Another Gloomy Bonus Season for the Buy Side

2016 Asset Management Compensation

Pay levels in the asset management industry are on the decline in 2016—marking the second consecutive year of reduced compensation for professionals at traditional asset management firms and the third for hedge funds.

Even after recent disappointments in pay, this year's bonus season could bring some unpleasant surprises. The reason: Last year, for the first time in recent memory, some traditional asset management firms faced difficult conditions but found ways to avoid or at least minimize compensation cuts. In the face of continued business headwinds, that will be much harder to do this year—and even more difficult for hedge funds, some of which are feeling extreme pressure following several consecutive years of disappointing performance. As major investment indices have climbed to record highs over the past 12 months, another pay reduction might come as unexpected news, particularly for portfolio managers that have notched solid investment returns in their own funds this year.

NOTABLE TRENDS AND TAKEAWAYS

- Incentive compensation down versus prior year
- Incentive declines for second year in traditional asset management and third year for hedge funds
- Potential for misalignment of expectations (employee perception and firm realities)
- Pressures on asset management business continue; regulatory effects and fee pressures expected to reduce margins
- Hedge fund pay continues to be below peak
- Flat or lower than prior year compensation levels for professionals across the board
- Deferrals have stabilized
- Even in challenging environment, better outcomes with improved communication and performance management
- Individual performance perceived as having reduced impact
- Increased differentiation and improved performance management essential
- Sales compensation remains in the cross hairs

Rising Costs and Pressure on Fees

Pressure on asset management profit margins is driving these pay cuts. On the revenue side, investors are pushing asset managers to reduce fees. For traditional managers, the rising popularity of passive investment strategies has put their own active management fees in the spotlight for investors. The pressure is much greater in the hedge fund industry, where uneven performance has caused investors to push back against the traditional “two-and-twenty” fee structure.

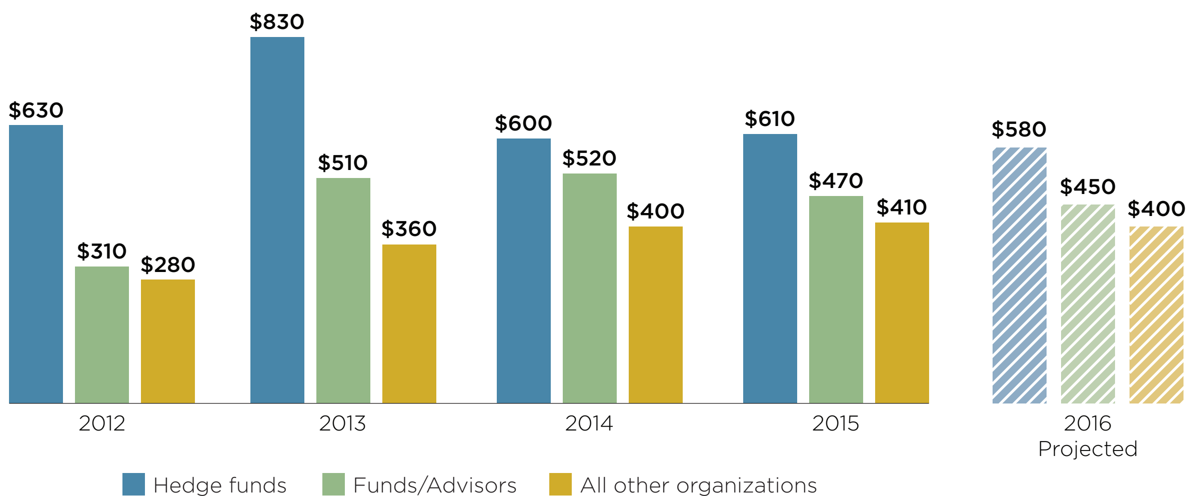
Meanwhile, costs are on the rise. Technology expenditures are up. New regulations, while targeted more directly at the sell side, have increased compliance costs for asset managers—in some cases substantially. “The reality is that compensation is not likely to recover to recent market highs and might even fall further in coming years,” says Johnson Associates Managing Director Francine McKenzie.

On the flip side, asset management professionals are still faring better than their counterparts on the sell side, who have endured head-count reductions, stagnant compensation and depressed morale caused in part by regulatory burdens. “Even several years of compensation reductions will not stop the flow of talent from the sell side, which sees the buy side as offering at least equal potential financially, with much better quality of life,” says Greenwich Associates analyst Kevin Kozlowski.

Unfortunately, it appears that challenges such as fee erosion, rising costs, slow growth in revenues, and margin contraction will remain in place and perhaps even intensify in 2017. In the final quarter of 2016, asset managers are looking seriously at steps to reduce their cost bases, including head count reductions, office relocations and, of course, compensation cuts.

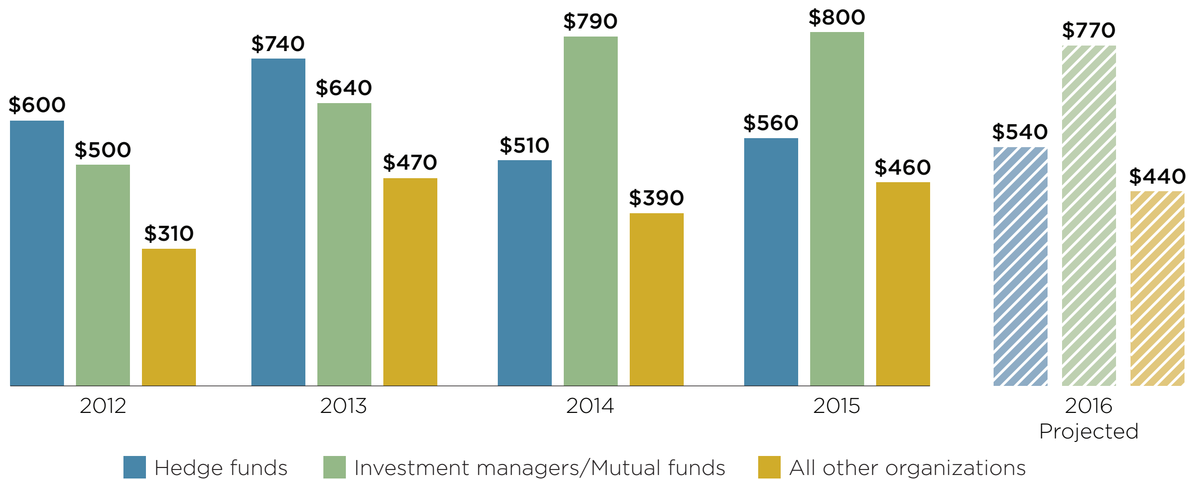
Moving into next year, Greenwich Associates and Johnson Associates expect ongoing pressure on compensation levels, as clients continue to push back on fees, and regulations and fiduciary standards are finalized and implemented, resulting in increased costs and complexity in compliance.

AVERAGE TOTAL COMPENSATION
Fixed Income



Note: Rounded to $000s. Based on 495 responses in 2012, 243 in 2013, 205 in 2014, and 206 in 2015.
Source 2012–2015: Greenwich Associates U.S. Fixed-Income Investors Studies
Source 2016: Johnson Associates projections on changes from Greenwich Associates 2015 data

AVERAGE TOTAL COMPENSATION
Equity



Note: Rounded to $000s. Based on 94 responses in 2012, 152 in 2013, 129 in 2014, and 128 in 2015.
Source 2012–2015: Greenwich Associates U.S. Equity Investors Studies
Source 2016: Johnson Associates projections on changes from Greenwich Associates 2015 data

As these trends play out, firms will increase their emphasis on identifying and rewarding top performers while reducing costs—and potentially head counts—through the rest of the organization. Survivors will be high achievers that demonstrate the ability to adopt multiple roles and new responsibilities, and to add value in innovative ways.

In some firms, this will create opportunity for younger professionals recognized as having high potential. "In part due to current compensation that is lower than that of professionals one or two levels higher in the organization, younger professionals are already finding new opportunities for growth in what is otherwise a very challenging environment," says Francine McKenzie.

ABOUT THIS REPORT

In this report, Greenwich Associates and Johnson Associates present the key findings of their joint 2016 Asset Management Compensation Study. Results are based on data collected by Greenwich Associates through telephone and in-person interviews with more than 1,000 financial professionals in equity and fixed-income investor groups at investment management firms, mutual funds, hedge funds, banks, insurance companies, government agencies, and pensions and endowments, as well as users of foreign exchange at large corporations and financial institutions.

Armed with this self-reported data as a baseline, Johnson Associates uses proprietary information on compensation and other industry data to project compensation levels and trends for 2016. Johnson Associates actively monitors compensation trends and issues through intensive research and ongoing client assignments. In select areas, the self-reported information from investment professionals may not necessarily align directly with overall market trends. Some of these variances can be explained by different sample sets of professionals year-over-year or specific circumstances related to individuals (transfers, new hires, promotions, change of job, etc.).

Contributors include analyst Kevin Kozlowski from Greenwich Associates and Managing Director Francine McKenzie from Johnson Associates.

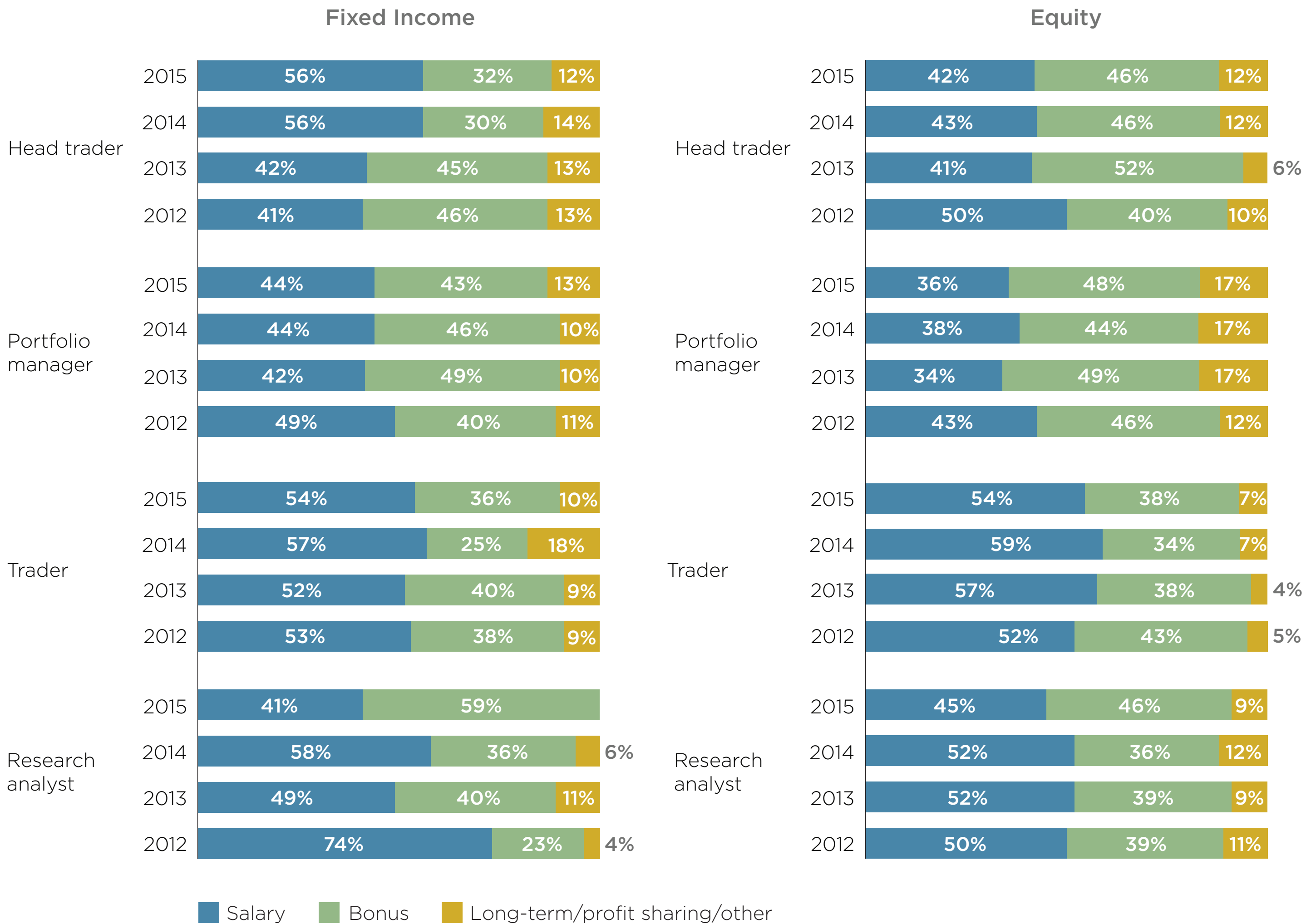
Compensation Trends

Overall buy-side compensation levels declined at least slightly from 2014 to 2015, and professionals in both equity and fixed income expect that negative trend to continue in 2016.

Bonuses accounted for approximately 50%–55% of cash compensation among senior equity professionals and 40%–50% among traders and analysts. In fixed income, bonuses made up 35%–40% of cash compensation in senior roles and 40%–60% for other positions. Across the industry, 2016 incentives are expected to drop by approximately 10% from 2015 levels. The pain will be greatest for hedge fund professionals, who expect incentives to decline some 10%–15%, compared to 5%–10% declines predicted for professionals at traditional firms.

"Hedge fund compensation still has not recovered from its steep decline from the 2013 high, and we do not expect to see a return to those levels anytime soon," says Kevin Kozlowski.

HISTORICAL MIX OF PAY FOR SENIOR BUY-SIDE INVESTMENT PROFESSIONALS



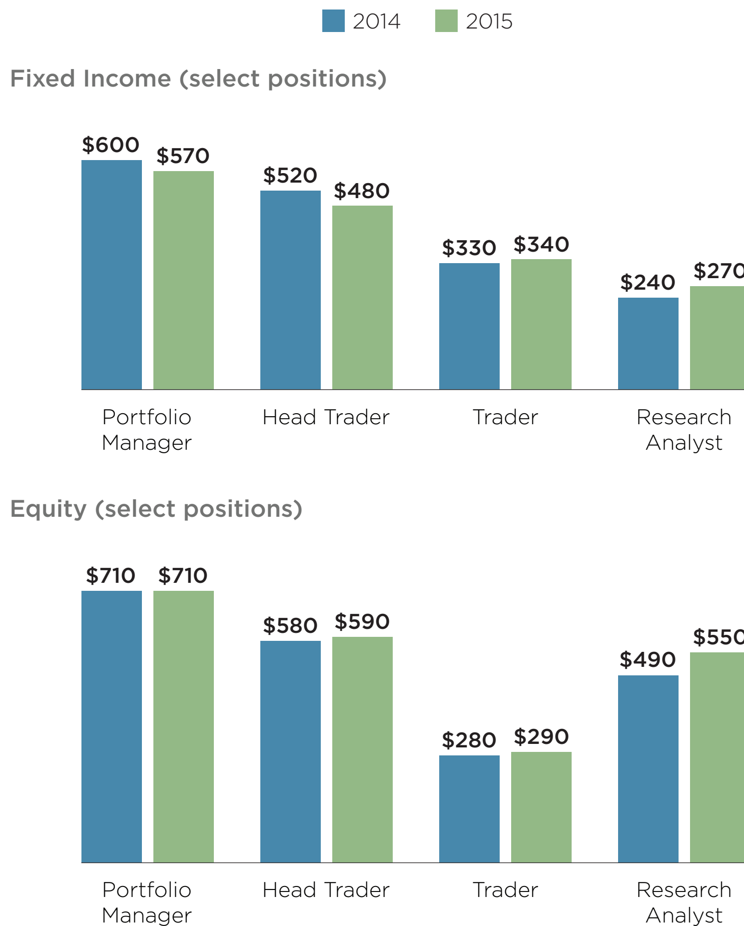
Note: *Data represents information from portfolio managers with analyst responsibilities. Estimated split of cash compensation between salary and bonus. Incorporated retirement across salary, bonus and long-term/profit sharing/other. May not total 100% due to rounding. Based on 318 fixed-income respondents in 2012, 564 in 2013, 275 in 2014 and 221 in 2015. Based on 423 equity respondents in 2012, 258 in 2013, 325 in 2014, and 275 in 2015.
Source: Greenwich Associates U.S. Fixed-Income and Equity Investors Studies

After increasing substantially in the years immediately following the global financial crisis, deferred compensation as a share of overall pay has leveled off. Publicly held asset management companies and subsidiaries of larger financial service companies remain at a disadvantage to privately held firms due to higher levels of deferrals and, in the case of the major banks, reductions in the value of outstanding stock-based deferrals that have acted as a "double whammy" alongside decreases in annual compensation levels.

Analysts Buck Trend of Declining Pay

While overall asset management compensation was flat to slightly lower from 2014–2015, one job title bucked that trend. Average pay for analysts increased approximately 12.5% last year. This significant rise could reflect the increasing seniority of analysts hired during the industry's post-crisis recovery, or it could be evidence that bottom-line-conscious firms are focusing on more junior and cost-effective professionals.

Across roles and responsibilities, equity market pay levels continue to top those in fixed income.



Note: Rounded to $000s. Based on 205 fixed-income respondents in 2014 and 206 in 2015. Based on 272 equity respondents in 2014 and 270 in 2015.
Source: Greenwich Associates 2015 U.S. Fixed-Income Investors Compensation Benchmarks Report

Hedge Funds vs. Traditional Managers

The compensation advantage for fixed-income professionals at hedge funds continued to narrow to just 1.3 times the level at traditional firms. Average compensation in fixed income in 2015 was $610,000 for hedge funds professionals versus $470,000 at traditional firms. However, equity professionals at traditional asset management firms out-earned their counterparts at hedge funds in 2015. Hedge funds' historic compensation premium has been upended, with professionals at traditional firms earning an average $800,000 versus $560,000 for hedge funds.

The news for 2016 doesn't appear much better for hedge funds. Although investors continue gravitating toward alternatives in search of returns and diversification, increasing fee pressure on new assets is squeezing historical margins. As a result, hedge fund incentives are expected to be down approximately 10% this year, albeit with wide variance within firm-to-firm performance.

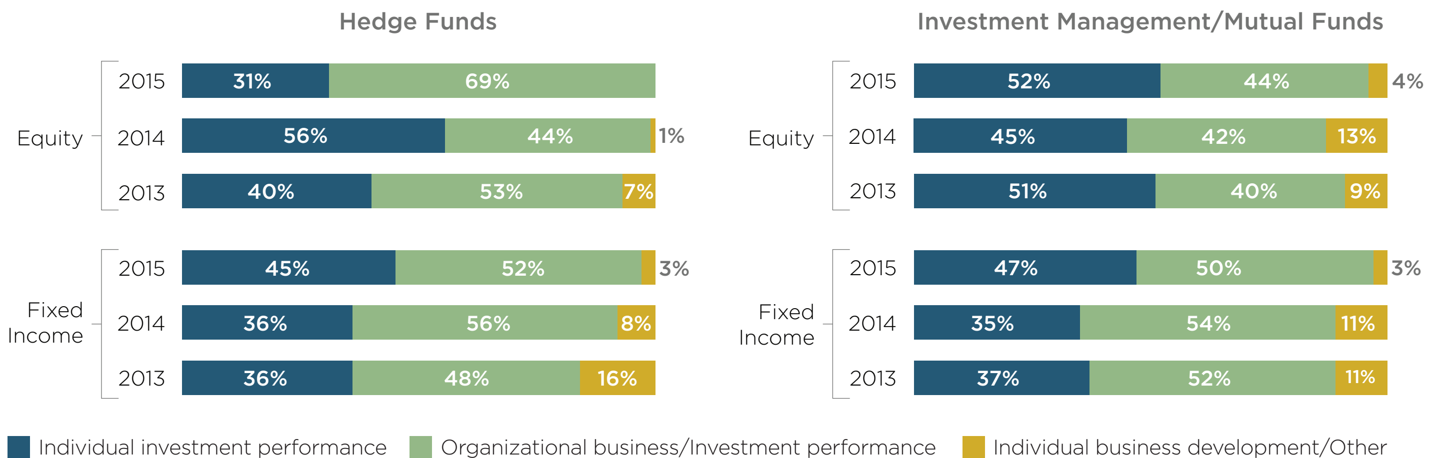
Drivers of Compensation

Participants in the 2016 Asset Management Compensation Study report that disappointing organizational business performance is crowding out individual performance as a driver of compensation. For 2016, study participants report individual performance (30%–50%) and organizational performance (50%–70%) as a driver of their pay. As firm business results have sagged, professionals feel that downward pressure is outweighing the results of individual performance. In other words: "I would have been up, but because the pool was down, I took a hit."

For hedge funds, this perception probably reflects reality. With performance fees depressed by weak investment performance, management fees are increasingly subsidizing annual incentives, placing greater emphasis on firm business results.

After increasing in importance as a compensation driver from 2013 to 2014, business development (including measures of fundraising and overall AUM growth) seems to have lost influence in 2015. In 2014, study participants reported that about 10% of compensation was tied to business development results. In 2015, that share dropped to approximately 5%.

TREND OF FACTORS DETERMINING BONUS



Note: Any difference between reported results in 2014 and 2015 and total of 100% was applied across categories proportionately. Based on 305 equity respondents in 2013, 272 in 2014 and 270 in 2015. Based on 527 fixed-income respondents in 2013, 265 in 2014 and 212 in 2015.
Source: Greenwich Associates 2013 - 2015 U.S. Fixed-Income Investors and Equity Investors studies

Sales in the Spotlight

Sales compensation structures will come under particular scrutiny—not only due to the same business pressures affecting the rest of these organizations, but also as a result of scandals and news headlines that have called into question some sales practices within financial services. Senior management will be forced to walk a fine line in setting compensation policies that make the sales and asset-gathering more effective while also adhering to the letter and the spirit of new fiduciary rules. They will also have to address concerns about creating incentives that could appear to encourage inappropriate behavior like that alleged in the Wells Fargo "cross-selling" scandal.

Threading that needle will require better communication from senior management, with clear cultural reinforcements about always doing what's best for clients, as well as properly designed compensation structures. These new challenges are likely to continue and even accelerate the trend toward hybrid sales compensation structures that employ a mix of objective and subjective criteria.

Conclusion

The 2016 bonus season is setting up to be a major disappointment. The business environment for 2017 doesn't look to be improving—and could get worse. As they enter their second or third year of declining pay, asset management professionals will take little comfort in the fact that, relative to the sell side, their industry is still a great place to work. As firms move to shore up their bottom lines, deteriorating morale among portfolio managers, traders, analysts, sales professionals, and staff throughout the organization will become a bigger problem for asset managers.

To counter this negativity, asset managers will need to focus attention and resources on two areas: 1) maintaining a disciplined, effective and transparent compensation structure that rewards high performers and properly aligns incentives, and 2) communicating to employees in a way that makes clear how performance—including both their own individual performance and the performance of the organization as a whole—is affecting compensation pools.

The data reported in this document reflect solely the views reported to Greenwich Associates by the research participants. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Greenwich Associates compiles the data received, conducts statistical analysis and reviews for presentation purposes in order to produce the final results. Unless otherwise indicated, any opinions or market observations made are strictly our own.

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