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# NYSE's Pay Board Should Quit, Not Dick Grasso: Graef Crystal

Sept. 10 (Bloomberg) -- For an organization that should be the standard bearer for good corporate governance, the board compensation committee of the New York Stock Exchange is a deplorable failure.

Yesterday, the NYSE finally fessed up to what it has been paying Chief Executive Officer Dick Grasso.

I normally roast CEOs; not this time. And that's because it's the compensation committee that's at fault here, not Grasso.

I know Grasso from the late 1970s when I was the exchange's compensation consultant. I designed the NYSE's first incentive plans, as well as one that covered Grasso, who was then in charge of garnering new listings. That was when previous CEOs William Batten and John Phelan were given pay packages -- which I also worked on -- that would be lost in the rounding of Grasso's packages.

Dick Grasso is a decent person who has boundless energy and who, despite not having a bachelor's degree or a pedigree from Princeton or the Harvard Business School, worked his way to the top in a career that has spanned 36 years so far.

## Brain-Dead Directors

At a press conference yesterday, Grasso declared: ``One decision I have never played a role in is the determination of my own compensation.'' And you know what? I believe him.

This isn't a case of a pushy CEO. It's a bunch of brain-dead directors, aided by equally brain-dead consultants.

Proof of that is Grasso voluntarily relinquishing $48 million of future pay. He is, though, keeping $139.5 million of special payments that were recently disclosed.

Should Grasso have given back some of that $139.5 million, too? In a perfect world, where everyone exhibits ``Satan, get thee behind me'' behavior, the answer would be a resounding yes. But Wall Street is so far from a perfect world that, if Grasso gave back much more, his peers would likely seek ways to have him committed.

According to a letter sent by Carl McCall, the NYSE's board compensation committee chairman, to William Donaldson, head of the U.S. Securities and Exchange Commission, Grasso's total pay for the years 2000, 2001 and 2002 was, respectively, $26.8 million, $30.6 million and $12 million. That's a three-year average of $23.1 million.

## Comparing Compensation

In his letter to Donaldson, McCall noted that Grasso's compensation had been set by looking at the pay of CEOs of U.S. financial firms and then discounting the results by 10 percent.

Let's look at the pay of CEOs in five major publicly traded Wall Street firms. They are Jimmy Cayne of Bear Stearns Cos., Hank Paulson of Goldman Sachs Group Inc., Dick Fuld of Lehman Brothers Holdings Inc., David Komansky, who ran Merrill Lynch for all but a few weeks in 2002, and Phil Purcell of Morgan Stanley. (I have excluded Sandy Weill from this comparison because: 1 - His company, Citigroup Inc., isn't only a Wall Street firm but a humongous commercial bank, and 2 - He is an outlier in any data set. In most years, when Weill jumps into a pool of pay data, all the water flies out.)

The median pay for the five CEOs in the years 2000, 2001 and 2002 was, respectively, $33.7 million, $17.3 million and $14.8 million.

If we include Grasso among those five CEOs, then his pay in 2000 would have ranked him fifth of the six, first in 2001 and sixth in 2002.

What has to be taken into consideration is that the median Wall Street firm had 16 times the net revenue of the NYSE in 2000, 14 times in 2001 and 13 times in 2002. Even more important, the average firm had 42 times the net income of the NYSE in 2000, 39 times the net income of the NYSE in 2001 and 75 times in 2002.

## Other CEOs

For another comparison, I recently looked at average total pay over the three years ending with 2002 for 243 CEOs running U.S. companies in a variety of industries with 2002 net sales of $5 billion or more.

Against that group, Grasso's three-year average total pay ranked him higher than all but 22 of the 243 CEOs. Moreover, the average net sales of the 22 companies were $43.4 billion in 2002, a figure that is 39 times the NYSE's 2002 revenue of $1.1 billion. On top of that, the average company among the 22 had 153 times the NYSE's net income and 109 times its assets.

It's quite obvious that the NYSE's compensation committee and its consultants exhibited total amnesia when it came to two fundamental principles of compensation.

First, there is a statistically significant, though not perfect, relationship between a company's size, whether measured by net sales, assets or employees, and a CEO's pay. Big companies pay more than little companies, and, in the context of the previous comparisons, the NYSE is not even a jumbo shrimp.

And second, all of the firms comprising my Wall Street and diversified databases, except the NYSE, are risk-taking organizations that aren't guaranteed any level of profit.

## Controlling Expenses

As to the first point, I would have thought that the exchange's pay and benefits consultants, Hewitt Associates and Mercer Human Resources, would have mentioned that correlation between organization size and CEO pay to the compensation committee, however politely.

And on point No. 2, I would have thought that the exchange's directors would have had at least a rudimentary conception of the difference between a real risk-taking, profit-making firm and a bureaucracy that, within limits, can produce whatever profits it desires.

Ask Morgan Stanley's Purcell if he would like to make any profit he desired simply by charging more for his organization's services. Don't bother waiting for an answer because that would be a rhetorical question.

Now get this statement that McCall made with the straightest of faces in his letter to Donaldson: The NYSE ``does not seek to maximize net earnings. However, it does control its expenses with the objective of generating a profit each year.''

Controlling expenses? What's that man saying?

One gem in Grasso's pay package has been huge deferred compensation awards, which, until they become vested, earn interest at a guaranteed rate of 8 percent a year.

In 1998, when that rate was first established, it approximated the U.S. prime rate, which ranged from 8.50 percent at the beginning of the year down to 7.75 percent at the end of the year.

It's not uncommon for a company to offer executives the opportunity to defer parts of their salary or bonus and to earn interest at the prime rate.

## That Awesome 8 Percent

Didn't those worthy directors note that there has been a secular decline in interest rates since 1998, to the point where an 8 percent rate today is awesome? It's currently twice the U.S. prime rate of 4 percent.

And didn't those worthy directors understand that an 8 percent pretax interest rate is also an 8 percent after-tax interest rate to Grasso, assuming tax rates stay the same, and more than an 8 percent after-tax rate if tax rates decline, as they have? Who, these days, is getting more than an 8 percent after-tax return with almost no risk?

Compounding the felony, while the NYSE was giving Grasso an 8 percent guaranteed return on his deferred compensation, he was also being promised that in determining his lump-sum pension, a rate of no more than 4 percent would be used for discounting purposes.

That combination would be akin to a bank paying depositors 8 percent interest and then lending the deposits at 4 percent interest. How long do you think that bank would remain in business?

On top of that, Grasso was credited with four extra years of service under the NYSE's retirement plan, notwithstanding that he has 36 years already.

The members of the board compensation committee of the NYSE who had anything to do with all that largesse should hang their heads in utter shame. Then they -- not Dick Grasso -- should resign.

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