Principles, not pitchforks

Some sensible new proposals for curbing corporate greed.

Illustration by David Simonds

Although the debate about excessive executive pay in America has been heated, cool heads prevailed when the time came to tackle the problem. On June 10th Tim Geithner, America's treasury secretary, said the government would not impose fierce restrictions such as caps on pay. Nor would it meddle in the detail of compensation packages. Instead, it wants companies to adopt a series of broad principles on pay and it intends to make it easier for shareholders to ensure that they do so.

This approach will infuriate pitchfork populists, who were hoping the Obama administration would impose a regulatory straitjacket on corporate pay after an outcry earlier this year over hefty bonuses dished out at firms rescued with taxpayers' cash. But Mr Geithner warned that such an approach would ultimately be "counterproductive". In practice only firms that have been bailed out will face stiff restrictions on bonuses and other forms of pay. Some will have to submit senior managers' compensation for review by a new, government-appointed "special master".

The rest of corporate America will escape such constraints, but the government still wants firms to take a fresh look at the way they reward staff. Among other things, Mr Geithner urged companies to avoid plans that offer big rewards for short-term risk-taking and called for a reconsideration of "golden parachutes", which can produce payouts that would make Croesus blush for bosses ousted for poor performance. He also exhorted firms to be more open with investors about the logic behind their decisions on pay.

Contrary to received wisdom, the process of linking pay to performance works reasonably well in America—witness the large number of bosses whose remuneration has plummeted during the recession. Nevertheless, several executives have made a mint even though their firms' track records have been lousy. Some experts say this is because they have packed their firms' remuneration committees with pals who are friendly to their cause. To address this issue, the government will push for legislation to give the Securities and Exchange Commission (SEC) powers to ensure that compensation committees are truly independent of management.

It also wants the SEC to ensure that consultants who advise such committees on pay are independent as well. Some of these work for bigger firms that sell a variety of services, which may make them reluctant to attack a boss's proposed pay package for fear of jeopardising other business. Consultancies say such concerns are groundless, but critics note that auditors said the same thing when they were pitching consulting services to audit clients. Yet the

Sarbanes-Oxley act significantly restricted auditors' ability to cross-sell other services in order to bolster their independence. Some experts think similar restrictions should now be imposed on compensation consultants, too.

Fixing executive pay will require more than just a few regulatory tweaks. Shareholders also need a chance to review and influence pay deals before they are inked. This week Mr Geithner said the government intends to give them one, by backing efforts in Congress that would require companies to submit their pay policies to an annual vote. Experience in Europe, where such ballots are common, has shown they encourage boards to consult more actively with shareholders on pay issues ahead of formal polls. That the current administration is so keen on "say on pay" is hardly surprising: the last time a measure proposing the process made it to the Senate, back in 2007, it was sponsored by a senator called Barack Obama.

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