

Hancock's D'Alessandro Hits Jackpot: Graef Crystal (Update1)

June 18 (Bloomberg) -- John Hancock Financial Services Inc. used to be John Hancock Mutual Life Insurance Co. It also used to be the last place you would expect to find pay excess.

The emphasis here is on "used to be" -- for the Boston-based company has given way to not only a name change, but to the same greedy compensation appetite found at so many other financial services firms. This time as practiced by CEO David D'Alessandro.

In 2002, D'Alessandro earned \$30.9 million, the major elements of which included:

- A salary of \$1 million.
- A cash bonus of \$1.1 million.
- Free shares worth \$11.7 million.
- A payout under a long-term incentive plan of \$4.4 million.
- A payout of a 1998-granted "retention award" of \$3.5 million.
- A stock option grant, which I estimated had a present value at grant of \$9.1 million.

To gauge just how lofty this pay package is, I compared it with the 2002 pay received by the CEOs of nine other major U.S. insurance companies.

Using pay data furnished by Equilar Inc., an independent provider of pay information, I found that D'Alessandro's package was 4.2 times the median pay. Indeed, it was even 2.1 times higher than the very highest pay package of \$14.6 million earned by Robert Benmosche, the CEO of MetLife Inc. And MetLife is nearly four times larger than John Hancock, judging by 2002 revenue.

Out of Fenway

With a pay package that large, you would have thought D'Alessandro hit a long ball out of Fenway Park all the way to Copley Plaza, Hancock's headquarters in Boston. But you would be wrong.

Consider, for example, D'Alessandro's cash bonus of \$1.1 million. That was 110 percent of his so-called target bonus. Generally, a company pays a target bonus for what it considers to be decent but not spectacular performance.

But here's the performance in 2002 that backed up that 110 percent of target bonus:

- A 7.2 percent decrease in revenue.
- A 19 percent drop in operating income.
- A 15.4 percent decline in diluted EPS.
- And worst of all for John Hancock's shareholders, a total return of negative 31.7 percent in a year

when the return on the Standard & Poor's 500 Index was negative 22.1 percent and when the return on the S&P 500 Financials Index was negative 14.6 percent.

The same pattern can be seen with D'Alessandro's \$4.4 million payout under a long-term incentive plan for his performance during the three years ended Dec. 31, 2002. The payout was 1.45 times his target payout, suggesting that he worked some minor miracles during the three-year performance period. Maybe he did well in 2000 and 2001, but those dismal results for 2002 had to have taken a lot of the luster out of the company's three-year performance.

The business press is full of articles about John Hancock being in play, with failed talks recently taking place with FleetBoston Financial Corp.

Stock Incentives

The fact that the company is in play probably goes a long way to explain the huge emphasis that John Hancock has placed on incentives tied to the company's stock price.

There is, for a start, the 250,000 free shares granted to D'Alessandro last year. Then there's his 750,000 option shares, which came on top of a grant covering 1.3 million option shares in 2001.

Then there are the stock incentives piled on top of stock incentives. Seems the company has adopted so-called "shareownership guidelines," which require an executive to build up his ownership of actual shares over a period of years.

If you think these guidelines impose a burden on senior executives, think again. First, making those guidelines becomes a lot easier if an indulgent board gives you hundreds of thousands of shares free, not to mention massive option grants.

But more than that, if a senior John Hancock executive uses some of his annual bonus or long-term cash bonus to purchase Hancock shares, the company throws in 25 percent to 50 percent more free shares to sweeten the pot. Would that the company's shareholders had received the same treatment.

The Board Joins In

If he does peddle his company, D'Alessandro is slated to become even richer. He gets three years' salary and bonus, a long-term incentive award, full vesting on his various stock plans and even a souped-up pension with no actuarial reduction. What is more, he doesn't even have to lose his job to receive these benefits. He can simply grab the safety valve during certain periods following a takeover, and the money will be released in a torrent. No reason is required on his part for quitting during those periods.

Even Hancock's board is getting in on the action. In recent years, outside directors were accustomed to receiving an annual option grant covering 5,000 shares, in addition to their annual retainers of \$50,000 and their \$2,000 fee for each meeting.

For 2003, however, the 5,000-share option grant has been replaced with a free-share grant worth \$50,000. The grant of 1,788 shares was made on May 12, the date of the annual meeting.

The Shareholders' Interests

At first glance, substituting 1,788 free shares for 5,000 option shares seems a strange thing to do if a company is in play. A larger number of option shares would seemingly give the directors more of an upside reward in a takeover.

But what is overlooked here is that a grant of 5,000 option shares would, by my estimation, have had a present value at grant of only \$29,100. Thus, by awarding themselves \$50,000 of free shares, the board has not only given itself a handsome raise, but has also reaped a bit of the best of both worlds.

Comparing the two alternatives, the 5,000 option shares wouldn't be worth more than the 1,788 free shares until Hancock's stock price rises to \$43.54, a comfortable margin over the closing price yesterday of \$32.23. But with any stock price less than \$43.54, the free shares are worth more than

the option shares, thereby dramatically increasing the outside directors' downside protection.

With both executives and directors grabbing everything not nailed down, the nagging question for Hancock's shareholders is: Who is looking out for their interests?

That question apparently was on Vanessa Wilson's mind, too. Wilson, an analyst at Deutsche Bank Securities, dropped her rating on Hancock's stock to ``hold" from ``buy" in May. She cited Hancock's pay practices as being the cause of her decision.

You know things are bad when analysts, who previously were terrified of dissing CEOs who could give them business, start speaking out.

Still, for whatever her reasons, Wilson, on June 2, reversed the call she made a month earlier and restored her ``buy" rating. Earlier she had declared: ``We cannot recommend investors add new money to this stock until pay-for-performance issues are clarified."

Obviously, she must have received the clarification she sought, though what that could have been eludes me. I've heard about conversions on the road to Damascus. Now I see there is also a road to Boston.

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The members of the John Hancock board compensation committee are:

-- Richard Syron, chair, executive chairman, Thermo Electron Corp.

-- Michael Hawley, retired chief executive officer, Gillette Co.

-- Judith McHale, president and chief operating officer, Discover Communications Inc.

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