

Bankers' Bonuses

Clare Murray looks at the rules and regulations surrounding the annual banker bonus period

Banker bonuses are receiving vast column inches at this time of year, just before bonuses are declared. Reports in the press suggest that the coalition government has failed, despite its public announcements to the contrary, to influence the level of bonus payments to be awarded at the London financial services institutions for 2010, with reports of an estimated £7 billion bonus payout.

What has changed following the credit crisis is that there are now rules stipulating that a proportion of bonuses must be awarded in shares, and that this can only be paid out over a period of time. The Financial Services Authority published its Remuneration Code on 17 December 2010, which follows the Committee of European Banking Supervisors' (CEBS) published guidelines. The Remuneration Code includes provisions that senior risk-takers in financial services can be paid only 20 per cent of their bonus in cash and that for the most senior employees, 60 per cent of bonuses must be deferred over three to five years, with guaranteed bonuses restricted to a period of one year. The new rules came into force on 1 January 2011.

However, crucially, the actual bonus levels remain to be determined by the banks. In the context of bonus payments, a distinction must be made between guaranteed and discretionary bonuses. Discretionary bonus payments tend to be a reward for performance, as well as an incentive for future performance. Guaranteed bonus payments, on the other hand, can include signing on bonuses or retention bonuses and are now more regulated within the financial services sector.

For most bankers, their annual bonus will be discretionary and there is little room to challenge the level of the discretionary bonus awarded by a bank, unless an employee can assert that no reasonable employer would have exercised the discretion in that way, i.e. the decision is irrational and perverse. A bonus award can be challenged if there are discrimination issues at play; for example, a female banker receiving a lower bonus award than her male colleagues in cases where their performance is of equivalent value.

A bonus award could also be subject to challenges in circumstances where it is alleged to have been reduced in response to whistle blowing. However, in general terms, it has become fairly difficult for senior executives within the financial services industry to challenge a lower than expected bonus.

With all bonus arrangements, a frequent question is: what happens on dismissal or resignation? i.e., is the bonus forfeited or is a pro-rated bonus payable? These issues should be (but are not always) set out in the drafting of the employment contract or bonus documentation.

Due to a recent Court of Appeal decision, there is now a further element of concern in terms of bonus entitlements. The court has held that an employer can, in certain circumstances, terminate the executive's employment immediately before a bonus is to be awarded and avoid paying an annual bonus otherwise due. In that case, the contract included a pay in lieu of notice provision, entitling the employer to pay out the notice entitlement in a lump sum, and a bonus clause stating that the employee had to be employed in order to receive his bonus. The employment was terminated ten days before the employee was due to receive his bonus; he was paid out in lieu of his notice (in accordance with the contract), but was not paid his bonus.

The employer won. Whilst there is an obligation on an employer not to exercise discretion in relation to a bonus payment in an irrational or perverse way, there is nothing to stop an employer from dismissing and not paying the employee a bonus that is about to fall due, in accordance with the contract.

So whilst the press may rage against the large bonus payouts to some key figures in the industry, most bankers' bonuses are completely discretionary and at risk of being withheld, even if the employee has performed outstandingly for the entire year. Things are not always quite as clear-cut as they seem in the press and bankers' bonuses are no exception. ■

Clare Murray is Managing Partner at specialist employment and partnership law firm CM Murray LLP. She can be contacted at clare.murray@cm-murray.com or 020 7718 0090. The contents of this column are for general purposes only. Specialist legal advice should be taken regarding specific circumstances.

