GREENWICH ASSOCIATES

JOHNSON ASSOCIATES, INC.

# U.S. Asset Management: 2011 Compensation Report

*November 2011*


## Executive Summary

Compensation levels for investment professionals in 2011 are expected to be flat to modestly higher than those reported in 2010. Within traditional asset management organizations, compensation is projected to be flat from 2010 levels to 5% lower for equity professionals and flat to 5% higher in fixed income. Within hedge funds, compensation is expected to vary widely in 2011 based on company performance for both equity and fixed-income professionals, with some down and others flat or up versus 2010. These expectations are bullish compared with industry projections for investment and commercial banks, for which year-to-year compensation is projected by industry analysts to fall as much as 30% or more.

An analysis of 2010 compensation levels reveals that the gap in pay between fixed-income professionals working for hedge funds and those employed by traditional asset management organizations widened slightly last year while compensation in equities remained close to parity between the two groups. Across both hedge funds and traditional asset management firms, equity professionals including portfolio managers, traders and analysts out-earned their fixed-income counterparts last year by a margin slightly larger than that recorded in 2009.

Although asset management compensation structures are shifting away from bonuses in favor of annual salary, the trend is less pronounced on the buy-side than it is among sell-side firms that have come under much greater pressure from regulators. In 2010, bonuses accounted for approximately 65% of cash compensation among equity portfolio managers and 55–60% among equity analysts and directors of research, with the remainder in salary.  For fixed-income portfolio managers, salary makes up a larger portion of cash compensation. Bonuses for fixed-income professionals last year ranged from approximately 55% for traders and portfolio managers to roughly 75–80% for head traders.


## Introduction

Investment professionals entered 2011 with relatively bullish expectations on pay. Although compensation in 2010 had come in lower than many had hoped, the economy was showing signs of recovery and stock markets were surging. Through the first half of 2011, market appreciation and net inflows gave a boost to investment managers' assets under management and many hedge funds climbed back toward and even cleared previous high water marks.

These positive market conditions released pent-up demand in the asset management job market. Every year, Greenwich Associates gathers CEOs of some of the world's largest asset management companies for a day-long discussion of the industry. The executives participating in this year's CEO Roundtable agreed that talent turnover was more intense in the first half of 2011 than at any other time in their careers. Asset management organizations that had retrenched during the crisis and made do with thin staffing levels entered expansion mode last year and began hiring individuals and lifting out teams. At the same time, portfolio managers, traders and analysts who had clung to jobs throughout the tumultuous years since the onset of the global credit crisis suddenly felt confident to strike out for greener pastures. "In 2010 and through the first half of 2011 we saw the delayed fallout from the crisis finally begin to play out," says Greenwich Associates Director of Institutional Marketing Jennifer Litwin. "Dramatic cost reductions implemented by many asset management organizations during the crisis had a real negative impact on firm culture and employee loyalty. When demand for talent began to pick up across the industry, employees of these firms finally got their chance to walk out the door — and many took it."

In terms of compensation, however, 2010 was a tale of two markets. In fixed income, compensation rose in step with the increased demand for talent and the spike in turnover. Average total compensation for fixed-income portfolio

## Study Participants

This report presents the key findings of a joint study on asset management compensation conducted by Greenwich Associates and Johnson Associates. 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 pension and endowments. Using 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 2011.

In select areas, the charts of 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.).

When referring to equity analysts, the data is based on portfolio managers with analyst responsibilities.


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managers, traders and analysts working for traditional asset management organizations increased by roughly 10% from 2009 to 2010 and jumped 18% for fixed-income investment professionals at hedge funds. The story was much different in equities, where average total compensation in equities dropped 13% from 2009 to 2010 at traditional asset management firms and declined by 10% at hedge funds.

In the summer of 2011, conditions changed dramatically. The onset of a new and more dangerous phase of the European sovereign debt crisis sparked volatility in markets around the world and erased prior gains in financial asset valuations. Amid signs of sputtering economic growth, the U.S. Federal Reserve announced that it would move to hold interest rates at current historic lows for the foreseeable future.

These events tempered expectations for 2011 considerably. As a result, investment professionals are now generally expecting year-end compensation to hold steady from 2010 levels, with hopes for at least modest increases. More specifically, Greenwich Associates and Johnson Associates are projecting 2011 total compensation levels for traditional asset management organizations that are flat to down 5% for equity investment professionals and flat to up 5% for fixed-income professionals. For hedge funds, we are projecting total compensation will vary widely based on firm performance, with some down and others flat or up versus 2010 across both equity and fixed income. "Although compensation at these levels would hardly be viewed as a home run by investment professionals, even stable year-to-year compensation would be vastly superior to what's in store for other areas within financial services," says Francine McKenzie, Managing Director at Johnson Associates. "We are projecting average total incentives for trading and investment banking professionals in investment and commercial banks to decline somewhere on the order of 30% or greater from year to year."

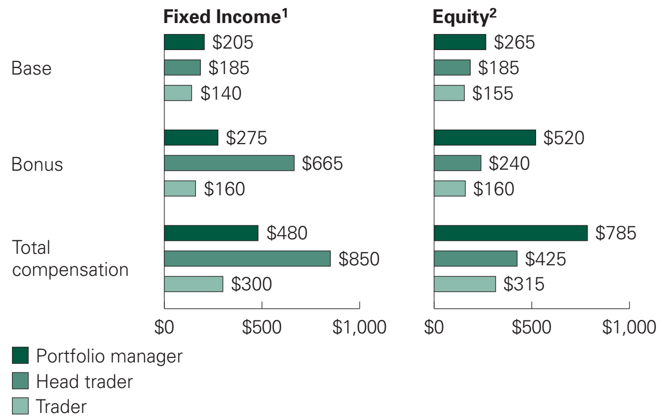
### Compensation: By Position

In general, equity market pay levels on the buy side are higher than those in fixed income for the same or similar positions, recognizing product and fee differentials. This variance was slightly more pronounced in 2009 than in 2010:

- Equity portfolio managers (PMs) earned 40% more than their fixed-income counterparts in 2010, with average compensation for equity PMs averaging $785,000 versus $480,000 in fixed income.

- Equity traders out-earned fixed-income traders by about 5% last year. Fixed-income traders earned an average $300,000, compared to $315,000 for equity traders.

### Compensation Comparison — 2010




Note: Rounded data in $000s.
Source: [1]2010 U.S. Fixed-Income Investors Compensation Benchmarks Study; [2]2010 U.S. Equity Investors Compensation Benchmarks Study (Portfolio Managers)

- Equity analysts earned about 50% more than fixed-income analysts last year, with equity analysts taking home an average $435,000 compared to $290,000 in annual compensation for fixed-income analysts.

- Compensation gap between buy-side and sell-side research analysts continues, where buy-side professionals generally receive roughly 5–10% higher pay and are perceived as having better career opportunities than sell-side peers.

- Fixed-income head traders earned an average $850,000 in 2010, double the total compensation of equity head traders.

- After widening in 2009, the gap in total compensation between Chief Investment Officers and other investment professionals seems to have leveled off in 2010. Average 2010 total compensation for CIOs in equities was approximately $1.1 million.

### Compensation: Traditional Asset Managers vs. Hedge Funds

The gap in pay between fixed-income professionals working for hedge funds and those employed by traditional asset management organizations widened slightly last year. In 2009, hedge fund fixed-income professionals earned 2.25 times the amount made by their counterparts at traditional organizations. In 2010 that ratio increased to 2.4 times, with average annual compensation for hedge fund fixed-income professionals increasing to the neighborhood of $1 million, as compared to $420,000 at traditional firms.

In equities, compensation levels remain roughly at parity between hedge funds and traditional management organizations, with average compensation in 2010 for hedge

fund equity professionals coming in at about $700,000 versus an average of roughly $730,000 at traditional firms. Compensation levels for hedge fund equity professionals remain depressed from prior years due to poor investment performance and the fact that, for much of 2009 and into 2010, many funds were operating below high water marks. For some, solid results in the first quarter of 2011 helped reverse those effects to some extent. However, recent market downturns will result in widely disparate pay outcomes. Currently, a majority of firms have underwater investment returns with a high percentage experiencing investor outflows.

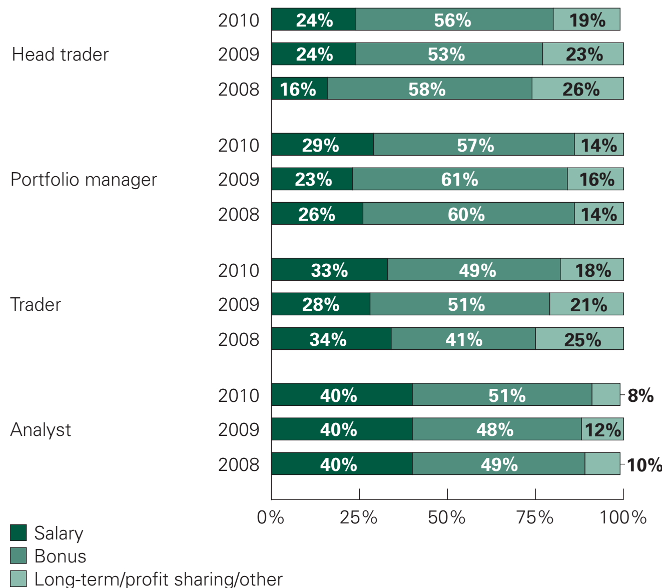
### Performance Incentives

Across the financial services industry broadly, employers are shifting compensation to increased salaries with

**Average Investors Total Compensation**
Equity

Note: Rounded data in $000s. Investment managers/mutual funds reflects weighted average results from each institution grouping. "All other organizations" data includes weighted average results from banks and pension and endowments. Source: 2010 U.S. Equity Investors Compensation Benchmarks Study (Portfolio Managers); *Johnson Associates projections on changes from Greenwich Associates 2010 data.

**Equity Mix of Pay**




Note: 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: 2011 U.S. Equity Investors Compensation Benchmark Study (Portfolio Manager)

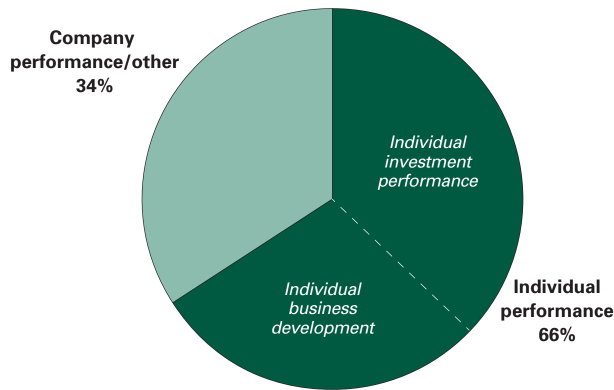
**Average Investors Total Compensation**
Fixed Income

Note: Rounded data in $000s. "All other organizations" data includes weighted average results from banks, insurance companies, government agencies and other. Source: 2010 U.S. Fixed-Income Investors Compensation Benchmarks Study; *Johnson Associates projections on changes from Greenwich Associates 2010 data.

**Fixed-Income Mix of Pay**

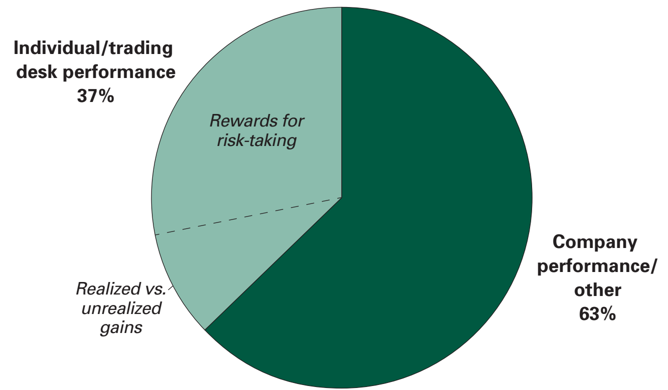
Note: Estimated split of cash compensation between salary and bonus. Incorporated retirement across salary, bonus and long-term/profit sharing/other. May not total 100% due to rounding. Source: 2011 U.S. Fixed-Income Investors Compensation Benchmark Study

## Equity Performance Metrics Across All AUM




Note: Reflects weighted average split across all AUM groupings.
Source: 2010 U.S. Equity Investors Compensation Benchmarks Study (Portfolio Managers)

## Fixed-Income Performance Metrics Across All AUM




Note: Reflects weighted average split across all AUM groupings
Source: 2010 U.S. Fixed-Income Investors Compensation Benchmarks Study

## Discretionary to Formulaic Performance Incentives

| | Discretionary | Objective Plus Discretionary Component | Formulaic |
|---|---|---|---|
| **Paradigm risk** | Lack of firm or clear focus<br>May limit new product growth and development | Investment returns may produce pay levels out of sync with financial results | May not fully reward top performers<br>Does not promote teamwork |
| **Performance focus** | Financial results | Investment returns, AUM and financial results | Investment returns and financial results |
| **Incentive funding** | Residual earnings "top-down" | Scaled on performance metrics (investment returns, AUM, financial results)<br>Combination top-down and bottom-up | Sum of formulas "bottom-up" |
| **Competitive market influence** | Less market influence | Best performers at top of market<br>Thoughtful use of survey/market information | Investment returns and financial results |
| **Equity/deferrals** | Limited equity | Firmwide schedule linked to pay; deferrals increase with higher compensation<br>Typically blend of equity and fund deferral (ranges 50/50 to 33/67 equity/fund deferral) | Broad participation<br>Variation for individual performance |

Source: Johnson Associates

offsetting reductions to bonus structures as regulators and the public at large maintain pressure on what are perceived to be outsized and incentive-skewing bonuses. The trend is evident in the asset management industry — although to a much lesser degree than what is now playing out among investment and commercial banks. In fact, among investment managers, the shift in compensation from bonus to salary is most pronounced among captive asset management divisions of larger global banking firms that are more directly in the regulatory and public line of fire on the issue. Salary increases have been much more modest among independent asset managers, which have generally offered relatively high base salaries to begin with and have not been the subject of such intense regulatory scrutiny. "Nevertheless, very large asset managers have gradually started to adjust the pay mix for senior management," notes Greenwich Associates Institutional Analyst Kevin Kozlowski.

In 2010, bonuses accounted for approximately 65% of cash compensation among equity portfolio managers and 55–60% among equity analysts and directors of research, with the remainder in salary. For fixed-income portfolio managers, salary makes up a larger portion of cash compensation. Bonuses for fixed-income professionals ranged from approximately 55% for traders and portfolio managers to roughly 75–80% for head traders.

On average, company performance determines 63% of performance incentives for fixed-income professionals, with individual or trading desk performance accounting for the remaining 37%. For equity professionals, individual performance accounts for two-thirds of performance incentives, with that amount weighted slightly to investment performance over business development. Company performance and other factors account for 34%.

Industry best practice calls for a blend of formulaic and discretionary determinants. The accompanying chart illustrates some common approaches.

### Deferred Compensation

Prior to 2011, most asset management organizations moved in line with other financial service companies by increasing the share of compensation that is deferred for most senior professionals. Expect that shift to level off in 2011 as fixed costs start to limit flexibility in accruals during a down year.

Nevertheless, asset managers will continue to defer sizable shares of compensation for most senior professionals. On average, highly paid senior professionals have 30–50% of incentives deferred. Pro rata vesting of three to four years is most common, with participation starting at a pre-established level of compensation. Incentive compensation generally is deferred into either investment funds or firm equity, with specific practices varying from firm to firm amid an overall move in the direction of a blended approach. "In our experience, deferral of incentive compensation into a mix of internal funds consistent with the investment strategy pursued by the professional provides an effective alignment of long-term interests of employees and investors," says Andria Cardillo, Vice President at Johnson Associates.

### Competitive Challenges: Benchmark Compensation Data for Asset Managers

Greenwich Associates Competitive Challenges is a rich source of benchmarking data of financial performance, operational productivity, distribution productivity, and compensation levels for asset management firms. Participating organizations provide Greenwich Associates with data about their own internal structures and operations. This information allows Greenwich Associates to, in turn, provide clients with comprehensive, consulting-aided, top-down view of the firm's performance and productivity, allowing for effective drill-down and root-cause analysis. Among one of the most important benefits: benchmark data that allows participants to compare their firm side-by-side with customized peer groups in compensation and many other topics. The Competitive Challenges compensation benchmarking data reports compensation structure and top-down personnel expense by department as well as detailed position by position compensation data for over 200 positions. The end goal: to help asset management organizations improve the effectiveness of their compensation structures in order to enhance both productivity and long-term profitability.

For more information on how Greenwich Associates helps investment managers develop their business strategies, please contact Alexander Bues at abues@greenwich.com or 203-625-5164.

### Sales Compensation

A CEO participating in the Greenwich Associates 2011 CEO Roundtable summarized the end goal in creating sales compensation structures for asset management firms as follows: Separate "sales alpha" from "sales beta," and pay for the former, as opposed to the latter.

Asset management firms have not always been disciplined in building sales compensation structures that limit payouts for "sales beta." In fact, many individual firms have been less-than-thoughtful in some of their decisions about how best to attract and retain talented sales professionals, leading to compensation structures and levels that have often proved unsustainable over time.

All the CEOs attending the 2011 Roundtable say they are acting this year to advance the long-standing goal of reducing sales trailers. Industry-wide, typical trailers have been reduced to three years at a maximum with diminishing payouts during this time.

**CEO Insights: Portfolio Manager Compensation**

The asset management CEOs participating in the 2011 Greenwich Associates CEO Roundtable are moving to increase the amount of discretionary awards in portfolio manager compensation structures. The reason: Revenue-based compensation structures encourage portfolio managers to emphasize asset gathering, which can shift their focus from investment excellence to product development and sales. The CEOs describe portfolio manager compensation structures ranging from 100% discretionary to some mix of discretionary compensation, revenue and/or earnings participation and performance-based metrics.

These efforts might be complicated by a market downturn in which standard commission approaches could fail to generate sufficient incentives to satisfy key sales professionals due to drops in new assets. Declining sales compensation could prove especially hazardous to asset management firms in coming months, since the sales function plays a critical role in keeping clients "warm" and maintaining relationships during downturns.

With these factors in mind, asset management firms should utilize the following best practices when setting sales compensation structures for the coming year:

- Assess impact of volatile market environment and changing conditions on plan design and ability to motivate;
- Provide uncapped sales compensation;
- Defer payouts above a given threshold to future years;
- Keep structures simple, streamlined, and easy to understand;
- Maintain competitive structures based on scope of role and performance level of employee;
- Build structures that explicitly incent desired behaviors and penalize unwanted behaviors;
- Recognize longer sales cycles and environmental challenges;
- Keep focus on aligning sales compensation structures with firm profitability goals.

## Conclusion

Many of the trends currently driving changes in compensation structure and payouts among commercial and investment banks are also playing out in asset management organizations, but on a more muted basis.

On the structural side, companies from all areas of the financial service industry are responding to public and regulatory pressure by increasing base salaries with offsetting reductions to bonus amounts. While the asset management industry is not immune from this trend, most shifts from bonus to salary are taking place within captive asset management divisions of larger global banking firms and at the most senior levels of investment management organizations. Asset managers continue to defer significant shares of incentive compensation for senior professionals.

In terms of 2011 payouts, the market volatility that appears to be bringing back layoffs and reductions in compensation to investment and commercial banks has dampened expectations for asset management compensation, but final compensation levels will still likely come in flat or even slightly higher than 2010 levels. These projections reflect an environment in which the talent turnover seen in the second half of 2010 and the first half of 2011 has clearly slowed, but not entirely abated. Of course, demand for talent and overall compensation levels could take a sharp downward turn if the European sovereign debt crisis continues to erode investment performance and asset valuations.

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*Contributors are Director of Institutional Marketing Jennifer Litwin and Institutional Analyst Kevin Kozlowski from Greenwich Associates and Managing Director Francine McKenzie and Vice President Andria Cardillo from Johnson Associates.*

## Methodology

*Every year, Greenwich Associates collects data on buy-side compensation levels and practices through interviews with more than 1,000 financial professionals in equity and fixed-income investor groups. The data is based on the individual responses of study participants and is self-reported. Interviews are conducted by telephone and in-person.*

*The findings reported in this document reflect solely the views reported to Greenwich Associates by the research participants. They do not represent opinions or endorsements by Greenwich Associates or its staff. 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.*

*Johnson Associates' 2011 projections reflect estimated changes from 2010 Greenwich Associates data. Projections are based on proprietary data, supplemented by current knowledge of levels and practices across asset management sector via direct industry contacts, surveys, third-party references, and research on market events/trends.*

*Johnson Associates actively monitors compensation trends and issues through intensive research and ongoing client assignments.*

*A long history consulting across business cycles provides Johnson Associates with a wealth of information to assist firms in navigating challenging markets and issues.*

### About Greenwich Associates

*Greenwich Associates is the leading international research-based consulting firm in institutional financial services. Greenwich Associates' studies provide benefits to the buyers and sellers of financial services in the form of benchmark information on best practices and market intelligence on overall trends. Based in Stamford, Connecticut, with additional offices in London, Toronto, Tokyo, and Singapore, the firm offers over 100 research-based consulting programs to more than 250 global financial services companies. Please visit www.greenwich.com for more information.*

### About Johnson Associates

*Johnson Associates is a boutique compensation consulting firm specializing in financial services. The firm has extensive experience advising high-end global and regional financial clients on an extensive range of compensation issues and practices. For additional information or background, please visit www.johnsonassociates.com.*

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