Obamagram: Inauguration Day, Excessive Pay, and Tom Daschle 2/5/09

Hello Everyone,

This is my second post-election Obamagram.

Before getting to the meat of the matter, let me offer a few observations about our experience at the Inauguration.

Inauguration Day

Overall, it was "priceless, but not without its price". It was also, to borrow a phrase from our daughter, Casey, both "admirable and aggravating".

Priceless goes almost without saying. History, wrapped in great good will. I had said it the night before Gail Collins used it to headline her column: "Woodstock Without the Mud." Or, drugs. The President's address was of a piece with his speech on November 4 – serious, verging on somber, preparing to govern. The price extracted was to be expected, given the great physical exertion the day required because of the size of the crowds and the grinding cold.

The accessibility premise of the day was admirable. As Christopher Hitchens put it, "…to occupy the same democratic space as everyone else…" A metaphor for our times and the President's reminder that we are all in this together. But, at the same time, it was aggravating. Our family wound up with seven precious tickets to the swearing in, but only Penny and I actually gained entrance to the Capitol grounds. Thousands of the ticketed were turned away.

But, our last – and lasting – image that day was of our new President and First Lady, out of their limousine, striding confidently as they turned the corner to cover the last hundred yards to the reviewing stand in front of the White House. They looked jubilant and entirely at ease – as if they were meant to be there.

This Obamagram is largely prompted by President Obama's decision on Tuesday to accept Tom Daschle's decision to withdraw and the President's pronouncements yesterday limiting executive compensation at companies receiving government support.

Excessive Pay

The issue of excessive compensation has been on the now-President's mind for a long time. I first became aware of his concerns in October 2005 during a trip I took with the then new Senator and his aide, Jordan Kaplan, to Omaha to meet with Warren Buffett. I had been invited to tag along because of my long-held interest in Mr. Buffett's philosophy about investing and all manner of worldly matters and my tangential connection to his world through our son, Peter. The latter was working at the time for Lou Simpson, one of Mr. Buffett's top lieutenants; Peter has since started an investment partnership of his own based on Mr. Buffett's beliefs.

As I'm sure I have told several of you, this was the trip on which I was asked if I was Barack's body guard (he had none back then). It was the trip's true highlight.

On the plane ride to Omaha, the Senator quizzed me about excessive executive compensation. Given my perspective as a long-time investment banker with Merrill Lynch (who could have known its fate after I left its employ), I was well versed on the subject. The following morning, after breakfast, the two of us consulted with Mr. Buffett for an hour and a half in his daughter's kitchen. The first topic raised by the Senator was excessive compensation. Mr. Buffett was quick to argue that its source was not greed – the pervasively popular explanation which I had shared – but envy. As always, a good point. My house, plane, yacht – and pay – are bigger than yours. Not much changes after 1st grade, does it?

As we left Susie Buffett's house, Warren tugged on my sleeve, drawing my attention to his Lincoln town car – which he drives himself – parked out front. He wanted me to see its license plate – no numbers, just the word "THRIFTY".

<u>Tom Daschle</u>
Fast forward to Tuesday, and the end of Tom Daschle's nomination for secretary of HHS. I applaud the President for pulling the plug on his close adviser, knowing how difficult it was.

Another Lincoln town car – or was it a Cadillac? – figured prominently in Daschle's decision to "withdraw." I don't know about its license plate. I do know the fellow who supplied the car – someone not particularly given to thrift.

<u>Lessons Learned</u>
I think there are connections here. Broader lessons to be learned.

Over the past several months, as the credit crisis has unfolded, I keep trying to understand its genesis. The root of it all may be the exploitation of what is now conventionally known as "Other People's Money". OPM, for short. Yes, pronounced like the illicit drug. And equally addictive.

Looking back, it seems to me that the investment banks laid the groundwork for their ultimate demise when they started to rely on OPM.

When I entered the business in 1970, I recall – hopefully correctly – that only one firm was publicly held. A perfect trivia question. Donaldson, Lufkin, Jenrette. Bill Donaldson was later chair of the SEC.

All, or virtually all, the other investment banks were partnerships. Their capital was supplied by the individuals who ran them. It was "Their Own Money." TOM, for short. Like a person's name. Something personal. But, not the way Tom Daschle though of that car.

And, these investment banking partnerships were even more personal than that. Most of them were <u>general partnerships</u>. That is, their partners, or owners, not only supplied the capital, but they had unlimited liability for the firms' obligations, and that liability was "joint and several". So if one partner made a bad "bet" that ate through all of his and his partners' capital, the creditors could come after all of the partners' houses – and even their cars. Investment banks viewed risk very differently back then. Because it was TOM, Their Own Money. The interests of all of the partners were closely aligned.

Compensation came principally in the form of a return on investment of TOM. Not out of the pockets of invisible shareholders – who one CEO once described to me as "those strangers."

Over the years, as all of the major investment banks went public, they relied overwhelmingly on OPM. Naturally, they came to view risk entirely differently. Heads I win, tails I don't lose. Little alignment between the shareholders (the owners who supplied the money) and the managers (who used the money.)

Compensation came to be driven by envy as Mr. Buffett pointed out. Somewhat like shortstops – I'm worth more than other shortstops in the league.

In the same vein, over the past forty years or so we have all become addicted to OPM. Debt can be seen as a form of Other People's Money. Credit card debt. Home equity loans. Mortgages. Leveraged buyouts (now called "private equity"). Government debt.

Warren Buffett owns his own car and drives it himself. Tom Daschle neither owns the car nor drives it. Envy for what the other guy has, and I don't. Joe Biden was right – it is patriotic to pay taxes. It all fits somehow, doesn't it?

A final footnote on a different subject. I am concerned about the "Buy America" language– and the protectionist stance it portends – in the House version of the stimulus bill, as I'm sure many of you are. I am contacting some in Congress and in the White House to voice my concern. You should, too. I was encouraged yesterday when the President said, "we can't send a protectionist message" in this legislation.

Chuck