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# Incentive Pay and Bank Risk-Taking: Evidence from Austrian, German, and Swiss Banks

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## Abstract

We use payroll data in the Austrian, German, and Swiss banking sector to identify incentive pay in the critical banking segments of treasury/capital market management and investment banking for 67 banks. We document an economically significant correlation of incentive pay with both the level and volatility of bank trading income—particularly for the pre-crisis period 2003–7, in which incentive pay was strongest. This result is robust if we instrument the bonus share in the capital markets divisions with the strength of incentive pay in unrelated bank divisions like retail banking. Moreover, pre-crisis incentive pay appears too strong for an optimal trade-off between trading income and risk, which maximizes the net present value of trading income. Further analyses indicate that the bonus moderation during the crisis has removed excessive pre-crisis incentive pay.

JEL Classification: G20, G21, D22

Keywords: Trading Income, Bank Risk, Incentive Pay, Bonus Payments

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