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Finra Committee Finds No Fault in 2008 Pay Amid Losses, Lapses

By Jesse Westbrook - Oct 5, 2010

The Financial Industry Regulatory Authority has no basis to fault its officials for paying senior managers more than $35 million in 2008 as it lost hundreds of millions of dollars on investments, an investigative committee formed by the brokerage watchdog's board found.

Compensation decisions were made by independent board members who set pay at levels to help Finra attract and retain executives, according to a 100-page report released today by the regulator. A $567 million loss that Finra's investment portfolio suffered stemmed from a strategy meant to match a diversified college endowment, and was approved by board members with "no personal interests" that conflicted with the watchdog's other members, the seven-month inquiry found.

The report addresses claims by Amerivet Securities Inc. that Finra managers didn't deserve their pay after failing to detect Bernard Madoff's Ponzi scheme and overseeing collapsed investment banks such as Bear Stearns Cos. and Lehman Brothers Holdings Inc. Finra rejected demands from Elton Johnson Jr., the president of Moreno Valley, California-based Amerivet, that its board recoup compensation to help offset losses.

Former Finra Chief Executive Officer Mary Schapiro received an $8.99 million "final distribution" when she left to become Securities and Exchange Commission chairman in January 2009, according to the report.

Pay Breakdown

Her pay included vested retirement benefits totaling $7.6 million, $100,000 for wages and an accrued vacation payout, and $1.3 million of incentive compensation, the document said.

A Finra tax filing from November 2009 said Schapiro received $3.26 million in 2008, consisting of a $937,961 salary, bonus and incentive pay worth $1.75 million and additional compensation totaling $565,995.

The special committee investigating compensation concluded that no member of the board "had a material interest in decisions relating to Mary Schapiro's compensation or lacked independence from Ms. Schapiro," the report said.

Mercer LLC, Finra's compensation consultant, recommended pay levels based on comparisons to brokerage firms, investment banks and insurance companies after determining that the regulator "competed primarily with the financial services industry for talent," the report found.

Washington-based Finra, which the SEC oversees, is funded by the almost 4,700 U.S. brokerages it regulates. The special investigative committee included James Weddle, a managing partner at Edward Jones, Shirley Ann Jackson, president of Rensselaer Polytechnic Institute, and Gary Stern, the former president of the Minneapolis Federal Reserve.

‘Alleged Oversight Failures’

In setting pay, Finra’s board took into account “alleged oversight failures” involving Madoff, Merrill and Lehman, the report said. Such an analysis wasn’t relevant for “many members of senior management,” because they weren’t in a position to contribute to lapses, the special committee found.

In addition, “little reliable information” was known about Madoff’s fraud and the collapses of Bear Stearns and Lehman when Finra set incentive pay for 2008 and salaries for 2009, the report said.

Finra released an internal review last October that found it didn’t fully probe transactions at Madoff’s firm and repeatedly failed to investigate tips about R. Allen Stanford’s alleged $7 billion fraud. Madoff, who operated a brokerage regulated by Finra, is serving a 150-year prison sentence after pleading guilty to running a $65 billion Ponzi scheme in his money-management business. Stanford is fighting civil and criminal charges.

The U.S. orchestrated a sale of Bear Stearns to JPMorgan Chase & Co. in March 2008. Six months later, Lehman declared the biggest bankruptcy ever after loading up on mortgage assets. Finra regulated the firms’ sales of securities.

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