2011 Realities & 2012 Opportunities:

A Tough Compensation Transition Continues

PRESENTATION AND DISCUSSION

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Introduction

- Independent financial services compensation consulting firm. Pure advice, annual and long-term incentive designs, market data and levels, agreements, and goals/metrics. Equity and partnership considerations. Expertise and in-depth knowledge across comparators, labor markets, and political/social considerations
  - Experienced, opinionated and informed
  - Both Board consultant and company programs

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

2011 Year-End: Industry Sectors & Areas

- For 2011, significant unexpected broad decline in incentive funding by sector and area
  - Major Investment and Commercial Banks (i.e., -20% to -40%) driven by Fixed-income and Equities (i.e., -20% to -50%), Commercial Banking (i.e., -5%), Investment Banking (i.e., -10 to -20%), and Wealth/Asset Management (i.e., +5% to -15%).
  - Market-based business mixed over 2010. Asset/Wealth Management (i.e., +5% to -5%), Hedge Funds (i.e., flat to -10%) and Private Equity (i.e., flat to -5%)
  - Investment Banking scaled for bigger volumes
  - Assumes no near term disaster (i.e., Greece, Italy, Spain…), then all bets are off

- Difficult trading environment
  - Both narrower spreads and reduced capital usage

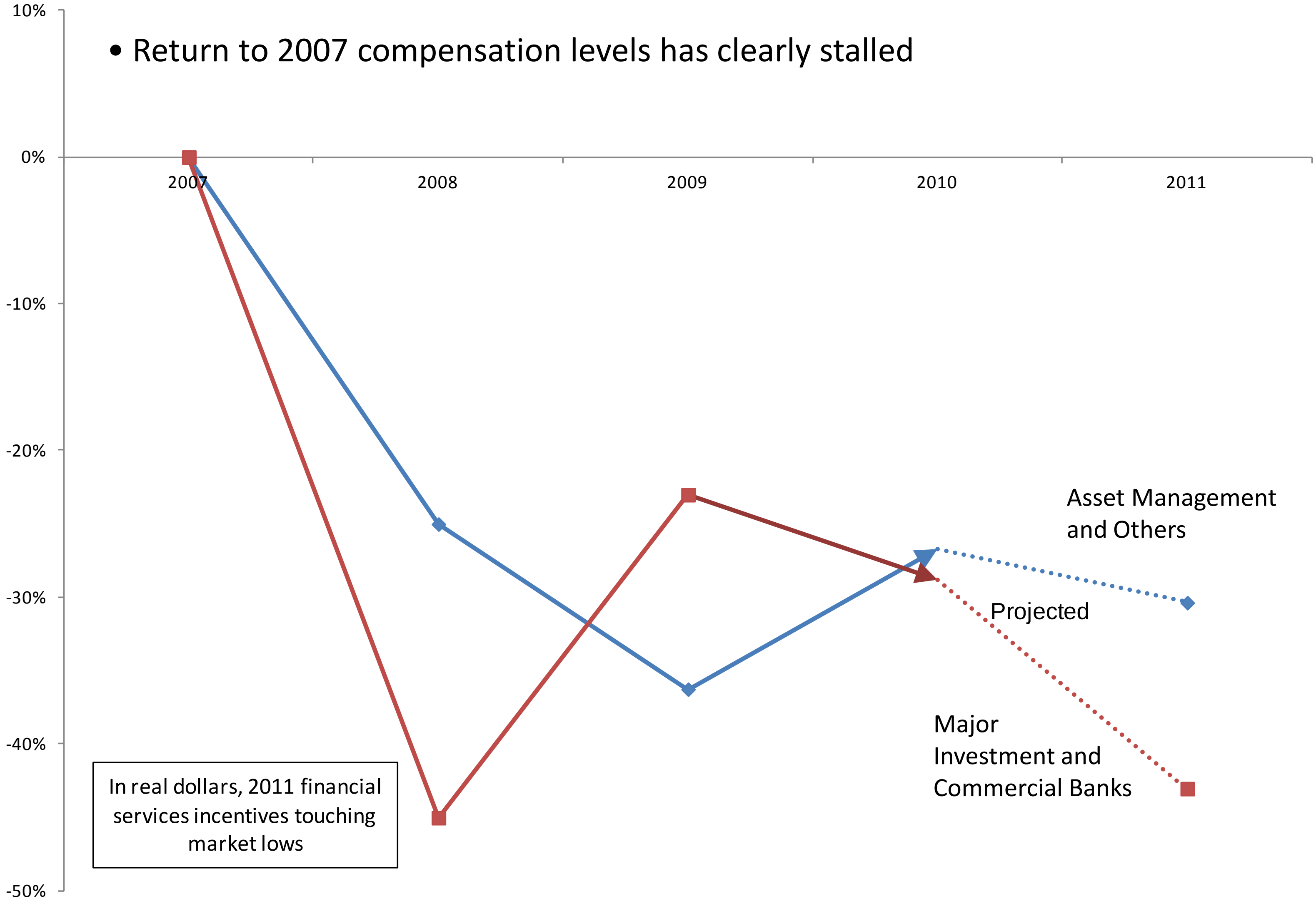
- Challenging to manage expectations, decipher market trends and recognize performance
  - Impact of regulation and public sentiment (Occupy Wall Street and variations)

- Moderate retention concerns heading into early-to-mid 2012
  - "So-so" labor market continues

- Very heavy Wall Street deferrals continue for 2011, variations by region
  - Accruals from heavy 2009/2010 deferrals meaningfully reduce reported 2011 earnings. Creates additional volatility in earnings along with own debt valuation

Incentive Trends Fairly Reflects Markets

- Return to 2007 compensation levels has clearly stalled



Impact of Regulation & Environment

- Most fundamental lesson: it's a political process with asymmetrical motivations
  - Emphasis by geography continues to evolve (Asia/Latin America a "winner," NY/London "losers")
  - Assumption major mistakes can usually be linked directly to individual
- Regulation includes more than significant risk-takers/delves deeper into organization
- Base salary levels are not regulated
  - High base salaries considered positive
- Reliance on accounting/models to capture risk continues
- Compensation Committees have only limited patience
- Broad incentives should be funded formulaically, including cost of capital
  - Allocations subjective but should be able to be calculated
- Environment negative to Wall Street compensation
  - Lingering view financial services caused maladies facing many countries
  - Symbol of inequality and greed

∴ ***Expectation by some compensation should move directly with earnings***

Compensation Regulatory Key Updates

Federal Reserve	Risk • Including a charge for liquidity risk for internal profit measures across incentive awards favorably viewed Risk Assessment • Quantitative risk measures preferred, however recognizes very difficult to implement. Judgment-based decisions more prevalent Deferral Latitude • Does not : (i) require deferral for all employees, (ii) suggest any specific formula, (iii) mandate any specific vehicle More Performance-Based Deferrals • Prefers performance-based deferral coverage to more employees Interaction between Committees • Increase communication between the compensation committee and risk/audit committees
Dodd-Frank	• Broadly defines and bans proprietary trading by banks with FDIC, limiting investments in a hedge or private equity fund, and require banks to install internal controls for compliance • Rule exempts trades related to market-making as long as the activity met at least seven standards, or principles. One principle traders paid from fees and spread of transactions only • Final rules and implementation still pending
FSA	• Compensation Committee Chairman required to certify firm compliant with the rules on compensation structure

Basel Pillar 3 Compensation Disclosure Requirements

- Global regulators intend to implement Basel Pillar 3 disclosure beginning in 2012, detailed information about risk related elements of incentive practices across covered institutions

Summary	
Qualitative Requirements	Quantitative Requirements
• Information on all parties overseeing compensation • Description of material risk takers, including number in each group • Information on design and structure of compensation processes • How current and future risks taken into account • How the bank links performance with compensation levels • How the bank adjusts compensation to take account of longer-term performance • Different forms of variable compensation used	• Number of meetings held by the Compensation Committee • Number of employees receiving a variable award • Number and total amount of guaranteed bonuses awarded • Number and total amount of sign-on awards made • Number and total amount of severance payments made • Total amount of outstanding deferred compensation split into (i) cash, (ii) shares and share-linked instruments and (iii) other forms • Total deferred compensation paid in current year • Fixed and variable compensation for the year • Employees' exposure to implicit and explicit adjustments of deferred compensation • Total amount of deferrals subject to adjustments

"Say on Pay": Lessons & Impact of Shareholder Advisors

- Discourages being outside norms
  - Firms in difficulty/new management further disadvantaged
  - Cannot satisfy everyone
- Heightened impact of weak/nervous Directors
  - Desire to please/not stick out
- Recognize "hot buttons" and "easy fixes"
  - Excessive contracts
  - Tax gross-ups
  - Weak clawbacks
  - Perquisites
- Lessons
  - Annual Say on Pay vote generally a poor decision
  - ISS quality even worse than projected. No guiding principles and expectation of evolving guidelines. Need handful of major firms to fail 2012 vote
  - Failing the vote <u>will</u> be a big deal with ramifications
  - Important to engage major shareholders early
  - Some compromises and/or creativity

2012 Fearless Predictions: Moderate Recovery

- Asset/wealth management, insurance, and alternatives stronger in 2012 (i.e. +15%+)
  - Lag effect of AUM and equity valuations moves compensation

- Investment/commercial banks higher (i.e., +15%+)
  - Fixed Income and Equities up on cost cutting. Real rebound depends on rising interest rates and normal yield curve
  - Investment Banking and Asset Management up significantly

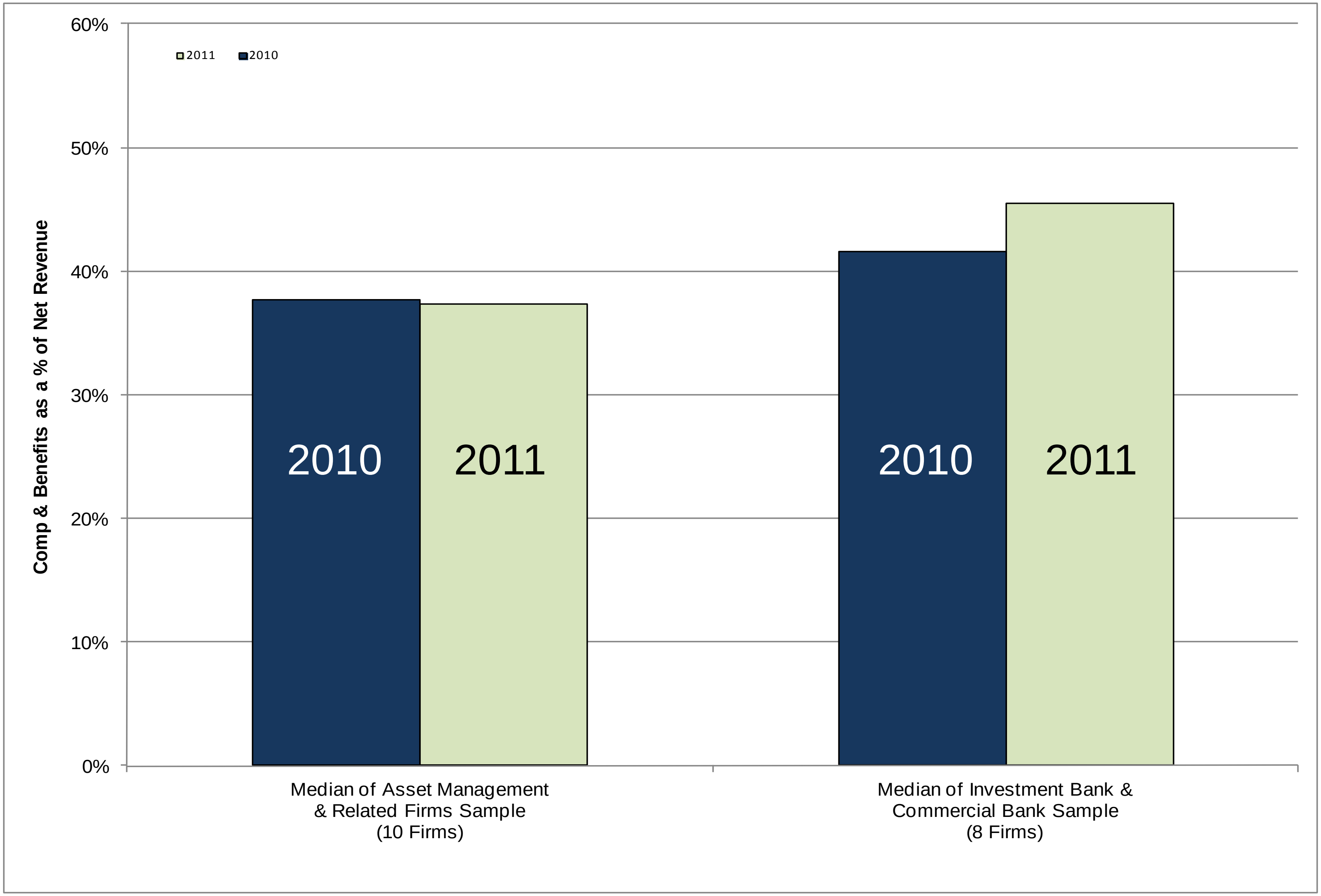
- Regulatory/political directions further Asian/emerging markets expansion
  - EU/U.K./U.S. hostility drives headcount and resource changes at margin

- Intermediate prospects clouded by next major storm
  - Inability to pay government-sponsored entitlements
  - Scenario: If major country/bank fails, directly impacts compensation environment

- Firms will get leaner in challenging revenue environment
  - Over 2012-2013 headcount perhaps 10%-15% less

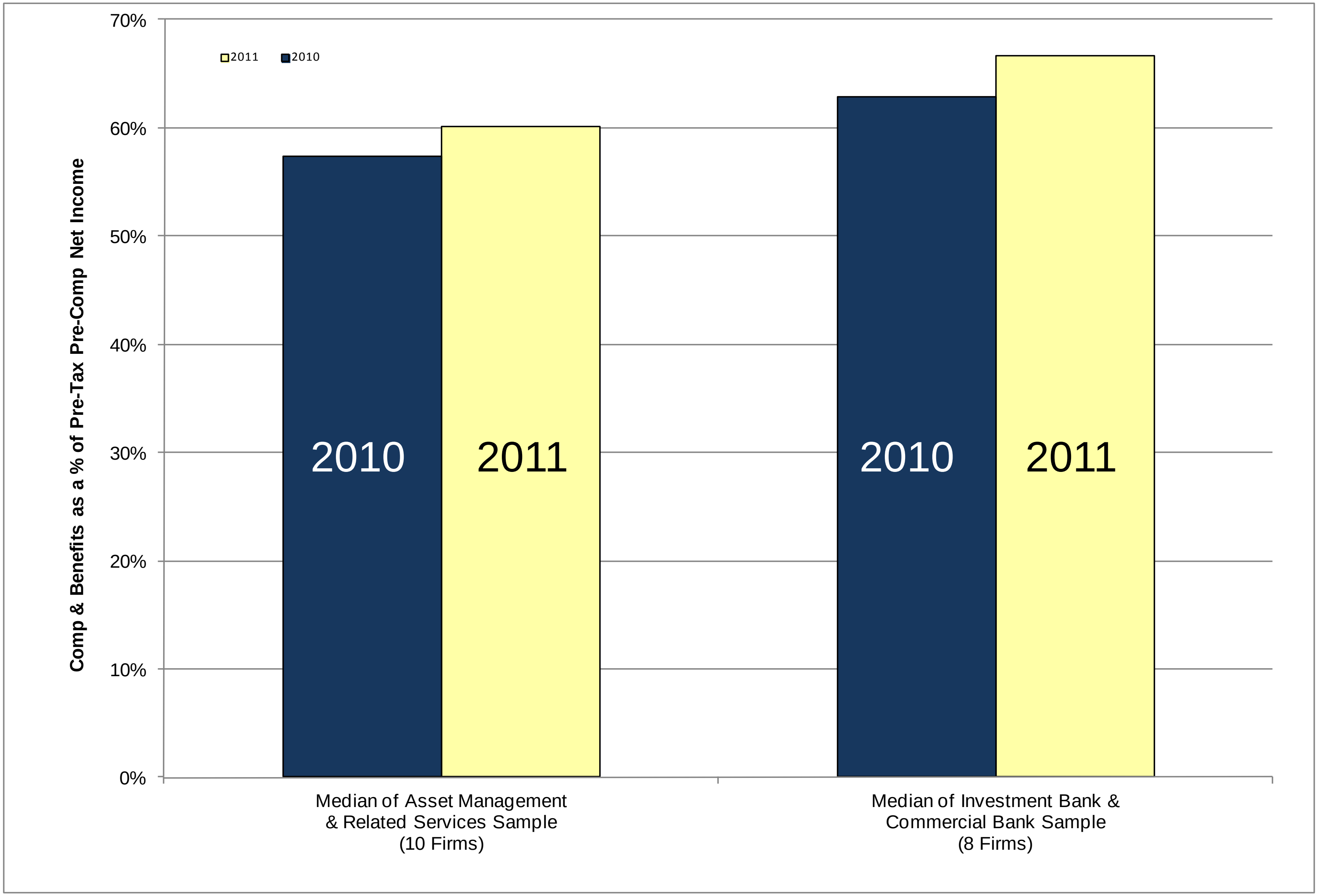
2011 vs. 2010 Compensation as % of Net Revenues

Note: Reflects available year-to-date data

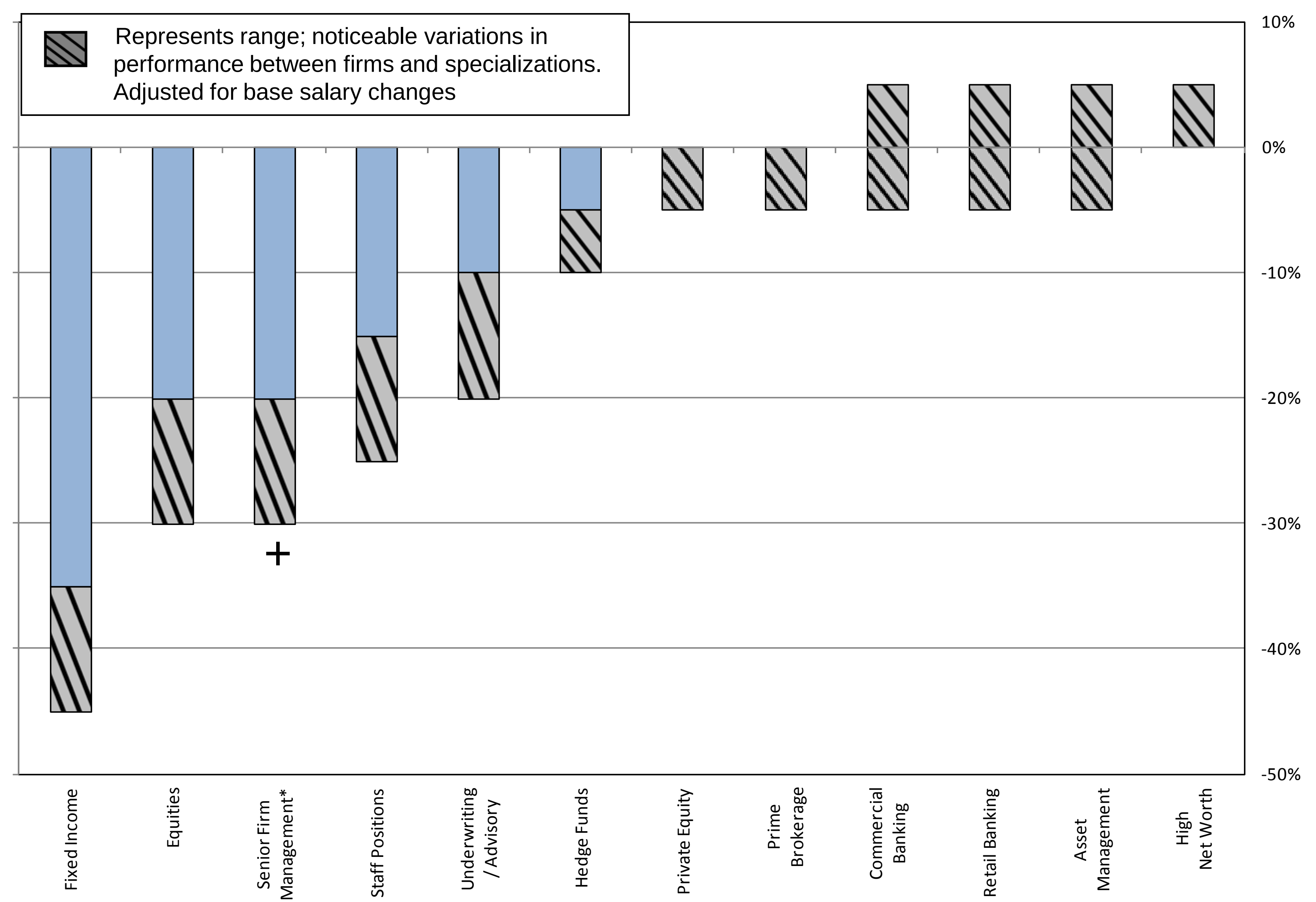


2011 vs. 2010 Compensation as % of Pre-Tax, Pre-Comp Income

Note: Reflects available year-to-date data



2011 Typical Incentive Changes (Value of Cash & Equity)



*Excludes proxy executives impacted by firm specific circumstances

Incentive Designs and Appropriate Risk - 2011 Version

- Initial product/desk funding on results adjusted for capital usage
  - % or range on risk adjusted results
  - Solely on 2011 results often inadequate

+

- Current market rates for comparable firms/skills/contributions

+

- Firm affordability
  - Heavier staffing
  - Accruals of 2009/2010 deferrals

=

∴ ***Compensation levels and ratios appear high to regulators, shareholders, politicians, media, and many citizens. Pressure is on Compensation Committee and Board. Even with strong negative views on Wall Street, high pay opportunities remain***

2011 Executive Compensation Considerations

- Broad decline in overall pools and incentives
  - View senior management should decline as much as or more than other professionals
- Overall compensation often higher than returns alone generate
  - Creates difficult environment
- Common view executives should increase/decrease with earnings
  - If earnings decline 40% executive pay should decline 40%
  - Requires at least considering multi-year scenarios since starting point for compensation is important

Base Salary: Equilibrium

- Moderate salary budget (i.e., 3 – 3.5%) off moderate levels
  - Has less meaning due to currencies, global markets, alternative work arrangements, etc.

- Tough 2011 year diverted more pay mix changes
  - Base salary remains smaller part of total compensation package

- Conflicting perspectives
  - Maintain significant compensation flexibility
  - Reduce needed incentive funding
  - Limit add on benefit costs

Sales Compensation Directions

- Emphasis on sales compensation across businesses continues
  - Consistent resources across longer sales cycles
  - Retention key in a difficult environment
- Recognize potential misalignment between sales funding and overall firm
  - Higher objective compensation, less socialistic
  - Cost of doing business
- Pressure for nuanced results
  - Appropriate products
  - Client retention
  - Team efforts
  - New clients
  - Multiple products by client
- Performance differentiation increasingly important
  - Real movements towards shifting grids/payouts from bottom to top

∴ ***Often quite difficult to sell average products. Increasing need for more specific client targeting***

Asset & Wealth Management

- Credible year considering market turmoil
  - Difficult business to understand for many parent companies
- Increasingly competitive, given focus on less capital-intensive businesses
- Partner pay model common and workable
  - Pre-agreed % of operating profit available for incentives
- “Commission” sales plans with weighting on new assets/retention
- Investment professionals
  - Generally objective and leveraged program on multi-year benchmarks
  - ≅ 20% for broader contributions (i.e., involvement in selling, management, product development, etc.)
  - More pressure to invest in own products (i.e., “eat your own cooking...”)

∴ ***For 2012, begin year flat without real benefit of trailing AUM growth***

Asset Management

Private Equity: Activity and Optimism

- Difficulties moderate
  - 2009 and 2010 vintages look promising
  - Clients remain committed

- Longer-term business focused on carry
  - More to top professionals; few/key people
  - Longer vesting
  - Improved terms for firm protection: clawbacks/non-competes
  - At captives, often 10-13 pts. in aggregate

- Scale a major pay consideration
  - Allowing the largest firms to outspend for talent
  - Dodd-Frank in U.S. pushes business away from banks

- **Optimism. Consensus opportunities exist, particularly in emerging markets, China, India and Brazil**

Hedge Funds: Need Alignment and Ownership

- Down returns brought high-water mark back into consideration
  - Industry has stabilized
  - Fund owners continue to pay to ensure stability

- Increasing need for alignment and broader ownership
  - Generational/succession issues become significant
  - Often cumbersome structure without clear roadmap/philosophy
  - Legacy legal advice overly focused on the past

- With oversight and regulations, incentive design details receive more focus
  - Risk profile
  - Alignment to both portfolio and firm

- Quick Equity Design Checklist:
  - Timeliness
  - Pricing and Valuation
  - Amount
  - Participation
  - Permanent/Expires
  - "Stock"/"Options"/Combination
  - Vesting
  - Non-Competes
  - Change-in-Control/Severance
  - Transition/Multigenerational

Contracts – The Good, Bad, and Ugly

- Continued prevalence of dysfunctional agreements
  - One-sided
  - Lengthy and imprecise
  - Don't consider all reasonable scenarios

- Non-competes and non-solicits
  - Consider when they make sense

- Change-in-control
  - Limits on acceleration of equity

- Severance definitions

∴ ***With issues facing financial services expectation of increased litigation***

Board of Director Role and Pay Implications

- Increased time commitments, complexity of issues and new legislation/ regulation more evident than ever
  - Pressure for increased accountability
  - Imprecise and lengthy
  - Unprecedented scrutiny of pay designs and magnitudes

- "Say on Pay" increases pressure
  - Will highlight impact of weak/nervous Directors

- Transparency and proactive communication between Boards and management
  - Crucial importance of open communication
  - Boards retain discretion on payouts

- While requirements increased, compensation growth slowed
  - Consistent with declines for management and employees

- Meaningful compensation changes needed
  - Major Committee heads not paid enough vis-à-vis other directors
  - Need more expertise on Compensation Committee (i.e., Human Resources)
  - Need better directors

Wishes vs. Reality of Financial Services Compensation

<u>Wishes</u>: Simple firms where compensation moves neatly with disclosed financials. Product profitability moves in lockstep, and risk follows historical, easily tracked outcomes. Professionals are not concerned about the short-term, and trust the firm will do right by them over time…

<u>Reality</u>: Complicated firms with compensation driven by an opaque merging of firm, unit, individual and market. Business dynamics always seem to move in different directions. Professionals are acutely focused on short-term, and skeptical about long-term treatment

∴ ***We all have to do a much better job explaining or changing reality. Fundamental lack of understanding about compensation, and risks/motivation, will continue to negatively impact the industry going forward***

Summary and Final Thoughts

- Financial services landscape unstable
  - General economy remains weak
  - Continued major macro concerns and weak political responses
- Compensation results mixed and confusing for 2011
  - Differ by business: Wall Street vs. Asset Management and Alternatives
- Retention concerns moderate for at least first half of 2012
- Heavy deferrals continue
  - Must be more creative; professionals do <u>not</u> always want all stock
- Many, many disappointed the perceived overall pay paradigm has not changed
  - Risk and capital charges difficult to formulaically build into program
  - Huge issue, much self inflicted through poor communications
- If catastrophic event, there will be great pressure to not pay incentives to anyone
- 2012 will be better as the industry gets leaner, and more focused