

## Bonuses in 2012 to be only 48% of their 2007 peak – so the markets will sort out excess bonus levels eventually



making business sense

Both the Prime Minister and the probable future Prime Minister have been on the record this week attacking bankers' bonuses. Neither talked much sense, though their attempts to ride the wave of public anger without committing themselves to doing something stupid made both their positions difficult.

Part of the difficulty is that **the public has a completely inaccurate perception of what makes up bankers' bonuses**. Different companies handle these things in entirely different ways. At one extreme, **many brokers in banks are in effect paid almost entirely on commission and although the commission is called a bonus, it is in reality a commission**. Some of the numbers may sometimes look large but that is the nature of variable pay based on results. There is no case for not paying these bonuses. **Some other bonuses are contractual and range from relatively small amounts for bank tellers to rather higher amounts for some of their managers**. Whether they are deserved or not, if the conditions met by the incentive schemes have been met, it will be very difficult to make a case for not paying these as well. **Yet other bonuses are at the discretion of the employer**. But in *Kent Management Services Ltd v Butterfield* the judge ruled that: *'An employer's failure to pay commission or bonus in these circumstances is likely therefore to constitute a breach of contract and will probably permit an employee to resign and claim constructive dismissal. Alternatively an employee could remain in employment and simply bring a claim for Unlawful Deduction of Wages'*. **So in practice it will be difficult to control bonuses without primary legislation which in many cases will have to be retrospective and will conflict with the Human Rights Act.**

cebr's forecasts indicate that bonuses by this year are likely to be down by 70% from their peak and even by 2012 will be only back to 48% of their peak levels. So it looks as though the market will – having got it wrong initially – sort out the excess bonus problem. Besides the fact that bonus schemes automatically are likely to pay out much less, some individuals will feel that their consciences will not allow them to accept bonuses that they feel that they do not deserve and some banks, particularly in the public eye, will feel that paying bonuses will do so much damage to their reputation as to be on balance bad for business even if the price is to lose some key staff.

But we have consistently said that both fees and pay in the city are too high. Fees are too high for what is often not particularly special work because of lack of competition in both the clearing and investment banking sectors. Pay is too high because the directors of the banks have allowed remuneration systems to build up which have rewarded the taking of excessive risk, particularly if it appears that the consequences of any risk will occur a long time away when whoever made the risky decision has already taken the bonus and headed off for the hills.

Our proposal to deal with the first problem is to **make sure that competition is increased throughout financial services. The bigger is better belief should be rejected**. Dealing with the second problem is harder and will require some rough justice. But it is clear that the directors who sanctioned the bonus schemes which have ended up encouraging excess risk have failed in their jobs. **The FSA should review banks' bonus schemes and where it is seen that with 20-20 hindsight they have ended up encouraging excess risk, the banks' former directors should lose their licences to practice in the City**. This would be a tough sanction, but it is clear that **too many bank directors have been engaging in what the French call 'pantouflage'** (literally putting their slippers on – in other words taking on a well paid but cushy job) rather than doing what they were paid to do. **Future directors would take note and ensure that their staff do so as well.**

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