



Executive Compensation: What now?

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Alan Judes – Strategic Remuneration
alan.judes@gmail.com
www.StrategicRemuneration.com



Agenda

- Let the market decide
 - I understand why Government is tempted to intervene
 - The alternatives are not attractive
 - We have experimented with them
- Government interventions seldom work without unintended consequences
- Suggestions for a market-based solution



The temptation to intervene is strong

- The situation is serious
- Regulators are blaming executive compensation for contributing to the problem – see FSA letter
- The Government wants to be seen to be doing something
- Gordon Brown loves a knee-jerk legislative reaction
 - He soon regrets it!



FSA letter of 13 October 2008

- First time a regulator has commented on remuneration structures
- “Widespread concern that inappropriate remuneration schemes, particularly but not exclusively in the areas of investment banking and trading, may have contributed to the present market crisis”
- “The FSA has no wish to become involved in setting remuneration levels: that is a matter for Boards, which should ensure that they have effective structures in place to set remuneration policies and monitor remuneration levels throughout the firm. However we want to ensure that firms follow remuneration policies which are aligned with sound risk management systems and controls, and with the firm's stated risk appetite.”



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- “We believe that it is possible to set out some high level criteria against which policies can be assessed. An illustration of our current thinking is set out in the attached annex.”
- “We would further expect firms to be moving towards good practice. We recognise that performance-adjusted, deferred compensation arrangements are complex to design: nevertheless, if they are not already in place we expect firms to be considering actively how they might be incorporated into remuneration structures within a specified time period.”



Comments from the media

- Bernard-Henri Levy – Without a free market we are simply fascists
- Irwin Stelzer – It's bad news when politicians replace markets
- Peter Montagnon – Let the market set the level of executive rewards
- FT Editorial – Payback time: Bankers' bonuses must be regulated by more than guilt



Great experiments of 20th century

- The Communist revolution and USSR 1917-1989
 - Sputnik was first
 - World domination seemed possible
 - Countries felt the “Communist threat”
 - Look at how it ended
- Prohibition in the USA 1920 – 1933
 - sale, manufacture, and transportation of alcohol for consumption were banned nationally as mandated in the Eighteenth Amendment to the United States Constitution.
- Inflation control in the UK in 1970s

Inflation control in the UK in 1970s

Annual Inflation Rates in the United States, 1974 - 2007, and United Kingdom, 1265 - 2007

Year	Inflation Rate US	Inflation Rate UK
	Plot Series	Plot Series
1974	10.98	16.02
1975	9.14	24.18
1976	5.76	16.50
1977	6.45	15.88
1978	7.61	8.30
1979	11.27	13.41

Annualized Inflation Rate US	Annualized Inflation Rate UK
1974 - 1979	1974 - 1979
8.03	15.54

[Another Computation?](#)

Citation

Lawrence H. Officer and Samuel H. Williamson "Annual Inflation Rates in the United States, 1265 - 2007," MeasuringWorth, 2008. URL <http://www.measuringworth.com/inflation/>



Inflation control in the UK in 1970s

- Inflation hit 24%
 - Legislate
 - Price controls
 - Wage Controls
 - Dividend Controls
 - Price Commission
- Unintended consequences
 - Red tape
 - Benefits in kind
 - Longer working week
 - Black economy grows
 - Maggie Thatcher gets elected
 - Price, wage, dividend, exchange controls abolished



Suggestions for a market based solution

- Appreciate and apply what we have
- Shareholders voting on non-binding Remuneration Reports
- Dialogue with shareholders
- Explain and support business strategy
- Quantify risk of business strategy
- Remuneration Reports containing two distinct sections
 - Historical audited past
 - Proposed policy for future
 - Separate votes may be necessary
- We do not want Gordon Brown designing executive compensation for UK plc