Do Bankers Deserve Bonuses?

Wall Street is making a comeback, but so too are some of its excesses, according to critics.

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Just one month after returning the federal government's bailout money, Goldman Sachs and JPMorgan Chase posted record second-quarter profits this week, earning $3.4 billion and $2.7 billion, respectively. And, with the rising profits came the expectation that bankers' salaries and bonuses would return to their pre-recession highs. For example, Goldman Sachs, which took $10 billion in TARP funds, has already set aside $11.3 billion to hand out to its employees in bonuses for the work they've done in the last six months.

Many bankers and those with ties to the financial industry argue that the bankers' large bonuses are fair, since it remains a risky, demanding business. And since the government is no longer financially invested in these particular banks through TARP, some argue that Congress and the Obama administration should stay out of their compensation deals. (Goldman Sachs and JPMorgan Chase accepted $10 billion and $25 billion in late 2008 as part of the federal government's $700 billion bailout of the financial industry.)

But not all is well in the world of banking, and to many people, cashing in with big bonuses seems premature. While it beat Wall Street's expectations, Bank of America on Friday said its profits still slipped 5.5 percent. CIT Group Inc., a bank that lends heavily to small businesses, may be facing bankruptcy despite the $2.3 billion it took in bailout money. NEWSWEEK'S Nancy Cook talked to Viral Acharya, a finance professor at the New York University Stern School of Business, about whether executives, whose companies were so recently on the public dole, deserve bonuses. Excerpts:

Why are some banks like JPMorgan Chase and Goldman Sachs posting record earnings? Just months ago, they were taking bailout money.

A large number of banks borrowed government debt in October or November of last year. It basically allowed the banks to borrow at a low fee, so effectively the banks became riskless. Once they got the large capital injections, suddenly the issue of them failing in the short term was gone. The bank earnings now seem a lot rosier. I'm happy for the banks, but I'm cautious in saying that this does not necessarily mean that banks are back to being profitable.
Why wouldn't they be profitable?
I wonder if the profits are coming from sustainable sources of business. We are not sure that the banks are not taking excessive risk. If it's the case that the banks are still borrowing money with government guarantees, it's not clear that the banks will be profitable once those guarantees are removed.

Do the bankers at Goldman Sachs and JPMorgan Chase deserve bonuses now? On the one hand, the banks are now making money. On the other hand, they helped get us into this economic mess.
My issue has never been the level of pay in banking. I know there's anger from the common man about how much money these guys are making, but the real anger should be at how they're making it. They have lots of trading strategies that can look like profitable businesses. If they are paying themselves out huge cash bonuses without seeing if the trade paid out, then they're collecting bonuses too early ... Lots of banks have returned TARP capital, but a lot of them have issued debt with government guarantee. If they continue to enjoy that guarantee, at some level, they have taken something from the government. There's not a lot of mention of that.

Should the government be in the business of regulating compensation?
What needs to happen in the banking sector is a cultural shift. No one firm can deviate on its own. Let's say tomorrow, Deutsche Bank said that it was not going to give out compensation in this way. It would lose people to other banks. Some people might set up their own hedge funds. It's a very, very complex problem. Unless the entire culture changes of how these cash bonuses are paid out in a global economy, it's hard to get any individual bank to do it, and you don't want Congress dictating pay. The issue will only get politicized.

What does the future hold for the banks that did well this week?
My sense is that there was a little bit of amplification. The stress tests had the effect of dampening the depression-type worries about the economy. Now people are talking about slow recovery, I don't think the kick in the next quarter will be that high.

By Nancy Cook