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Undervalued Private Bankers

By Paul Wagner and Peter Keuls
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Private bank margins have been squeezed from all sides of late. Low federal fund rates and high deposit insurance costs have lowered spreads on banking products; defensively inclined clients, holding high levels of cash, are reluctant to become more aggressive which is driving down fees and commissions; and private banker compensation has been rising faster than the revenue they bring in.

Firms can't do much about macro trends, but they can actively manage private banker pay and performance.

McLagan has been tracking private banker productivity by collecting individual banker performance data for more than 10 years. Our analysis of historical private banker pay and productivity has shown that firms systemically overpay poor performers and underpay strong performers.

We define a banker as over or under-paid based on the market percentile ranking of their performance versus their total compensation rank. If a banker's performance rank is more than twenty percentile points greater than their compensation rank, the banker is under-paid. If their performance rank is more than twenty points lower than their compensation rank, the banker is over-paid.

Our analysis of market data from 2008 – 2011 shows that 18% of bankers were over-paid and these over-paid bankers were on average half as productive as a typical banker. Firms do also try to manage them out resulting in a turnover rate of approximately 25% per year.

As great as the cost of overpaying bankers is, under-paying bankers may be even more expensive. The number of over and under-paid bankers in any given year is quite similar and the turnover rates for under-paid bankers are also very high with 35% of under-paid bankers leaving firms within three years. This wouldn't be so bad if the under-paid bankers were also under-performing, but these under-paid bankers significantly *outperform* the overall market (see chart 1). Nearly 40% of bankers that were under-paid in 2008 left their firm by 2012, and the median total revenue of those who left is 174% of the market median. Firms are losing this talent by failing to pay them appropriately for their productivity.

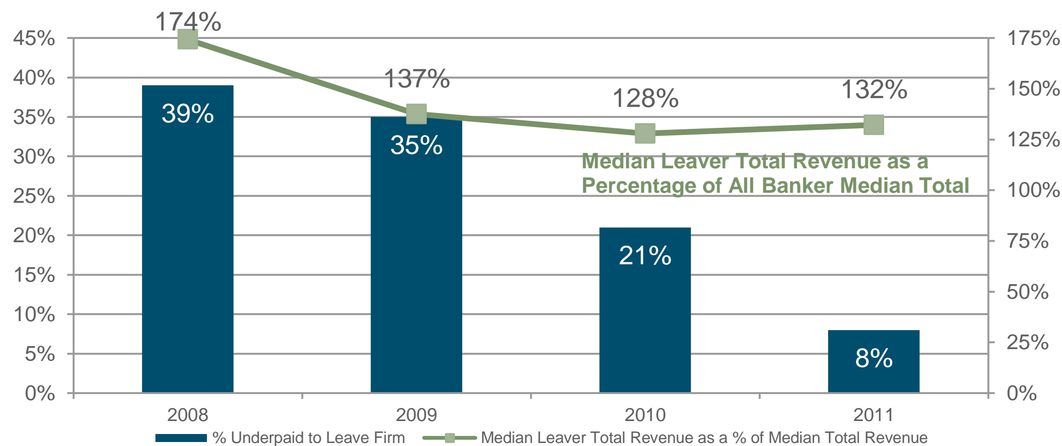
Fortunately, we can mitigate the risk of losing under-paid talent (and their market-beating revenue) by effectively aligning their compensation with external pay and performance benchmarks.

External performance benchmarking can help to identify strong and weak performers, but more importantly understanding the market pay and performance relationship is critical to motivating and retaining top performers. Firms that use Pay and Productivity Benchmarking tools hold a powerful advantage over competitors that do not. Smart firms use these tools to identify over-paid bankers and either reduce their pay or manage them out and more importantly, identify and retain strong performing under-

paid bankers by increasing their compensation before they take their revenue to a competitor.

Chart1: Undervalued RMs That Are No Longer with Firm in 2012**

2008 - 2011



** 39% of RMs that were undervalued in 2008 were no longer with the firm in 2012. 35% of RMs that were undervalued in 2009 were no longer with the firm in 2012, etc.

ABOUT THE AUTHORS

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