The NCAA Adopts “Dodd-Frank”: A Fable

By David F. Larcker and Brian Tayan
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INTRODUCTION
In 2011, the executive committee of the National Collegiate Athletic Association (NCAA) gathered in the organization’s offices in Indianapolis to discuss the string of high-profile violations that had rocked the college football world in recent years. These included revelations that Reggie Bush of USC had received improper financial payments from an agent during his Heisman-winning year, that players of Ohio State traded memorabilia and cash for tattoos which head coach Jim Tressel knew of and failed to report, that a booster of the University of Miami provided thousands of dollars of “entertainment” to players (including access to nightclubs, boat rides, and prostitutes) over a nine-year period, and that the father of Auburn quarterback Cam Newton tried to “market” his son to Mississippi State in exchange for a $180,000 payment.

The committee members agreed that these occurrences were unacceptable. Moreover, their frequency was troubling and suggested that the problems might not be ones of isolated incidence but instead indicative of a systemic failure in athletic governance. If this were the case, the integrity of college football itself could be at risk. The committee decided that it had to intervene. The question was, how? The historical record of dealing with a problem of this magnitude in the world of athletics was less extensive, so the committee turned to the business world.

The committee reasoned that if the legislation was good enough to remedy the ailments of the business world, surely it would be adequate to protect college football. So the committee set to work “adapting” Dodd-Frank to the world of athletic governance. By the end of the summer, it unveiled the final package of rules, collectively referred to as the NCAA College Football Reform and Athletic Fan Protection Act. Its athletic governance mandates were as follows.

LEADERSHIP STRUCTURE AND TRUSTEE QUALIFICATION
Each university must describe in an annual report to alumni the leadership structure that it has chosen and explain why this structure is appropriate. In particular, the university must disclose the relation between the board of trustees and the athletics department, and whether this relationship is “independent.” It must also disclose the specific experiences, qualifications, and attributes that make each individual qualified to serve as a trustee. Finally, the university must disclose whether it has a policy regarding trustee diversity, and if so, how diversity is considered in identifying trustees.

COMPENSATION AND DISCLOSURE
The compensation contract of the head football coach typically offers financial incentives relating to the program’s regular season record, bowl game appearance and performance, and the academic standing of student-athletes. In addition, the coach might receive payments relating to exclusive contracts that

only in its length (2,319 pages) but in its title: the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The committee reasoned that if the legislation was good enough to remedy the ailments of the business world, surely it would be adequate to protect college football. So the committee set to work “adapting” Dodd-Frank to the world of athletic governance. By the end of the summer, it unveiled the final package of rules, collectively referred to as the NCAA College Football Reform and Athletic Fan Protection Act. Its athletic governance mandates were as follows.

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the university maintains with apparel and sports equipment providers (such as Nike or Under Armour), and for conducting summer camps and similar programs. He also receives benefits from the university including football, basketball, and other sports tickets for family and friends, use of a jet for recruiting, country club membership dues, leased cars, and cell phones. Under the NCAA Act, the university was required to discuss the relationship between the coach's compensation contract and the “riskiness” of the football program, and whether incentives offered to the coach encouraged him to take “excessive risks” to boost the program’s performance. It was also required to disclose the relation between the amount of compensation awarded to the football coach and the coach’s performance, including the performance measures used to determine bonus payments. Finally, the university was required to develop a “clawback” policy under which bonuses paid to the coach would be returned were the program’s record to be subsequently revised due to a compliance violation such that the payments would not have been merited.

DISCLOSURE OF INTERNAL PAY RATIOS
Researchers have long noted that the compensation of college football coaches has risen faster than the compensation of other university employees. According to one study, the compensation awarded to head coaches rose 500 percent between 1986 and 2007. By comparison, the compensation of university presidents rose 100 percent and the compensation of full professors only 30 percent over this period. Student athletes receive no compensation. As a result, the average head football coach of an NCAA Division I school earns three times the compensation of the average president, 17 times the salary of an assistant professor, and an infinite amount more than the average student athlete. The NCAA Act required that each university calculate and disclose these ratios for its constituents.

SAY ON PAY
The compensation of the head coach is negotiated with the athletic director and subject to approval by the board of trustees. Critics of coach compensation believe that pay levels are too high because the balance of power between the head coach and the university lies too much with the coach. In particular, they criticize the use of third-party agents who create a “ratcheting effect” on pay. Some also believe that psychological factors (including collegiality, team spirit, a natural desire to avoid conflict, friendship and loyalty to the program, and excessive competitive drive) bias the board of trustees to approve uneconomic pay packages. As such, critics contend that it is impossible for the university to conduct a fair, arms-length negotiation with the head coach. To remedy this imbalance, the NCAA required that coach compensation be subject to a nonbinding (advisory) vote of the school’s alumni. Under the NCAA Act, universities were required to hold a nonbinding vote on whether alumni approve of the coach’s compensation at least once every three years. At least once every six years, universities were required to hold a vote to determine the frequency of say-on-pay votes (every one, two, or three years, but no less frequently).

SUCCESSION PLANNING AND DISCLOSURE
College football programs generally do not engage in succession planning. In general, the departure of a head coach either to another program or to the National Football League leaves the athletic director without an immediate replacement. A successor is typically recruited from another program, although occasionally an assistant coach is promoted to the job. In the past, the NCAA held that succession planning was a leadership issue best left to the discretion of the institution. However, following the recent scandals, the NCAA reversed its position and decided that lack of succession planning created too much uncertainty that could adversely affect a football program due to a vacancy in leadership. As such, it was now considered a risk management issue. Although not officially a part of the NCAA Act, the organization encouraged college football programs to develop a succession plan for the head coach, and to disclose the plan to alumni.

WHISTLEBLOWER
The purpose of a whistleblower program is to facilitate early detection of compliance violations by providing financial rewards and protections to
individuals who witness and report improper behavior. Under the NCAA Act, a whistleblower providing “original” information to the NCAA that leads to a successful enforcement action against a university program is eligible for a reward between 10 percent and 30 percent of the size of the penalties (calculated as the value of cash penalties, athletic scholarships suspended, and revenue of bowl games forfeited). Whistleblowers were not required to first report suspicions to the university, but rather were allowed to communicate them directly to the NCAA.

SYSTEMIC RISK AND “TOO BIG TO FAIL”
This last provision was not a governance provision per se, but as the most famous element of the Dodd-Frank Act, the NCAA decided that it was too important to exclude. In the view of the committee, the recent violations highlighted the vulnerability of the entire sport of college football to reckless or irresponsible actions of individual institutions. The failure of one prominent program put the integrity of the entire sport at risk. To remedy this, the NCAA created an Athletic Stability Oversight Council, which (among other things) had the authority to designate certain university programs as “systemically important,” to require such programs to maintain extra compliance, and to subject those programs to reputational “stress testing” to determine the impact of a severe violation. The council had the power to break up or dissolve a university program whose failure would present a “grave threat” to NCAA football.

CONCLUSION
The executive committee was proud of the NCAA College Football Reform and Athletic Fan Protection Act and confident that it would reduce the frequency of violations by improving athletic governance.

WHY THIS MATTERS
1. While the above story is clearly fictitious, it provides a setting for evaluating the governance provisions of Dodd-Frank, which imposes similar requirements on publicly traded companies. Will these requirements reduce the frequency of governance failures? If they would not work in the world of college football, should we expect them to work in business? What are the key features that are necessary for the Dodd-Frank provisions to improve corporate governance?
2. Some recommendations of Dodd-Frank seem well reasoned while others seem arbitrary. Why are the governance provisions of Dodd-Frank legally required? Why are shareholders and boards of directors not allowed to decide which to voluntarily adopt and which are unnecessary?
3. Dodd-Frank places a strong emphasis on executive compensation, in terms of disclosure, internal pay equity, and shareholder voting. What role do incentive contracts play in causing (or failing to detect) compliance violations? What is the evidence that these requirements lead to improved governance outcomes?

1 One example in the sports world was the NCAA’s response to massive violations at Southern Methodist University where supporters of the athletics department maintained a slush fund for making illegal payments to players. The NCAA responded by issuing the so-called “death penalty” and entirely cancelled the school’s 1987 season. It remains the most severe penalty issued to a college football program.
3 “Independence” was defined as having “no material relationship,” meaning that neither the trustee nor a member of his or her family had been employed on the coach’s staff or played for the football program within the last three years, had not made donations to the football program in excess of $120,000 in the last three years, had not been employed in the compliance department of the athletic department in the last three years, had not been employed on the staff or played for the coach at other football programs where the coach had previously been employed in the last three years, and was not an officer of a company whose business with the university or its athletics program accounted for 2 percent or more of gross revenues or $1 million within the last three years. These rules were modeled after New York Listing Exchange requirements for independent directors.
4 The NCAA considered but ultimately omitted from the final rules the requirement that alumni or groups of alumni granting gifts to the university equal to 3 percent or more of total gift income for three consecutive years be granted the right to nominate up to 25 percent of the board of trustees. Following Dodd-Frank, the SEC had tried to adopt similar “proxy access” rights for shareholders of public companies only to have the law struck down by a federal appeals court, which ruled that the SEC had “inconsistently and opportunistically” presented the economic costs and benefits in justifying the rule. It was an accusation the NCAA wished to avoid. Still, activist alumni continued to lobby the NCAA to reconsider. See Jessica Holzer, “Court Deals Blow to SEC, Activists,” The Wall Street Journal (Jul. 23, 2011).
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6 This presumes that scholarships are treated as expense reduction rather than income. Players typically do not work in part-time jobs during school, given the burdens of schoolwork and practice.
8 (Go Cardinal!)
9 In addition, a failed football program had negative consequences for a school’s entire athletics program, because the revenue from football generally subsidized other sports programs and Title IX scholarships.

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