Making the case for pay in the capital markets
Breakfast PR and comms workshop – January 2016

This is a summary of the main points of discussion at a recent PR and comms breakfast hosted by New Financial on the question of pay. It is intended as a 'playbook' for improving communication around pay and bonuses, and should not be treated as representing the position or views of any of the individual participants.

1) Keeping up the pressure
More than seven years on from the financial crisis, pay in the financial markets is still a lightning rod for criticism of banks, investment banks and asset managers, both in terms of quantum and structure. While there has been some relief in pressure over pay as the economy has improved and other macro issues (such as the EU, immigration and terrorism) have become more prominent, pay remains a political and PR problem for the industry. Given the uncomfortable cultural relationship with high pay in many countries of Europe, it is likely to remain so.

2) Political risk
While pay and bonuses may have dropped out of the headlines in recent years, if the industry behaves as though the issue has gone away there is a danger that it will encourage a radical political reaction in the form of blunt and heavy-handed regulation. Populist and anti-establishment political movements have flourished across Europe since the financial crisis (and to a lesser extent in the US). While these movements are unlikely to gain power they have had a significant impact in defining the political agenda – and there are plenty of MEPs in Brussels who are pursuing a strong social justice agenda.

3) Waiting for reality to bite
There is a disconnect between the overall levels of performance in the investment banking and asset management industry and the pay and bonuses that many people in the industry continue to earn. Most banks are still struggling to beat their cost of capital, shareholders are still waiting for an improvement in returns from the sector, and the industry is still heavily supported by abnormal monetary policy and central bank intervention. Despite the progress in reducing pay and the regulatory clampdown on deferrals and clawbacks, the industry is still clinging to a disproportionate amount of returns in the form of pay. This suggests that the culture around pay in the industry has not fundamentally changed.

4) Making progress: quantum
There has been progress in reducing levels of pay, although it is clear that the industry is not yet at the end of the road. On average, pay per employee has fallen at investment banks by a quarter since before the crisis (and is continuing to fall based on the handful of investment banks that have reported results for 2015). At a structural level, pay relative to revenues has fallen significantly (from about 50% of revenues pre-crisis to 40% since). Despite this progress, in absolute terms, pay remains high relative to other sectors, and many politicians and readers of certain newspapers will not be comfortable with pay (if ever) unless it falls further.

5) Making progress: structure
The regulatory response to pay since the financial crisis has changed the structure of remuneration across the industry. The bonus-cap may be blunt, but in reducing the potential scale of bonuses it has addressed some of the behavioural and systemic risk embedded in bonus structures. A much higher proportion of bonuses are now deferred (roughly 35% of all bonuses and 60%+ for the highest paid staff), more than half are paid in stock or bonds, and the introduction of malus and clawback (for up to 10 years) has reduced the risk of paying for illusory performance.

6) Redefining performance
Redefining performance, and demonstrating better alignment between pay and performance, could be a way of addressing the continued controversy around pay. Providing more clarity about what a firm means by 'performance', better disclosure of what performance metrics are used to calculate pay, and better communication around the impact of poor financial performance on pay and bonuses would help. For example, banks provide exhaustive detail on how they pay their most senior executives, but are far less transparent for the majority of their staff. In terms of reporting, pay and bonuses could be included in the presentation of financial results.

7) Better disclosure
Disclosure around pay in the industry is patchy, inconsistent and often confusing. While improving disclosure may sound like a recipe for more negative headlines it could also help defuse the debate. Many firms disclose as little as possible on pay and bury their required disclosures on their websites or by delaying them as long as possible (although a few, such as Barclays, voluntarily disclose more than required). And even the disclosures under Pillar 3 of pay for senior staff are often hard to compare from one firm to the next. Many journalists do not have time to work out the underlying numbers and maths is often not their strong suit, so the industry should aim to help rather than hinder them *(see our recent paper on 'What we do and don't know about pay')*

8) Stepping up
Shareholders and pension funds could be the key to keeping up the pressure on banks to improve the balance of reward between employees and investors. One challenge here is that the asset management industry – where average pay has been rising in line with growth in assets under management since before the crisis – faces some of the same challenges around pay and performance as the investment banks. Pressure may come instead directly from pensions funds: in the US, pension funds that invest directly have been more activist on governance than asset managers. Better communication around the interaction between shareholders and banks could help address this issue.

9) Asset managers in the spotlight
The asset management industry has attracted a lot less flak than investment banks over pay since the financial crisis. However, as governments require people to take more responsibility for their future pensions provision, the asset management industry is going to face more pressure over the level, structure and transparency of its fees. Unlike with the banks, which had a collective cardiac arrest in 2008, this process is likely to be more gradual for asset managers. It is important for the industry to get to grips with defining and communicating what employees are paid for, how they are paid – and how this relates to the outcomes for the individuals whose money they are managing.

10) Rebuilding trust
Ultimately the question of pay for investment banks and asset managers is a question of trust: do politicians, customers, shareholders and the wider public trust the industry to be acting in their collective interest rather than in its own interest? The industry can do a huge amount to address these concerns by communicating more effectively about the value and purpose of what it does and the economics of how it does it. It also needs to demonstrate more clearly how it has changed since the financial crisis – and addressing pay is one of the clearest signals that the industry can send.