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# The rise and fall of the elite investment bank lawyer

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*By [Scott Gibson]*

**Introduction**

From a recruitment perspective, the past 20 years has seen the position of the in-house lawyer change beyond all recognition, from being a poor relative to its private practice cousin to an alternative, and increasingly compelling, career path for high-achieving associates on partnership track. The gravitational pull of working in-house for private practice lawyers is well known and this shows no signs of diminishing; in 2010 alone the number of solicitors working in-house in commercial roles swelled by nearly 8%[1] - almost all drawn in from commercial law firms.

No sector of industry has been as hungry for elite law firm talent, nor as successful at attracting legal stars to move in-house, as investment banking. From the late 1990s investment banks were the employers of choice for hundreds of top City law firm lawyers. Not only were the banks able to offer the usual lifestyle and proximity-to-business benefits associated with working in-house, they also offered work quality equal to, and sometimes better than, magic circle law firms together with significantly better pay.

At the time of writing the economy is in its second post-Lehman state of flux and investment banks, in large part given the blame for this state of affairs by politicians and the public alike, are firmly in the cross-hairs of governments and regulators around the world. Although this may be good news for regulatory lawyers in the short term, in the longer term regulatory changes and political pressure will simplify investment banking products and restrict the activities investment banks can undertake. This restriction on business, together with the enormously increased costs arising from mandatory infrastructural and organisational changes, increased capital charges under Basle III and potentially increased taxes, is likely to make these organisations less remunerative and therefore less compelling for elite transactional law firm lawyers on partnership track.

**Exponential growth in number of lawyers**

From the mid-1990s, the combination of a benign regulatory environment, cheap credit and misunderstood and mispriced risk spawned a proliferation of increasingly complex, often highly leveraged debt and equity-linked financial products by investment banks. Whole new service lines rapidly became mainstream, as did proprietary trading (where the banks traded on their own account rather than on behalf of a client). The result was exponential growth in the London operations of investment banks and the number of lawyers employed by them.

During this period the high-performing investment bankers prized top-flight transactional lawyers who were considered integral to "deal making" in real time through their ability to speed up the decision making process, increase management options and, of course, minimise legal risk. Tangible evidence of the importance of lawyers to the revenue generating process was the number of them who sat alongside the bankers on the trading floor.

Between 1997 and 2007 the sheer scale of hiring was phenomenal and the number of lawyers at bulge bracket investment banks (Goldman Sachs, Morgan Stanley, Merrill Lynch, JP Morgan, Credit Suisse, Deutsche Bank, UBS, Citigroup and Lehman Brothers) increased ten-fold. This was matched by similarly exponential growth at scores of other banks -predominantly subsidiaries of large European and Japanese commercial and retail banks or insurance companies (such as Nomura, RBS, Dresdner Kleinwort, Barclays Capital and BNP Paribas). All of

[1] *The Law Society Annual Statistical Report 2010*

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this was to the consternation of City law firms which were regularly bled of expensively trained legal talent, contributing to annual attrition rates of more than 30% in many departments.

The growth in lawyers was by no means confined to the banks' legal departments and often dozens of transactional lawyers would be permanently based on the trading floor in transaction management departments which sometimes appeared to duplicate, and even rival, legal departments in scope and responsibility. To add an additional gloss, occasionally lawyers would be hired and paid directly by the front office banking team, anxious to have their own creature assist them in steering their legally risky project through the legal and compliance departments.

**Banks & Money**

Because many investment bankers were themselves sophisticated users of legal services, they were particularly appreciative of high-end legal input. This was, in turn, reflected in the compensation of lawyers, who through high performance-bonus payments, were paid significantly more on average than those in law firms or their peers at retail or commercial banks.

In the early 2000s, as a rule of thumb, leading investment banks in London paid their transactional lawyers a base salary of about 10%-15% less than that paid at magic circle law firms but, due to the ubiquitous high bonus payments at banks, about 20% more overall at every level up to law firm partnership. As law firms responded throughout the 2000's by increasing base salaries and bonuses so too did most investment banks and by 2007, base salary offers at banks for junior and mid-level lawyers were similar to those at magic circle law firms with the added benefit of significant (often in excess of 50%) guaranteed bonus payments[2]. As a result investment banks were able to outbid virtually any class of law firm for lawyers below equity partner level.

The hike in compensation of lawyers was not limited to premium investment banks - second or third tier banks, anxious to break into the premium market, saw a dramatic hike in pay (and ultimately quality) of their lawyers. Banks such as BZW (which became Barclays Capital), having embarked on a hiring spree of top investment bankers in their drive to enter the global elite, essentially had to build a 100-plus lawyer team in London from scratch, in order to provide the skill set and nimbleness demanded by their newly hired front office. Similarly other banks found that, in order to attract top legal talent, they were often having to pay a slight premium over and above the elite names simply because they did not have the cachet of being a "bulge bracket" bank.

Such was the "market rate" for transactional lawyers at investment banks that even once cutting-edge product lines eventually became commoditised, the lawyers servicing them were still able to enjoy compensation levels markedly above those at magic circle law firms. This favourable compensation differential also extended to non-transactional lawyers such as technology, employment and litigation specialists who, although hired in far fewer numbers, were also able to benefit from the largesse of investment banks.

**Work and opportunity**

The banks' attractiveness was not confined to money alone and lawyers would very often find themselves working on the most innovative legal work before law firms were even involved, as new frontier financial products were created, developed and structured in-house. For many incoming transactional lawyers the work they were hired to do was by its very nature complex, highly structured and therefore legally risky which made it all the more intellectually challenging. The proliferation of new products, new geographical markets and completely novel business lines meant that bank legal departments were constantly able to provide new

[2] *Pre-2008 a junior to mid-level lawyer in a bulge bracket investment bank in London might typically expect a 40-70% bonus, a "Director" 60-200% bonus and a Managing Director 200-400% bonus.*

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opportunities and work types for their better lawyers who might, through a mix of talent and serendipity, gain rapid promotion and the approbation of the bank's management team. Such individuals with proven track-records and prepared to leave their comfort zone, might commonly find their role and responsibilities changing every 18 months as they made their upward progress through the bank.

With such compelling arguments for joining an investment bank, and with law firm equity partnership becoming steadily harder to obtain, it is easy to see why so many City lawyers considered investment banks a career Utopia.

**After the hubris, the fall**

The current global financial crisis has been blamed in large part on the risk taking activities of investment banks. At the time of writing the banks remain firmly on the defensive and subject to sustained public censure. The resultant confused, and at times conflicting, national and supra-national proposals for regulating financial institutions are making long term growth, and even physical location of some investment banking operations, almost impossible to plan.

Doubtless, eventually investment banks will find a new niche and start to expand their business lines once more. When this will be, and just how attractive London will remain as a major hub for investment banking, is not clear. However, what is clear is that there has already been a significant change in culture at many of the investment banks which have been keen to de-risk their product base and undertakings. In the medium term at least this will result in the creation of fewer and less leveraged esoteric products and, to the extent that there is growth, it will likely be at a much more sedate pace than in the previous decade.

For most lawyers this will inevitably mean less opportunity. The traditional route to Managing Director level positions for lawyers in investment banks – the constant creation of new business lines - will simply not occur and most banks have already significantly reduced the number of lawyers at Managing Director level.

This is not to say that investment banks will not still provide exceptional legal work. Far from it; for regulatory and compliance lawyers there is a cornucopia of directives, restructurings and policy implementation which will provide incredibly interesting, complex and high profile matters on which to gorge themselves for years to come. Even for transactional lawyers there is a veritable tsunami of interesting de-risking work in the form of the unpicking and winding down of run-off business. Indeed many senior level transactional lawyers have already found that, over the past three years, they have become de-facto regulatory lawyers anyway.

The difficulty for regulatory lawyers is that no matter how legally interesting the work is, or how important it is for the functioning of the bank, it will never be mistaken as revenue generating and, as a greater proportion of lawyers in banks become regulatory, there is a risk that the standing of all lawyers with the front office will diminish over time as they become seen as rule keepers rather than transaction facilitators.

**New Money**

Governments have concluded that a key contributor to the pre-Lehman risk taking at investment banks was the high bonus culture where bankers are paid relatively modest base salary payments - a fraction of their overall compensation - with the "real money" being paid in contingent annual lump sum, non-deferred, bonus payments. In order to counter the public's image of bankers undertaking risky structurally unsound trades in return for multi-million pound bonuses and then retiring to the Seychelles, leaving the tax payer to pick up the bill when the trade goes wrong, regulators have been forceful in pushing through changes in compensation structures at investment banks.

Although aimed at bankers, these regulatory changes have caused a shift in the compensation culture at investment banks which has had a significant impact on how lawyers are paid. Whilst lawyers have never

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enjoyed bonus payments at the level of investment bankers, the cultural shift away from high bonuses led to rises in the base salary compensation for nearly all investment banking lawyers. At the senior (Managing Director) level these were very significant – more than doubling in many instances. However, for virtually all lawyers this has been at the expense of total compensation since headline bonus payments, as a percentage of salary, have fallen - sometimes dramatically - so that total compensation levels, for equivalent lawyer roles in 2011, were lower in every bank than they were in 2007.

Not only have headline bonus payments fallen, but the method in which they are paid has often altered with an increasing proportion of a given year's bonus payments being in restrictive stock and deferred over as many as three years. The result of this is that working out total compensation for a senior lawyer in any given year is problematic to say the least. Whilst at the time of writing it is probably right to say that investment banks still pay more than magic circle law firms for non-partners, and can certainly still make impressive offers to incoming lawyers, it would also be right to say that the gap in compensation is narrower than at any time since the 1990s.

For a period of time average compensation at investment banks for lawyers will remain relatively high, in part due to the elevated demand for exceptional regulatory specialists. However, as the need for a constant stream of elite specialist lawyers to work on the cutting edge of financial products reduces, it is likely that average compensation levels, relative to private practice lawyers, will fall further and the pecuniary attraction of such banks to elite lawyers will diminish.

**The future**

So transactional lawyers in investment banks can look forward to less interesting work, lower overall compensation relative to law firms and much reduced promotion prospects. Inevitably this will make investment banks much less attractive to lawyers on partnership track. Some of the more attractive roles have already migrated to high end brokerages, hedge funds and other niche financial organisations with the suffix "Capital" in their title. Indeed in a depressed market these organisations have begun to proliferate or widen their business lines in the hope of capturing the frothier aspects of the market ceded by the retreating banks. Of course, because these highly leveraged operations will be undertaking risky trades and will not be "too big to fail", they will carry a significantly elevated risk of collapse (as seen by countless hedge funds and more recently the brokerage MF Global). Nevertheless, for many lawyers the greater rewards and interest will mean that this is a risk they are prepared to take.

Going forward, assuming the business units remain in London at all, we will not necessarily see a significant reduction in overall lawyer headcount because, like every other industry sector, investment banking will doubtless continue to insource legal work to save on external law firm costs. However, what we are likely to see is a significant change in the *type* of lawyer hired by banks. Legal departments will continue to hire some fine transactional lawyers but, outside of regulatory specialists, they will be less likely to attract or retain corporate or finance "stars" – with the result that investment bank legal departments will ultimately more closely resemble those at corporate and retail banks rather than the more blue-chip "pre-Lehman" line up.

For the investment banks themselves it is likely that the loss of their elite in-house legal functions will put them at a competitive disadvantage relative to other financial organisations but whilst capital adequacy, cost-saving and de-risking products remains the order of the day, this argument is unlikely to carry much weight.

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