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Bankers pocket three times pre-tax profits

William Wright

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Investment banks have paid their staff three times as much as they have generated in pre-tax profits over the past six years, raising fresh questions about the appropriate division of rewards between employees and shareholders in the securities industry.

Over the past six years, a period that includes the last years of the boom in 2006 and 2007, the crisis in 2008 and the mixed recovery since, a sample of seven large investment banks that publish comparable data have spent $362bn on compensation for staff.

This is 2.9 times the aggregate pre-tax profits of $124bn these staff generated over the same period, according to analysis commissioned by Financial News.

This “payout ratio” varies widely between different banks. Over the six years, Goldman Sachs was top of the class, with compensation costs of $91bn equivalent to 126% of its underlying pre-tax profits of $72bn.

JP Morgan’s investment bank was close behind with a payout ratio of 145%. Compensation at Morgan Stanley’s institutional securities division was more than three times pre-tax profits, but at UBS Investment Bank pay of Sfr46bn dwarfs aggregate pre-tax losses over the period of Sfr51bn.

If banks were to bring the compensation down to a one-to-one ratio with pre-tax profits, they would have had to reduce their compensation bill by 29% last year.

The analysis also showed that the compensation ratio – the banks’ preferred metric that expresses pay as a percentage of revenues – rose at five of the seven banks last year, despite efforts to reduce pay and bonuses, with only JP Morgan and the corporate and investment bank at Deutsche Bank posting a decline.

This is mainly because a large part of compensation cost in any given year is from previously awarded deferred bonuses, and the cuts in the bonus pool of between 30% and 60% for 2011 will take several years to work through to the banks’ bottom line.

The aggregate compensation ratio across the banks climbed last year from 40% to 43%, compared with an average of 48% over the past six years.

At the same time, pay as a proportion of the total costs for the banks declined from 58% in 2010 to 54% last year, compared with an average of 60% over the six years.

All the banks were given the opportunity to confirm the numbers but they declined to comment.

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