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THE MONEY GRAB

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HALL: Over the last quarter of a century, the global finance world has provided unprecedented opportunities to get rich.

From London to New York, Hong Kong to Tokyo, the high rollers of high finance have seemingly been counting an ever-increasing string of zeroes on their pay cheques.

Last year, in London alone, a record 12.6 billion pounds was paid in bonuses – with thousands of individuals taking home more than a million pounds as their annual reward.

This money grab that started in the gilded age of global finance, has spread throughout corporate boardrooms around the world.

Over the next two weeks, I'm going to explore how this bonus boom was borne, and what sent salaries into the stratosphere.

And will the ongoing financial crisis put the brakes on executive pay, or will the gravy train keep on rolling?

In my quest for answers, I travelled to Canary Wharf in London's docklands - epicentre of the UK's most recent financial boom.

On the trading floor of BGC Partners - where securities, derivatives, and other wonders of the modern money world are bought and sold I met David Buik, a man with nearly 50 years experience working in the financial markets.

I asked him, is money the prime motivator for people working here?

BUIK: The challenge, the intellectual challenge, that can't be thrown out, I'd say that thirty percent of that was the intellectual challenge. The rest of it is the money, and anyone who tells you anything to the contrary speaks with forked tongue!

HALL: Do you have to love money in order to be successful?

BUIK: No, the quality for being successful is ruthlessness. Money is just an adjunct. You have to be ruthless. If you think about it Alvin, if you've been successful as a trader, for, I don't know, 10 years at the top and you've made a couple of million bucks every year, how much more do you need to have stability for the rest of your life? It's the smell of power and ruthlessness in your nostrils that drives you on.

HALL: And with ruthlessness, comes selfishness. David Charters entered the world of investment banking in the late 1980s and knows too well the demands put upon the go-getters reaching for the top.

CHARTERS: What is the city for? It's for itself. They work intensely hard and they work weekends, they interrupt their holidays, there are many marriages sacrificed on the alter of the firm. Without the financial incentive, why would people be willing to commit as much of their one, unrepeatable life to such an extraordinary lifestyle?

HALL: There's a five letter word that people always use associated with The City and the Financial Markets – greed – do you think everybody is there for greed?

CHARTERS: When people work in the city, they are very, very financially motivated, they want more, and, in a sense, it's almost as if they're addicted to it. The first time I had a million pound bonus, you could have heard the Hallelujah chorus going off in my head. I didn't say that to my boss ... when he told me the number, I was dead pan, poker faced, looked at him, nodded looked thoughtful and said 'well, it's not the number I had in mind, but let me think about it'. I just hoped he couldn't hear the music.

HALL: And what about when you had 2 million?

CHARTERS: After a while, the absolute number becomes less important than the relative number. Two million pounds may sound like a fantastic sum of money, until you hear that someone who sits two rows of desks away from you had three million pounds and suddenly you're unhappy ... how bizarre is that?

HALL: I don't find it bizarre. Living in New York and working for the best part of three decades on Wall Street, I've come to realise that money and modesty don't exactly mix. But I do find this money grab to be decidedly un-British. So when did this materialistic mindset start to creep in?

ARCHIVE: MARGARET THATCHER: “**T**here are many things to be done to set this nation onto the road to recovery and I don’t mean economic recovery alone but a new independence of spirit and a zest for achievement”.

HALL: At the end of a very sluggish decade, which ended with the winter of discontent, in 1979 Margaret Thatcher was elected as Prime Minister, promising to revitalise the fortunes of the British economy.

ARCHIVE: MARGARET THATCHER: “**B**ut with confidence in ourselves and in our future, what a nation we could be”.

HALL: With a new spirit of meritocracy, Maggie made it her mission to change the mindset of the country. In the Square Mile, the

Thatcher creed of self reliance and wealth creation became twisted into something more ... greedy. Hugo Dixon is the Editor in Chief of the financial commentary service, Breaking Views dot com.

DIXON: An idea that wealth creation was good and, indeed, even greed was good, that was an attitude which was very much pervasive from the, sort of, early 80s on and people were therefore unchained. They didn't have to worry so much about the social consequences and whether or not they were doing something that was good for society. It was get the most that you can possibly, for yourselves.

HALL: David Buik.

BUIK: I was such a fan of Margaret Thatcher, I can't tell you, because she gave people incentive. It never mattered anymore where you were educated – what school you came from – it was were you any good. And if you were good you got paid. The change in the taxation by Margaret Thatcher when the rate was dropped from 80% down to 60% and down to 40%, which was a change of emphasis, whereby you were taxed on what you spent, and not what you earned. And THAT is when the really competitive world started.

HALL: The new Conservative government was essentially playing catch-up, having kept a close eye on what had already been going on across the Atlantic during the 1970s. Deregulation on Wall Street had

ushered in an era of unfettered competition, and, as the American markets expanded and investment companies grew richer, London was losing ground as a global finance capital. Hugo Dixon of Breaking Views dot com.

DIXON: I think that people in the city were always very keen on making money, but the opportunities for making money were not so great. Thatcher coming into power in 1979, that was the beginning of the mass revival of the city and there was a lot of financial deregulation. And so clearly, the more you deregulate it - these markets - the easier it was to operate in them, and the bigger they grew, and those who were sitting in the middle, like spiders in the middle of the web, then they had bigger webs, and more flies flying into their webs, and more to gobble up for themselves.

HALL: The water shed moment for The City came on October 27th, 1986 and Big Bang.

News Archive: FX: Cheers “Nine o’clock this morning and there were cheers in the stock exchange at the start of what’s been called the biggest financial revolution in 100 years”

HALL: Big Bang meant London’s Stock Exchange was no longer the cosy closed shop it once was, and it was flung open, allowing foreign firms to conduct business there. London was now part of the emerging electronic network linking the world’s stock markets. Despite some early technical hitches, and the sudden jolt of the stock market break a year later in 1987, the

big American finance houses like Solomon Brothers, Goldman Sachs and Warburg were swift in moving into London.

Alongside the big name banks of the British high street, they embarked on a whirlwind period of mergers and acquisitions, as stock broking firms were swallowed up by the banks looking to make money on the newly emancipated markets.

And with more capital flooding into the city, and more stocks and shares being traded, those who worked there were also cashing in on these rising fortunes.

David Buik, of BGC Partners:

BUIK: The acquisitions that went on at the time were very, very fierce and we'd never seen anything like it. Barclays bought David Bevan Simpson and Webb De Lacquer, Warburg was bought by Swiss Bank Corporation, which also bought Mullins and Co, which also bought another stock broker, called Rowe & Pitman, and Midland Bank bought W Greenwell & Co, and so it went on, and UBS Phillips and Drew, and all these had numbers the likes of which we had never seen before. And therefore the bar was set at a much higher level than we had ever seen, and the whole idea of compensation changed.

HALL: Compensation ... now there's a word. In the world of big business, you don't earn a salary, or a wage ... it's a 'compensation package'. A combination of basic salary, commissions, bonuses, shares, and at the extreme end, private jets. And with all this trading activity going on in the City of London, compensation really started to take off.

BUIK: Those people who were involved in trading or in mergers and acquisitions earned a decent basic, but nothing vulgar, but from that they were paid proportionate to the amount of profit that they actually delivered. And the limit was the sky.

HALL: Are we talking about half a million, six hundred thousand, seven hundred and fifty thousand ...

BUIK: Well some of the better people would have been paid two or three million. Now that sounds, by modern day standards, pretty average stuff, but believe me, in those days, it was extremely grown up.

HALL: What did you think when you saw that happening?

BUIK: I loved it.

HALL: Why did you love it?

BUIK: Because I loved to see success.

HALL: And success was the story from the early 90s onwards as the UK embarked on one of the longest periods of economic growth in history, which in turn supercharged the financial services industry. Hugo Dixon of Breaking Views dot com.

DIXON: During that economic upswing one of the things that's happened is that finance has become a much bigger portion of the economic activity than it used to be. It's not just about ships and steel and coal, it's all this buying and selling of companies, and trading of assets and trading of shares, and it became a much, much bigger component of economic activity.

Now, in the old days, the financiers they wanted to take their slice of everything that was going on in the financial world, but nowadays, there's so much more going on so the same slice translates into much more money for themselves personally.

HALL: This story of wealth creation is one without borders. A combination of de-regulation and technology transformed the financial markets into the first truly global industry, with New York and London leading the way.

And for those working in the investment banks or as traders ... location didn't matter, as long as the price was right. Companies embarked on a cross-continental tussle for the top talent. Jamie Scott Katz has worked in executive recruitment in New York since the early 90's – he witnessed first hand just how competitive the job market became.

KATZ: I have seen tremendous increases that I thought would have been impossible and unspeakable and I think the reason for this is that

there was such intense competition for these firms to find specific types of talent – that they would have no choice but to give in - everybody's compensation did increase, with the increased trading volume, and the demand for more hands on deck.

HALL: What type of percentages are we talking about?

KATZ: I did see people increase 40 to 50% - bonuses – 5 million dollars. Pretty good.

HALL: When somebody would get that type of increases did you think, God, this company has too much money?

KATZ: I didn't think that it was because the company had too much money, I think it was because the company's business was doing so well, and because this person was in a key support area, it would have cost them more money to be without that position filled for a duration of time ... even losing that head count for one week, could have cost them more than potentially half a year's salary that they were paying the person anyway.

HALL: When you saw these huge salaries being paid on Wall Street, did you ever think to yourself this is insane?

KATZ: Every day ... every day ... during this era, during this gilded age, we really did see a culture of money ... everybody was getting it, everybody was getting it fast, and everybody wanted more.

HALL: Former investment banker, and author of "Trust Me, I'm a Banker", David Charters:

CHARTERS: Suddenly it became the case that the best way to make money might well be to job hop every two or three years, going from one guaranteed package to another.

HALL: What do you mean by guaranteed?

CHARTERS: This is where you would be guaranteed a certain amount of bonus on top of your salary, there may well be a sign-on on day one when you arrive. If you've got shares in your own original firm that you were leaving, that you would lose on leaving, you may be bought out of those - compensated for losing them and then at the end of the first year, you get a guaranteed amount of money as a bonus, and then maybe at the end of your second year as well, and in extreme cases, you might get three years of guaranteed bonus.

HALL: No matter how you performed?

CHARTERS: That's right, it's a contractual commitment.

HALL: Were the markets so buoyant, then, that they didn't have to worry about performance?

CHARTERS: They were extraordinary markets. Whether you can justify paying that kind of money, is another question.

HALL: What's the biggest bonus you've ever known someone to receive?

CHARTERS: There are certainly people who get into the low tens of millions of pounds at the big firms. In the hedge fund industry, where people are paid a percentage of performance fees, they can be much, much bigger than that.

HALL: But is one person really worth that? Every time I ask that question it's always met by laughter or silence. It's always the same.

CHARTERS: It's a great question. How can any one person really be worth that? Of course they can't be.

HALL: Whether the whizz kids working for the big financial firms really earn every penny they're paid ... it's extremely hard to tell, because there's no way of finding out what every trader or broker earns, or how much money they bring to their company. That's private information. But that's not

the case for the senior management, such as the Chief Executive and Chief Financial Officer.

In the early 1990s, both the UK and the US governments brought in new rules regarding the disclosure of executive compensation in public companies – basically, the bosses' pay details were published. This has proven highly valuable for shareholders, who can compare their Dividends to the rewards earned by the management. However ... there were unforeseen side effects of this new law. Brok Romanek is Editor of Compensation Standards – an advisory service on executive pay.

ROMANEK: What happened after companies started to disclose the pay levels for their CEOs, a lot of CEOs got pay envy. They saw what the CEOs at peer companies were making and so everyone wanted to get paid in the top quartile and if everyone gets paid in the top quartile over the course of a number of years, in this case 15 or 20, that's one of the major causes of escalating pay.

HALL: But did anybody mind having their salaries revealed?

ROMANEK: Sure, I think one of the most sensitive disclosures that companies have to make is regarding the pay levels of their officers. The way that it works in the United States is that the top five paid executive officers have to have their pay levels revealed, executives always hate to be that fifth

person, they wish they were the sixth so that their pay levels weren't disclosed, and so it's definitely something that senior managers really hate.

HALL: And they still get what they want. It's estimated that in 2008, the average annual compensation package for a CEO working in one of America's Top 500 companies was worth around ten and a half million dollars. At the top of the pyramid, CEOs like Lloyd Blankfein of Goldman Sachs is taking home closer to \$70 million a year in total compensation. Simon Garrett is Director of Compensation Practice at the Hay Group and advises companies on what to pay their execs. I asked him what influence do the huge pay hikes in America have on executive pay in the UK?

GARRETT: There are obviously those companies that look to the Americas as being part of their market place, part of their talent pool, if you like. Those companies I think have had to follow the American trends. That inevitably has consequences for other companies, listed companies in the UK market, so there is a sort of trickle down approach here which has happened.

HALL: Some people have said this is down to supply and demand – there are so few executives out there who are capable of running these companies.

GARRETT: It is the case that it is a pretty rare talent to be able to run a very large organisation. You get it wrong, you lose tens of thousands of jobs, you lose tens of billions of pounds worth of investors' money. You get it

right, the opposite applies. So, there are not many people who can do that role at that sort of level.

HALL: So you're saying Simon, that the people are really worth these salaries, or at least some of them are.

GARRETT: I think some of them are. Inevitably that doesn't always happen, and there are some failings. But, of course, when you take a Chief Executive on, you usually set up the contract and arrangements then in full expectation of success. And those sorts of arrangements then can sometimes come back to bite you at the end of the process. But I think it's also important to recognise that those who are successful will deserve to be rewarded for their success.

HALL: Can you think of an example where the high amount of money being paid is de-motivating?

GARRETT: If you pay some people too much, you perhaps give them the opportunity to retire from the business, rather than continue to work for you, and that may be exactly the opposite of what you intended.

I think, in many instances, though, there is a degree to which being the highest paid executive in the FTSE or wherever else it might be, is about claiming a badge of honour.

HALL: And you don't necessarily have to be the best to take the title. To explain, let's head to the Prairies of Minnesota and the fictional town of Lake Wobegon.

ARCHIVE: PRARIE HOME COMPANION: “It’s been a quiet week in Lake Wobegon, Minnesota - my hometown out on the edge of the prairie ...

HALL: Fans of Garrison Keiler's radio show, the Prairie Home Companion will know that it's a town ...

ARCHIVE: PRARIE HOME COMPANION: ... where all the women are strong, all the men are good looking and all the children are above average”

HALL: The CEOs working in the world of finance are a lot like the children of Lake Wobegon ... they're all above average, or at least they think they are. And there's a reason for this, other than their inflated egos. The idea of over-stating your true ability is perceived to have real market value – and can also explain why a company may knowingly, and wilfully over-pay its Chief Executive.

Professor Scott Schaefer is an economist at the University of Utah, who has researched the so-called “Lake Wobegon Effect”.

SCHAEFER: The idea is that every firm wants its investors and potential investors, in particular, to believe that the firm's CEO is above average and, of course, one thing you can do is pay the CEO like he's above average. Everyone knows how labour markets work, the superstar performers make high salaries and the not so superstar performers tend to make less, and by paying your manager like he's a superstar you might be able to influence market perceptions of that CEO's quality, and therefore influence market perceptions of the value of the firm.

HALL: So, Scott, is this overpayment then, a PR effort to fool the shareholders and the investors?

SCHAEFER: It is and the interesting thing is that it doesn't work. Now, the complication comes up when you start asking why the stock market, why they would be fooled by this? If every firm is doing this - paying their manager more than the manager is worth - wouldn't the stock market at some point say "wait a minute, I'm not going to be tricked by this anymore ... I'm going to anticipate that the manager is being overpaid and treat the firm accordingly". And the kind of interesting thing is that that doesn't matter.

And the reasoning goes as follows ... if the stock market expects that managers are going to be overpaid, and a firm says "Well I'm just not going to play that game, I'm going to pay my manager without playing this try-to-fool-the-market game". Well, if the stock market expects that firms are going to try to fool the market and a firm decides not to try well then the stock market's

logical response is to say “oh, that firm is paying their manager very badly, that firm must have a truly, truly abominable horrible manager”. So what this means is that even if the stock market correctly anticipates that managers are going to try and overpay their CEOs as in the Lake Wobegon Effect ... firms still have an incentive to do it, because if they don’t, they’ll be treated like their managers are truly bad.

HALL: Does every company have to play this game, in order for the salary averages to be over-priced?

SCHAEFER: No ... not every firm has to play this game. For example, if all the firms on the North side of the street are overpaying their managers to try to convince the stock market that those firms are good ... what’s going to happen is all the managers are going to walk from the South side of the street to the North side of the street, because that’s where the wages are higher. How can the south side of the street hire anybody? Well, they’ve got to raise wages too. And so the south side of the street firms, they might not even care about influencing market perceptions about value, but they’ll have to pay as if they do in order to attract that talent.

HALL: The decision making process regarding the levels of executive pay does have a degree of checks and balances in place ... compensation is not decided by one person alone.

Each company has a compensation committee, featuring board members, lawyers, and compensation consultants, who together try to decide someone's true value and pay them accordingly.

But have company boards really been paying enough attention to the pay issue?

Compensation consultant, Simon Garrett of The Hay Group.

GARRETT: I think over the last ten years or so – they call it the nice decade, the sort of no inflation, continuing growth, and so on – the temptation has been to say 'well, the executive pay levels are going up, returns to shareholders is going up, everyone is getting a little bit richer, so we don't have to spend too much time on it. Whereas I think now the issue of course is now is much more in sharp focus, performances of companies have declined, and everyone is saying, well, are we getting value for money out of our executive pay arrangements?

HALL: Some critics argue that the consultancy firms themselves have helped hike up pay ... they put in a good word for the CEO during pay negotiations, and he repays them in kind with more business from the company, further down the line.

I put this to Brok Romanek of Compensation Standards, an organisation campaigning for responsible remuneration.

ROMANEK: It's possible they're part of the problem, and they don't want to get fired. They want the board and CEO to hear what they want to hear, and so they don't want to rock the boat. You know, behind the scenes, talking to a number of them, I really hear that they're urging boards to take the responsible actions, but boards are just not listening.

These directors, again, are very self-confident and willing to take their own approach, and usually they want to follow the footsteps of what they've done on other boards, because most board members serve on multiple boards, and so they feel confident that they've been doing the right thing for a long time, and it's hard to change course when everyone else is doing it.

HALL: It sounds like there's an echo chamber effect going on here, you're on one board you hear this, on another you hear that, and eventually they're your own words coming back at you, instead of some objective evaluation going on.

ROMANEK: Yeah, that's what happens, because there are so many directors serving on other boards and so even when they hear a lot of criticism from shareholders, from the media, from regulators, they still feel like they're right because they're getting affirmation in that board room from their peers.

HALL: So how do you fix it?

ROMANEK: Well, the first step is, obviously, recognising that you have a problem. There's still a lot of people heavily involved in the pay setting process that don't think there's a problem.

HALL: But of course, when you ignore a problem too long, it can creep up and smack you in the face.

The banking world in particular experienced a massive wake-up call last year, as companies failed on a huge scale, requiring billions of pounds in tax payers' money to save them from going under. The finger was firmly pointed at the bosses of these banks – accused of being arrogant and out of control, the public has quite rightly been baffled and angry when it came to light that despite their huge failure, many of the execs in charge of these banks were still entitled to pay outs and bumper pensions. So where does the buck stop? Who is to blame? John McFall is the Chair of the Treasury Select Committee, which has led the inquiry into Britain's banking crisis.

MCFALL: Firstly because we had weak institutions. As William McChesney Martin, the first governor of the Federal Reserve said, the regulators and the policy makers have to be there to take away the punch bowl when the party is in full swing. Nobody dared to take away that punch bowl. So we need a bit of grit in the system, so that somebody comes in and says 'hey guys and girls, we've had enough, the party is over, get to bed'

HALL: Next week I'll be investigating the proposals being put forward both in the UK and US to regulate executive pay ...

ACT: **I'm as angry as anybody about those bonuses that went to some of the very same individuals who brought our financial system to its knees.**

HALL: Will this enforced restraint do more damage, than good? And did the shareholders have a hand in this bonus boom too?

ACT: **When we're talking about shareholders, we're talking about fund managers and fund managers – they are all paid a lot of money too.**

HALL: Could they have done more to keep compensation under control? And as some of the bailed out financial firms continue to pay bonuses, is the money grab really over?