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Say on Pay at Citigroup

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On April 17, 2012, Citigroup found itself in a position that few US companies (and no Wall Street giants) had yet experienced: on the losing end of a shareholders' advisory vote on executive compensation, also known as "Say on Pay" (SOP). Of the 75% of total shareholders voting, 55% had rejected the proposed compensation packages for CEO Vikram Pandit and several other directors.[1] This voting outcome was remarkable considering that Citigroup's compensation practices had obtained 93% of shareholder support in the prior year and that only 2.6% of companies in the Russell 3000 that voted on Say on Pay in 2012 had obtained less than 50% support.[2] Citigroup's was the first Say on Pay majority defeat on Wall Street.

Say on Pay

Say on Pay was first introduced to Citigroup as part of the Emergency Economic Stabilization Act of 2008 (EESA) following the 2007–2008 financial crisis. This act established the Troubled Asset Relief Program (TARP), which provided funds to shore up companies that had been hit hard by the crisis. EESA required companies with outstanding TARP funding to provide shareholders with a nonbinding advisory vote on executive compensation.[3] Such companies were required to fully disclose their compensation structure and curb senior executives' salaries. EESA also required that any additional compensation be paid in restricted stock vesting after the government had been repaid.[4] SOP tried to address anxieties among lawmakers, investors and the country at large concerning outsized executive pay and the risky behavior it could potentially encourage. As House Financial Services chairman Barney Frank decried, "We have a heads I win, tails I break

[1] Semler-Brossy. "2012 Say on Pay Results: Russell 3000 Year-End Report."

[2] The Russell 3000 Index is a stock market index that measures the performance of the 3,000 largest US public companies in terms of market capitalization.

[3] Full text of EESA available at https://www.congress.gov/110/plaws/publ343/PLAW-110publ343.pdf

[4] Joe Bel Bruno. "'Say-On-Pay' Movement Gets Boost from Obama Wall Street Plan." *Dow Jones Business News.* Feb. 4, 2009.

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even compensation system in the financial services industry in America. Executives have a perverse incentive to expose their companies to more and more risk, but only shareholders realize the downside of bad bets."[5]

On July 21, 2010, US President Barack Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act into federal law, extending the SOP requirement to all US public companies on a minimum three-year basis. Section 951 of Dodd-Frank implemented requirements for shareholder meetings to include a Say on Pay vote to approve executive compensation.[6] Similar legislation existed previously in the UK and has been introduced in other countries such as Australia, Germany and Switzerland.[7]

The introduction of mandatory Say on Pay votes increased the informational burden on voting shareholders, leading to the growing use of proxy advisory services. These firms provide institutional investors with recommendations on how to vote at annual company meetings. Institutional Shareholder Services (ISS), the largest proxy advisory firm, covers 115 markets and executes approximately 9.6 million proxy ballots annually, covering about 42,000 meetings for close to 2,000 institutional clients.[8] **Appendix 1** contains the ISS voting recommendation policy regarding SOP.

SOP votes are nonbinding, meaning the board of directors is not required to act on them. However, shareholder disagreement is thought to act as a constraint resulting in more efficient bargaining between executives and boards. SOP also provides an opportunity for shareholders to impose reputational consequences on directors by drawing public attention to their decisions on compensation.[9]

A Brief History of Citigroup

Citigroup can trace its history back over 200 years. The bank originally received its charter in 1812 as the City Bank of New York and was initially funded using capital from the dissolution of the Bank of the United States, the US government's first attempt at central banking. In 1998, John Reed, Citibank's chairman, and Sandy Weill, the CEO at Travelers Group, negotiated a $140 billion merger and Citigroup Inc. was born. Citigroup immediately became a supergiant on a global scale, offering an almost endless array of financial services including credit cards, foreign exchange, private banking, derivatives, consumer finance, asset management, investment banking, insurance and capital markets.[10] By the end of fiscal year 2006, Citigroup had $1.9 trillion in assets under management and net earnings of $21.5 billion.[11]

Unfortunately, this did not last. High exposure to mortgage-backed security derivatives in the buildup to the 2007–2008 financial crisis led to write-offs of over $19 billion in loan-related losses and the firm's stock price plummeted (see **Exhibit 3**). From the beginning of 2007 to the end of 2009, Citigroup's stock price lost 94% of its value. During this time, a single share's selling

[5] David Usborne. "Obama picks 'pay tsar' to target Wall Street." *The Independent*. June 11, 2009.

[6] US Securities and Exchange Commission. https://www.sec.gov/answers/about-lawsshtml.html#df2010.

[7] Aaron Lucchetti. "Global Finance: Banks for 'Say on Pay'" *Wall Street Journal*. April 1, 2011.

[8] Institutional Shareholder Services. https://www.issgovernance.com/about/about-iss/.

[9] Burns, N., & Minnick, K. (2013). "Does Say-on-Pay Matter? Evidence from Say-on-Pay Proposals in the United States." *Financial Review*, 48(2), 233-258.

[10] Citi History. 2018. "New Bank Born in New York." https://www.citigroup.com/citi/about/timeline/.

[11] Citigroup 2006 Financials and Form 10-K. https://www.citigroup.com/citi/investor/annual-reports.html.

price fell from $552.50 to $33.10, closing at an all-time low of $10.20 on March 5, 2009.[12] Citigroup was forced to accept bailout money to the tune of $45 billion under the US government's Troubled Asset Relief Program (TARP) in order to stabilize and return to profitability.[13] Citigroup was worth under $16 billion, down more than $250 billion from its peak during the pre-crisis years.

Vikram Pandit Becomes CEO

Vikram Pandit was appointed CEO of Citigroup on December 11, 2007. Pandit, a long-time veteran and former star executive at Morgan Stanley, arrived at Citigroup after starting the hedge fund Old Lane in 2006 with partners John Havens and Guru Ramakrishnan. Pandit was considered one of Wall Street's most savvy chiefs and was known for being particularly talented in risk management. Citigroup bought Old Lane in 2007 for $800 million despite poor performance and a short track record. Then-CEO Charles Prince III said of the deal, "This transaction is an investment as much as it is an acquisition. It is an investment in world-class talent at Old Lane, in a senior leadership team with a track record of building profitable businesses in institutional securities, and an investment in Vikram and John."[14] Citigroup initially brought Pandit and Havens on board at Citi Alternative Investments, with Pandit taking the roles of CEO and chairman. Pandit received $165.2 million in payment for the sale of his partnership interest in Old Lane, which was closed completely by summer 2008 after posting losses throughout the year.

Charles Prince preceded Pandit at the helm of Citigroup from October 2003 to November 2007. He resigned on November 4, once it became clear that the losses on mortgage-backed securities and collateralized debt obligations due to the subprime mortgage crisis would be significant. Prince had aggressively pursued a strategy of leveraged buyout deals and was subsequently vilified as an example of the risky banking practices that led to the 2007–2008 financial meltdown. Speaking of leveraged buyouts in an interview, he famously remarked, "As long as the music is playing, you've got to get up and dance."[15] Despite the situation at Citigroup, Prince received a cash and stock bonus of $23.9 million for 2007. Pandit took the reins just as Citigroup had announced 4,200 job cuts worldwide and posted a fourth-quarter loss of $9.8 billion, the largest in the bank's history.[16]

Citigroup became one of the largest recipients of TARP funds from the US Treasury, receiving $25 billion in October 2008 and another $20 billion in early 2009. Citigroup also agreed to what Pandit called an "insurance" arrangement with the US government, who guaranteed up to $300 billion of potentially toxic assets.[17] Such large inflows of capital gave the US government a 1/3 stake in Citigroup and gave policymakers in Washington substantial control over pay practices at the bank. Most notably, compensation for the five highest-ranking executives and the 20 highest-paid employees were subject to approval from President Obama's 'pay tsar', Kenneth Feinberg.[18] Salary caps were set at $500,000/year and most compensation was paid through time-vesting stock awards and options.

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[12] Price adjusted for reverse 10-for-1 stock split in 2011.

[13] Citi History. "Amid Economic Turmoil, Citi Recapitalizes." 2018. https://www.citigroup.com/citi/about/timeline/.

[14] Uttara Choudhary, "Vikram Pandit in Line for Top Job at Citigroup", Daily News & Analysis, April 18, 2007.

[15] Michiyo Nakamoto and David Wighton. "Citigroup Chief Stays Bullish on Buy-outs." Financial Times. July 9, 2007.

[16] "Citigroup's CEO Vikram Pandit Gets USD 30-mn Bonus." OANA. January 27, 2008.

[17] Madlen Read, "Citigroup Paid Pandit $38.2 Million Last Year, Mostly in Stock." Associated Press. March 16, 2009.

[18] David Usborne. "Obama Picks 'Pay Tsar' to Target Wall Street." The Independent. June 11, 2009.