

'Back To The '70s' For Street Pay

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By [Gerelyn Terzo](#)

One former fixed-income trader resigned from the familiarity of a large investment bank last year -- a firm that received TARP funds -- to launch a distressed debt hedge fund. The trader ran the firm's prop desk for 15 years and was given relative autonomy to manage a team, a group of traders that incidentally is now working for him at his new hedge fund.

While he wouldn't say compensation was the reason he left the big bank, he admitted his pay there was tied to a performance bonus. "I would argue that it would have been riskier to stay," the fund manager, who declined to be named, said of his former employer.

The same scene has played out all over Wall Street this past year, and compensation data compiled by **Johnson Associates** for *IDD* illustrates just how difficult 2008 was for investment bankers.

For instance, compensation for the highest echelon of bankers, a desk head with 10-plus years' investment banking experience, plummeted 35% to \$2.6 million. The drop in pay for the most senior managing director with at least eight years of experience was similar. Compensation in this group fell 33% to \$1.6 million from \$2.4 million in 2007.

Investment bankers at large firms may have to get used to this pay range for a while. "The days of an average managing director making seven figures per year are over for the foreseeable future," says **Russ Gerson**, chief executive officer with Wall Street recruiting firm **The Gerson Group**.

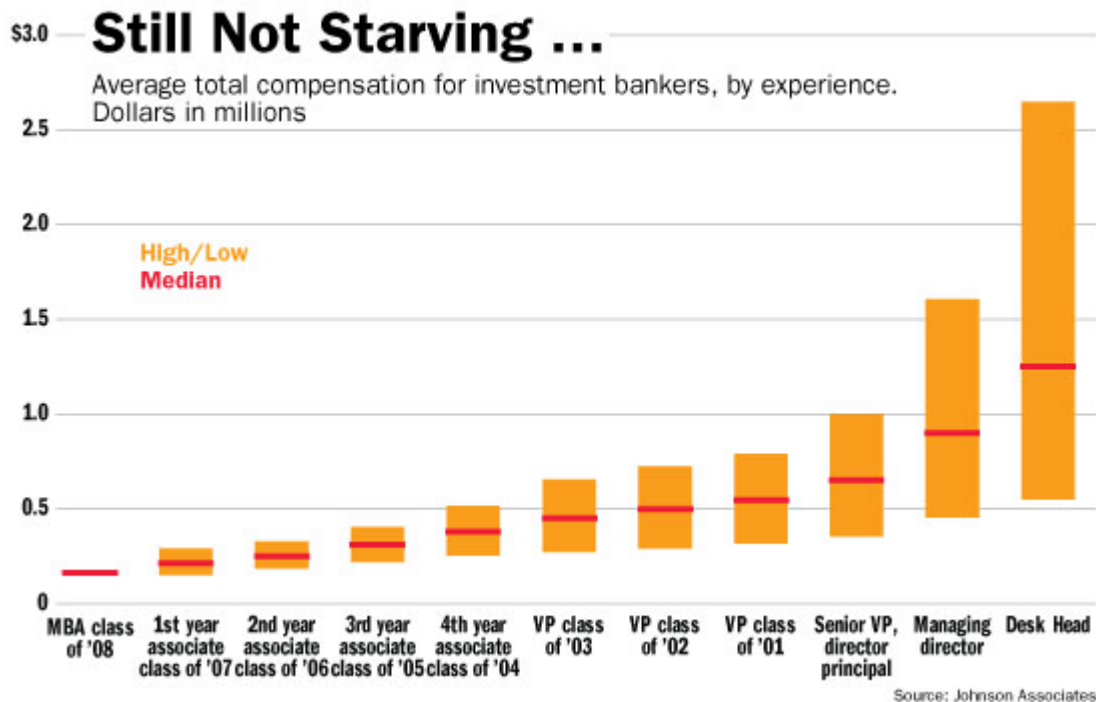
Wall Street's bonuses were especially controversial last year in light of the government's rescue on the Street. It was in part his call for a \$10 million bonus that cost **John Thain**, former **Merrill Lynch & Co.** CEO, his job at **Bank of America**.

The 2008 bonus pool dropped a precipitous 47% to \$18 billion from \$36 billion in 2007, according to compensation data provider **Equilar**. The average bonus for a managing director at a global investment bank spiraled 55% to between \$900,000 and \$1.1 million, according to **Options Group**, while that of an investment banking vice president fell 55% to between \$300,000 and \$400,000. Bonuses trended especially low for

"beleaguered banks such as Merrill Lynch and **Citigroup**," according to an Options Group report.

In New York, the average individual bonus dropped by about 37% to \$112,000 in 2008 versus 2007, according to the New York State comptroller's office. The decline in the average individual bonus was smaller than that of the entire Wall Street bonus pool because the bonuses were shared among fewer jobs. More than half of Wall Street's CEOs didn't take bonuses in 2008.

"People have been working entirely for their bonuses," says **Alexander Cwirko-Godycki**, research manager at Equilar. "Salaries have been an afterthought, and bonuses have been tied to the volume of business, not necessarily to the quality of those business decisions." Decisions, he adds, that have become huge liabilities for a company. "Pay programs have created perverse incentives where people have been taking on excessive risks in the short term not caring what the longer term ramifications might be."



As a result, there is a shift developing in the way compensation packages are structured, one that will rely less heavily on the almighty bonus. One of the changes being discussed is deferred bonus payout, whereby a bonus may be deferred for three to five years. Cwirko-Godycki points out that such changes would be difficult to implement, however, as they require more management of the bonus program than currently exists. Bonuses would have to be placed in an escrow account, and compensation could be adjusted based on an employees performance over the period.

The U.S. Treasury's TARP program extended hundreds of billions of dollars to Wall Street banks and insurance companies, loans that **JPMorgan's Jamie Dimon** says he can pay back tomorrow and **Goldman, Sachs & Co.'s CEO Lloyd Blankfein** is feverishly

trying to repay. The loans have opened the door to more scrutiny of executive compensation, and now all of Wall Street pay has become every U.S. taxpayer's business. It's all unfolding during an era that produced the demise of **Bear, Stearns & Co.** and that firm's subsequent fire sale to JPMorgan, and the infamous bankruptcy of **Lehman Brothers**. Adding insult to injury on Wall Street is the fact that now the government has a hand in running the banks, including compensation. This has made the allure of the profitable boutique advisory firm that much more attractive, and has magnified credit losses at the bigger banks.

"In the past, a CEO had his hands on the wheel through a rocky sea. The reality today from a compensation and business perspective is that now those decisions are being made in Washington D.C.," says **Alan Johnson**, managing director at Johnson Associates.

Johnson's firm has been around since the early '90s, and has survived the demise of **Long Term Capital Management**, the savings and loan crisis, and the market crash of 1987, not to mention the Sept. 11, 2001, terrorist attacks and the bursting of the technology bubble. But Johnson admits to being in uncharted territory. "In the last three or four months, business has just kind of stopped. There has been no M&A, no new refinancings. Even the business that was completed in the past three to four months was booked months before that. Business is frozen," he says.

Declining I-bank profits

An investment bankers' compensation, of course, is heavily dependent on the firm's profitability, and revenue at Goldman Sachs and **Morgan Stanley** has taken a shellacking in recent quarters. On April 22, Morgan Stanley posted a 62% decline in first-quarter revenue, to \$3 billion, versus the year-ago period. Goldman's first quarter-investment banking revenues declined 30% to \$823 million compared with the year-ago period and dropped 20% versus last year's fourth quarter.

Gerson compares the current economy to that of the 1970s, a decade when inflation was high and the unemployment rate averaged 7.9% between 1974 and 1979, according to the Department of Labor. The perception at the time was that there was not a lot of money to be made in investment banking, and subsequently much of Wall Street's best and brightest went into consulting or commercial banking.

From 1982 through 2007, however, investment banking compensation enjoyed an upward trajectory (with the exception of certain bad years, including 1987, 1994, 2001-2002, and 2004). "If you were to plot Wall Street compensation since 1982, it has been a consistent progression upwards," Gerson says. This has been fueled by the profitability of institutions and demand for people, he adds. "New and esoteric products have been major revenue drivers," Gerson says. Fewer new products combined with less deal activity has hurt profitability, and the demand for professionals at large investment banks has effectively disappeared. "Their model is not dependent on high impact professionals," Gerson says. Additionally, there is increased "populist and regulatory" pressure on

compensation, he says, which, combined, points to what he says is a significant downward trend that will continue for a very significant period of time.

"We're going back to the seventies, where the opportunity to create wealth and make significant compensation did not exist at large institutions," Gerson says. The key beneficiaries of this transformational shift have been the boutique firms, and according to Gerson, will continue to be. Impact high-quality bankers are opting go to boutiques, retire or do something outside the industry rather than taking significant pay cuts, he says.

"There will be a huge brain drain from the large institutions, firms won't be able to retain their top professionals," he says.

Boutique firms, such as **Moelis & Co.** and **Centerview Partners**, don't have the cost infrastructure and are not subject to populist and regulatory pressure that the large institutions have ([see related story](#)). Indeed, according to Gerson, impact professionals going to boutiques will have the opportunity to make as much money as they did in the past or more. Centerview Partners, for instance, generated \$50 million in revenues last year, according to sources.

Gerson is currently advising one former top-tier investment banker from a large investment bank on launching his own boutique firm. "In this case, the person left earlier this year before compensation declined. We are working towards a fall launch," Gerson says. "Moelis & Co. did \$100 million in their first full year. It would not be inconceivable that given the right people and the right deals that one could do [between] \$50 million and \$75 million in the first year."

Gerson insists that the large institutions have very little leverage these days because they have lost so much credibility, and that it is the top-performing investment bankers who hold the cards. In some cases, however, bankers are using that leverage with the large institutions.

Richard Lipstein, managing director with **Boyden Global Executive Search**, recently spoke with the head of a corporate finance group at a large firm who is hiring an investment banker. The banker will be paid a little more than \$1 million, plus a one-year guarantee. "Good bankers are still getting guarantees. They're not getting two-year deals anymore but are still capable of getting a one-year contract," Lipstein says.

Despite smaller bonuses and shorter promises, the next generation of investment bankers does not seem deterred. **Jennifer Blouin**, assistant professor of accounting at Wharton, says any decline in the number of students heading to Wall Street is because of fewer jobs, not smaller pay. "It is because there are fewer opportunities. The students who are going to Wall Street are still going off to be investment bankers and analysts," she says.

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