2018 Financial Services Compensation:

Higher Compensation In A Complicated Environment

DISCUSSION AND PRESENTATION

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Discussion Topics

Johnson Associates

- Independent financial services compensation consulting firm offering informed advice, reflecting best practices and customized solutions. Proud of straightforward recommendations, and successful programs. Common services include annual and long-term designs, nuanced market pay data, performance metrics and goals, equity and partnership issues, and Board Committee advice
  - Balance market/best practice with firm dynamics
  - Both Board consultant and company programs
  - Creative, opinionated and informed

- Diverse clients and issues
  - Asset Management and Wealth Management firms
  - Hedge Funds/Private Equity/Fund-of-Funds/Alternatives
  - Major banks and units
  - Insurance companies
  - Brokerage firms
  - Trading organizations

Higher Compensation for Now

- Upward 2018 compensation movement from recent market levels and business dynamics

- Near term issues
  - Increased competition and consolidation
  - Market levels, particularly internationally
  - Short-term fee levels and asset shifting to lower cost products
  - Over-staffing particularly in operations/sales/management

- Continuing issues
  - Perceptions/reality on real value add to clients
  - Staffing model in an era of excellence

- Compensation isn't everything and can be an excuse
  - Culture, broadly defined, matters
  - Career opportunities

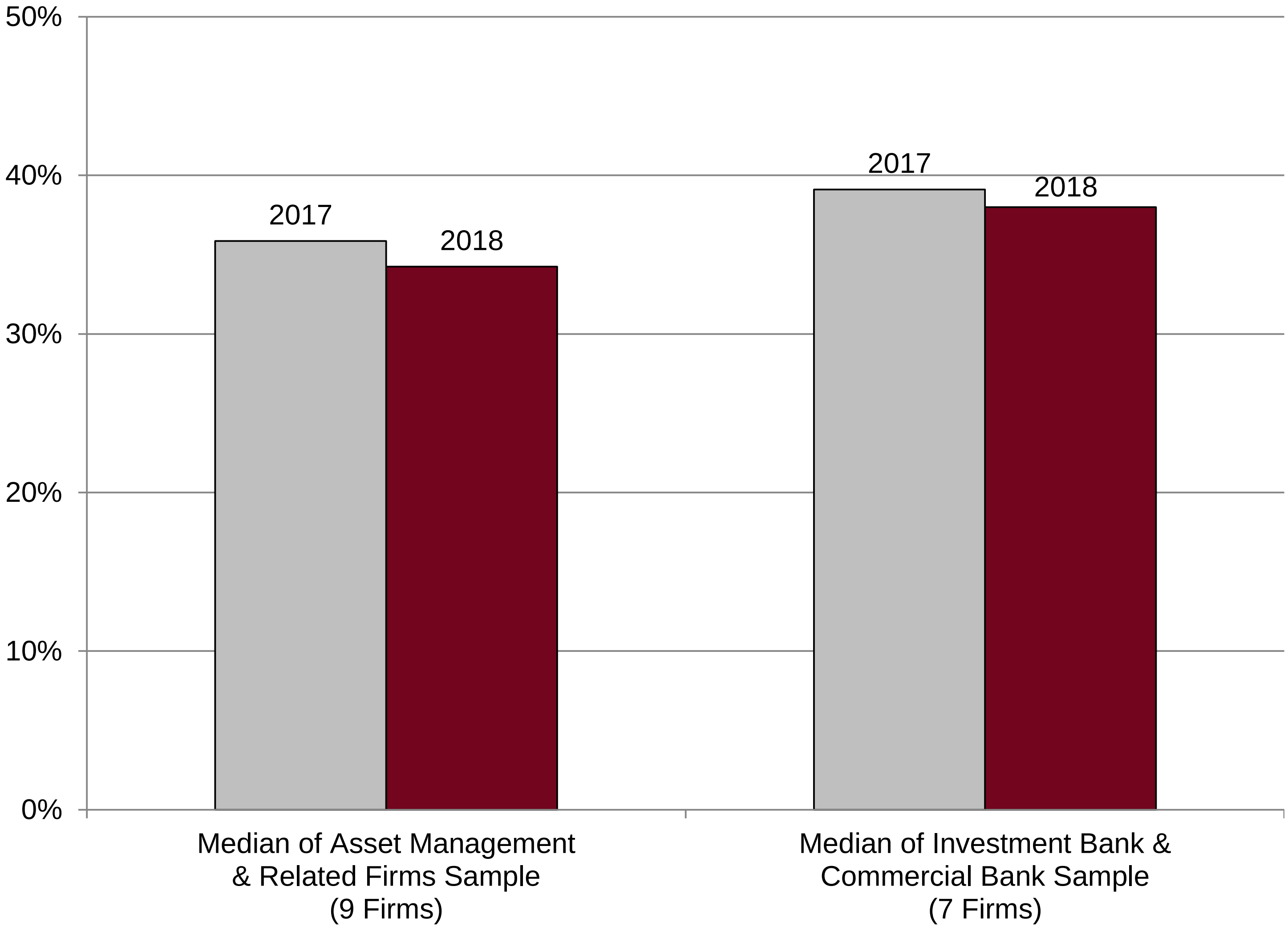
2018 Industry Incentive Changes

% change from 2017 "same store" basis

- Positive 2018 despite market volatility
  - However, respite ending from longer-term dynamics
- Asset and wealth management: +5%
  - Slowing revenues
  - Interest rates remained low but increasing
  - Difficult global markets and creating value
- Hedge funds: flat to +5%
  - Mildly positive
  - Continued consolidation and pessimism
- Private equity and real estate: +5% to 10%
  - Strong fund raising and realizations
  - Economics of scale increasingly dominate
- Major bank incentives driven by equities and underwriting
  - Fixed income and other areas positive

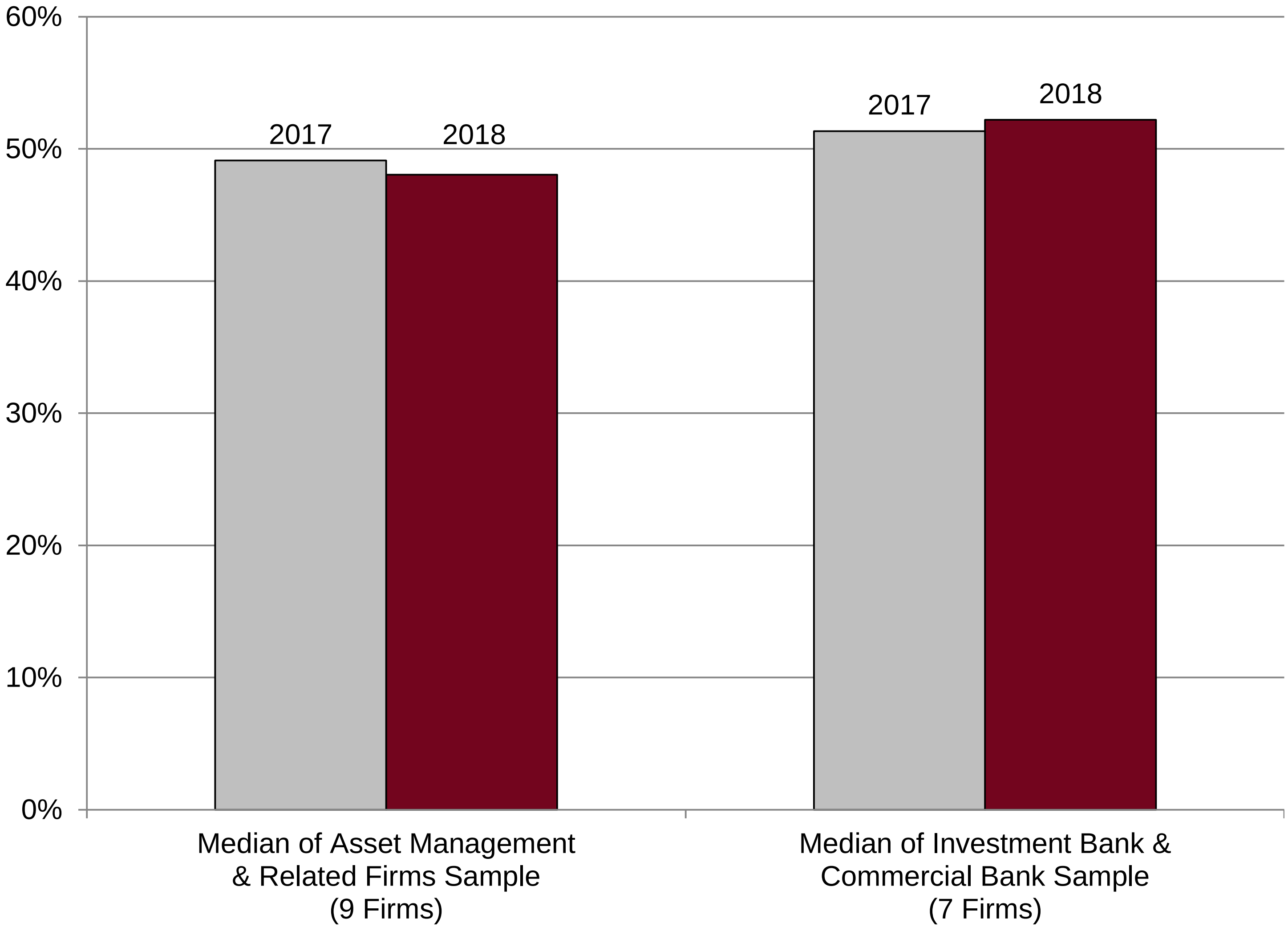
2018 vs. 2017 Compensation as % of Net Revenues

Note: Reflects available year-to-date data

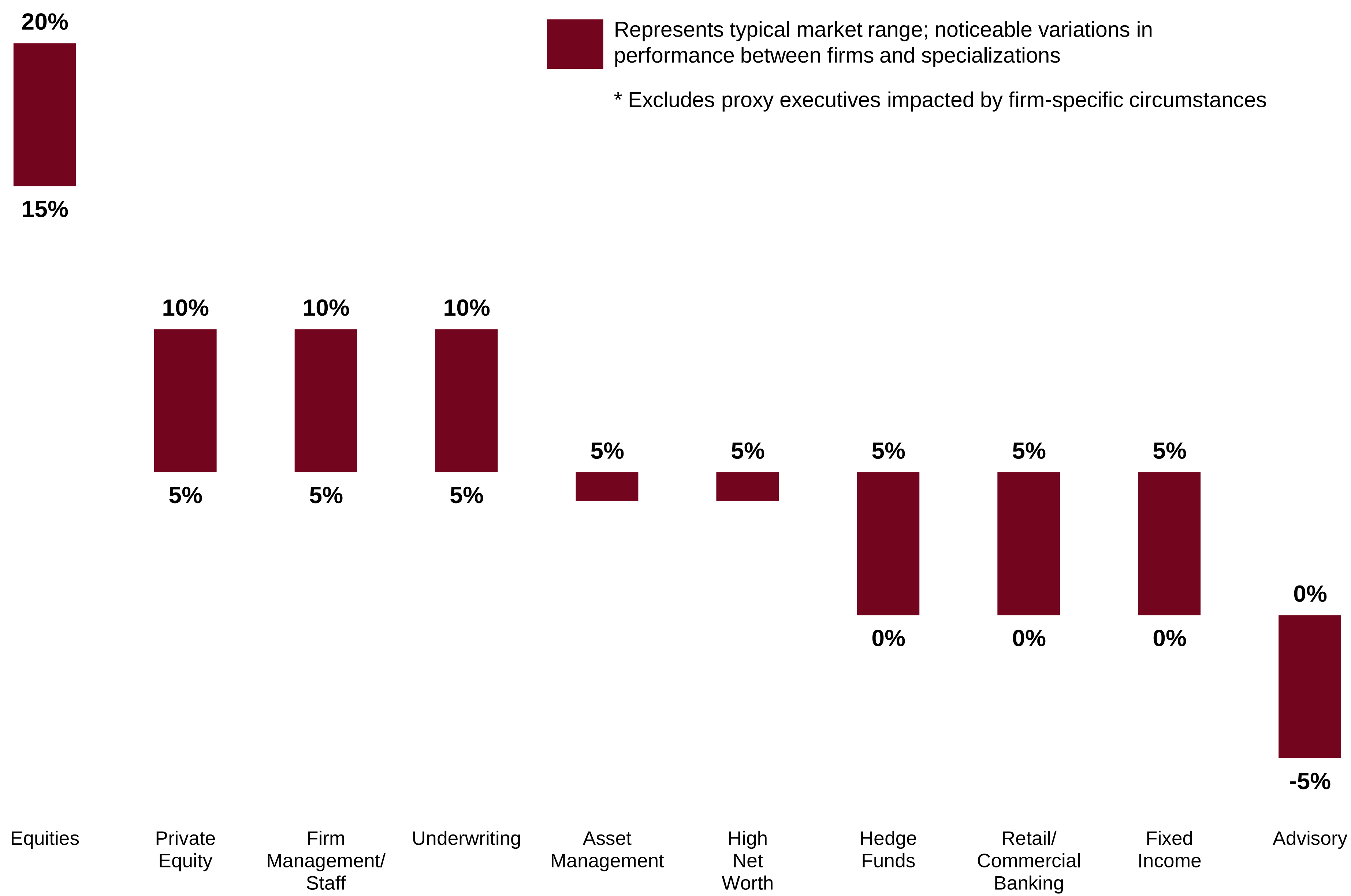


2018 vs. 2017 Compensation as % of Pre-Tax, Pre-Comp Income

Note: Reflects available year-to-date data



2018 Common Incentive Changes (Cash & Long-term/Equity)



Gender Inequality – Long-term Considerations

- Ongoing need to monitor compensation across levels and positions
  - Relatively blunt tool provides an indication of potential problems. Further analysis of performance, role, tenure and other factors (i.e. location, title and content differences) can identify if real problems exist
- Oftentimes, more significant issue is whether equality of opportunities exist. Are promotions fair, has the organization done enough to recognize circumstances, where do we recruit, etc.
  - Unfortunately limited real analysis of available candidates for roles and levels is performed
- Gender inequality is a business issue
  - Expectation is financial services should make significant progress, even if remedies don't come easily or quickly
  - Continued public scrutiny
  - Should be thoughtful and exhaustive process

Base Salary Increases Accelerate – Direct and Indirect

- Single meaningful merit budget has lost much of its meaning. Most firms do not formally recognize the various sources of increase (i.e. 3% is really 5%)
  - Title changes
  - Equity adjustments
  - Promotional increases
  - New hires and replacement hires

- Focus on base salary increases/levels remains an oddity in an industry preaching total compensation
  - It has an innate appeal as a simple metric. Low base salaries today often indicate dated thinking

- Reality is base salary levels matter to almost every professional
  - In a world focused on incentives, it remains underappreciated

Perspectives from Technology Competitors

Financial service firms have often been caught flat-footed by core technology competitors. Continued lack of information and resistance to change/arrogance

- Fact: Excellent technologists are very well paid (i.e. 75th percentile +)
  - Wide differentiation on skills and contribution
- Myth: Need large equity grants to be competitive
  - Cash usually works fine, probably better
- Fact: Interesting tools and work are important
  - New challenges emphasized
- Myth: Millennials overly concerned with work-life balance
  - The best expect to work very hard
- Fact: Expect to progress on contribution/skills, not seniority
  - Tenure becoming less important
- Myth: Technologists are plus/minus the same as average
  - The best are 2-3x as productive as the average

Lessons from the GE Debacle

- Equity focus – or lack thereof telling
- Trust in complicated accounting rather than equity value to drive programs
- Focus on historical and market practices rather than accountability and performance
- Long-term objectives unclear across multitude of plans
  - Restricted stock
  - Stock options
  - Performance plans
- Corporate vs. business unit emphasis
  - Key question is what will better motivate performance?
- Simplicity and clear objectives abandoned
  - Complex designs can hide entitlements

Compensation programs in isolation made sense. Together a complicated mix, reflecting lack of clear objectives and accountability

Impact of Cost-of-Living Increasing Over Time

- Impact of cost-of-living differences (mostly housing and taxes) will build over time
  - Reality, and belated recognition, financial services over-concentration in select cities will diminish. Few today expect to be paid the same in New York and Atlanta
  - Seeing more aggressive strategies to minimize costly locations

- Increasingly will need to customize pay levels to reflect markets
  - Can't afford "New York" wages for everyone and shouldn't try
  - Local market rates will diverge

Annual Compensation for Equal Standard of Living

City	Annual Compensation
San Francisco	$265,000
New York	$250,000
Boston	$204,000
Chicago	$170,000
Atlanta	$136,000
Austin	$134,000
Salt Lake City	$133,000
Tampa	$130,000

Source: CNN Money

2019 Fearless Predictions

- Layoffs/downsizings coming in first quarter
  - Recognition of business dynamics and productivity increases/automation

- 2019 compensation down moderately (i.e. 5%)
  - Markets, fee levels, and product shifting

- Continued angst about competition for high-end technology talent
  - Noticeable improvements needed

- Effective base salary increase often in 4% - 5% range

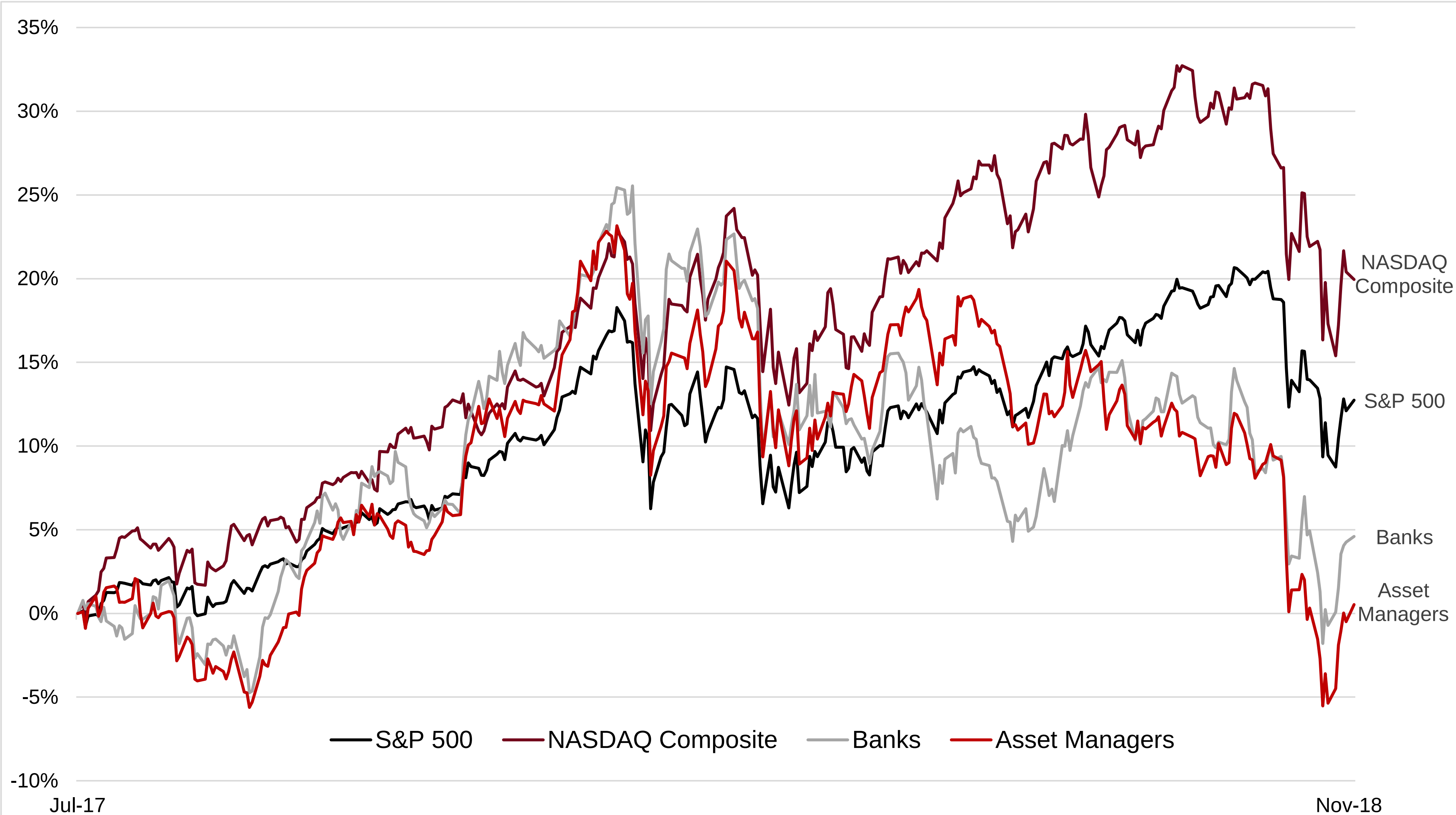
- Hedge funds utilize more "direct drive" compensation designs
  - Greater individual accountability v. group success/harmony
  - Asset class in need of a spark

- Greater focus on long-term incentive designs
  - Emphasis on performance and metrics
  - More thoughtfulness around alignment and behaviors

- Quantitative products and talent remains focus

Market Sending Clear Signals

- Stock market clearly believes asset management firms and banks face more difficult business dynamics going forward



New Thoughts on Market Positioning – Part I

- Evolving views on importance of talent
  - "Front office" broadly paid on contribution so general market levels less relevant
  - "Back office", for select positions, viewed as value creators rather than only a cost

- Paradigm shift more difficult for larger/more entrenched organizations
  - Historical perceptions on criticality of non-direct revenue producers. Overwhelming perception outstanding professionals are a bargain vis-à-vis average contributors
  - Continuing organizational resistance to paying at the 75th percentile vs. median for any support professionals

- In a changing marketplace relative value of experience has declined, while talent increased. Goes against orthodox practices where levels and hierarchy key drivers
  - Impacts weighting of factors for promotions
  - Firms overly concerned with turnover, some average performers leaving could be a positive

New Thoughts on Market Positioning – Part II

Perplexing Messages
How can they both be right?

Market pay for position "X"	Best performers for position "X"
Up 3% to 5%	**Up 10% to 15%**

- Need to be open and clear about distributions of talent along the pay continuum
- Key nuance is definition of market: Can't assume simple tracking year-over-year fully reflects market for all talent
  - For less valuable performers market may not have moved at all
  - Market data must be considered in a more nuanced fashion, for select positions
  - Interesting that many firms have embraced outsized increases for lower-levels

Rebooting Long-term Incentives

- Increasingly important to understand objectives (which may vary in a firm)
  - Enhance and focus performance
  - Retention/competitiveness
  - Meet governance expectations/requirements

- Performance measurement and metrics

  - Equity or equity-like
  - Absolute financial results
  - Relative financial or stock results

  →

  Linked to what trying to achieve and **not** simply market practice

- Design simplicity and consistency is vastly underrated
  - Overlapping cycles with multiple high-level generic measures big disadvantage in driving performance

Asset Management – Future is Almost Here

- 2018 compensation moderately positive, but slowing
  - Systemic fee issues continue
  - Client perceptions of value and cost become more acute

- 2019 staff reductions
  - Firms over-hired from 2016 - 2018
  - Impact of technology and productivity/automation

- Need for more focused annual and long-term incentive plans
  - Clear assessment of objectives and metrics
  - More accountability

- Observing more “Haves” and “Have Nots” in firm results and prospects
  - Real variations in future prospects
  - Increasingly compensation impacted by firm results and situation. Affordability, head count, and individual performance become more important

Private Equity – Carry is Overemphasized

- Compensation clearly up on fundraising and realizations
  - Outpacing other sectors

- Carry is economically crucial – but often a human resources crutch
  - Allows annual compensation and performance management to be neglected. Need to make human resources decisions recognizing incomplete information and timeframes

- Compensation allocations and messaging need to be more nuanced
  - Reality few mid- and senior level professionals will voluntarily quit. Treating them as fine porcelain counterproductive
  - Should not strive for “equalness” of bonus and carry awards

Hedge Funds – Change Required

- More "direct drive" incentives focusing on individuals/teams
  - Reaction to broad malaise, attempt to drive greater accountability
- Often lack of clear compensation philosophy and practices
  - More important in periods of volatility and pessimism
- Technology firms provide instructive template
  - Focus on excellence
  - Wide variations in compensation and career with performance
  - Less emphasis on tenure and non-relevant experience
- Increasingly targeting ultra-high end talent
  - Desire the best computer scientists
  - PhDs and data scientists (i.e. "Big Data")
  - Have explainable compensation philosophy and trajectory

Final Thoughts

- 2019 compensation moderately lower
  - Impact of markets and fees
- Staff reductions in 2019
  - Impact of technology and productivity/automation
- More energy needed on incentive plan designs
  - Need for clarity, urgency, and accountability
- Employee excellence paradigm has broad implications
  - Talent increasing relative to experience
  - Both compensation and career trajectories
- Many long-term incentive plans in need of a reboot
  - Objectives and metrics refined
- More hedge fund “direct drive" incentive plans
  - Requires accurate measurements and sound design
- Increasingly complicated compensation environment requires greater analysis and willingness to break from past practices and mindsets