Asset Management Compensation: Second Choice No More

Asset managers have had another strong year in 2014. Market appreciation and positive inflows boosted AUM for traditional firms, while hedge fund AUM continued to grow despite mixed results. Across the industry, this performance has pushed up incentive compensation.

Greenwich Associates and Johnson Associates project:

- 2014 incentive compensation at traditional asset management firms will increase 5–10%, with equity products outpacing fixed income.
- Salaries will increase 3–3.5%, including merit and promotional budgets.
- Incentive compensation among hedge funds will vary much more widely, reflecting performance volatility from strategy to strategy and firm to firm.
- Employees at underperforming hedge funds can expect to see incentive compensation that is flat to down 5%, while incentives at better performers are projected to increase by up to 5% and perhaps higher for top performers on average.

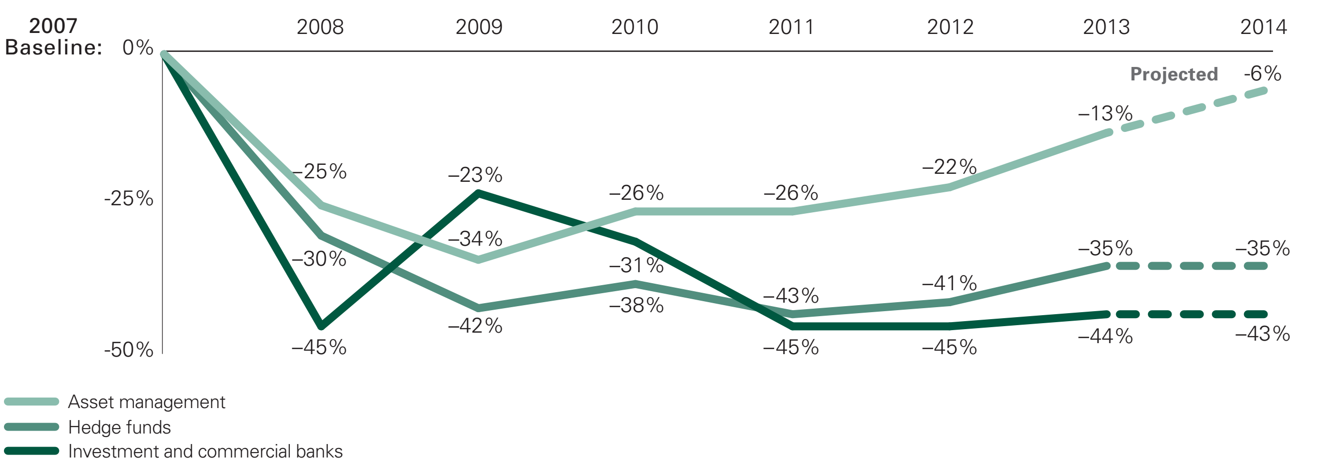
These ongoing positive trends are making asset management more appealing as a career choice for financial professionals, relative to a sell side that is still plagued by reduced compensation on results,

About This Report

Greenwich Associates and Johnson Associates present the key findings of a joint 2014 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 2014. 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.).

Change in Incentives Since 2007: Senior Buy-Side vs. Sell-Side Investment Professionals



Source: Johnson Associates 2014

intense regulation and somewhat diminished social status. Nevertheless, job turnover rates remain near historic lows, despite a modest pickup in hiring over the past year. Voluntary turnover remains depressed due to professionals' concerns about job security in an era when financial firms of all types are focused on cost minimization. To that end, firms are being more diligent and aggressive in separating high-performing employees from low performers and differentiating compensation accordingly. In fact, more than ever before, compensation in asset management is being determined by performance—for both firms and individuals alike.

After years of playing second fiddle to the sell side as a career option, the asset management industry is emerging as the first choice for many financial professionals.

The combination of attractive and stable pay and better quality of life has made asset management an appealing destination for new entrants to the industry and market veterans alike. The buy side looks particularly welcoming relative to a banking industry that still has not recovered fully from the global financial crisis. By nearly every metric, the sell side is not what it once was as an employer. Previously coveted sell-side positions are diminished in terms of job stability, societal prestige and, perhaps most importantly, compensation opportunity relative to job demands.

Incentive-based compensation for professionals at traditional buy-side organizations has almost recovered to pre-crisis highs. By contrast, incentive pay at investment and commercial banks is still down more than 40% from the peak. Although sell-side compensation started from a much higher base, the differential between buy-side and sell-side pay has narrowed. For many investment professionals, perceived quality-of-life benefits of buy-side jobs more than make up for that difference.

That's not necessarily the case for "captives," or asset management firms owned by commercial or investment banks. These firms are finding it more difficult to recruit professionals to businesses perceived as being part of large organizations that are under scrutiny from regulators, focused on cost reductions over growth and generally more onerous places to work. Compounding the problem is mounting competition for talent from other industries, such as consulting and technology. In response to these pressures, Wall Street firms are increasing starting salary levels for professionals and making efforts to improve the work-life balance of employees.

The same dynamic is playing out with regard to hedge funds to at least some extent. Although hedge funds pay somewhere between 1.5–2 times as much as traditional asset managers for comparable titles, incentive compensation at hedge funds is down some 35% from pre-crisis highs. While hedge funds remain a popular destination for professionals leaving the sell side, they are attracting fewer professionals from traditional asset management firms.

Notable Trends and Takeaways

- Incentives up on average 5–10% across asset management
- Salaries will increase 3–5%, including merit and promotional budgets
- Incentives for equities fare better than fixed income during 2014
- Stable mix of pay with little movement between compensation components
- Incentive compensation among hedge funds will vary much more widely
- Underperforming hedge funds will see incentive compensation that is flat to down 5%, while better performers can expect increases of up to 5%
- Modest turnover and hiring, but clear emphasis on performance management and pay differentiation

Asset Management: Year-Over-Year Results and Other Factors

Overall, the asset management sector is posting another strong year in 2014, with significant AUM growth driven by both market appreciation and positive net inflows. This performance has resulted in robust compensation growth. Greenwich Associates and Johnson Associates project incentive compensation for traditional management firms, including cash and long-term incentives, to increase 5–10% on average in 2014. Salary levels are projected to increase 3–3.5%, including merit and promotional pay.

Hedge fund incentive increases have been weaker and less uniform than traditional peers. Overall hedge fund investment performance over the past year has been disappointing, with considerable variation from strategy to strategy and from firm to firm. This performance is mirrored by hedge fund incentive compensation, which is projected to be flat on average, but with actual incentive pay expected to range from -5% to +5%.

Across the asset management industry, hiring has picked up modestly from the lows of prior years, with the biggest demand for talent seen in risk, compliance, regulatory functions, and in alternative products. Voluntary turnover remains at historic lows as asset management professionals—like individuals in other sectors of the financial markets—continue to hold onto the stability of current jobs in a less-than-certain economic environment.

These professionals have reason for their caution. Despite the industry's recovery, the trials of the global crisis remain fresh in the minds of asset management firms. Firms are keeping a tight leash on compensation funding as part of a broader commitment to cost management and profit margin maintenance. As part of those efforts, firms are being more diligent and aggressive in weeding out poor performers, adhering to strict head-count management and developing talent internally. Growing talent in-house is increasingly viewed as more cost-effective and less risky than bringing in new hires.

Professionals Have Reason for Caution

- Emphasis on performance assessment and weeding out poor peformers
- Adhering to strict headcount management
- Developing talent internally results in fewer external opportunities

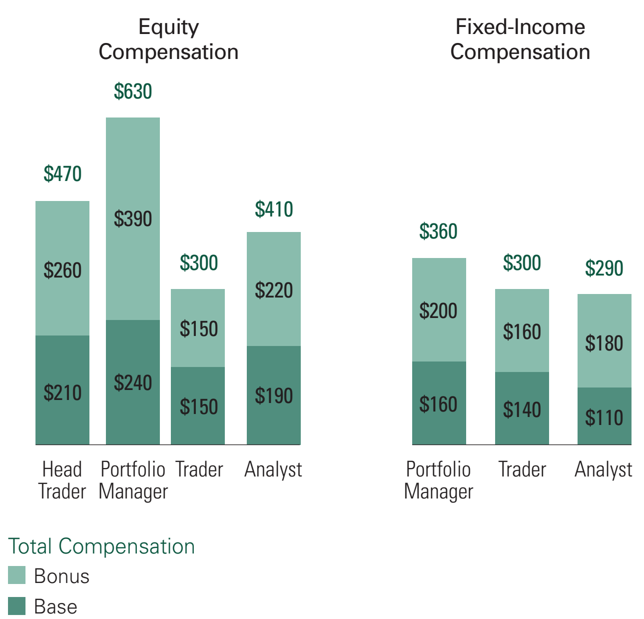
Together, these trends are keeping turnover rates low while creating new opportunities for existing employees to boost their own compensation through strong performance. More than ever before, compensation in the asset management industry is being driven by individual and organizational performance, with high performers seeing significant increases and poor performers experiencing stagnant or reduced pay.

Equity vs. Fixed Income

Thanks in part to the ongoing bull market, equity professionals are out-earning their counterparts in fixed income, in some cases by a considerable margin. Incentive payouts driven by strong investment performance increased reported total compensation for equity portfolio managers by nearly 25% from 2012 to 2013. Equity traders, head traders and analysts also experienced increases in total compensation.

Meanwhile, total compensation for fixed-income portfolio managers was flat to only slightly higher from 2012 to 2013, with traders and research analysts also experiencing only modest increases. Base salaries

Compensation Comparison
(in $U.S. 000s)



Note: Data is rounded in 000's. Head trader role excluded in fixed income due to lack of 2013 information. Source: Greenwich Associates 2014 U.S. Equity and Fixed-Income Investors Studies in fixed income have been on the decline for the past three years—possibly reflecting a "juniorization" of staffing at banks forced to find ways of reducing costs as a means of preserving margins.

For 2014, Greenwich Associates and Johnson Associates project incentive increases for equity professionals at the higher end of the 5–10% range, with fixed-income incentives coming in at the lower end of that range.

Hedge Funds vs. Traditional Firms

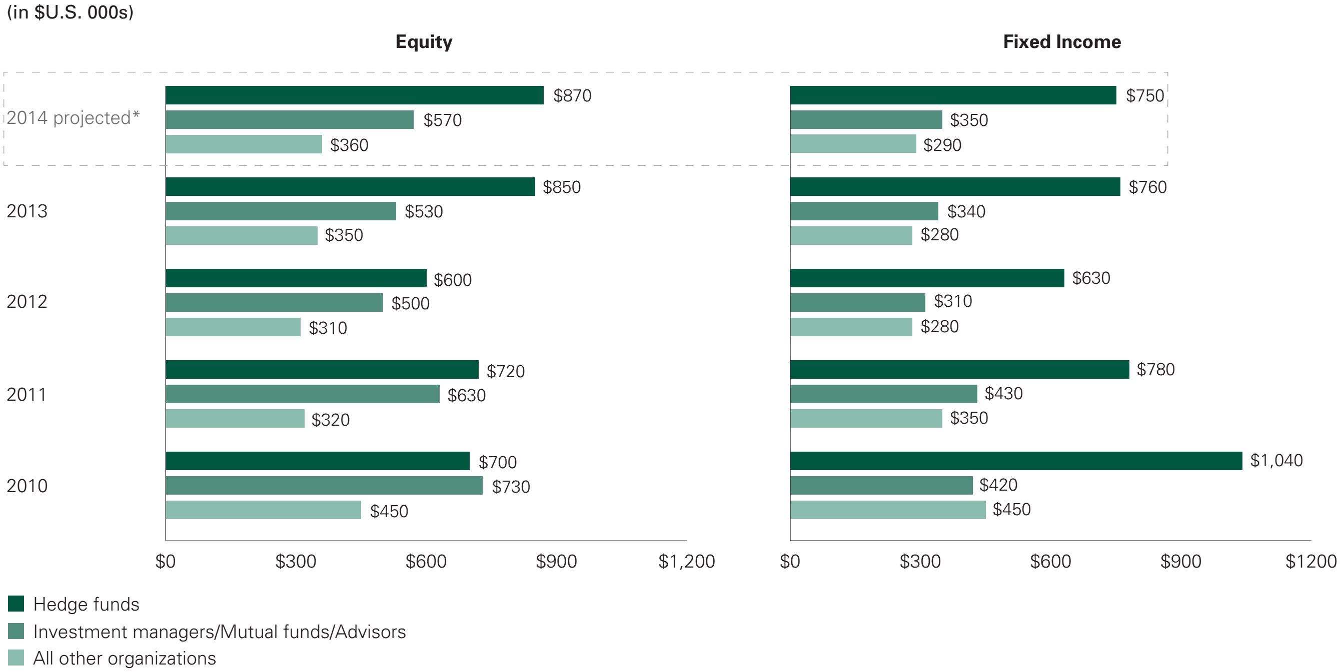
The pay differential between hedge funds and traditional firms widened from 2012 to 2013 in both fixed income and equities.

In 2013, hedge funds paid roughly twice as much as traditional firms for comparable positions in fixed income. Average compensation for fixed-income professionals was approximately $760,000 at hedge funds versus $340,000 at traditional firms.

In equities, strong market performance drove the pay differential wider and hedge funds are now paying roughly 1.6 times more than traditional managers in the asset class. Average compensation in 2013 for equity portfolio managers was $850,000 at hedge funds compared to $530,000 at investment managers and mutual funds.

Hedge funds began returning to pre-crisis high-water marks in 2011 and experienced asset inflows in 2011–2012. Following several years of weak performance for hedge funds as a whole, inflows have moderated and investors have become more discerning and fee-conscious. On net, inflows remain positive, but those new assets are flowing mainly to hedge funds with good and even great performance. Compensation trends reflect this widening dichotomy. Hedge funds that have delivered disappointing investment performance are struggling to attract assets and, in many cases, employees at these firms will be hit with reductions in incentive compensation of up to 5% in 2014. Strong performers will deliver incentive increases of roughly the same magnitude. These variations in performance are expected to balance out, leaving industrywide incentive compensation roughly flat for 2014.

Historical and Projected Compensation for Senior Buy-Side Investment Professionals
By Type of Firm
(in $U.S. 000s)



Note: "All other organizations" includes weighted average results from banks, insurance companies, government agencies, and other.
Source 2010–13: Greenwich Associates U.S. Equity and Fixed-Income Investors Studies
Source 2014: Johnson Associates projections on changes from Greenwich Associates 2013 data

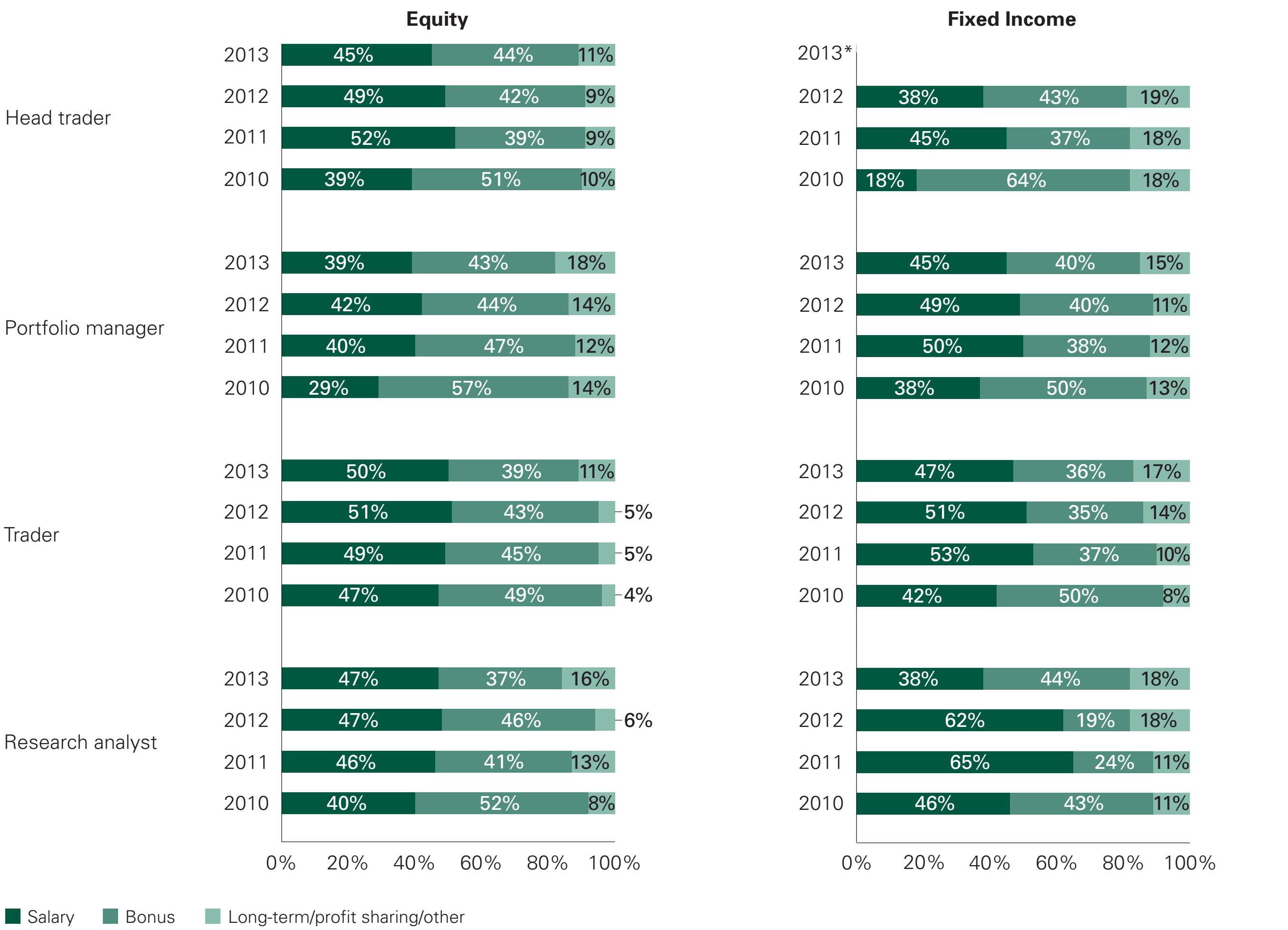
These trends are likely to remain in place for the coming year, with strong performing hedge funds continuing to attract positive inflows. At the very least these firms will be able to maintain incentive compensation at current levels, and in many cases firms with good investment results will increase incentive pay. Meanwhile, increasingly selective investors will continue to spurn funds that fail to deliver performance, and employees of these funds will see compensation continue to stagnate and even decline.

Stable Mix of Pay

The post-crisis movement to manage overall pay levels in financial services by replacing incentives with increases in base salary appears to have run its course. Through 2011, many asset managers followed the example of the sell side, which was being pressured by regulators and the public to rein in "excessive" compensation. During that period, asset management firms shifted compensation from incentives to base salary. That trend slowed in 2012 and stopped entirely in 2013. Last year bonuses accounted for approximately 45% of cash compensation in equity positions, with salary making up the remainder. That mix was essentially unchanged from the prior year.

For highly paid professionals working for public companies, standard market practice still calls for a significant share of incentives, roughly 30–50%, to be deferred. Private firms and boutiques make less use

Estimated Mix of Pay for Senior Buy-Side Investment Professionals



Note: *Head trader role excluded in fixed income due to lack of 2013 information. 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.
Source: Greenwich Associates 2014 U.S. Equity and Fixed-Income Investors Studies

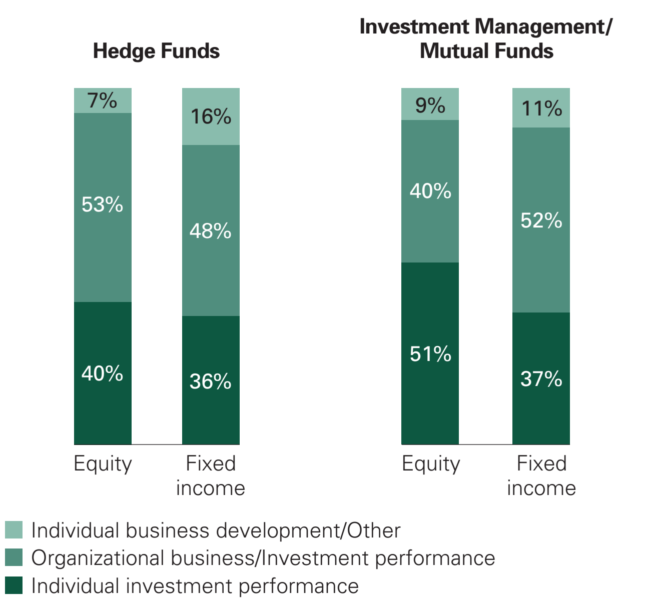
of deferrals, which average 20–30% of incentives—a differential that represents one more factor in favor of independent firms in the competition for talent.

In general, participation in these deferral plans is mandatory above a pre-established compensation level (e.g., above $200,000), and awards are formulaic based on a graduated scale. Prorated vesting over three or four years is standard practice.

Bonus Determination Trends

Although the structure of incentive award programs varies considerably from firm to firm and even position to position, across the asset management industry individual investment performance determines at least one-third of incentive awards on average. Organizational performance is responsible for approximately 50% of incentive pay—a significant component that reflects firms' increasing emphasis on teamwork, cost management and overall organizational performance. Multi-strategy firms are especially committed to establishing the right balance between organization results and individual performance. The final 10% of incentive awards are determined by business development metrics such as contribution to AUM growth, fundraising and other factors.

Trend of Factors Determining Bonus in 2013



Source: Greenwich Associates 2014 U.S. Equity and Fixed-Income Investors Studies

> Many firms are making a proactive effort to shift from a product-sales approach to a solutions-based model.

Sales Compensation: Less "Eat-What-You-Kill," More Teamwork

One of the biggest compensation-related topics for senior management of asset management firms today is how to structure sales compensation. Many firms have come to the conclusion that traditional structures based mainly on commissions are no longer the best approach. There is no doubt that the sales process has changed.

Many firms are making a proactive effort to shift from a product-sales approach to a solutions-based model in which they attempt to help clients solve problems. Even firms skeptical of solutions-based approaches are being forced to respond to changing client expectations by providing more transparency and deeper conversations about investment products, markets and portfolios.

For sales teams, the end result of these developments has been a raising of the bar in terms of the expertise and qualifications required to operate as an effective sales professional. Also, meeting new client demands often requires the combined effort of sales professionals, client service, the growing ranks of product specialists, consultant relations specialists, and investment teams. Since it is usually the sales professional spearheading the effort, teamwork is slowly replacing "eat what you kill" as the asset management sales mantra.

Reflecting these shifts, asset management firms are adding or expanding discretionary components in their sales compensation structures. Virtually all firms retain aggressive commission-based programs, which on average still comprise roughly 70% of sales compensation industrywide. However, the integration of bigger discretionary pools is intended to better reflect a sales process in which multiple individuals or groups often contribute to a sale, and to incent sales professionals to shift from a transactional attitude to a relationship-building mindset.

In summary, as the end of 2014 approaches with considerable stock market volatility, we believe the asset management sector overall had a strong year but may be moderated by current events. Focus on cost management and performance differentiation will continue. Asset management built a strong foundation in the past few years and is still expected to grow as we move into 2015. ■

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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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