capital injections from, taxpayers. And let's imagine the firm wants to pay him a $5 million bonus on top of a $500,000 base salary. Washington's message to him: You must be punished! We'll make sure you're not incentivized to perform as well this year. Thus, the best performers, those most eager to show their stuff and get paid for what they produce, will leave the firms that most need excellent performers. They'll go to companies that can pay people what they're worth.

Deutsche Bank chief Josef Ackermann can hardly wait. "Talent will be happy to work for us," he said in anticipation of the new. rules. Employees who stay put, by contrast, will be time servers who most like the comfort of guaranteed pay. Sounds like the post office.

Senator Dodd's attempt to turn masters of the universe into bureaucrats even extends to where they dine. Instead of using the Zagat guide, TARP recipients may be expected to work from a list of restaurants "identified by the Secretary" of the Treasury, since by law he must now specify which entertainment expenditures are "excessive." Thus, a Washington civil servant could end up judging whether a Manhattan banker can take good customers to dinner at Per Se, or whether TGIF might be elegant enough to close a deal. Your tax dollars at work.

So here's my suggestion: Trash the rules in the stimulus bill and let Wall Street's ruthless labor market work. It's true that Wall Streeters sometimes get staggering bonuses; they also get fired without pity. Tens of thousands are out of work now, the guilty and the blameless, including top dogs from Citigroup, Merrill Lynch, and AIG. Washington would do a terrible job of figuring out who specifically was responsible for the billions in losses at Lehman, for example. But in coming months the Wall Street employment market will figure it out brutally well, a

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