Economic Review

Federal Reserve Bank of San Francisco

1993 Number 1

FDIC Improvement Act and Corporate Governance of Commercial Banks

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This paper examines provisions of the FDIC Improvement Act related to corporate governance of banks. These provisions focus on the composition and independence of the audit committee and on increased regulatory influence over executive compensation. The composition of audit committees for a sample of banking firms for 1990 is compared with those of industrial firms and with the provisions of FDICIA. The findings suggest only minor differences between banks and other firms; however, under FDICIA provisions, large changes in the composition of bank audit committees are likely. Provisions related to compensation have focused on CEOs. To address this issue, I compare the 1990 levels and factors explaining differences in CEO compensation for a sample of banks and industrial firms. The findings suggest that bank CEOs earn slightly less than their industrial counterparts and that cross-sectional differences in CEO compensation in banking and other industries are explained by similar factors.

Most aspects of corporate governance have traditionally been beyond the scope of corporate law and bank regulation. Recent problems in the savings and loan industry are credited with motivating the FDIC Improvement Act of 1991 (hereafter FDICIA) provisions related to the role of boards of directors in governing banks. Specific provisions are designed to strengthen the audit function of the board and to have regulators develop guidelines for compensating directors and officers. Both provisions can be viewed as increased regulatory influence on the previously largely unregulated area of corporate governance in banks.[1]

This article explores the provisions of FDICIA that directly affect the board of directors' role in corporate governance.[2] After reviewing the issues of debate related to compensation for boards of directors and CEOs, I compare the composition of board audit committees for a sample of banking and nonbanking firms. Additionally, I examine whether the provisions of FDICIA related to the audit committee will substantially alter the composition of this committee.

The provisions related to director and officer compensation appear to reflect the current national concern that CEO pay is excessive. While the answer to this question is beyond the scope of this paper, the focus here is to compare levels of compensation for nonmanagement directors and CEOs for the sample of banks and industrial firms. Additional analysis of CEO compensation is undertaken to determine if cross-sectional differences in CEO compensation reflect the same factors in banks as in industrial firms.[3]

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1. Nationally chartered banks have faced a minimal amount of regulation related to the size of the board and to stock ownership by the board per the Banking Act of 1935 (see Brickley and James 1987 for a discussion).

2. While one can argue that virtually all of the provisions will affect the board, the focus here is on the impact of provisions related to the composition of the audit committee and to guidelines for officer and director compensation.

3. Recent controversy has developed in Japan over bank employee and officer compensation relative to industrial firms. Some evidence suggests that, on average, Japanese bank executives earn 20 to 30 percent more than their industrial counterparts.

This will allow us to evaluate bank CEO compensation relative to that of less regulated firms.

The empirical findings of this paper suggest that the provisions of FDICIA related to the composition of the audit committee may cause major changes in current practices. For a sample of large banks I show that the audit committee is composed of independent directors as traditionally defined. However, as interpreted under FDICIA, considering outside directors of bank customers as a bank customer likely will exclude current bank audit committee members. The evidence related to compensation practices suggests that, on average, CEOs of banks earn less than their industrial counterparts. In analyzing cross-sectional differences in CEO compensation between banks and industrial firms the evidence presented suggests similar factors appear to explain levels of CEO compensation for banks and for industrial firms. These findings suggest that banks do not appear to differ significantly from their industrial counterparts in terms of the role of corporate governance in board audit committees and CEO compensation.

The remainder of the paper is structured as follows: In Section I, a brief description of the debate about the role of boards of directors in corporate governance is summarized, followed by a brief review of the debate over executive compensation. Section II describes the provisions of FDICIA related to the independence of the audit committee and executive compensation. Section III presents the empirical analysis of the composition of audit committees of banks, followed by the analysis of CEO compensation for sample bank and industrial firms. The article concludes with a discussion of the policy implications of these findings.

I. Board of Directors, Corporate Governance, and CEO Compensation

Board of Directors and Corporate Governance

Corporate governance has traditionally been beyond the scope of corporate law and bank regulations. Regulations related to transactions between directors and banks are specific, but it is unlikely that these materially affect the composition of bank boards of directors.

The last decade has seen numerous proposals for reforms in director selection and board composition.[4] The traditional role attributed to corporate boards of directors is to resolve conflicts of interest among decisionmakers and residual risk-bearers. Their power arises from their ability to hire, fire, evaluate, and compensate senior management teams. It is frequently argued that the selection of directors is left almost totally to the discretion of the managers whose behavior they are supposed to monitor (Dunn 1987, Mace 1987, Vancil 1987). As a result, reform proposals focus on greater board independence from firm managers. These have ranged from requiring a majority of independent directors to requiring that no current or past employees be on the board of directors with the exception of the CEO.

Empirical support for the benefits of board independence is reflected in a number of studies that have examined market responses to changes in the composition of the board and other managerial actions. Rosenstein and Wyatt (1990) document a positive stock price response to the appointment of an additional outside director but no significant price response to the appointment of an additional inside director. Byrd and Hickman (1991) examine takeover activity and find a positive relationship between board independence of bidding firms and wealth effects associated with tender offers. Additionally, Lee, et al. (1992) find that greater board independence is associated with more positive stock price response for firms undertaking leveraged buyouts.

Direct evidence on the monitoring actions of boards is reported in Weisbach (1988) who finds that as the level of board independence increases, the likelihood that the board will replace the CEO after a period of poor performance increases. Brickley and James (1987) examine measures of perquisite consumption for a sample of banks and conclude that a greater presence of outside directors reduces managerial consumption of perquisites when the takeover market is limited by the presence of state regulation. They note that this may reflect differences in the cost of producing banking services in the presence of increased state banking regulations. In a more recent study of the life insurance industry, Mayers, Shivdasani, and Smith (1992) find evidence that for the companies where the takeover market is absent (i.e., mutuals) outside directors are used more extensively to monitor management.

Although virtually all previous studies have addressed the composition of the entire board, many of the activities of boards of directors are accomplished in smaller groups or committees. A survey of the Fortune 1000 firms by Kesner (1988) showed an average of 4.3 committees, with 70 percent of sample firms maintaining between three and five committees.

Kesner found that virtually all boards have audit, nominating, compensation, and executive committees, and that their most common duties are as follows: The audit committee sets the scope and reviews audits with the external auditors; the compensation committee reviews and makes recommendations on compensation for senior management; the nominating committee considers stockholder

4. See Baysinger and Butler (1985) for a discussion of these proposals.

recommendations and selection of nominees for directors; the executive committee acts in lieu of the full board if immediate action is required and counsels the CEO on ideas and proposals prior to disclosure to the full board.

CEO Compensation Debate

The motivation for incorporating regulatory oversight into bank compensation appears to reflect congressional reaction to a few widely publicized abuses in the savings and loan industry and to a growing sentiment that CEOs are overpaid. The criticisms of CEO pay focus on concerns that the level of pay in recent years is too high and that cross-sectional differences do not reflect differences in firm performance.

The concern about the level of CEO pay is not new. Brownstein and Panner (1992) note that in 1939 President Roosevelt railed against the "entrenched greed" of corporate executives. They also note that at that time the U.S. Treasury published a list of executives earning more than $15,000 dollars per year and the Securities and Exchange Commission (SEC) started requiring corporations to submit detailed disclosure of executive compensation to shareholders.

The recent concern over pay has led to the SEC decision that it will no longer permit corporations to exclude from their proxy statements nonbinding shareholder proposals concerning executive and/or director compensation. New reporting requirements related to noncash compensation are also an outcome of this round of concern over CEO pay. Additional pressure is forthcoming from large institutional shareholders and shareholder rights groups that have negotiated changes in executive compensation at several companies.

While FDICIA potentially affects a broad range of compensation contracts, the primary focus is on CEO compensation. Previous studies have focused on economic explanations for cross-sectional differences in CEO compensation and the degree to which compensation reflects relative performance. Studies generally find that firm characteristics are able to explain 20 to 30 percent of the variation in cash compensation (see Jensen and Murphy 1990b for a discussion). However, studies of the relationship between performance and compensation are mixed.[5] Generally, studies attempting to explain CEO compensation control for firm size, profitability, job tenure, plus measures of ownership and control.

5. For a discussion of the issues, see *Performance and Compensation: An Issue of Corporate Governance* pp. 1-102. Conference proceedings from Northwestern University, January 13, 1992.

II. Provisions of FDICIA Related to Board Structure and Compensation

While enhanced regulation likely will affect the composition of the entire board, proposals specifically focus on the composition of the audit committee and on the activities of the compensation committee. FDICIA introduces two regulations that potentially affect the structure and actions of boards of directors in banks. The changes reflect the desire to protect the soundness of the deposit insurance fund through increased managerial accountability to the board of directors and restrictions on employee compensation.

In an effort to improve accountability, the legislation focuses on the composition and structure of the audit committee of the board of directors. Specifically, under the new legislation banks are required to have audit committees composed of outside directors that are independent of the management of the institution. Additional requirements are imposed on "large" institutions: Their audit committees must be composed of members who are not large customers of the institution, who have banking or related financial management expertise, and they must have access to the committee's own outside counsel. The magnitude of the changes in the composition of this committee likely will reflect how precisely regulators define "large customers" of the institution.

The legislation prescribes that the audit committee shall review the external audit with management and the independent accountants. These actions are designed to increase the independence of the audit committee, thereby strengthening its ability to monitor management and curtail its risk-taking behavior.

The impact of FDICIA on board compensation committees is less direct. The activities of this committee typically include reviewing and making recommendations to the board, and in some cases setting senior management compensation. The provisions do not specify the composition of compensation committees, but do provide more oversight by regulators. The legislation calls for each appropriate federal banking agency to prescribe guidelines for reasonable compensation. Specifically the agencies are to prohibit as unsafe and unsound any employment contract that could lead to a material financial loss to the financial institution. Employment contracts are to include any compensation or benefit agreement, fee arrangement, perquisite, stock option plan, post-employment benefit, or other compensatory arrangement that would provide any executive officer, employee, director, or principal shareholder of the institution with excessive compensation, fees, or benefits. Additionally, the appropriate regulatory agency is required to specify when compensation, fees, or benefits are excessive. The factors to be considered include the combined value of all cash and noncash benefits provided to the individual, the compensation history of the individual and other individuals with comparable expertise at the institution, the financial condition of the institution, and compensation practices at comparable institutions, based on such factors as asset size, geographic location, and complexity of the loan portfolio or other assets. For post-employment benefits regulators must consider the projected total cost and benefit to the institutions, any connection between the individual and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the institution, and other factors that the agency determines to be relevant, and such other standards relating to compensation, fees, and benefits as the agency determines to be appropriate. These provisions potentially restrict much of the power of board compensation committees in determining senior executives' salary and board of directors' fees. Not surprisingly, this aspect of FDICIA has been widely criticized within the industry.

III. Empirical Analysis

To gauge the potential impact of FDICIA on bank boards I examine the characteristics of boards for a sample of 22 banks and 367 nonbanking firms included in the S&P 500 in 1990. Public utility firms are excluded as a result of the strict regulatory burden these firms face. Nonbank depository institutions are excluded from the banking firm sample.[6] Additional exclusions are due to incomplete data. Sample data are based on 1990 proxy statements compiled by the Investor Responsibility Research Center.

Summary statistics for sample firms are presented in Table 1. Banks tend to have larger boards of directors than nonbanking firms. The directors of banking firms meet more frequently and are compensated at a slightly higher level than those of nonbanking firms. Additional benefits that may be provided to outside directors of corporations include retirement plans, stock purchase plans and deferred compensation plans. Under a retirement plan, nonemployee directors receive all or part of their annual retainer fee for a certain period of time after they retire from the board. In a stock purchase plan, the company grants nonemployee directors stock or stock options on a regular basis, in addition to their regular compensation. Deferred compensation plans generally allow nonemployee directors to defer cash compensation (retainer and meeting fees) until after they retire from the board, but only if the funds are invested in shares of common stock or stock equivalents.

6. Two savings and loan holding companies are excluded. Including these firms does not materially affect the results.

TABLE 1

Firm and Board Characteristics

	Banking Firms[a]	Nonbanking Firms[b]
Sample Characteristics		
Size	22	367
Sales ($ millions)	7,211.1	7,355.2
Total Market Value ($ millions)	4,172.4	5,805.2
Profit ($ millions)	293.7	307.5
Number of Board Members	18.6	12.2
Board Compensation		
Annual Fee	18,277	20,021
Meeting Fee	1,185	923
Meetings per Year	10.1	7.7
Retirement Plan	68%	45%
Deferred Compensation Plan	34%	16%
Stock Purchase Plan	35%	34%
Board Affiliation and Ownership		
Ownership (mean)	3.05%	9.46%
Nonmanagement	81%	73%
Independent	65%	54%
Affiliated	16%	19%
Interlocking Directorships	55%	20%
Board Chairman is CEO	89%	70%

[a]Includes two savings and loans.
[b]Excludes communications, electricity, water, and gas utilities.

The data in Table 1 indicate that banks use all three methods of indirect compensation at least as frequently as nonbanking firms and have director retirement plans and deferred compensation plans more frequently than nonbanking firms. Data on the dollar value of each of these plans are not available, but the frequency of their use suggests that the benefits to being a bank director are understated relative to nonbanking firms. However, it should be noted that bank directors face increased potential liability due to the presence of a maze of potentially litigious regulatory authorities.

Bank boards have a larger percentage of nonmanagement directors (81 percent) than nonbanking boards in the sample (73 percent). Nonmanagement directors are divided into those affiliated with and those independent of the company. To be classified as affiliated, a director must hold one of the following relationships with the firm: member of an insiders' stockholder group (10 percent or more of voting stock); part of an interlocking directorship; former employee; related to an officer; member of a professional firm that provides services to the company; a significant supplier/customer relationship; derive personal benefit from the company. By these criteria, on average, 16 percent of banks' outside directors are affiliated and 19 percent of nonbanks' outside directors are affiliated.

These results are consistent with greater board independence for banking than for nonbanking firms. In contrast, evidence in favor of less independence for bank boards is that the CEO is also chairman of the board in 89 percent of sample banks compared to 70 percent of nonbanking firms. Interlocking directorships are present in 55 percent of sample banks versus 20 percent for the nonbank firms. This difference likely reflects regulation-induced bank holding company structure under which most banks operate. This structure encourages legally separate corporations under a bank holding company umbrella.

Although sample data are limited to a a small set of large banks, they do suggest differences between the composition of boards of banks and nonbanking firms. The provisions of FDICIA are intended to increase the independence of bank boards in general and the audit committee in particular. To gauge potential consequences of this legislation on board of director audit committees, I next consider this committee in greater detail.

Evidence on Audit Committee Composition

Table 2 contains summary statistics for the composition of the audit committees of sample firms. Commercial bank audit committees average six directors as compared to four for nonbanking firms. None in the sample report management directors on the audit committee. However, on average both banking and nonbanking firms have one affiliated outside director on this committee. This indicates that in percentage terms the audit committees of bank boards are more independent than those of nonbanking firms. Whether the composition of these committees meet the requirements of FDICIA is unclear since it does not exclude affiliated directors from this committee unless they are judged to have a significant direct supplier/customer relationship. If ultimately directors with indirect relationships are considered to be de facto customers then the composition of this committee will likely change substantially. For example, if outside directors of a bank customer cannot serve on the audit committee of the bank, then many current bank directors will be precluded from this committee.

TABLE 2

AUDIT COMMITTEE COMPOSITION

	Banking Firms		Nonbanking Firms	
Number of Members (mean)	6.0		4.2	
Independent	5.3		3.5	
Affiliated	.7		.7	
	Number	Percent	Number	Percent
Affiliated Directors—Form of Affiliation				
Interlocking directorships	5	27.8	32	11.5
Former employee	6	33.3	79	28.4
Member of professional firm that provides services to the company	4	22.2	99	35.6
Derives personal benefit from company	3	16.7	21	7.5
Supplier/customer	0	0	15	5.3
Significant stockholder	0	0	32	11.5
Independent Directors—Occupation				
CEO or other executive of large company	59	42.1	344	23.3
CEO or other executive of small company	21	15.0	205	13.9
Retired business person	34	24.3	444	30.0
University official	9	6.4	85	5.8
Academic	4	2.9	83	5.6
Works for non-profit	4	2.9	57	3.9
Self-employed	4	2.9	48	3.2
Investment and commercial bankers and insurers	—	—	76	5.1
Other	5	3.5	136	9.2

NOTE: Because data were available on audit committee composition for more nonbanking firms in the S&P 500, the size of that portion of the sample in this table is 462; the size of the sample of banking firms remains the same.

Table 2 presents the form of director affiliation for the members of the audit committees. For bank audit committees, most affiliated directors are former employees (33.3 percent); in 27.8 percent of the cases, these directors are part of an interlocking directorship; the remaining affiliated directors are either members of professional firms that provide services to the firm (22.2 percent) or directors that derive personal benefit from the company (16.7 percent). Nonbanking firms have fewer audit committee members that are part of interlocking boards of directors (11.5 percent) or are former employees (28.4 percent). Firms in the nonbanking sample more frequently have members of professional firms providing services to the firm (35.6 percent), significant stockholders (11.5 percent), and representatives of organizations that have significant supplier/customer relationships with the firm (5.3 percent). For sample banks, independent director members of the audit committee are composed more of current CEOs and executives and relatively less of retired business persons than are nonbanking firms. If independent directors having affiliations with customers of the bank are considered to be customers of the bank for regulatory purposes, as has been suggested, this is not reflected here.

Under a standard interpretation of customers these findings suggest that the composition of audit committees of large banks in the sample generally satisfies the spirit of the related provisions of FDICIA. Under a more strict interpretation through third-party (outside director) affiliations, the analysis here understates the likely impact of these provisions. While it is not possible to draw inferences regarding smaller banks on this question, the provisions are most strict for large banks. FDICIA guidelines likely will lead to greater independence in the composition and the operations of this committee. It is specified the committee will have access to its own outside counsel and thus may provide a greater degree of direct monitoring of management by this committee.

Evidence on CEO Compensation

No aspect of FDICIA has caused as much industry uproar as the provisions related to officer and director compensation. Under FDICIA the appropriate federal banking agency must prescribe compensation standards for all insured depository institutions by August 1, 1993. The standards are to apply to all forms of compensation for any executive officer, employee, director or principal shareholder of the institution. The standards are to specify when compensation, fees, or benefits are excessive, unreasonable, or disproportionate to services performed by the individual after considering a long list of factors including all cash and noncash benefits, compensation history of the individual compared to others of comparable expertise, financial condition of the institution, compensation practices at comparable institutions, size, location, complexity of loan portfolio, and other assets, and total projected cost of post-employment benefits. Most of the debate in the press has focused on CEO pay. In this study I focus on CEO and board of director compensation.

Table 3 presents data on CEO compensation for the sample of bank and industrial firms. CEOs of sample banks have mean and median salaries of $936,000 and $740,000 respectively, for 1990. Sample industrial firm CEOs earned mean and median salaries of $1,183,000 and $980,000 respectively, for the same period.

Assessing the value of noncash compensation is a difficult task subject to much debate. The most difficult component of compensation to value are stock option grants. For the purposes of this paper I use the valuation technique and data presented by Crystal (1991). This procedure assumes the stock price will increase at the normally expected rate for eight years, deducting the strike price and discounting

TABLE 3

CEO COMPENSATION—SUMMARY STATISTICS

	BANKING FIRMS	NONBANKING FIRMS
NUMBER OF CEOs	22	367
MEDIAN SALARY + BONUS ($ thousands)	$740	$980
RANGE OF SALARY + BONUS ($ thousands)	$420–1,580	$150–14,820
MEAN COMPENSATION ($ thousands)		
Salary + Bonus	$936	$1,183
Stock Options	$267	$1,246
Restricted Stock	$409	$208
Preferred Grants	$93	$190
Total	$1,705	$2,827
USE OF NONCASH COMPENSATION		
Stock Options	19%	71%
Restricted Stock	86%	24%
Preferred Grants	52%	26%
All Forms	19%	5%
COMPENSATION COMMITTEE COMPOSITION		
Number of Members	6.0	4.1
Independent	84%	79%
Affiliated	14%	17%

the future gain. For restricted stock the value is assessed as the product of the annualized number of restricted, or free, shares granted to the executive and the market price per share at the time of the grant. Performance grants include awards of both stock-based performance shares and performance units paid in cash. While these procedures likely add some noise to the measure of total CEO compensation, the direction of any bias in the true value across banks versus industrial firms as a result of these assumptions is unclear. Adding these components of compensation to the salary and bonus provides a measure of total compensation for the sample of nonbanking firms of $2,828,000, while for the sample of banking firms the average is $1,705,000. This indicates that the addition of noncash compensation further increases the divergence between the total CEO compensation of nonbanking and banking firms.

Table 3 also provides statistics on the percentage of each group of sample firms using each type of noncash compensation. The sample of banking firms uses more forms of compensation on average. Restricted stock is a particularly popular form of compensation for bank CEOs, but as indicated in the table, the size of these awards for 1990 are a fraction of total compensation. Popular press accounts of the excessive CEO pay debate suggest the lack of independence of the compensation committee is a factor. To address this, the final section of Table 3 presents the composition of the audit committees for sample banks and industrial firms.

The data presented in Table 3 are used to determine whether cross-sectional differences in the level of compensation between these two groups can be explained by firm characteristics. Previous studies of the determinants of CEO compensation suggest that among the factors important in explaining cross-sectional differences are firm size, CEO tenure, whether the CEO is also chairman of the board, ownership by insiders, and firm performance. These studies have generally concluded that firm and performance characteristics have relatively low power to explain cross-sectional differences in CEO pay. Since it is difficult (and somewhat controversial) to value non-cash compensation the analysis initially will focus on cash compensation and on a measure of total compensation. The cash compensation measure includes salary plus bonus as reported in Crystal (1991) and is cross-checked against the data for the same period from other sources. The estimates of the value of non-cash compensation are those provided in Crystal (1991).

The results from regressing CEO cash compensation (salary + bonus) on firm characteristics are reported in Table 4. Consistent with previous studies, cash compensation is a positive function of firm size measured by market value and total sales. Cash compensation is also higher for those CEOs that also serve as chairman of the board. CEO pay is a positive function of the number of years the CEO has been in the job, and the percentage of the firm owned by the board. The binary variable indicating that the CEO is managing a banking firm is negative though not statistically significant. These results suggest

TABLE 4

DETERMINANTS OF CROSS-SECTIONAL DIFFERENCES IN THE LEVEL OF CEO CASH COMPENSATION

	REGRESSION		
VARIABLE	(1)	(2)	(3)
Constant	4.59 (18.78)*	4.58 (18.44)*	4.57 (18.44)*
Log (Sales)	0.12 (3.71)*	0.14 (3.77)*	0.14 (3.92)*
Log (Market Value)	0.15 (4.18)*	0.14 (3.97)*	0.14 (3.90)*
CEO Years	0.01 (1.99)*	0.01 (2.00)*	0.01 (1.94)*
Chairman	0.12 (1.98)*	0.12 (1.93)*	0.12 (1.87)*
Board Ownership	0.01 (2.51)*	0.01 (2.50)*	0.01 (2.66)*
Bank	−0.04 (0.38)	−0.17 (0.08)	−2.94 (0.84)
Bank × Sales		−0.18 (0.90)	−0.15 (0.70)
Bank × MV		0.23 (0.93)	0.48 (1.51)
Bank × Chairman			0.01 (0.02)
Bank × Board Ownership			−0.04 (1.93)*
R^2	.32	.32	.32
F-value	19.41	14.03	11.06

*Indicates the t-value is statistically different from zero at the 0.01 level.

NOTE: Values are corrected for heteroscedasticity using the procedure by White (1980). Dependent variable: Salary + Bonus.

that bank CEOs earn cash compensation similar to that of nonbank CEOs. To determine whether CEO pay is more or less sensitive to firm characteristics the binary variable bank is interacted with sales, market value, and return. None of the interacted variables is statistically significant at the 0.10 level.

In (3) the binary variable called "Bank" is interacted with ownership percentage by the board of directors, with whether the CEO is Chairman, and with the number of years as a CEO. The coefficient on bank board ownership percentage is negative and significant indicating that salary and bonus of CEOs decline as ownership by the board increases. This result is the opposite than that for nonbanking firms.

Using the measure of total compensation from Table 3 we are able to examine how the same independent variables relate to cross-sectional variation in CEO total compensation. The regression results are presented in Table 5. Consistent with earlier findings for cash compensation, total compensation is a positive function of firm size as measured by sales and market value of equity. Total pay is a positive function of CEO's tenure in the job and whether he also serves as chairman of the board (though the coefficient on "Chairman" is not statistically significant). The coefficient on total pay is negative, though not statistically significant, relative to ownership percentage by the board of directors. The coefficient on Bank indicates that total pay for banks is not statistically different from total pay for nonbanking firms. The coefficient on the ownership percentage by bank boards indicates that as board ownership increases total compensation decreases (although the significance level on this coefficient is at the 0.11 level).

These results suggest that CEOs of banks earn levels of cash and total compensation that are comparable to those earned by nonbank CEOs. The most significant differences between banks and nonbanking firms related to CEO compensation are related to how cross-sectional differences in levels vary with ownership percentage by the board of directors. For the sample as a whole, cash compensation is a positive function of ownership percentage for the board of directors. The measure of total CEO compensation is a negative function of the ownership percentage by the board of directors. For commercial banks total salary is less sensitive to ownership percentage by the board and total CEO compensation is more sensitive (negatively related) than for the sample as a whole.

TABLE 5

DETERMINANTS OF CROSS-SECTIONAL DIFFERENCES IN THE LEVEL OF CEO TOTAL COMPENSATION

	Regression		
Variable	(1)	(2)	(3)
Constant	4.55 (12.70)*	4.53 (12.42)*	4.51 (12.46)*
Log (Sales)	0.13 (2.57)*	0.14 (2.59)*	0.14 (2.62)*
Log (Market Value)	0.221 (4.20)*	0.21 (4.03)*	0.21 (4.07)*
CEO Years	0.01 (1.73)	0.01 (1.70)	0.01 (1.73)
Chairman	0.12 (1.27)	0.11 (1.20)	0.14 (1.47)
Board Ownership	−0.01 (1.32)	−0.01 (1.31)	−0.01 (1.11)
Bank	−0.09 (0.54)	1.12 (0.33)	5.12 (1.00)
Bank × Sales		−0.21 (0.72)	0.36 (1.18)
Bank × MV		0.08 (0.22)	−0.16 (0.32)
Bank × Chairman			−0.30 (0.52)
Bank × Board Ownership			−0.05 (1.63)
R^2	.27	.26	.27
F-value	15.92	10.65	9.02

*Indicates the t-value is statistically different from zero at the 0.01 level.
NOTE: See Note to Table 4.

IV. CONCLUSIONS

This paper examined the provisions of the FDIC Improvement Act related to the corporate governance of banks. Specifically, the composition of the board audit committee for a sample of banks was compared to industrial firms and to the guidelines under the Act. For 1990 the 22 depository institutions included in the S&P 500 show that for the most part audit committees are composed of outside directors, and typically one outside director has a direct affiliation to the bank. These are likely to be replaced by more independent outside directors as a result of FDICIA. It has been indicated that directors with affiliations as outside directors to customers of the bank are ineligible for the audit committee. This suggests FDICIA will likely have a large impact on composition of these committees for large banks.

Potential consequences of provisions related to officer and director compensation are examined by focusing on the levels of CEO and outside director compensation. A comparison is made between banking and industrial firms regarding the level and form of compensation. Cross-sectional differences in the levels of CEO compensation are examined to determine if firm characteristics can explain cross-sectional variation in CEO compensation for banks and nonbanking firms. The results indicate factors important in explaining CEO compensation for the S&P 500 firms also explain cross-sectional differences in CEO compensation for banking firms. Differences between banking and nonbanking firms are primarily related to the relationship between equity ownership by the board of directors and the level of CEO compensation. Both cash and total compensation for bank CEOs is a negative function of equity ownership by the board of directors. For the sample as a whole, CEO cash compensation is a positive function of ownership by the board, while total compensation is a negative (though statistically insignificant) function of ownership by the board of directors.

One interpretation of the findings of this study is that the provisions of the FDIC Improvement Act of 1991 related to corporate governance and CEO compensation were unnecessary. The basis for this is that audit committees for large banks, the apparent target of this legislation, are already composed mainly of outside directors. Secondly, the compensation of bank officers (CEOs) and directors (outside) appears to be at similar levels and largely determined by characteristics similar to those of nonbanking firms. While it is beyond the scope of this paper to determine whether the overall level of CEO pay is excessive, it does conclude that there appears to be nothing special about banks in this regard.

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