

Taking the bull by the horns, and . . .

What can politicians and the FSA really do to curb massive bonuses? Edward Fennell reports

Reining in bankers' bonuses has become like a Wild West rodeo in which every political cowboy in town strives to bring to heel a powerful bull. Its advocates argue that it should be allowed to run free if it is to generate healthy profits for banks and tax receipts for governments in the future.

Nonetheless, George Osborne's attempt on Monday to capture headlines by suggesting that retail bankers should be tethered to bonuses worth no more than £2k in cash with the rest in shares underlines that it is open season on bonuses from all parts of the political spectrum. "Where banks do want to pay bonuses this year to those senior staff who have earned them," the Shadow Chancellor of the Exchequer said, "those bonuses should take the form of new equity capital — shares in the business."

City lawyers were, to put it mildly, sceptical about this latest attempt to put the bankers in their place. "It's crazy — a nonsense," said Ronnie Fox, of Fox Lawyers, who says that he is already being approached by bankers about the fine detail of their contractual rights. "I fear that the consequence of this will simply be that bankers will have their salaries doubled or trebled and that this in itself could increase the risk-taking because the link between performance and profitability will be severed."

Alex Lock, of Beachcroft, agrees that legally there could be all kinds of complications arising from the Osborne proposals — not least in terms of the conflicted position in which employers would find themselves by trying simultaneously to obey the law and meet the contractual obligations to employees. Plus, further down the line, there are likely to be tax problems on these share handouts, not to mention upsetting existing shareholders who see the value of their own shares diluted by these giveaways.

The heart of this problem is a clash between two sets of policy drivers. The politicians are feeding off the public's deep-seated resentment over bankers' levels of pay after the financial crisis. Meanwhile, the regulators are primarily concerned about effective risk management. As Hector Sants, chief executive of the Financial Services Authority, has said: "We are not an incomes regulator."

This point may be lost, however,

next week when the banks present to the FSA their plans for salaries and pensions. The FSA will want to see that firms are implementing remuneration policies and practices that promote effective risk management. Failure to come up to scratch could mean that firms face enforcement action or, as a last resort, be forced to hold additional capital if they pursued "risky processes".

But the FSA cannot impose a cap. And if it did the banks would find some way around it. So, instead, the focus now is on Sir David Walker's proposals for corporate governance in UK banks, which are due to be published next month. His early draft attracted so much hostile lobbying that the word on Threadneedle Street is that the proposals have been watered down significantly. Or as one well-placed lawyer said, the final version will be wishy-washy.

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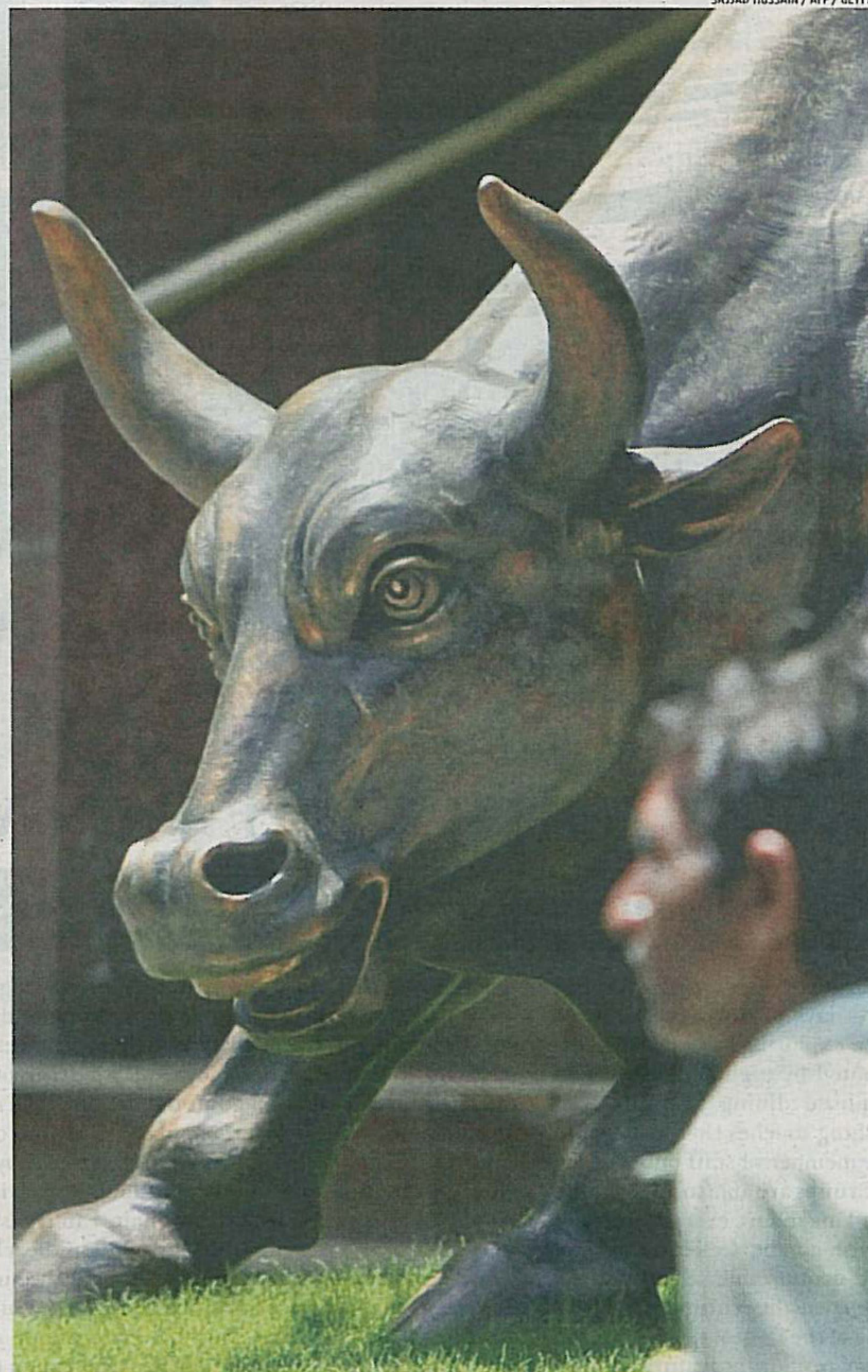
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There are two main devices being suggested to moderate bonuses payments — deferral and clawback. "No one talking about clawback actually knows what it means in practice," says Nick Ralph, of Archon, the employment and remuneration lawyers. "There are so many complications around it, including the question of what happens if an individual has already left the business."

Nonetheless, with such a barrage of criticism levelled at bonuses it is likely that there will be changes. Ralph predicts that they will come in the form of a move to make the award of bonuses more transparent and linked to clearly defined targets. "The era of the discretionary bonus is over," he says. "Instead, the way bonuses are awarded will become much more formulaic. The big banks are going to be concerned to put in place procedures that demonstrate a link between the level of bonus and an individual's performance."

Will that make a profound difference? Barney Reynolds, of Shearman & Sterling, suggests that all the hoo-ha over bonuses is misplaced if



Some City lawyers are sceptical about efforts to control vast payouts

the priority is to ensure that another crisis does not wreck the economy. "It's not pay that's the issue — it's management," he says. "What went wrong in the lead-up to the crisis was that the senior management in banks adopted strategies that were erroneous. The remuneration systems they set up then drove the traders in a certain direction. The problem was not the remuneration system but the strategies they were serving."

Meanwhile, the imminent £6 billion

question facing Goldman Sachs and others is exactly how much they will hand out in bonuses over the next couple of months. Arun Srivastava, of Baker & McKenzie, reckons that hefty bonuses will be paid, unaffected by arrangements coming into force in 2010. He warns that there is ambiguity in the FSA's provisions that allows for a lot of creative invention by banks.

Whatever the future may hold, this could be a last glorious bull run for the bonus culture.

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