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Salary Increases: Separating Fact from Speculation

By Patrick Connell and Brian Dunn
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OVERVIEW

There is a lot of noise in the market and in the press that seems to *suggest* that many banks and financial services firms of all types are increasing salaries broadly – a sentiment that is reinforced by those lobbying for such action. The topic is emotionally charged and like most market events, the perception may often create its own reality.

So far, the reality is that salary increases have been largely limited to a handful of global banks that have experienced below industry performance and have applied only to the executive level and/or investment banking/capital markets divisions (mostly revenue generating areas). The increases have been characterized as market adjustments and philosophical changes in the desired mix-of-pay, with a 1:1 trade-off of incentive for salary, rather than an increase in compensation. The reality is that most global and large national banks have devised/considered salary adjustments in the event that the market tips in that direction.

We continue to advise that a one-size-fits-all approach to adjusting salaries (or *not*) does not exist. Firms would be wise to pause and consider internal needs and actual actions taken by competitors and avoid relaying the sentiment that Banks have implemented broad salary adjustments—they haven't—at least not yet.

In the McLagan Alert, *Considering Salary Increases* (May 4, 2009), we suggested that the debate on whether or not to increase salaries was being driven by:

- Proposed legislation that may limit (or eliminate) the ability to pay bonuses
- Total compensation philosophy and belief that the delineation between salaries and incentives is somewhat arbitrary.
- Opportunity to trade at-risk incentives for salary while saving money in the process
- Need to offer some sort of assurance as to what people will get paid, particularly for firms in crisis

INFLATION

Officer salaries have been largely static in the Banking / Capital Markets space for several years and it can be legitimately argued that a one time adjustment (e.g., to 1999 purchasing-power parity levels) is appropriate in order to retain employees in high-cost banking centers in light of significantly reduced incentive opportunities.

EXCHANGE-RATE (at-risk incentives for secure salary)

We continue to maintain that where firms are shifting the mix of pay from at-risk incentives to secure salary the conversion rate should be more than $1 of incentive opportunity for each $1 of salary. The current conversion rates of 1:1 for those firms having actually implemented salary adjustments may reflect a practical approach to providing a minimum level of pay in order to retain staff and the realization that the incentive opportunity may be more permanently de-levered.

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FLEXIBILITY

Flexibility is important and there are real dangers to increasing fixed costs. Additionally, memories tend to be short, and with a hopeful return to prosperous times, expectations of historic bonus levels will creep back. Firms would need to be extremely diligent to maintain a new pay mix paradigm.

The following illustrates the structure of salary adjustments for the limited number of firms actually implementing such changes.

STRUCTURE OF SALARY ADJUSTMENTS (for those actually implementing)

	Executives	Banking / Capital Markets
Philosophy	Shift in mix-of-pay Temporary extraordinary increase until regulations are clarified	▪ Shift in mix-of-pay ▪ Market adjustments ▪ Provide transparency in compensation/minimum secure compensation
Eligibility	Top 25 Executive Officers	▪ MD, Directors and VPs in Investment Banking, Equities, Fixed Income and other Capital Markets areas mostly in revenue roles (**excludes** corporate banking, leasing, commercial finance, retail, consumer and mortgage banking) ▪ Excludes most infrastructure staff (oddly infrastructure is where the academic case for salary increases is the greatest)
Administration	Different rates for CEO, PFO, NEOs and non-proxy officers vs. significant individual producers	▪ There may be multiple salary rates applied at each officer title level with a discount applied to infrastructure aligned roles (for the very limited number of firms that increased salaries for officers within infrastructure) ▪ Rates adjusted by region (i.e., not simply a global rate with FX adjustments)

CUSTOM APPROACH

Most banks remain hesitant to increase salaries at this time, but prudence suggests having a contingency plan in place to address targeted populations that may be affected by regulations and competitors adjusting salaries. Such a plan should consider all opportunities to provide transparency in pay and not focus solely on salaries. ■

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