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Banks 'had to offer bonuses to retain top talent'

BYLINE: Aled Blake Business Correspondent

THE banking bonus culture was a result of the need to compete with the increasing draw of hedge funds for talent, a City insider said yesterday.

As former banking bosses were questioned by MPs at the Treasury Select Committee over the collapse in the industry, independent investment consultant Conrad Preece said the rapid rise of the hedge fund phenomenon caused banks to introduce a new type of bonus system. There were concerns in the sector that talented staff would leave their roles in banking to go to work in highly-paid jobs for hedge funds.

Mr Preece, who worked for Allied Irish Bank's asset management arm as a fund manager as well as a number of other major financial institutions, said the bonuses due to staff could not simply be withdrawn because they were contractually obliged to give them out.

He said: "There has been a migration of people from banks to hedge funds that has created competition between the two and put pressure on banks to retain talent."

Mr Preece is a fund manager for Welsh-registered hedge fund Cadwyn Capital - one of the few hedge funds to make a positive return last year - and in his time in the City was also a derivatives specialist for Fidelity Mutual.

He said banks were under a contractual obligation to pay the bonuses, making it difficult for them to renege on the deals.

"The problem is that the bonuses have been written into the contracts regardless of companies' performances," Mr Preece said.

His point has been backed by employment law specialist **Ronnie Fox,** who said he was representing clients at three different banks who maintain they are entitled to payouts despite the recent conditions.

Mr Fox said a large number of bankers could take action if the Government imposes a blanket ban on bonuses.

The Government's recapitalisation scheme included agreements that board members in banks taking state money would not receive bonuses this year.

But ministers indicated they could not prevent the payment of bonuses even in banks where the state has a majority interest, as many traders and brokers have legal entitlements written into their contracts.

Areview of City corporate governance by former financial services regulator Sir David Walker has been launched by the Treasury, with a remit to look into remuneration policies, board practices and risk management.

Andy Hornby, formerly of HBOS, and Sir Fred Goodwin, previously chief executive of RBS, confirmed they were paid salaries last year of nearly pounds 1m and pounds 1.46m respectively.

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Mr Preece said: "RBS took over ABN Amro and I suspect, based on what the Treasury Minister Yvette Cooper has said, that there are a significant number of contracts there with guaranteed bonuses written in to the contracts.

"This is one of the dilemmas the Government has as a major shareholder in RBS. Because bonuses are no longer discretionary they do not relate to the overall profit of the business. "When Sir Fred Goodwin was asked by the Treasury Select Committee whether bonuses would have been valid if RBS had not been bailed out by the Government, he didn't know. That tells you that some of these contracts are not related to overall performances of these companies."

Mr Preece said the banking system was changing, with the reliance on the wholesale funding market being reviewed.

"The core banking business is taking a deposit from a customer and lending that to a business.

That model has clearly evolved so it has a far bigger reliance on the wholesale markets." Many of the wholesale banks, which came to the UK from abroad, have repatriated in the last six months. The change in the banking landscape will also see a shift in the way bonuses are structured, Mr Preece said.

The former chief executives of Royal Bank of Scotland and HBOS claimed they lost millions from the near-collapse of their banks, but said pay across the industry needed to be overhauled.

Mr Preece added: "Banks will be looking at bonuses to be linked to a range of things, one of them being overall profitability."

MPs at the Treasury Select committee heard that the bonus system, which sometimes rewarded staff with handouts of 10 times their salary, became ingrained in the industry at a time when investment banks were not publicly-listed companies.

US-style pay practices also transferred to these shores in recent years, according to the witnesses.

The bankers said there needed to be change "across the board" to align pay better with reward and long-term results.

Mr Hornby said he "never received a single penny" of his bonuses in cash during his tenure at the bank, while Sir Fred claimed to have lost more than pounds 5m in shares, having invested his bonuses in stock.

Neither received a bonus last year, they said. Mr Hornby called for changes in the bonus system for bankers.

"If people are rewarded for purely short-term cash form and are paid very substantial shortterm cash bonuses without it being clear whether these decisions over the next three to five years have proven to be correct, that is not rewarding the right type of behaviour," he said.

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Mr Hornby said bonuses should be tied to the performance of an institution's shares over a period of years. He said he invested all his bonuses in nine years as both chief executive and, previously, as a board member, in HBOS shares.

"In the two years that I have been chief executive, I have lost simply more money in my shares than I have been paid."

He confirmed he is being paid pounds 60,000 a month in consultancy fees under a three-month contract with Lloyds, but said he would "do it for free" if the bank required his help after this time.

Sir Tom McKillop, previously chairman of RBS, sought to assure that "fat cat" bonuses were not the norm across the group, which owns NatWest.

"The average salary in RBS is just over pounds 27,000, the maximum bonus for the vast majority of those people is 10%, and the average payout is about 5%, so just so we can get a bit of perspective, not everyone is in this class, a long way from that," he said.