

Nonprofit Salaries, Intermediate Sanctions and the New York Stock Exchange

By Rick Cohen

If one looks past the questionable “compromise” that Congress crafted—that is, that Congress accepted from highly paid foundation lobbyists—to avoid increasing private foundation grantmaking (Section 105 of H.R. 7, the Charitable Giving Act of 2003), the big news in the nonprofit sector was the article in the Oct. 2 *Chronicle of Philanthropy* on the salaries of top foundation and charity executives (Elizabeth Schwinn and Ian Wilhelm, “Nonprofit CEOs See Salaries Rise;”). A lot of attention went to the chairman of the Lilly Endowment, Thomas Lofton, whose salary grew 83 percent between 1997 and 2002, hitting \$822,000, though with benefits and expenses, Lofton’s total reported compensation package tops \$1 million. All this with the backdrop of a 36 percent plunge in Lilly’s grantmaking during the same period.

Private foundation executives in the *Chronicle* survey earned a median salary of \$402,000, not including benefits and other compensation, and CEOs at charities got a median annual pay of nearly \$283,000. It should be noted that this is hardly a survey of all nonprofits, just those drawn primarily from the ranks of the nation’s 50 wealthiest foundations and from the *Chronicle*’s “Philanthropy 400” list of the biggest nonprofit fundraisers. Most nonprofits don’t pay salaries like those of the big nonprofits and big foundations. To the contrary, most nonprofit leaders are working around the clock just to raise enough money to meet payroll, sacrificing their own paychecks here and there when the cash flow is less than robust, and hardly filing W-2s worthy of intermediate sanctions concern.

For readers who may not be familiar with “intermediate sanctions,” they are penalty taxes imposed by the federal government on individuals employed by or associated with nonprofits who receive unreasonable compensation or are parties to insider deals, both practices considered “excess benefit transactions” in the argot of the Internal

Revenue Service. The individuals covered by intermediate sanctions are termed “disqualified persons.” They are individuals, usually insiders, with substantial influence over the decision making of the organization—CEOs, chief operating officers, board members and sometimes even their family members—and organization managers knowingly conferring excess benefits.

Of course, the reported salaries in the *Chronicle* survey don’t necessarily constitute all of the work-hours compensation earned by these foundation and nonprofit leaders. As the *Daily News* reported in Douglas Feiden’s “Nonprofit Execs Dodge Budget Ax That Hits Their Institutions” (*Daily News*, May 30, 2003), some directors of big nonprofits also get cushy corporate board slots as well, and corporate boards typically pay their trustees quite well, unlike nonprofits. In Feiden’s investigation, the president of the American Museum of Natural History supplemented her \$470,000 nonprofit salary with fees for service (plus stock or option awards) on the boards of Con Edison, Bristol-Meyers Squibb, American International Group and J.P. Morgan, bringing her total compensation from the museum and just these four board slots to \$910,000.

While most nonprofits don’t pay their board members, some foundations compensate their board members handsomely, as Christine Ahn, Pablo Eisenberg and Channapha Khamvongsa of the Center for Public and Nonprofit Leadership at the Georgetown Public Policy Institute have detailed in *Foundation Trustee Fees: Use and Abuse*. (The study is available from NCRP; it was covered by major media outlets such as *The Washington Post* and the *Philadelphia Inquirer*, as well as in the Fall 2003 edition of *Responsive Philanthropy*.)

Of course, coverage of this issue did not start with this study of trustee fees. Mainstream newspapers have been stumbling onto this issue for the last several months, including the *Buffalo News* (Jay Tokasz, “Givers Under Scrutiny; Charitable

Foundations Nationally Gave \$30 Billion in 2002, but Some in Congress Think They Could Give More, if Less Were Spent on Salaries and Trustee Fees," July 11, 2003), the *Baltimore Sun* (Kate Shatzkin, "Some Foundations Spend Lavishly on Their Own Board Members," May 11, 2003), and the *Puget Sound Business Journal* (Carol Tice, "Some Foundations Pay Trustees Quite Well," Aug. 18, 2003; and Carol Tice, "Local Foundation Among Highest in Pay to Trustees," Sept. 22, 2003). In any case, most nonprofits would get a zero in foundation grants if they reported using foundation money for paying their board members.

You don't hear too much from nonprofit leaders about excessive salaries, especially when their friends and associates might be among those raking them in. It seems to be only Rutgers-Camden professor Jon Van Til, quoted in the *Chronicle* article, laying out a challenging proposition suggesting that there should be some sort of benchmark limiting nonprofit salaries—Van Til proposes \$400,000, the salary of the president of the United States. Give Van Til credit for putting forward a credible idea, at least something for public debate. It has generated a lot of discussion on nonprofit Internet chat sites, but not among nonprofit sector leadership organizations. They hide behind "intermediate sanctions" for determining excessive executive compensation, with the penalties recently toughened in the version of H.R. 7 passed by the U.S. House of Representatives.

Of course, it's a pretty pathetic foundation executive that cannot navigate compliance with intermediate sanctions (Section 4958 of the Internal Revenue Code). Here's the tip sheet for ensuring that your foundation's hefty executive salary meets the requirements of the regulations:

1. Make sure the board of directors or trustees that is supposed to set the executive's salary does so with no participation of people with personal interest in the decision (meaning the executive director, or his or her subordinate, really shouldn't participate in the salary-setting deliberations of the board or the designated board committee).
2. Make sure that the board justifies the salary based on comparable data, industry surveys, information about people serving in similar positions, expert studies, etc. The comparisons need not be limited to comparisons among

nonprofits; they can also include comparable for-profits. Therefore, a \$10 billion foundation can compare its salaries not just against other big foundations, but against for-profits with hefty asset bases as well.

3. Make sure that the board or designated decision-making entity documents the decision with specifics, such as who participated in the decision, when it was approved, what comparability data was used and how it was obtained, and whether anyone had to be recused because of conflict of interest.

Following these procedures (including making sure that the documentation is prepared before the next meeting of the board or committee or 60 days after the final decision is reached, whichever is later) gives the organization a rebuttable presumption that the compensation is reasonable. In other words, the IRS is hardly likely to do anything. Give Van Til credit, because at least he's questioning whether the "almost anything works" comparisons allowed under Section 4958 provide the kind of guidance big foundations need, regardless of the stiffened penalties in H.R. 7 for violating these regulations.

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In the absence of a real standard, the Senate Finance Committee may be looking into a nonprofit salary that didn't appear in the *Chronicle's* list and also didn't get much commentary, if any, from the nation's nonprofit sector leaders—Dick Grasso's \$140 million compensation package from the New York Stock Exchange. Unless you've been living under a rock, you know that the NYSE was compelled to reveal Grasso's salary, with the result that Grasso finally resigned to take a good chunk of his benefit package with him. NYSE chairman since 1995, Grasso had a base salary of \$1.4 million and a target bonus of \$1 million plus \$139.5 million in deferred compensation, accrued retirement and other benefits he was slated to receive this year (Kathy M. Kristof, "NYSE Chief's Pay Spurs Protests," *Seattle Times*, Aug. 28, 2003), a package the NYSE board of trustees had committed to extending through 2007. Actually, due to protests, Grasso agreed to forgo \$48 million of what would have been a \$187.5 million compen-

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Former NYSE Chairman Dick Grasso's enormous compensation package raises questions that ought to be asked throughout both the corporate and nonprofit sectors.

sation package (Susan Harrigan, "Counting Grasso's 'Blessings,'" *Newsday*, Sept. 11, 2003). Grasso had done well at the NYSE, with compensation skyrocketing from \$3 million in his first year as the exchange chair (Meg Richards, "NYSE Discloses Additional Pay for Grasso," *Newsday*, Sept. 10, 2003).

What prompts NCRP's commentary on Dick Grasso and the New York Stock Exchange? It isn't the irony that the demands for disclosure of Grasso's entire compensation package came from the Republican chair of the Securities and Exchange Commission (SEC), William Donaldson, and the defense of Grasso came from the Democratic chair of the NYSE board, former New York gubernatorial candidate Carl McCall, who has since resigned. Of course, Donaldson as NYSE chair earned a ton less than his successor Grasso (never topping \$1.85 million, because Donaldson says he viewed the NYSE as akin to running a "public utility"), opposed the transparency that he is now demanding of the NYSE, and at the SEC earns a paltry \$142,500 (Greg Farrell, "SEC Probe Escalates Debate Over Grasso Pay," *USA Today*, Sept. 9, 2003).

Our interest in this is that besides being sort of a regulator, the New York Stock Exchange is incorporated in New York State as a "not-for-profit corporation," which may be why so much of the public debate—and so much of the content of McCall's letter to the SEC (<http://www.nyse.com/pdfs/donaldsonletter.pdf>)—sounds just like the information a foundation board would generate in response to a challenge on intermediate sanctions. Even more important within the scope of NCRP's mission, the NYSE has its own grantmaking foundation.

Might the NYSE Foundation have used some

of its charitable largesse to influence its board members, who might not look very closely at a compensation package for the executive director nearing \$200 million? During Congress's consideration of corporate accountability legislation, NCRP wrote about the philanthropic grantmaking of Enron and other corporations making grants to charities associated with corporate board members (cf. the Fall 2002 issue of *The Nonprofit Quarterly*, in "Corporate Giving: De-Cloaking Stealth Philanthropy" for a discussion of Enron's philanthropic gifts to Enron board members' charities). Grants from the NYSE Foundation caught the attention of the press, although the national nonprofit leadership organizations chose not to comment, at least not publicly.

The Council of Institutional Advisors, which was a critic of the tainted Enron grantmaking, noted that 40 percent of the NYSE Foundation's grants went to organizations with NYSE board members on their boards, including the New York City Police Museum, the New York Philharmonic, the Panetta Institute and Duke University's "Director Education" program (Terry Keenan, "Scratch Dick's Back He Will Scratch Yours," *New York Post*, Aug. 31, 2003).

The Panetta Institute is the Leon and Sylvia Panetta Institute for Public Policy, created by former congressman and former Clinton White House Chief of Staff Leon Panetta (Grasso serves on the Panetta Institute's national advisory board). Panetta defended the grant from the NYSE Foundation as "a legitimate gift" that Panetta did not recall having solicited from Grasso (David S. Hilzenrath, "Directors' Charities Got NYSE Money," *The Washington Post*, Sept. 18, 2003). The *Post* also noted a grant to St. Peter's Prep in Jersey City, where Grasso and NYSE Executive Vice President for Communications Robert Zito graduated (Zito is also on the board of St. Peter's Prep).

Another press report indicated that "Grasso held positions in charities and other organizations with more than one-third of the 27 people who served on the compensation committee during his tenure" (Andrew Countryman, "Grasso, Pay Committee Were Well-Connected," *Seattle Times*, Sept. 18, 2003), which might constitute the kind of conflict of interest that the intermediate sanctions rules were meant to guard against. During Grasso's tenure as NYSE chair, the NYSE and its

foundation acknowledge having donated \$2.7 million to charitable organizations affiliated with NYSE board members who were on the compensation committee, including half of the grant-making in 2002 going to groups affiliated with Home Depot's Kenneth Langone, who chaired the compensation committee (Grasso has served on Home Depot's board of directors and ironically on its compensation committee).

NYSE's fundraising services were not only available for charities. Politicians certainly received some benefits, including hosting fundraising events at the suggestion of Grasso or the NYSE's lobbyists for such politicians as Sen. Christopher Dodd, D-Conn.; House Financial Services Committee Chairman Michael Oxley, R-Ohio; former Senate Banking Committee Chairman Phil Gramm, R-Texas; Sen. Charles Schumer, D-N.Y.; Gov. George Pataki, R-N.Y.; and former New York City Mayor Rudolph Guiliani (Kathleen Day and Ben White, "NYSE Fundraisers Draw Scrutiny," *The Washington Post*, Sept. 26, 2003). At least the NYSE's own political action committee's direct political contributions have dropped from \$238,000 to federal candidates in the 1997-1998 election cycle to \$125,500 in the last election cycle.

Seeing the political gift to former Sen. Gramm makes us think of Enron, which gave grants to the Mercatus Center at George Mason University. Mercatus, a very conservative economic research center, happened to employ Gramm's spouse, Wendy, who lobbied for regulatory changes that would benefit Enron's energy and other services. Mercatus pops up in the NYSE Foundation's 990-PF with a grant for \$50,000 in 2002 along with a small grant of \$10,000 to the Congress of Racial Equality, politically balancing the grants to the more liberal Panetta Institute and \$50,000 to the National Urban League (all but the Panetta Institute got identical grants in 2001).

As Harrison noted in *Newsday*, Grasso "hand-picked" the members of the board and the compensation committee. As Hilzenraf noted in *The Washington Post*, NYSE directors are each paid \$30,000 for their board service. Did NYSE Foundation gifts (or gifts we still don't know about from the NYSE itself that didn't get reported in the foundation's 990-PF) sway board members to give Grasso his hefty paycheck? Heck, these people are well off, they weren't personally bribed and

people like Panetta are certainly among the most reputable in public life. But grants to their charitable organizations create the impression of a conflict of interest, and "such contributions can help co-opt board members and make them less likely to challenge a chief executive they are ... overseeing," according to the Council of Institutional Investors' Teslik in the *Post* article.

NCRP agrees and for several years has advocated for full disclosure of corporate charitable giving and particularly disclosure of charities connected to corporate officers and directors. We estimate that only about half of corporate philanthropy is revealed through the 990-PF filings of corporate foundations, the remainder coming from executive offices and marketing departments in amounts too inconsistent to catch the attention of the SEC.

A *Philadelphia Inquirer* columnist said that the NYSE is technically known as a "self-regulatory organization" or SRO (Jeff Brown, "On Personal Finance: Self-Regulation Won't Lead to Needed Change," *Philadelphia Inquirer*, Sept. 21, 2003). Maybe the tag team of Sens. Grassley and Baucus at Senate Finance will spark some change, not only with excessive compensation packages, but also with corporate philanthropic disclosure, which are both in play in the NYSE scandal. The silence from our nonprofit and philanthropic sector leaders on the Grasso brouhaha is pretty obvious. Like Juvenal, we ask again, "*Quis custodiet ipsos custodiet?*" Maybe the answer was in the headline of an editorial in the Sept. 8, 2003, *New York Observer*: "Grasso and McCall: Foxes Guarding the Henhouse." ○

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