Political Storm Threatens Wall Street Bonus Spoils

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NEW YORK -(Dow Jones)- Wall Street's biggest rite each year has been the bonus season, when everyone from the chief executive to the junior analyst got handed a big splashy check.

That all could be about to change. A report that financial companies in New York City doled out $18.4 billion in bonuses last year has triggered a backlash among taxpayers and politicians.

Bonuses might become another casualty from the worst financial crisis to sweep Wall Street since the Great Depression. They have triggered the ire of President Barack Obama, who called out Wall Street for excesses in light of the banking industry's multibillion-dollar taxpayer bailout.

"The bonus model is broken," said Campbell Harvey, professor of finance at Duke University's Fuqua School of Business.

Bonuses helped further the financial crisis by promoting short-term gain and long-term instability, critics say. Companies are making efforts to come up with solutions. Companies including Morgan Stanley (MS) and UBS AG (UBS) have implemented "clawback" provisions that would take back part of the payment if the employee causes financial losses or other harm to the firm. Credit Suisse Group (CS) is creatively paying bankers bonuses in illiquid assets. The Wall Street Journal reported Friday UBS is deferring bonus payments for 2008.

But for all the change, being rewarded for the spoils of the financial industry is part of the culture. Bonuses aren't considered an extra perk at the end of a year but something counted on to deliver the bulk of a person's compensation.

Brokers don't get bonuses in the same way as other financial-services employees, but events such as the massive mergers in the past year can trigger extra payments to them. These bonuses haven't gotten swept up in the political furor over Wall Street compensation yet, but Congress and the administration will be looking at bonuses in the financial sector over the next few weeks. Signing and retention bonuses for brokers could be included in that conversation, a person familiar with the matter said.

Bonuses paid by the securities industry in New York have climbed steadily for more than 20 years, rising from $1.9 billion in 1985 to $34.1 billion in 2006, according to the New York state Comptroller's office. Even with massive losses on Wall Street last year, the bonus pool was still the sixth-largest payout on record, the comptroller said earlier this week.

Historically, Wall Street has paid executives a very low percentage of their compensation in salary. The expectations were that a bonus, for top performers, could be 10 or 20 times their salary.

Employees such as investment bankers receive a significant portion of their total annual compensation in cash and stock bonuses, rather than in base salary. The higher the base salary, the bigger the bonus is in terms of total compensation.

Alan Johnson, managing director of Johnson Associates Inc., a financial- services-industry pay consultant in New York, estimated that for investment bankers who make between $200,000 and $250,000, bonuses account for 30% to 50% of their total payout. For those earning $1 million and higher, bonuses account for 75% of their total payouts.

Employees lower on the totem pole also get bonus money. From top executives to the lower-rank employees, bonuses are expected, said Kenneth A. Raskin, partner at White & Case who heads the global executive

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Consultants said it is hard to determine what proportion of bonus pools go to lower-ranking employees, though it is much smaller than the sums going to the bigshots.

Gordon Kaiser, a partner with expertise in corporate governance at global law firm Squire Sanders & Dempsey LLP, said, "If you cut out bonuses entirely, you cut into [Wall Street employees] the way your salary or mine would be cut into if our base salary is reduced."

Wealth Management

Brokers, or financial advisers, typically don't receive a year-end bonus. Intead, the are paid a portion of the fees and commissions they generate for managing client assets - around 40%. They can receive additional compensation for meeting certain goals, such as having a certain percentage of their clients in annuitized accounts.

They also can also earn much more by getting large signing bonuses for switching firms. Deals vary, but top producers who move between Wall Street firms can garner upfront payments as much as 200% of the revenue they generated for their prior firm over the past 12 months.

The bulk of these bonuses are paid in cash, with a smaller portion in company stock that vests over a period of years. Brokers must remain with their new firms a certain number of years - nine years is common - or pay back a pro-rated portion of the cash they received.

These transition packages are meant to attract talented brokers and compensate them for clients and assets they lose in the move. They are also meant to keep brokers at the firm long enough to earn back the costs of hiring them.

Firms are fixated on client asset levels because they charge fees and commissions for managing money and executing trades. The wealth-management business provides a relatively steady revenue stream, though financial-market turbulence has hurt the business recently.

Brokers can also be given a bonus for remaining at a firm that is combining with another. Over the past year, the drastic consolidation of the industry has resulted in brokers at most major firms receiving some sort of "retention bonus, " including Bear Stearns, Merrill Lynch, Bank of America Corp. (BAC), Wachovia Corp., Morgan Stanley (MS) and Citigroup Inc.'s (C) Smith Barney brokerage unit.

These bonuses differ from most executive and banking bonuses because they are contractual and obligate the brokers to stay with the new firm for a certain number of years in order to keep the cash. Merrill Lynch's contract required a seven-year commitment. Wachovia, Morgan Stanley and Smith Barney brokers haven't received their retention offers yet.

Retention bonuses usually range from 25% to 100% of the fees and commissions the broker produced over the prior 12 months. The higher the production, the higher the percentage.

So far, broker bonuses haven't been under scrutiny like those given top executives. For example, the Merrill Lynch retention packages were not a part of the accelerated bonuses the firm gave out before being acquired by Bank of America.

(Kristen McNamara contributed to this story.)

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