Uneven, but Encouraging Compensation Forecast:

Mixed 2009 & Positive 2010

PRESENTATION AND DISCUSSION

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Introduction

Johnson Associates

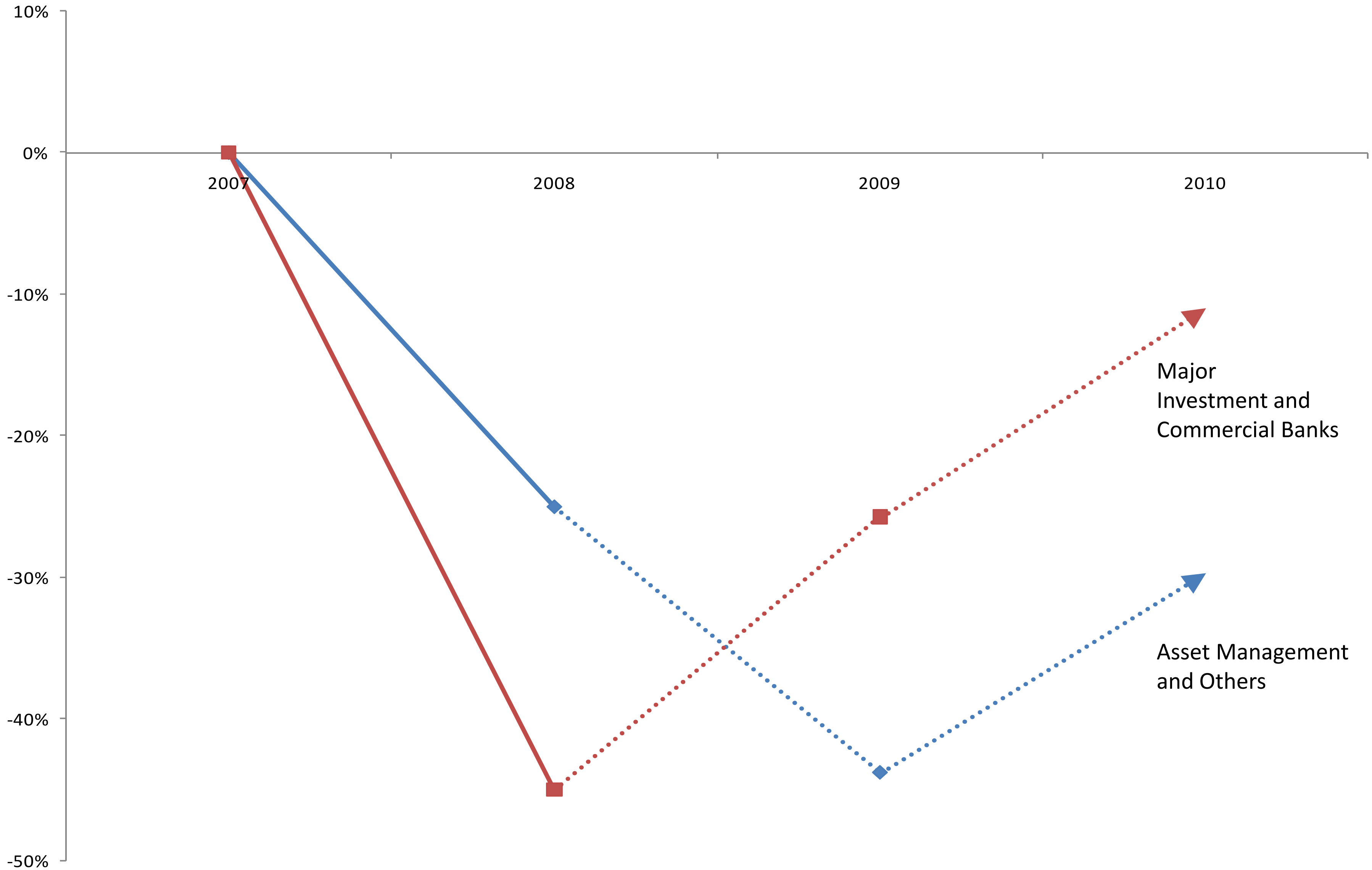
- Long-standing, independent compensation consulting firm for financial services. Pure advice, annual and long-term incentive designs, market data and levels, agreements, and goals/metrics. Equity and partnership considerations. Expertise and in-depth knowledge across comparator groups and labor markets
  - Experienced, opinionated and informed

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

2009 Year-End: Focus on Industry Sectors

- For 2009, significant divergence in incentive funding by sector
  - Major investment and commercial banks up significantly (i.e., 40%)
  - Asset management, insurance, and alternatives down meaningfully (i.e., 15% - 30%+)
- Conflicting messages from media, shareholder groups, and politicians
  - Outside Wall Street, downward trend not aligned with workforce expectations
  - Many positive contributions vs. available economics
- Signs of improvement clear
  - Outpacing recovery of broader economy
- Challenging to manage expectations, decipher market trends and recognize performance
  - Especially after wave of political correctness and input from various shareholder groups
- Retention concerns with anticipated hiring uptick early-to-mid 2010
  - "Ice-Cold" transitioning to "so-so" market is a big change
  - <u>Disclaimer</u>: Late 2008 - 2009 turnover not necessarily good predictor of 2010
- Heavy Wall Street deferrals for 2009 and 2010
  - Heavy 2008 increased further by clear regulatory direction

Confusing Incentive Trends

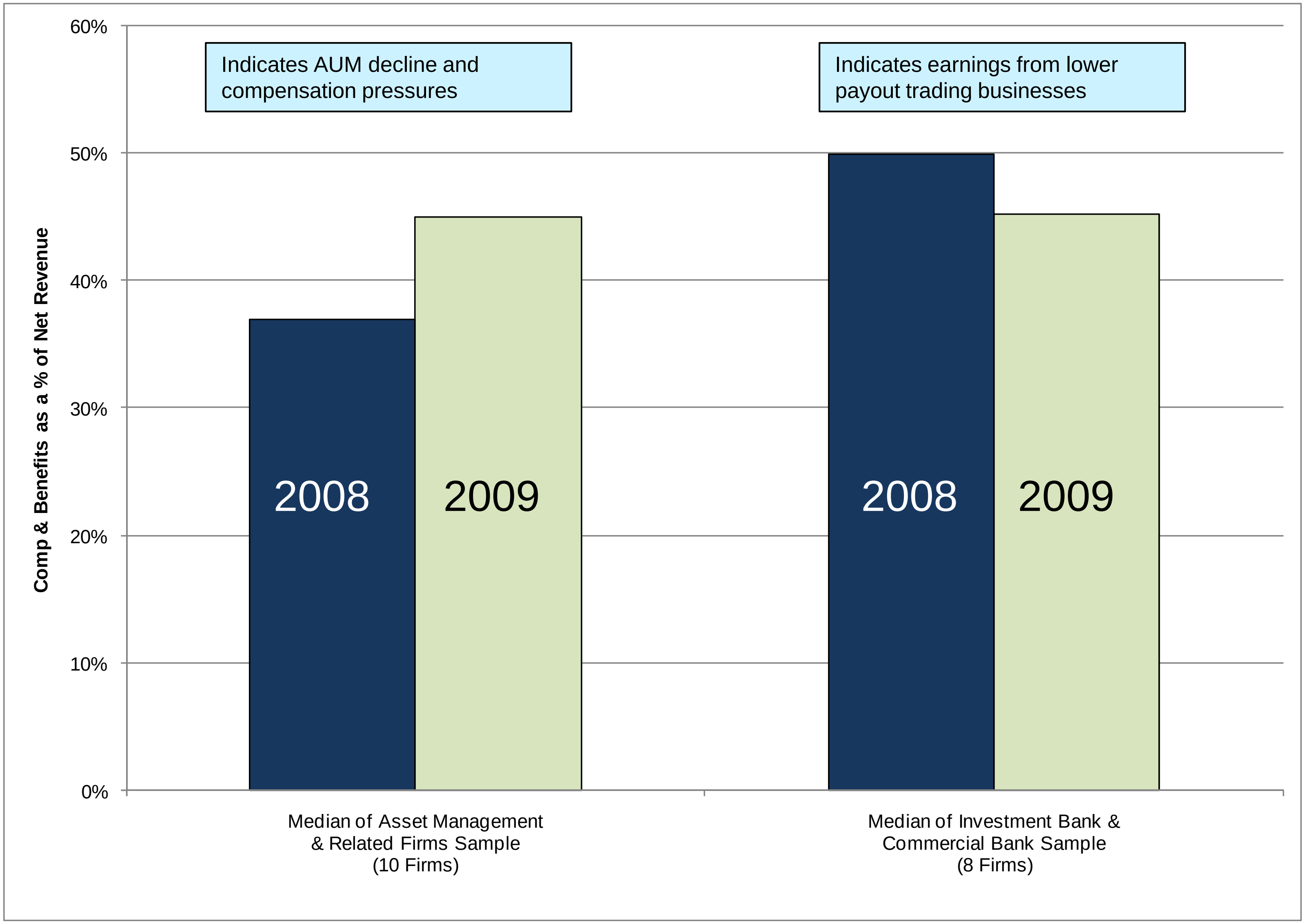


2010 Fearless Predictions: Better Times, Generally

- Asset management, insurance, and alternatives stronger in 2010 - 2011
  - Lag effect of AUM and equity valuations moves compensation in positive direction
  - "Purpose of 2009 was to get to 2010 - 2011"
- Investment/commercial banks moderately down off 2009
  - Fixed-income and equities less favorable
  - Investment banking and asset management up significantly
- Regulatory compensation directions will be ignored by some/many
  - Will make an example of firms/executives/boards of directors
- Recruiting market much improved
  - Troubled or complacent firms have more difficulties

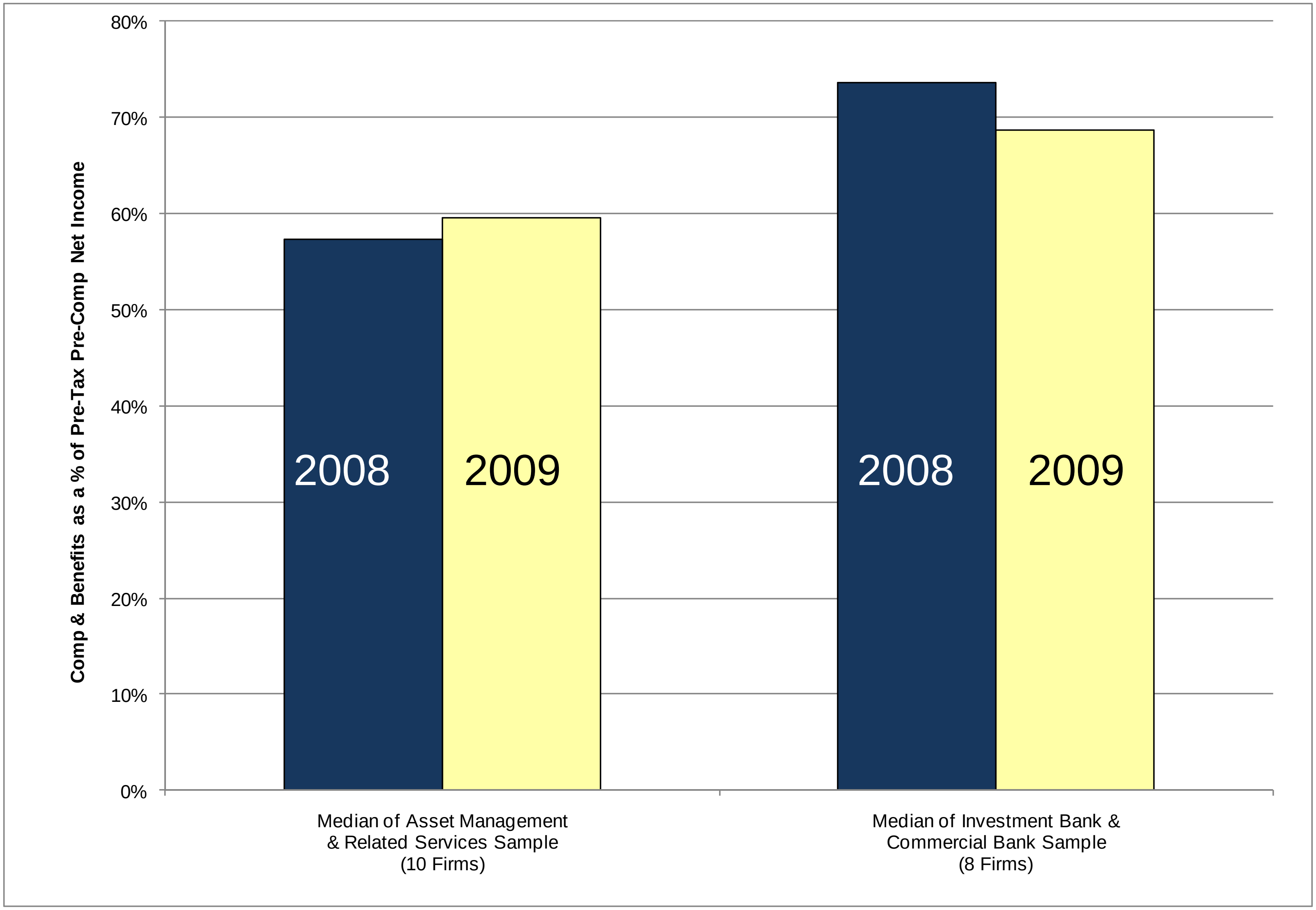
2009 vs. 2008 Compensation as % of Net Revenues

Note: Reflects available year-to-date data

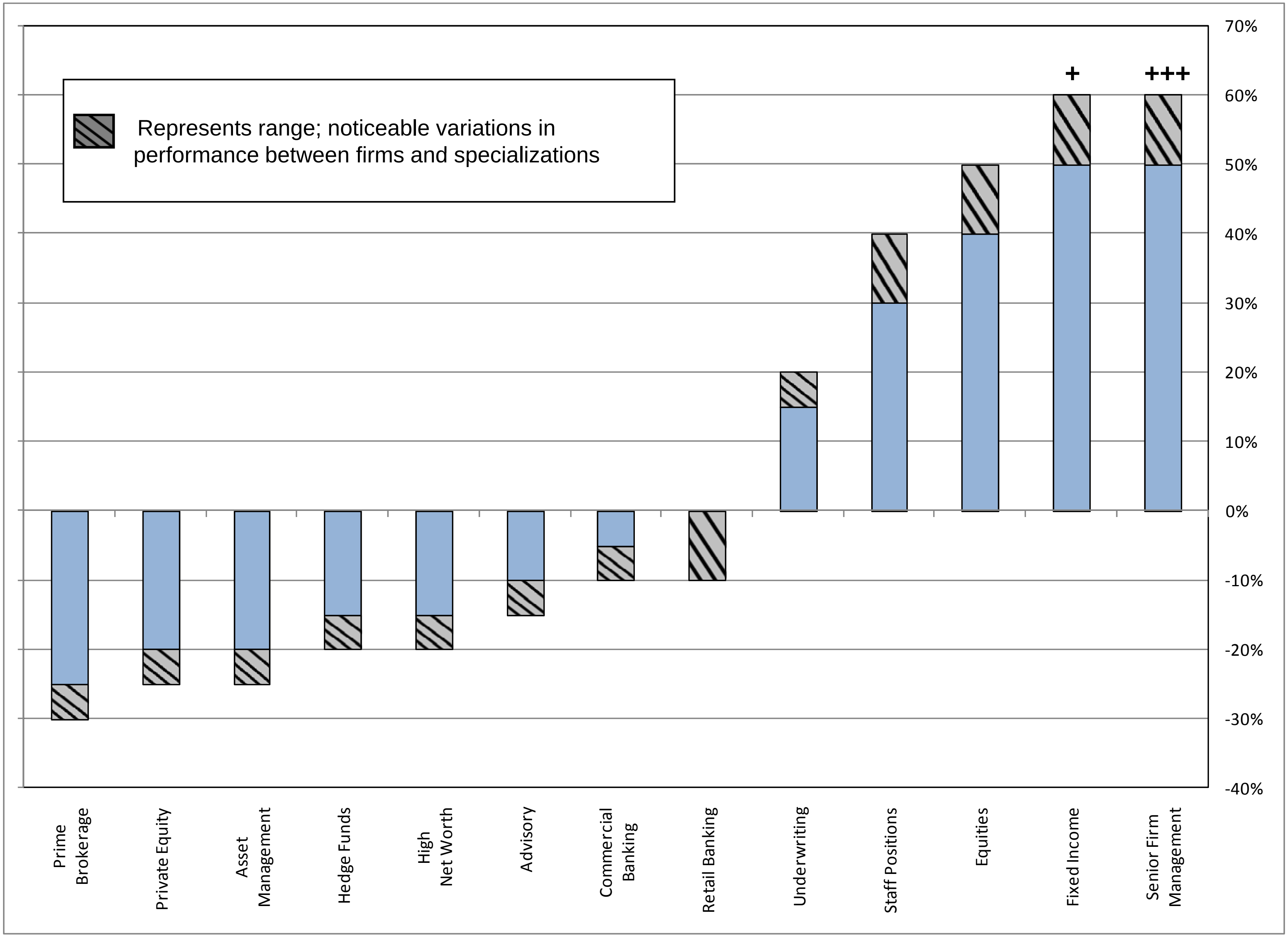


2009 vs. 2008 Compensation as % of Pre-Tax, Pre-Comp Income

Note: Reflects available year-to-date data



2009 Typical Incentive Changes (Value of Cash Bonus & Equity)



Broad Impact of Regulation on Compensation Design

- Recognize current debate over <u>TWO</u> separate, but intertwined, issues

  1) Discourage excessive risk-taking

  <u>AND</u>

  2) Reduce financial services compensation to more socially acceptable level

- Regulators' current menu of directions:
  - Plan designs to discourage excessive risks (broad employee group)
  - Heavy deferrals with long vesting (prefer 4 or 5 years)
  - Clawbacks for both fraud and future losses

- Unofficial rules at least as important as regulations
  - Anything causing a public outcry is problematic
  - Upward pay at year-end 2009 is major potential problem

- Always probability of new laws/rules
  - Programs should be flexible to reflect periodic/conflicting guidance

Clawbacks and Challenging "Motherhood-and-Apple-Pie"

- Simple, idyllic view : employee takes proprietary positions in a single product over time with complete control over sizing and exits. No hedging. No transfers. No promotions. No reorganizations. No multiple products. No mark problems. No transfer pricing. No cost allocations.

- In the real world, a professional can lose a significant amount and the firm can be quite happy
  - Lose much less than competitors
  - Hedged other positions
  - Historical record of success
  - Multiple products/positions
  - Transferred to a losing position/made it better

- Major risk
  - Don't take it seriously – hammered later by regulator(s)

- **Individual performance clawbacks lusted after by regulators/politicians/media are unworkable, potentially destabilizing, and encourage litigation**

Incentives: Risk & Cost of Capital

- Risk management universally accepted
  - Formulaic risk adjusted plans difficult to implement/quantify
  - Objective and subjective measures common
  - Align pay with risk horizon
  - Significant stock ownership and meaningful deferrals help long-term alignment

- Governance of compensation and processes key
  - Independent and strong risk and compliance units; annual assessment
  - Balance with day-to-day operations
  - Board retains discretion on payouts

- **For capital-intensive businesses, an informed, “light touch” inclusion of capital**
  - **Recognize hard-wired formulas, off of imperfect risk measures, can create a more leveraged payout opportunity as units are only rewarded above a significant hurdle**

Retention Issues in First Half of 2010

- Uptick in hiring expected Q1 and Q2 2010
  - One-off opportunities, especially for transferrable skills
  - Attractive opportunities in other sectors

- For those with down year, year-end 2009 incentives and 2010 programs impact ability to retain/focus professionals
  - Minimizes distractions
  - Motivates during difficult period

- Improved performance across financial services will lead to additional opportunities
  - Broader set of potential employers
  - Firms need to address competition for talent and changing landscape
  - Broader skill sets/potential employers, size and product offering

- **Number of firms are complacent**
  - **Believe low 2009 turnover will be sustained in 2010**
  - **Impact of morale "killers" felt (i.e., reduce benefits, sodas, car service, training, etc.)**
  - **Much about opportunity/fatigue, rather than only compensation**

Heavy Deferrals Continue and Expand

- 2008 deferrals appropriately heavy due to financial crisis
  - Retention
  - Alignment
- 2009 deferrals even heavier
  - Clear regulatory direction
  - Clawback introduction
- Often underutilization of vehicles other than firm stock
  - Funds
  - Private investments
  - Cash deferral with ROE return
- Consider reducing participation to save shares
  - Dealing with risk metric, and others, problematic and life-shortening

Base Salary: Tale of Two Worlds

- Traditional low salary budget (i.e., 3 – 3.5%) off of usually low/moderate levels
  - Asset management
  - Hedge funds/alternatives
  - Insurance

OR

- Pay mix change with high nominal increases (i.e., 20% - 80%), offset with incentive declines dollar-for-dollar

- Base salary levels have been too low across financial services
  - Regulators right, even if for wrong reason (i.e., meaningfully increases risk profile)

Sales Compensation: Increasing Importance

- Emphasis on sales compensation across businesses continues
  - Consistent resources across longer sales cycles
  - Retention key with improving market
  - Ability to attract assets not as difficult moving into 2010

- Recognize potential misalignment between sales funding and overall firm
  - Higher objective compensation, less socialistic
  - Little firm impact
  - Cost of doing business

- Performance differentiation increasingly important
  - Less funding for bottom and average results

- More about selling, less about broader objectives

Investment Banking

- 2009 compensation for senior professionals under pressure
  - Strong trading revenues supporting firm earnings; however, subsidy from trading moderated

- Modest improvement in underwriting offsetting continued decline in advisory
  - Pipeline remains weak entering 2010

- Equilibrium in research
  - Buy-side research provides enhanced careers and higher compensation
  - Competition from hedge funds weakened
  - Premium for quantitative analysts disappeared; fundamental in vogue

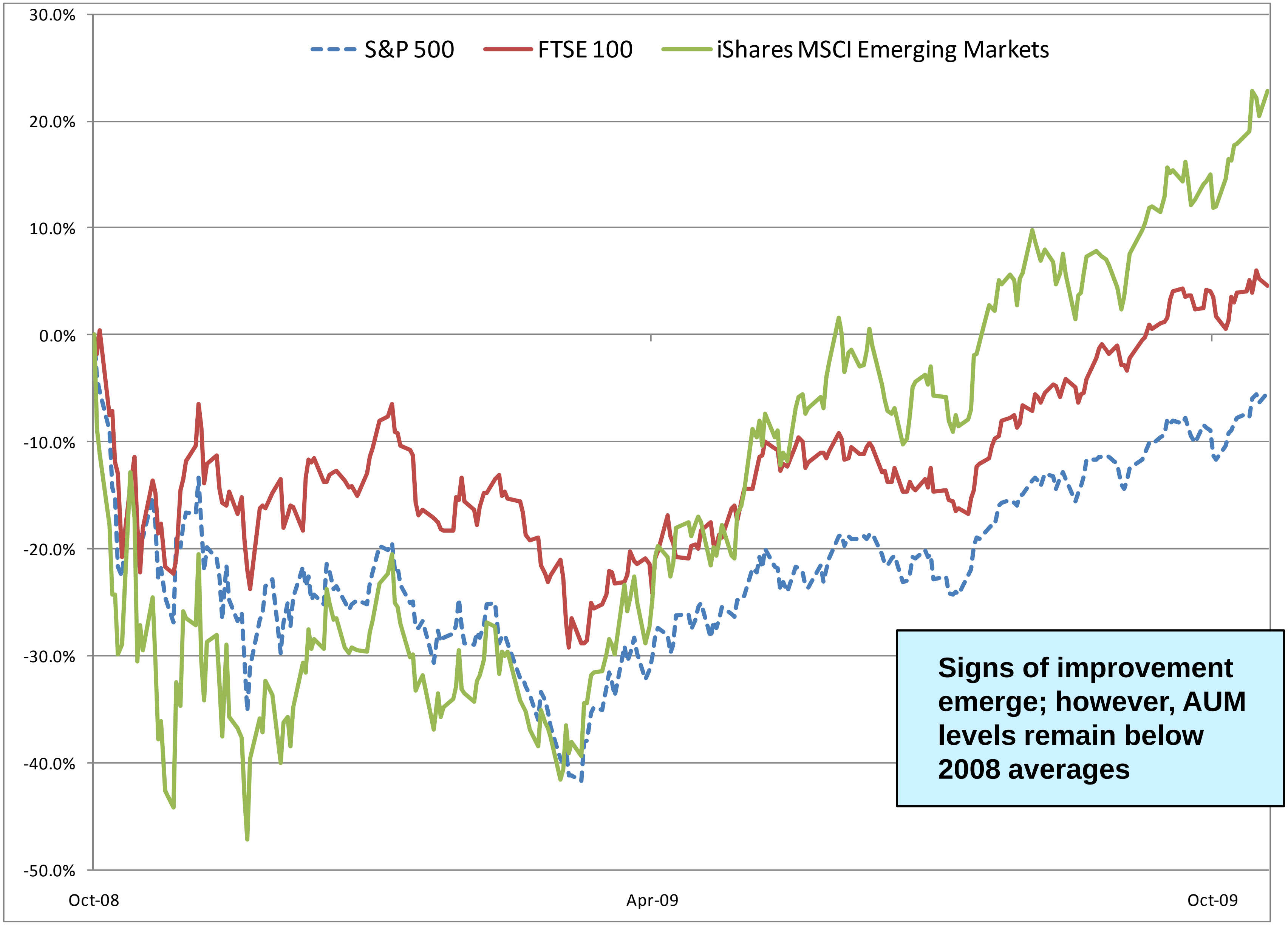
- Selective hiring becoming evident as industry stabilizes
  - Firms beginning to take advantage of available talent pool

- 2010 will be better, mostly in second half, from pent up transactions as capital markets return closer to normal

Asset Management

- Asset management stabilizing with market rebound
  - Improving investor sentiment leading shift back to equity products from cash
  - Market rebound creates misleading compensation expectations
  - Reduced AUM creates downward pressure on incentives
  - Difficult business to understand for many parent companies
- Partner pay model common
  - Pre-agreed % of operating profit available for incentives
- Sales
  - “Commission” plans with weighting on new assets/retention
- Investment professionals
  - Generally objective and leveraged program based on 1-, 3-, 5-year returns vs. benchmark
  - ≅ 20% recognize broader contributions (i.e., involvement in selling of funds, management, product development, etc.)
- Much better in 2010 and probably 2011, due to lag effect of AUM

Asset Management



Private Equity: Modest Optimism

- Difficulties continue
  - Transactions difficult: modest financing/leverage
  - Poor investment results: questionable prior transactions
  - Pressure on fundraising: investors shying away
  - Push back on capital calls: some resistance from LPs

- Still a longer-term business focused on carry; structural trends:
  - Proportionately more to top professionals; 3 top/key people
  - Longer vesting
  - Improved terms for firm protection: clawbacks/non-competes
  - At captives, often 10-15 pts due to firm economics and sales support

- Scale a <u>major</u> pay consideration
  - Allowing the largest firms to outspend for talent

- **Some optimism from market upturn. However, long-term viability depends on ability to source and manage quality transactions**

Hedge Funds: Mixed Messages

- Downward pay trend across many funds may not align with expectations
- Compression of fees
  - Management fees impacted by decline in assets, despite improved returns
  - Performance fee pressures continue, given many still trail high-water mark
    - $100 declined to $70 in 2008. 40% increase only returns investor to break-even
- Industry difficulties continue
  - Questioning value proposition (asset class or just a "fee schedule")
  - Already oversold to key wealth management clients
  - Harder to (i) operate with less leverage, and (ii) produce risk-adjusted returns
- Pay moderately in 2009, but more compensation optimism in 2010
  - Future, incremental returns will produce incentive fees
- Design details linked to what investment professionals do has crucial impact on performance, risk profile, culture, and investor perceptions
  - Aggressively quirky no longer a strength
  - Need objectivity on PM's fund/specialty with some subjectivity
  - Investors/consultants demanding more alignment from key professionals

Board of Director Role and Pay Implications

- Increased time commitments, complexity of issues and new legislation/ regulation more evident now than ever
  - Pressure for increased accountability
  - Unprecedented scrutiny of pay designs and magnitudes
- Conflicting messages in market adding uncertainty to pay decisions
  - Need ability to balance market indicators, firm performance, and retention needs
- Transparency and proactive communication between Boards and management necessary
  - 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 plan
  - Major Committee heads not paid enough vis-à-vis other directors

Summary and Final Thoughts

- Financial services landscape stabilizing
  - Recovery outpacing overall general economy
- Compensation results will be mixed and confusing for 2009
  - Differ by business: Wall Street vs. Asset Management and Alternatives
  - Differ by year-end: late fiscal years will pick up more good months
- Retention concerns more prevalent with expected hiring uptick in early-to-mid 2010
- Heavy deferrals continue and amplify
  - High rates for multiple years in a row no longer an emerging trend
  - Must be more creative; professionals do not always want stock
- Some will be disappointed the overall pay paradigm has not changed
  - "If you produce, you will be paid" …pay delivery/elements may differ
  - Risk and capital charges difficult to formulaically build into programs
- Financial services pay will continue to be under unprecedented scrutiny
  - Risk still not well defined; unclear laws and regulations
  - Firms agreeing to things and not all will follow (some will cheat)
  - Regulatory, political, and investor pressures ongoing
- 2010 will be better across many dimensions