

The Winter of Our Discontent

By Kathryn Tully

The mortgage debacle has left many without a job. Bonus time will trigger more departures and headhunters are not optimistic of a quick upturn. But there's still some growth abroad, notably in Asia. And back in the U.S. the buy side should be able to offer a home to at least some of those hunting for employment.



It's a crowded place out there, but some will get back in

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Pick your adjective to describe the job losses in the last few months in the mortgage markets. "Brutal," one recruiter calls it; another prefers "ugly."

Either way, redundancies have been swift and, in places, deep. That's no surprise considering the structured credit market has been hit by the double whammy of a virtual shut down of the more lucrative parts of the mortgage markets and widespread multi-billion dollar write-downs on related assets like CDOs.

In previous crises, there was usually an investment bank or two that was well placed to take advantage of a rival's pain to jump into a new market, or at least bulk up. Not this time. But it's not all bad news. Those firms that have escaped the worst of it, like Goldman Sachs, are selectively hiring. And Barclays Capital says it still wants to add staff globally to its various businesses. Meanwhile, buy-side firms are keen to hire the structured finance staff the banks have laid off, especially those setting up distressed asset-backed funds. They are unlikely to take up all the slack, though. One structured finance recruitment guru reckons there will only be two or three such jobs for every 10 lost on Wall Street.

The first waves of job losses hit mortgage lenders. The US Bureau of Labor Statistics reports that by the end of the third quarter last year employment in the mortgage banker and broker sector had fallen 20%, from 500,000 in October 2006. Of these, 26,800 full-time positions went in August alone, and another 25,100 in September.

That hit origination shops owned by Wall Street, too. Merrill Lynch and Morgan Stanley have both cut staff from the lenders they bought just over a year ago. And 1,200 jobs went when Lehman Brothers, one of the first investment banks to jump into mortgage lending, shut its subprime subsidiary, BNC Mortgage.

"Most of the people that have been let go are in their subprime origination shops," says Joe Mevorah, a director in global markets at executive search firm The Whitney Group. He focuses on placing structured products and securitization staff and says things have started to change since Fall, when redundancies spread to the securities business — although it's more difficult to come up with a precise number of how many structured finance bankers and traders have lost their jobs.

UBS has been hit particularly hard. In October it announced 1,500 job cuts, the majority of them in structured credit. But it is hardly alone. Bear Stearns, which had already cut around 600 jobs from its mortgage origination unit, announced its third round of layoffs in November, this time 650 across the company. HSBC shut down its US MBS trading desk, cutting a further 100 jobs, after closing its subprime mortgage Decision One subsidiary in September.

How many more?

Speculation is mounting as to how many structured finance staff will be culled at Citigroup and Merrill Lynch, the two firms that have suffered the biggest write-downs on CDOs,

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Joe Mevorah, The Whitney Group

as their new chief executives try to turn things around. That’s on the back of key asset-backed houses such as Credit Suisse cutting 150 jobs in mortgage-backed securities in New York and London in September, Bank of America laying off 700 in wholesale mortgages in October and Nomura cutting 400 staff in the US, another firm that has closed its US residential mortgage-backed securities business altogether.

That’s how matters stood in early December. It’s a far cry from the situation two years ago when foreign banks were clamoring for a piece of the US domestic mortgage bond market and were paying top dollar and guaranteed bonuses to poach teams from elsewhere on the street.

But new mortgage loans, and residential MBS origination, had virtually ground to a halt, leaving staff on MBS and CDO origination and sales desks twiddling their thumbs. Executive search and consulting firm Options Group was predicting that as many as a third of MBS and CDO originators and sales people could be laid off by the end of 2007. Desk traders will still be necessary to reposition the firm’s exposures.

“On the secondary side, the banks are hanging on to the traders that they can, because people can see that eventually there will be a turnaround,” says Mevorah, who spent 20 years in the securitization industry at firms such as Lehman Brothers, PricewaterhouseCoopers and Macquarie Securities before joining The Whitney Group.

Nevertheless, the position of traders is still precarious. “Unlike previous years where the trading desks supported the bankers, it’s now the other way around. Bankers are supporting the trading groups, which is always a difficult time,” says Mevorah. “If you’re working at a firm like Bear Stearns at the moment

on the trading side, you’re just trying to hold on to the job you’ve got.”

The jobs of CDO and mortgage derivative structurers ought to be more secure as they are the only ones that really understand the collateral the banks are holding. As the mortgage bonds and CDOs that are trading in the secondary market continue to reprice with each new default or ratings agency action, getting to grips with that collateral is crucial. “Banks are going to have to hang on to their structurers to get them out of some of their positions,” says Eric Moskowitz, who heads up compensation research at Options Group. That may guarantee continued employment, but there are slim prospects of reaping a good bonus from potentially selling at a loss those positions the desk originally had a hand in taking.

But not all structurers will be needed. UBS’s origination, structuring and sales staff in its US structured finance CDOs team were among those who lost their jobs in October. That same month RBS Greenwich Capital reduced by almost half its 20-strong CDO team, including managing director and co-head of CDOs Rick Caplan.

“Over the last four or five months, particularly in the CDO groups, whole departments were let go, or otherwise the majority of people were let go with a couple of people kept on to wind down the positions until year end,” says Ted Gregory, partner at executive search firm Heidrick & Struggles, who specializes in asset securitization and commercial real estate lending.

Thankfully, the buy side offers a silver lining. “Credit hedge funds are looking for anyone who can trade the current volatility in the ABX index,” says Moskowitz. “That’s become a very popular trade.”

That credit and real-estate hedge funds are expanding is no surprise. Several have already made a killing shorting the mortgage market: Lahde Capital’s US Residential Real Estate Hedge V, for example, which shorted the ABX index from the BBB- up to the AA tranche, has bagged a return of 1000%.

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Ted Gregory, Heidrick & Struggles

Such continued outsized returns from merely shorting the market are unlikely considering the lowly levels most ABX tranches now trade at. But arbitrage opportunities still exist. Other hedge funds are hoping to profit from buying distressed bonds and CDOs when banks, investment banks and other investors are forced to sell their holdings (see story, page 51)

“Hedge funds are not necessarily buying right now, but they are picking up professionals who can explain to them what they’ve got and can look at things they might want to buy in

the future," says Gregory. "They are no longer going to be able to rely simply on yield and ratings, so they're looking for CDO structurers and underwriters, not so much quant types, but more guys that understand the collateral and the structure of the paper." He adds that some mortgage loan servicing companies are also picking up some good underwriting people at the moment.

The prospect of distressed debt investing being a big revenue generator in the next year or so means those with structuring, bankruptcy and work-out experience are in high demand. "We've got a couple of mandates from well-established equity trading houses looking to pick up good people with distressed debt backgrounds to build out distressed debt desks," Mevorah says. "The equity side of the business is doing great, they've got the money, so they're saying this is a good time for us to diversify."

Selective hiring

On the sell side, commentators see some selective hiring as banks try opportunistically to upgrade their teams from the pool of unemployed talent on the cheap, or certainly at a significant discount to what they would have paid a couple of years ago. Goldman Sachs seems to be doing that. Mevorah thinks that Lehman Brothers' mortgage trading desk, which is also holding its own, will be making strategic hires as will some foreign banks such as Barclays Capital.

Yet this sort of hiring is limited. As Gregory puts it: "There is a lot of cheap talent in the market. This is the perfect time for firms to upgrade their teams. But I can't say we're seeing a great deal of it at the moment."

Nor do banks seem to be reallocating staff to other parts of the asset-backed market. It's not just the subprime market that's affected. The commercial mortgage-backed market is suffering too. Issuance of US commercial mortgage-backed securities plummeted to \$6.3 billion in October, down 84% from a record \$38.5 billion in March, according to Commercial Mortgage Alert.

But deals backed by other assets are, at least, still pricing. "There are other securitization areas that are exhibiting strength right now such as student loans, so there should be some recruitment out there. But it's strange right now," says Gregory. The wait-and-see attitude that infected the mortgage markets

spread to the rest of the market, he says "Towards the end of the summer, everything came to a halt. People are still waiting."

Outside the US securitized markets, banks are hiring, notably in Asia. Morgan Stanley announced that some of the 200 jobs cut in the US investment bank in October could be relocated to Asia. "While banks are letting go of people in the US, they can't hire enough people in Asia," points out Gregory.

But Moskowitz at Options Group thinks there are opportunities closer to home. "If you can look outside the US, Latin America and Canada are both possibilities."

Overall, though, there are likely to be a lot more sell-side

exits than entrances for MBS and structured finance stuff in the months ahead. The bonus season is not going to be pretty. Those working in mortgage-backed securities are going to take it on the nose more than anyone else in fixed income, according to the Options Group's 2007/2008 Global Financial Market Overview and Compensation report. Bonuses for mortgage-backed securities professionals, which were 5% up in 2006, are likely to be a third lower for 2007 and as much as 40% lower for ABS and CDO sales people and originators.

Recruiters think that plenty of staff will voluntarily head for the door once they find out their bonuses. "There's going to be two waves. First there are people who have actually been let go," says Heidrick's Gregory. "The second wave will be the negative surprises in the bonus check." Options Group's report predicts that lower bonuses will put a lot of top sales people and traders in play in 2008.

"The situation is similar to what happened in 1999," says Gregory. "Some people will get new jobs, there's going to be a certain number of people exiting the business, others are going to get retooled." It will be a painful shake-out for some. But the good news is that, despite all the pain, there are still enough jobs out there to make pounding the sidewalk in the New Year worthwhile. ▼

Bonus Increase (Decrease) by Sector			
CATEGORY	2007 (%)	2006 (%)	2005 (%)
Regions			
Americas	(10-15)	10-15	15-20
Europe	(5-10)	15-20	20
Asia	0-5	20	20-25
Fixed Income	(15-20)	10	10
Commodities	15-20	15	30
Credit Derivatives	(15-20)	10-15	0-5
Emerging Market Debt	10-15	5-10	20
Fixed Income Proprietary Trading	5	0-5	0-5
FX	(0-5)	0-5	15
High Yield Credit	0-5	5-10	(10)
Interest Rates	5-10	0-5	5-10
Investment Grade Credit	10-15	0-5	5-10
MBS	(30-35)	0-5	0-5
Municipal Derivatives	(0-5)	5-10	5-10
Structured Credit	(20-25)	15-20	15-20
Structured Finance	(15-25)	15	10-20
Equities	10	20	20

Source : Options Group

Kathryn Tully is a freelance journalist covering capital markets and finance. She is a regular contributor to the *Financial Times*, and her work also appears in *Euromoney* and *Institutional Investor*.