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Banks walk the bonus tightrope - Attempts to meet bankers' expectations on remuneration raise the risk of more public anger over their pay

By the end of last year, global regulators had reached a broad consensus on how bankers should be rewarded in a way they hoped would curb excessive risk-taking and align the actions of individuals to the long-term prospects of their employers. Implementation has varied from country to country, but bodies such as the G20 and the UK's Financial Services Authority have made it clear that most year-end compensation should be deferred and that bankers should be prevented from earning huge bonuses and then leaving with no regard to the consequences.

However, Financial News disclosed last week that some banks are taking actions that the industry's critics might question. Bank of America Merrill Lynch and Citigroup are granting a proportion of the shares component of bonuses in stock that vests over the next few months – and they are unlikely to be alone. Some individual bankers are reported to be taking matters into their own hands: some in the US are understood to be attempting to monetise their restricted stock holdings by using equity derivatives.

Peter Hahn, a lecturer at the Cass Business School in London and a former managing director at Citigroup, said: "There is an awful lot of money at stake and some very, very smart people out there. People will always try to figure out ways around the rules." After a bumper year for much of the industry, bankers are looking for recognition and that includes liquidity in their awards. Investment banks are walking a tightrope between rewarding and retaining their biggest earners, and making sufficient concessions to keep regulators and public ire at bay.

At Bank of America Merrill Lynch, bankers will receive a mixture of cash, deferred, restricted shares and shares that start vesting as early as August. Thus, while the cash component of a banker's year-end bonus may have drastically shrunk, a chunk of the stock he or she has been given will be as good as cash by the end of summer. Citigroup has capped cash bonuses at \$100,000 (€72,000), granting the rest of the \$5bn bonus pool in shares and options. However, only 25% to 40% of those shares are in the form of the deferred, restricted stock that regulators want introduced.

The rest comes in the form of units that will convert to common stock in April. One outcome of this is that high earners in the UK could have to wait up to three years longer to access a portion of their bonuses than their colleagues in the US as a result of the FSA's more onerous rules on deferment.

Bank of America Merrill Lynch and Citigroup were among the banks worst affected by the financial crisis. Along with some others, they struggled to retain talent, losing big names to rivals while bound by restrictions because of their reliance on US troubled asset relief programme funds.

Repaying government money was a priority because it allowed them to regain control over how they paid and attracted staff. Giving certain staff access to cash more quickly than some of their competitors is a way of enticing and hanging on to top performers, but it is seen by some as counter to the spirit of the law. In an interview with Financial News, John McFall, chairman of the UK Treasury Select Committee, said: "I think it is a stubborn refusal to face reality, and the public are bemused and feel that these people live on another planet. I'm sympathetic to that view." In another development, some senior bankers in the US are seeking to bypass the guidelines by using equity derivatives to turn their restricted stock into cash immediately, albeit at a discount of as much as 50%.

Gustavo Dolfino, senior managing director of US executive search firm Accretive Solutions, said he had been approached by several senior bankers who had negotiated to receive the stock component of their bonuses in shares that are already vested. This gives them the option of entering derivatives trades with counterparties at broker-dealers that are willing to offer a reduced sum now in exchange for shares that will be worth more when the restrictions pass.

Prepaid forward contracts, for example, allow the investor to receive an up-front payment – typically 75% to 85% of market value – in exchange for delivery of a variable amount of shares or cash in the future. They have already attracted attention in the US because they have been used to defer paying taxes, but some say they could also be tailored to help bankers seeking immediate liquidity. Other derivatives strategies being considered include deep in-the-money calls, over-the-counter puts and collars.

Dolfino said: "Rather than wait three or five years for the stock component of bonuses to vest, bankers would rather take a discount of up to 50% now just to get out and do something else."

The practice is unlikely to become widespread because it is only possible for the handful of executives who have been granted vested stock, which they can hold on to even if they leave. Employment lawyers and pay consultants in the UK suggest that, while technically possible in Europe in limited cases, monetising deferred stock would cause public outcry and should therefore be avoided.

Jeff Visithpanich, principal at US-based pay consultant Johnson Associates, which helped reform Credit Suisse's compensation structure, said: "This doesn't surprise me. You will always find somebody who is willing to make that deal on the other side but it runs completely counter to what the regulators are trying to achieve."

- The figures behind the great bonus debate

30-40% increase in the total investment banking bonus pool to be paid this year based on 2009's performance, according to compensation consultancy Johnson Associates

75% The higher estimate of the percentage of bonuses at Citigroup in the form of cash or stock that vests this year

60% The proportion of bonus that in the UK must be deferred for three years for those earning over £1m, according to the Financial Services Authority