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Greed comes back to Wall Street

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Big risk-takers are once gain hot commodities

Janet Whitman in New York, Financial Post

Reuters

While the aftermath of the financial crisis continues to rip through Main Street, Wall Street is getting back to business as usual.

Goldman Sachs Group Inc., which only eight months ago accepted billions of dollars in bailout money from U.S. taxpayers, is gearing to pay out the biggest bonuses in its 140-year history, putting pressure on rivals to follow suit. And in one outrageous example, Andrew Hall, a star energy trader at Citigroup Inc., is entitled to a US$100-million bonus this year for reaping many more hundreds of millions of dollars for the beleaguered bank. The payout would come as Citi has yet to pay back its US$45-billion in federal bailout money.

Big risk-takers - a class of banker shunned by the industry only six months ago - are once gain hot commodities. And the fast return to greed, as though the worst financial crisis since the Great Depression never even happened, could be setting Wall Street up for another fall.

Lawmakers in Washington, D.C., Friday approved a bill to rein in the excessive compensation that led to the risk-taking blamed for bringing the global financial system to its knees.

But the proposed bill's future before the U.S. Senate and Barack Obama, the U.S. President, is less certain. Support is waning for regulations that would curb compensation as lawmakers begin to concede the futility of pay caps. If forced to accept less pay, traders and bankers can simply find a higher-paying job in a less regulated part of the financial industry.

More important, there's a growing recognition on Capitol Hill that the real threat is that investment banks remain free to resume their old ways without any new restrictions on the risks they can take.

"Lawmakers have really just begun to discuss this issue in the United States and it's going to be as tough to get passed as health-care reform," said Roy Smith, a professor of finance at New York University and a former partner at Goldman Sachs. "In the meantime, once a bank [pays its bailout money back to the government] it can go back to the way it was before. There are no new restraints on risk that are applied to these guys that are too big to fail. They could fail again. Someone might."

Multi-million-dollar bonuses are simply "the tail behind the dog," Mr. Smith added. "With US$150-trillion in securities trading around the world, there's a lot of money sloshing around. If we think we can restrict all this by restricting what people get paid in New York, we're really whistling in the dark."

Many bank industry observers say U.S. lawmakers should focus on the "too big to fail" problem at the heart of the current crisis. New regulations could encourage financial behemoths to downsize so they're small enough that their failure wouldn't throw the markets into chaos as the collapse of Lehman Brothers Holdings Inc. and near-demise of insurance giant American International Group Inc. did last fall.

Another alternative would be to force big banks, whose failure could damage the financial system or the economy, to pay "insurance premiums" to the government for the implicit guarantee that they won't be allowed to fail.

Sweeping financial sector reforms were initially slated to come as soon as the spring. Now it appears, however, that the proposals won't wind up on President Obama's desk before the end of the year, at best.

"We don't expect to see any major financial reforms until next year because of all the other projects U.S. Congress is working on, particularly health care and cap and trade," said Gerard Cassidy, a bank industry analyst with RBC Capital Markets. "The urgency of it will get dampened. But we truly believe that new regulations will be coming to help prevent another global meltdown of the financial system. Even financial players are committed to reform so that they're not put in the precarious position they were in."

Some other analysts worry, however, that as memories of the financial crisis grow dim, support for a meaningful overhaul of financial regulations could wane.

Industry observers don't expect investment banks to repeat the mistakes that led to the current crisis, such as the creation of the complex, hard-to-value and now nearly worthless home loans they bundled together and sold off to investors.

But once the current market volatility subsides and profits aren't so easy to rake in, big banks may come up with new risky bets to maximize returns.

"The government will always be behind the curve in even understanding that risk, much less trying to contain it," said Bert Ely, a bank industry consultant.

In the meantime, big bonus payouts to Wall Street bankers and traders are likely to remain a hot-button issue.

Andrew Cuomo, New York State's attorney general, fanned the flames earlier this week by releasing a report that showed nine big banks paid out US$32.7-billion in bonuses last year, despite posting huge losses and receiving billions of dollars in bailout money from U.S. taxpayers. As the financial system teetered, nearly 5,000 bankers and traders were awarded bonuses of US$1-million.

Those opposed to a crackdown on bonuses argue that banks are merely following a formula, where close to half of revenue goes toward compensation and banking stars typically make at least 90% of their money in bonuses.

"A lot of banks down in the United States are starting to change their numbers so there's more base pay, which might mitigate the stigma attached to big bonuses," said Bill Vlaad, a corporate recruiter based in Toronto who specializes in capital markets.

But Mr. Vlaad doesn't expect to see big changes in how bankers are paid.

"This is not an industry based on charity," he said. "In order to retain good talent, you have to keep up with the Jones.

Fierce competition in the United States forces big banks to pay their top performers large bonuses. "If they don't, someone else will," said Alan Johnson, a compensation consultant with Johnson Associates in New York City. "The other financial firm may be located two blocks away and the job may literally be the same with the same sized desk. I had a client who switched jobs and literally ended up calling the same 30 people the next day as he did before."

The easy transition leaves little chance of disrupting the trader's bonus-making potential.

The Obama administration, which originally proposed pay caps of US$500,000 for executives at bailed out banks, has softened its stance dramatically.

President Obama appointed Kenneth Feinberg as a "pay czar" to oversee compensation for the top earners at banks that received exceptional amounts of government aid.

The first big test for the czar could be how he weighs in on Mr. Hall, the energy trader at Citigroup. "That's an easy one to pick out and make it sound like the norm," said Dennis Nason, a former banker, who now runs Nason & Nason, an executive search firm specializing in banking and finance.

"If a contract's going to be violated because somebody made too much money, why sign a contract?" Mr. Nason said. "There are a lot of moral issues here, but do we want the banks that were helped making money or would you rather have them languishing?"