

BANKERS' PAY: A PROBLEM OR AN ARTIFACT?

A bit of banking history puts perspective on evolving pay issues

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When I started out at The Bank of New York many years ago as a brand-new college graduate, I honestly didn't think much about the long-term career aspects of being a banker.

There was no sifting of priorities, evaluation of positives and negatives, or any real database I'd acquired about what I wanted to do. I'd faced two years in the Army and was about to get married and those were priorities enough. I needed a job, my degree was in finance, and The Bank of New York offered me a decent wage and had a certain formality about developing young college graduates into banking professionals. I trusted my gut and signed on.

It was one of the best single decisions I ever made. I had found my life's work, a congenial and prestigious place to work, and had a solid background that was as good as anyone could receive at the time.

Before the day of "banker's pay"

From the inside looking out, I found a working structure that was not unlike a public utility. Banking has always been a regulated business and this normally puts some sort of lid on risks and likewise on rewards, such as compensation.

After all, the business exists for some public good and there are constraints on what we can be paid in terms of a reasonable risk-reward relationship by stockholders of the business. In those days-and really until the late 1970s, the Federal Reserve more or less determined our net interest margin as an industry by the way it set rates on deposit instruments. Regulation Q was alive and well and, in fact, vestiges of it remain today in the prohibition on paying interest on demand deposits on business. There was a day when the Fed proscribed those things.

If we were limited on what we could pay for our principal source of funding, then there was a natural limit on what we could charge on loans. Those rates were not regulated but the Fed had its ways of nudging overall market rates up or down in response to monetary policy needs, so the marketplace was subject to the Fed's direction.

Banks were regarded as relatively risk-averse businesses, so "home runs," in the earnings sense, were not expected.

What I came to understand, in those days, was that there were not many legitimate opportunities to make a "ton" of money. The industry attracted competent but not entrepreneurial talent both on Wall Street and Main Street. We were paid well enough, but bankers were not considered to be superstars in the earned income sense.

How "bankers" became "superstars"

When Regulation Q was finally largely repealed, the paradigm shifted.

If bankers could pay a market rate for sources of funding, then raising that funding and putting it to work at a decent spread had increased urgency to it.

Competent managers with more hustle and dealmaking sense were necessary for banks to grow and compete with one another. When this transition began, banking was not on the forefront of highly paying jobs. To attract the best talent into the business, salary structures began to improve. Regional banks had to compete with money-center banks for a more or less finite pool of talent out of the better universities.

This transition took time, but it was largely accomplished over the ten-year period of the 1980s. By 1990, banking attracted top talent from a variety of sources and at competitive salaries.

Changes in attitude and environment

Wall Street investment banks were where the top-paying jobs were, both then and now. But we should keep our perspective about this. An investment bank is not a commercial bank. The business models are very different and they still are today, even though the term "bank" is applied to both.

We are now in a "pay for performance" environment throughout most of the banking industry. Talent has its price and the market does not operate in a vacuum.

We know what happened over the last 20 years or so. We grew as the economy grew and our numbers inflated as inflation gradually ballooned our balance sheets. Too many good years dulled our memories of difficult years and the institutional memories of senior officers were retired and replaced by those who did not have a conservative frame of reference formed in less ebullient times.

Attitudes toward compensation have changed, as have the expectations of the work force. Stock options, incentive pay, bonuses, and the whole mindset of individual career development have undergone great change. Banking has come of age as an attractive career opportunity for large numbers of professionally trained managers and functional specialists.

Rethinking compensation

What we have to do now-and quickly-is to realign our business models with the new realities. We're going to get a lot of help too, surely more than we probably want, from Congress and the federal bureaucracy.

The good news for each of us is that our industry has not lost its relevance to modern economic life. We're as needed now as we were 50 or 100 years ago-but in different ways with different skill sets. Expectations need to be different too. We have to clear out the underbrush accumulated in recent years and mend many fences with many constituencies.

Better to get after the fence mending with some alacrity and enthusiasm, than have someone else's vision of our future crammed down our throats.

- About Ed O'Leary:

Veteran lender and workout expert O'Leary spent more than 40 years in bank commercial credit and related functions, working with both major banks as well as community banking institutions. He earned his workout spurs in the dark days of the 1980s and early 1990s in both oil patch and commercial real estate lending.

O'Leary began his banking career at The Bank of New York in 1964, and worked at banks in Florida, Texas, Oklahoma, and New Mexico. He served as a faculty member and thesis advisor at ABA's Stonier Graduate School of Banking for more than two decades, and served as long as a faculty member for ABA's undergraduate and graduate commercial lending schools.

Today he works as a consultant and expert witness, and serves as instructor for ABA e-learning courses and a frequent speaker in ABA's Bank Director Telephone Briefing series. You can hear interviews with Ed about workouts here. You can e-mail him at etoleary@att.net. O'Leary's website can be found at www.etoleary.com.

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