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US, Europe split on approach to bonuses

By EMMA VANDORE and DESMOND BUTLER , 09.21.09, 12:26 PM EDT

PARIS -- How far to go in limiting bankers' bonuses looms as one of the toughest issues at this week's summit of world leaders in Pittsburgh, with clear differences between the United States and Europe despite recent moves in each other's direction.

The European push, led by the French, for concrete bonus curbs appeared to have found some response in the U.S. when the [Federal Reserve](#) said Friday it wanted an oversight role that would let it review compensation policies. But those proposals - which may or may not have the backing of the White House - fall short of many European demands.

Arguing that bonus incentives encourage bankers to take excessive risks, France and Germany are calling for strict limits on salaries. French President Nicolas Sarkozy has even threatened to walk out of the Group of 20 summit of rich and developing countries if he doesn't get his way.

U.S. and British leaders envision something looser, echoing some of the tough talk of European leaders, but veering away from regulation that might scare away talent - and lucrative economic activity - from their financial centers on Wall Street and the City of London. Washington wants to address the issue of risk by requiring banks to keep bigger capital reserves as buffers against losses, but Europe may resist measures that would put pressure on their banks.

"The U.S position is to say 'We can't control bonus payments. All this is going to do is push activity out of our financial centers without addressing the underlying issue and we need to approach this through capital requirements'," said Simon Tilford, chief economist at the Center for European Reform in London.

"The French and German governments don't want to go down that route because they are fearful their banks are under capitalized and this will put them at a disadvantage and they don't see themselves as having a problem."

The Basel-based Financial Stability Board, the international body of finance officials and central bankers tasked with the tough job of making specific proposals to the G-20, wants to tie bonus pools to the amount of capital banks have to set aside. French and German banks fear they might be disadvantaged under the proposed new capital rules.

The summit Thursday and Friday comes amid voter anger at bankers, who have returned to setting aside large sums for bonuses even after the chaos in the global economy and huge taxpayer bailouts blamed on their risky behavior.

At a meeting last week, EU leaders called for links between bankers' pay and the company's long-term performance, with claw-back mechanisms on bonuses if profits prove to be transitory. The EU wants an end to so-called "guaranteed bonuses" where a banker is paid a set amount regardless of the risks he takes.

And they want regulators to have teeth. Bonus rules should be "backed up by the threat of sanctions at the national level," the EU statement said.

EU leaders softened calls for concrete caps, saying the G-20 should "explore ways" to limit bonuses to a proportion of revenue or profits.

While Britain was aboard, British officials acknowledge differences on the details.

The Fed's proposal, details of which emerged on Friday, falls short of the explicit guidelines the EU is pushing. The American central bank wants to review salaries, bonuses and other compensation for CEOs, senior managers and traders to ensure they don't encourage employees to take gambles that could endanger a company, people with knowledge of the proposal said.

French Finance Minister Christine Lagarde downplayed the move, noting that that regulatory authorities such as the Fed are only there to apply rules set by governments.

"An authority is very good, but an authority is only there to apply the rules and we need rules first, and then an authority to make them respected," she said Monday.

Meanwhile, Obama is treading carefully on financial regulation as he fends off Republican critics of his health care plan. Opponents have gained some traction by claiming Obama is already advocating too much government involvement in the economy.

"It's clear that we are at a juncture of time in the U.S. where the highest stakes are in the health care reform and that has taken precedence over whatever else the government wants," Georges Ugeux, a former vice president at the New York Stock Exchange who now runs the Galileo Global Advisors consulting group.

In a recent speech to Wall Street outlining his financial reform packages, Obama urged bankers to move quicker than lawmakers to tie pay to long-term performance and to give shareholders a vote on compensation.

Whatever the summit outcome, Sarkozy has vowed to press on alone. French banks signed up to a set of curbs which include withholding at least half of a bonus, to be paid out over three years depending on performance. He has also threatened to withhold government contracts from companies that did not agree.

The Obama administration says the threat sounds like protectionism.

"We do want countries to implement things in a way that does not give rise to protectionism or lead to the fragmentation of markets, but rather creates some consistency across markets," said Mike Froman, deputy national security adviser for international economics.

European Commission President Jose-Manuel Barroso said the EU should go ahead regardless of how the United States deals with bonuses.

"It's a scandal what is happening - it's really an ethical problem - and I think that if necessary, we should go it alone," he told TV5 television on Sunday.

But he noted that European banks may not want to play by a stricter set of rules than their American competitors.

"It's in our interest in Europe to have a level playing field," he said.

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Desmond Butler reported from Washington. Associated Press writers Jeannine Aversa in Washington, Joe McDonald in Beijing, and Erika Kinetz in Mumbai contributed to this report.

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