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A Halloween Surprise for Wall Street

By FRANCESCO GUERRERA

Trick or treat? The seasonal rallying cry of children across the U.S. resonates with Wall Street workers awaiting their year-end bonuses.

No, bankers and traders aren't swapping their suits and fat-knotted ties for ghoulish costumes and fake blood. But Halloween's signature question isn't much different from the one posed every year by finance employees to their bosses: "Are you going to take care of me?"

Corbis

Smaller paydays will mean less cash for toys like this 1956 Testarossa.

For at least a decade—with one, brief, interruption after the financial crisis—Wall Streeters received treats from their banks. Soaring profits and fierce competition for "talent" combined to send bankers' pay skyward.

In recent times, however, lackluster markets, stricter regulations and the unhealthy glow of the global economy have prompted financial groups to cut staff and tighten belts.

The bad news for bankers and traders is obvious: The era of big bonuses for large swaths of Wall Street's labor force is over, at least for a while.

But that isn't the whole story. In the great reshuffling of the global financial sector caused by the 2007-2008 turmoil, some people will still emerge as winners—and be all the richer for it.

Banks aren't cutting bonuses across the board. Instead, they are firing middling performers in ho-hum markets and redirecting their shrinking bonus pools toward star individuals in lucrative sectors such as bond trading and asset-backed securities.

The paradox of these leaner years is that they are turning Wall Street into a much more of a meritocratic, pay-for-performance industry than it

ever was during the boom periods, when rising market tides lifted a lot of pay packages.

The financial industry has always been a Darwinian a place where underperformers get culled and/or paid less than top rainmakers. But the dichotomy has been exacerbated by the current tough conditions.

In 2012, one in five financial workers eligible for a bonus won't get one, a rise of more than 50% in the proportion of "unbonused" workers from a year ago, according to a new study by the executive search firm Options Group.

Those who do receive a payout won't necessarily celebrate. Take stock traders. As a result of dwindling revenues in banks' equities businesses, they are expected to see total compensation (including salary and bonus) drop by around 30%, on average.

"On average," though, is a problematic concept in an industry as specialized and individualistic as finance. "It's going to be uneven," says Jeanne Branthover, head of the global financial-services practice at Boyden, an executive search firm. "If you are a valuable person to your employer, they will want to keep you, and the only way to keep people is financially these days."

Cutting staff helps. At Goldman Sachs Group Inc., compensation expenses in the first nine months of the year are up around 10% on the same period in 2011 while staff numbers are down nearly 5%.

The result: More money available for those who stay (with the caveat that compensation numbers include severance costs). Goldman has set aside $336,442 for the mythical "average" employee—a 15% rise on last year. From "Nice job, if you can get it," to: "Nice job, if you can keep it."

But which jobs are actually worth keeping? Here's my advice: If you work on a bond-trading desk, hold on tight to that chair.

The long bull run of Treasurys, a renaissance in mortgage-backed securities and a spike in trading volumes in securitized products should ensure a nice jump in pay for fixed-income whizzes this year.

Middle-of-the-pack equity traders and salespeople—as well as investment bankers—shouldn't put down a deposit on a Testarossa sports car. The stagnant markets they inhabit are set to "reward" them with steep pay cuts or unemployment.

In the long run, though, most of Wall Street's workforce is heading for smaller paydays as

tough new rules at home and overseas begin to bite.

As Thomas Philippon of New York University and Ariell Reshef of the University of Virginia, argued in a seminal 2009 paper, changes in regulation have played a major part in the sharp swings in financial sector pay since the 1990s.

"When you have a deregulated financial services industry, there's a lot more scope for creativity and complexity and that's going to attract smart people who want to be compensated," Mr. Reshef told me. "Moreover, in a complex world, banks may have to provide incentives so that workers don't make mistakes." The opposite also applies: Tighter regulations, such as the Dodd-Frank law in the U.S. and the Basel III international capital standards, lead to smaller profits and leaner paychecks.

Unless bankers find new tricks, their treats will get smaller and less tasty in years to come.

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