

Debunking the EU bankers' bonus cap

The 'great financial crisis' had devastating impacts on private and public finances. In Europe, there was a direct causal link to the subsequent sovereign debt crisis, with severe economic, social, and political scars still apparent today.

Ever since, international policy makers¹ have been reforming the global financial system, forcing financial institutions to be more crisis-resistant, most notably through increased own funds (capital), more, longer-term, and better-quality liquidity, and comprehensive resolution frameworks.

But one element of the EU's post-crisis framework still takes a disproportionate amount of media interest: provisions to install a cap on bankers' bonuses.

Recently, the new UK government announced its intention to drop the bonus cap, evidence, to some, of the UK's unshackled freedom from EU rules made possible by Brexit. Despite major political upheaval in the UK in the last days, the new Chancellor, Jeremy Hunt, has decided to press on with plans to scrap the bonus cap, protecting one of the most divisive policies from his predecessor's 'mini-budget'.

So why, given the political and economic turmoil, would the UK government remove the bonus cap whilst u-turning on most other mini-budget measures perceived by most of the British public as socially unjust and disproportionately favourable to wealthier citizens and businesses? Many would question whether this is the right measure (and the right moment) to demonstrate tangible divergence from EU rules.

To debunk the bonus argument, one first needs to understand two fundamentally contradictory forces which are at play here - economics and politics.

Economically, there may be some rationale for the UK's decision, given the limited impact of the cap on tax revenue (the cap led to increased fixed remuneration and reduced variable remuneration). Non-EU headquartered banks strongly lobbied against the bonus cap when it was negotiated (counterproductively in my view - focussing on this element of a 650-page package designed to shore up the financial system only led EU lawmakers in Council and Parliament to dig in with a more punitive cap than may have been the case had industry not been so insistent on scrapping it entirely).

Even after adoption, international banks continued to bitterly complain about the bonus cap, citing talent acquisition/retention problems due to an unlevel international playing field. The UK government went as far as taking legal action to the European Court of Justice, claiming the bonus cap was unlawful but finally backed down following an opinion by the advocate general which ruled the cap lawful.

Of all the EU countries, it is true that the bonus cap hit the UK hardest - as EBA data on high earners indicates (UK accounted for 71% of all EU high earners in 2019)². UK entities tend to have a more global

¹ For example: the Basel Committee, Bank of International Settlements, Financial Stability Board and the G20

² See p6 of [EBA report](#) and EBA's [interactive tool](#)

outlook/investor base and larger wholesale/investment bank operations than their EU peers. They were more negatively affected when competing for talent compared to international peers headquartered in the US/Switzerland/Singapore/Hong Kong, where no such limits on bonuses/variable remuneration exist. EU banks (many with UK entities) did not like the cap either but understood the politics of the day.

So, whilst the UK might have some justification from an economic perspective, they are on very thin ice politically. Some UK politicians have in the past obsessed about the bonus cap, citing it as an example of a lack of UK influence or the EU forcing its rules against the UK's will. But many industry executives fear that removing the cap during a cost-of-living crisis is optically problematic. They were not consulted on the move; nor have they been asking for it as a so-called 'Brexit dividend' given the current crisis context.

It is true that the UK did not support the bonus cap in the Capital Requirements package in Council and was indeed subsequently 'outvoted' (by a comfortable margin) under the qualified majority voting rule system which applies to most EU single market laws, including the bulk of financial services legislation.

But of the thousands of pieces of legislation passed over the years of UK membership, there are startlingly few examples of the UK being outvoted in this way. And the argument that the UK was not influential in EU FS policy simple does not bear out when one looks at EU rules such as MiFID, PRIIPS and AIFMD, to cite only a few, all of which have UK fingerprints all over them. So much for no influence!

Politically speaking, the EU's intention with the bonus cap was to rein in perceived excessive variable remuneration which was thought to incentivise ever-greater risk-taking, threatening financial stability.

Asides broader, cross-sectoral executive/CEO remuneration, the financial sector has long been an outlier when it comes to high-earners' variable remuneration. The idea in the EU, then, was that increasing fixed remuneration but still allowing up to a 200% variable element would break the direct link between riskier trading activity and 'excessive' personal gain by speculative traders, thereby improving financial stability whilst still offering generous remuneration compared to other sectors.

The UK decision to remove the cap during another economic crisis seems, at the least, untimely. The economic rationale may never have been entirely convincing in global financial markets. But neither was, nor is, the political rationale to scrap it now. UK opposition politicians and trade unions are delighting in the opportunity to brand this decision as out of touch with hard-pressed citizens. Hunt's justification that removing the bonus cap is less impactful than his decision to maintain the highest level of income tax (u-turning on his predecessor's most controversial mini-budget announcement) may be factually accurate. But such a portrayal does little to restore politically credibility amongst the wider electorate that this government has the interests of all citizens, especially the most vulnerable, at heart. For that reason alone, the UK might still regret choosing the EU bankers' bonus cap as the appropriate piece of EU legislation from which to symbolically diverge at this current juncture.