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Comment&Debate

Don't cap banking bonuses; scrap them

Deborah Hargreaves

1 While the EU should be applauded for tackling the thorny issue of bank bonuses, my concern is that the plan to cap payouts at a year's salary will have perverse consequences. Already base salaries in the banking sector have been rising sharply as regulators try and choke off the multimillion-pound annual bonus awards. The EU's plan could lead to **30** .

2 Banks have increased salaries across Europe by 37% in the past four years in response to a crackdown on bonuses and pressure from regulators to claw back some rewards if bets go wrong later on. Banks are very good at getting round the letter of the law and bankers are very competitive. Bank bosses say they are held to ransom by star traders who threaten to walk off to a rival if they believe they are not compensated adequately.

3 However, bank executives should dig their heels in and resist calls to jack up wages if bonuses are restricted. Few banks are hiring at the moment since all are facing a squeeze on profits. Star bankers probably have few options for poaching by rivals and the threat to leave could be an empty one.

4 Investment banks generally pay fairly low salaries to keep their fixed costs down. In a good year, they can pile on the rewards in the annual bonus round. In a bad year, they can cut back on bonuses rather than sack a load of trained staff.

5 But what has tended to happen is that bankers continue to get paid large bonuses even if it has been a loss-making year for the bank. The Royal Bank of Scotland has just announced a $7.5bn loss along with a £432m bonus payout for the investment bank. Stephen Hester, the CEO, said bonuses were a lot lower than in previous years.

6 How do the vast majority of people who work in the bank branches and deal directly with the customers feel about this? Starting salaries for branch staff are around £13,000 and Unite, the union at Barclays, recently said that some of the staff were eligible to claim tax credits to make ends meet. This cannot be good for morale across the banks.

7 I would suggest scrapping bonuses altogether and introducing a company-wide profit share. It works for John Lewis, where every member of staff gets the same percentage of their salary as a share of profits. Obviously, those on higher pay get more. But this is a big motivator for those who work there. It also gets round the reward for apparent failure when banks pay bonuses without actually making any money. If there's no profit, there shouldn't be any profit share.

8 PIRC, the influential pensions investment adviser, says the EU plan should be a starting point for a discussion about the effectiveness of variable pay in general. Some shareholders are beginning to doubt that it works in the right way and share-based awards and bonuses have driven pay packages for bankers and top executives to sky-high levels.

9 So the EU is right to take on the toxic issue of bank bonuses. Its plan hopefully will work to reduce payouts. There are also some new bank bosses in charge such as Sir David Walker and Antony Jenkins at Barclays who are talking about reforming pay structures. Maybe they can use this cap to exercise some restraint over pay.

10 But shareholders and regulators should watch the banks like hawks to see they don't just boost salaries to compensate for the loss of bonus potential. Given the way banks behave, this is what I fear may happen.

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