Will new EU-wide bankers' bonus rules end excessive risk-taking?

(http://www.cipd.co.uk)

New laws will stipulate that between 40 and 60 per cent of any bonus must be deferred for at least three years

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The European Parliament recently approved legislation to restrict bankers' bonuses throughout the EU member states.

In the wake of the financial crisis, banks have increasingly been making use of deferred bonus schemes linked to long-term performance and have also cut the amount of cash bonuses as a result of a variety of different legislative initiatives, codes of practice and recommendations. The current changes are intended to prevent banks returning to previous remuneration styles as the economy and recruitment pressures grow, and are designed to discourage excessive risk-taking.

Upfront cash bonuses, based on expected rather than actual performance, are a key driver towards a high-risk, short-term bonus culture. The new rules will stagger payments over time and link them to banks' actual performance. Banks will only be allowed to pay 30 per cent of any upfront cash bonus in cash, and this cap will drop to 20 per cent for particularly "large" bonuses. What constitutes a "large bonus" will be decided by national regulators – the Financial Services Authority (FSA) in the UK – in due course.

The new laws will also stipulate that between 40 and 60 per cent of any bonus must be deferred for at least three years, and can be reduced if the relevant investment funds do not perform as well as expected. Half of any bonus must be paid either as shares or as "contingent capital" (funds that can be called on first if the bank gets into difficulties). Banks will also have to set a maximum limit on the size of their staff bonuses, and the bonuses must be capped as a proportion of salary.

The final value of pension payments must be linked to the overall strength of the bank (to prevent the re-occurrence of bankers retiring with substantial pensions unaffected by the crisis facing their bank). There will also be further restrictions on the payment of bonuses at banks bailed out with taxpayers' money.

The rules are in line with G20 recommendations made last year and have been agreed between the European Parliament and the Council of the European Union. They will require the capital requirements directive (CRD) to be amended, and will empower national supervisory authorities to take action against any financial institution governed by the CRD that fails to comply with any part of it. The FSA will be able to impose penalties, or enforce remedial measures, on banks for breaches of the rules or the causes of breaches.

The new arrangements will apply to banks at group, parent company and subsidiary levels, including those established in offshore financial centres. Member states must implement the rules nationally so that banks' bonus provisions comply with the new requirements by January 2011. Bonuses committed before January 2011 but paid after this date will also be covered by them.

British MEP Arlene McCarthy justified the new measures by saying, "A high-risk and short-term bonus culture wrought havoc with the global economy and taxpayers paid the price. Since banks have failed to reform, we are now doing it for them." How successful the amended directive will be in reforming the culture of excessive risk-taking will depend largely on how strictly national authorities like the FSA implement it and to what extent they enforce it.

Recommend

Further Info

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