Accepted Manuscript

Optimal Pay Regulation for Too-Big-To-Fail Banks

John Thanassoulis, Misa Tanaka

PII: S1042-9573(17)30023-2
DOI: 10.1016/j.jfi.2017.03.001
Reference: YJFIN 747

To appear in: *Journal of Financial Intermediation*

Received date: 27 July 2016
Revised date: 23 March 2017
Accepted date: 29 March 2017

Please cite this article as: John Thanassoulis, Misa Tanaka, Optimal Pay Regulation for Too-Big-To-Fail Banks, *Journal of Financial Intermediation* (2017), doi: 10.1016/j.jfi.2017.03.001

This is a PDF file of an unedited manuscript that has been accepted for publication. As a service to our customers we are providing this early version of the manuscript. The manuscript will undergo copyediting, typesetting, and review of the resulting proof before it is published in its final form. Please note that during the production process errors may be discovered which could affect the content, and all legal disclaimers that apply to the journal pertain.

ACCEPTED MANUSCRIPT

Optimal Pay Regulation for Too-Big-To-Fail Banks*

John Thanassoulis[†]
Warwick Business School and CEPR
University of Warwick

Misa Tanaka[‡]
Bank of England

April 8, 2017

Abstract

This paper considers optimal executive pay regulations for banks that are *too-big-to-fail*. Theoretically, we map the consequences of a series of commonly-used pay schemes, describing their relative optimality and ultimate societal consequences. We argue that in a world of too-big-to-fail policy, simple equity-linked remuneration schemes maximise shareholder value by incentivising executives to choose excessively risky projects at the expense of the taxpayer. We find that paying the executive partly in debt fails to mitigate the project choice distortion when debt markets are informed. By contrast, both clawback rules and linking pay to interest rates can incentivise the executive to make socially optimal risk choices, but only if they are accompanied by appropriate restrictions on the curvature of pay with respect to the bank's market value. Pay curvature can be generated by tools such as equity options and promotion policy. The policy implication is that unless regulators can enforce restrictions on pay curvature, bank shareholders can undermine the effectiveness of these pay regulations.

Keywords: Clawback; Executive compensation; bankers' bonuses; too-big-to-fail; risk taking; financial regulation.

JEL Classification: G21, G28, G38.

*We are very grateful to the editor, Murillo Campello and an anonymous referee for extensive comments and guidance on prior versions of this work. Any errors and all views remain our own. We are also grateful to seminar audiences at the London School of Economics, IE Business School in Madrid, the American Economic Association Annual Meeting, the Bank of England, University of Oxford, University of Birmingham, University of Kent, Cass Business School and the University of Warwick. This manuscript replaces a previous version with title *'Bankers' Pay and Excessive Risk'*.

[†]email: john.thanassoulis@wbs.ac.uk. https://sites.google.com/site/thanassoulis/
Further affiliations: Oxford-Man Institute, University of Oxford, Associate Member and Nuffield College, University of Oxford, Associate Member. I am grateful to the *Fondation Banque de France* for their hospitality whilst I have been undertaking some of this research.

[‡]email: misa.tanaka@bankofengland.co.uk. This paper reflects the views of the authors and does not reflect the views of the Bank of England, the MPC or the FPC.

ACCEPTED MANUSCRIPT

Download English Version:

https://daneshyari.com/en/article/7362284

Download Persian Version:

https://daneshyari.com/article/7362284

Daneshyari.com