JOHNSON ASSOCIATES, INC.

End of Compensation Headwinds and Annual Recap

Financial Markets Total Rewards Group

March 2018

19 West 44th Street, Suite 511, New York, New York 10036
(212) 221-7400 • Fax (212) 221-3191

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- Independent financial services compensation consulting firm offering informed advice, starting with best practices leading to customized solutions. Proud of straightforward, aligned, successful programs. Common services include incentive and carry designs, nuanced market pay data, performance metrics and goals, equity and partnership issues, and Board Committee advice
  - Balance market/best practice with firm dynamics
  - Both Board consultant and company programs
  - Creative, opinionated and informed
  - Non-generic survey data or solutions

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

Compensation Headwinds End

- Today broad consensus on healthy business and compensation dynamics
  - Global economic growth
  - Client optimism
  - Stable, if not lessened, regulatory focus
  - Volatility generates trading and advice
  - U.S. tax changes

- Leaner more efficient firms
  - More focused customer offerings
  - Continued impact of technology

- Need to competitively compensate high-end talent
  - Real, increasingly competitive with technology and other sectors
  - Quants, "Big Data", and Fintech

- Cultural issues remain for many
  - Work environment and values
  - Time in grade vs. performance/potential
  - Established mindset

2017 Industry Incentive Changes

% "same store" change from 2016

- 2017 broadly positive markets
  - Predicted positive momentum actually occurred

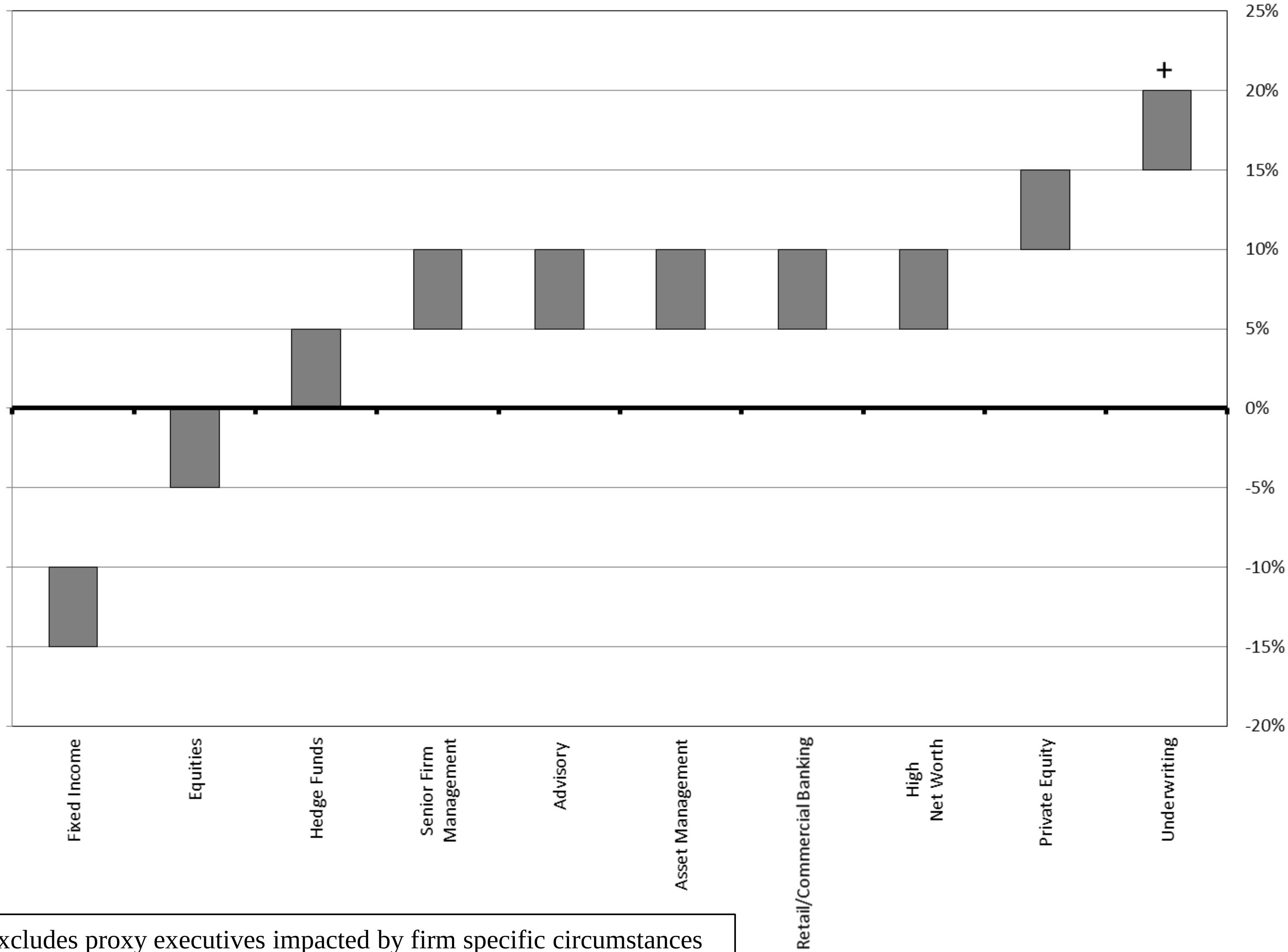
- Asset Management: 7% +
  - Positive global equity and bond markets
  - Interest rates remained low

- Hedge Funds: 5%
  - Mildly positive after three years of declines
  - Search for new opportunity sets intensifies (i.e. credit)

- Private Equity and real estate: 10% to 15%
  - Strong fund raising and realizations
  - Cost pressures for mid-sized firms due to reduced fee schedules

- Major bank incentives driven by commercial/retail and underwriting
  - Fixed income and equities down moderately (but if felt worse)

2017 Common Incentive Changes (Cash & Long-term/Equity)

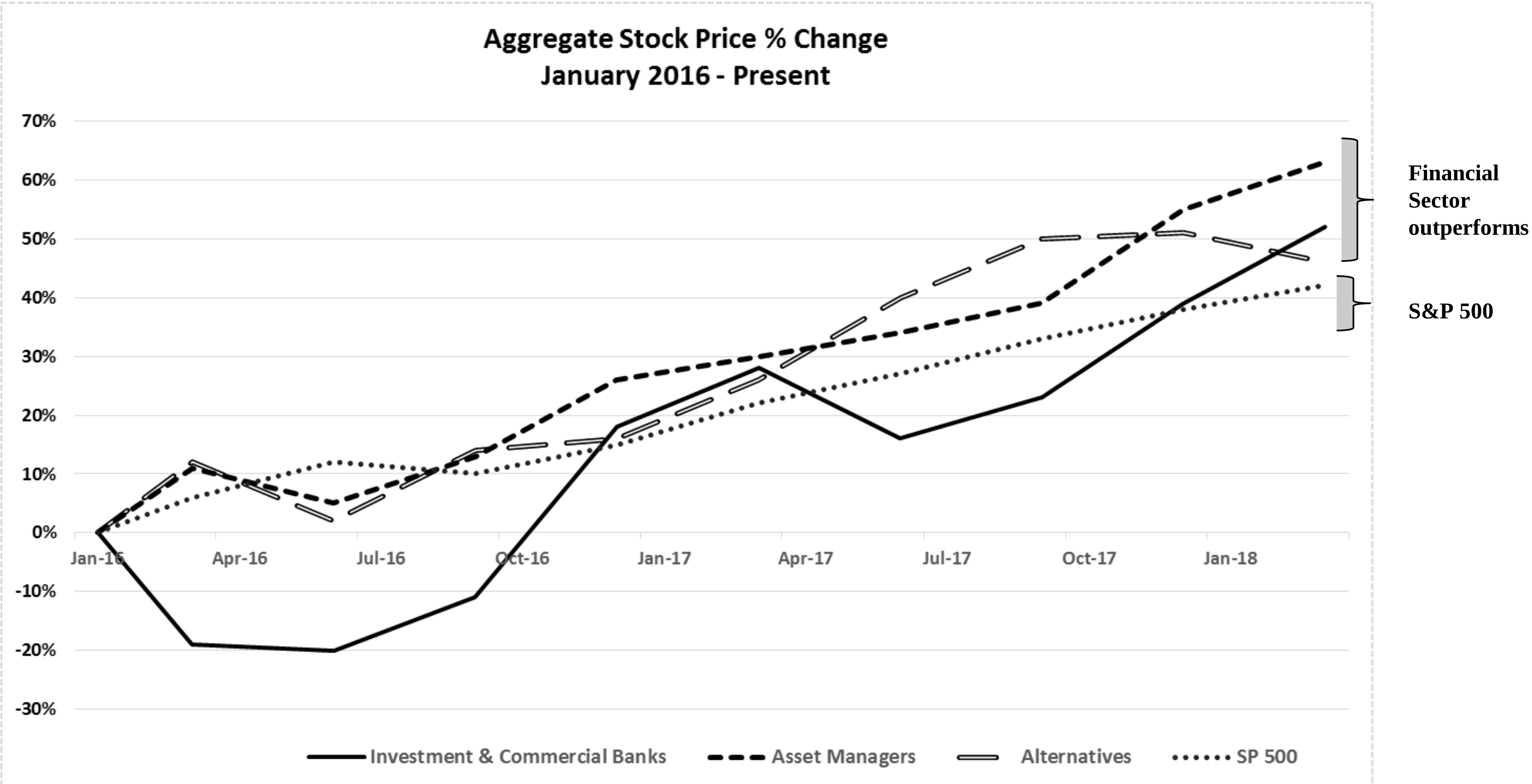


*Excludes proxy executives impacted by firm specific circumstances

2018 Fearless Predictions: Positive Momentum Builds

- Pressure on base salary levels
  - Talent and market driven
- Asset management up strongly
  - Impact of 2017 market uptick and investor optimism
  - Fee pressures continue but reckoning delayed
- Hedge funds up but unevenness persists
  - Volatility remains a trading friend, but not clear how much in a more efficient world
  - Credit! Credit! – major move into less efficient markets (?)
- Private equity roars ahead
  - Historical transactions benefit from new market levels
  - Hazard of investing large new funds (ala 2007 – 2008)
- Real estate boom continues but teetering clear
  - Clear valuation bubble, particularly on U.S. coasts
- Banks benefit from economic fundamentals and volatility
  - Volatility benefits client trading
  - Loan fundamentals remain strong

Messages From Stock Price Changes



Technology Sector Reward Lessons

- Importance of a few great people
  - Often worry about having too many people
  - Talent and contribution over hierarchy

- Secret is <u>not</u> just stock
  - High levels of absolute compensation, career progression

- Turnover accepted and generally healthy

- Contribution does not always equal managing people

- Fully competitive base salaries. No excuses

- Substantial differentiation on contribution

- Time in grade far less important/more aggressive tone

- Value interesting challenging work. Less nonsense

Base Salary – Increases Coming

- Building pressure for more meaningful increases/levels
  - Impacts those that have suppressed salaries
  - To some degree embedded in promotions/job level changes

- Opportunity for competitive advantage
  - Nimbleness and clear link to total compensation

- Tyranny of small increase pool (i.e. 3%) gets in the way
  - Few adjustments for workforce demographics/static view
  - Math does not work with young talented workforce (i.e. treat separately)

- Structure levels vs. individual amounts
  - All MD's have $400K salary
  - Large portfolio managers are $350K

Hybrid Positions/Hybrid Comparators

- Increasingly positions are a combination of roles (i.e. “Hybrid”)
  - CFO and CAO, GC and compliance, business lead and technology, etc.
  - Blend of research <u>and</u> portfolio management <u>and</u> running a strategy
  - While most visible at senior levels, across the organization

- Generic surveys and anecdotal data points don’t account for/include hybrid roles
  - Create unintentional downward skew in market perspectives

- Recognize differences, even if requires judgment for realistic market role
  - Premium on largest role for additional duties or combination of market data

- If not adequately addressed, increases pressure for heavier staffing

- Degree of hybrid comparators (i.e. different groups) by function
  - Necessary customization creates complexity

- Not sufficiently marketed to candidates, yet offer interesting opportunities

Impacts of Tax Law/State Regulation

- Removal of Section 162(m) tax deduction
  - For proxy executives compensation over $1 million no longer tax deductible
  - Creates need to manage proxy executives
- Elimination of deduction for state and local taxes (SALT)
  - Both economic and psychological impact
  - Impact builds as perception increasingly “Dumb” to work in NY/CT/NJ/MA/CA/IL
- “Don’t Ask” pay rules for job candidates
  - Smart to document pay discussions
- Believe tipping point in terms of cost of living
  - Increasing advantage for Atlanta, Dallas, Phoenix, Charlotte, etc.
- Over time, some states adopt U.K. style disclosure
  - Average compensation for males/females and other groupings

Long-term: Continuing Malaise

- Often muddled long-term pay element philosophy and implementation
  - Retention
  - Firm alignment
  - Client products and expectations

- Overly broad use of firm equity
  - Sub-optimizing currency where alignment less important/appreciated

- Often “wimpy” executive ownership guidelines/expectations
  - 3X or 5X modest base salary. Clearly not enough

- Uneven application of investment in client products
  - Often sound substitute for firm equity

- Vesting goals need to be refined
  - Employment elsewhere or competition
  - Clear definition of retirement

Partnership

- Partner most misunderstood word in financial services
  - Economics across scenarios
  - Firm vs. individual performance
  - Flexibility in allocations up or down
  - Details and clarity really matter !

- Common objectives of partnership
  - Mutual commitments and succession planning
  - Alignment and transparency
  - Wealth building
  - Be more than an employee

- Solvable common issues
  - Founder economics vs. new partners
  - Dilution flexibility
  - Governance (i.e. founders)
  - Profit share and tail
  - Valuation
  - Clear termination provisions

Asset and Wealth Management: Aggressiveness Needed

- 2018 likely strong business and compensation year
  - Impact of 2017 markets and client flows

- Medium-term fundamental issues remain
  - Fee pressures and index/ETF products
  - Changing client expectations on value
  - Greater investment spending needed for competitive advantage

- Motivational levers
  - Incentive funding and metrics linked to strategy
  - Quality long-term structure (i.e. vehicles, participation, amounts, etc.)
  - Ownership
  - Sales compensation
  - Overall growth emphasis

- Staffing profile changing
  - Quants, “big data” and high end technology (just not too many)
  - Requires different compensation analytics

Hedge Funds – Need to Perform

- Increased volatility and opportunities
  - However now trading in more efficient markets

- How important are academic credentials to future firm success?
  - Very smart (i.e. top tier undergrad / MBA / big bank experience)

    OR

  - Super smart (i.e. PhD in economics / finance and thought leader)

- Recent improvements in performance management
  - Progress in identifying quality idea generators
  - More discipline in process
  - Less tolerance for mediocrity (but still far too much)

- Increased focus on credit as new product area
  - Competition for right talent
  - Risk of moving out of core competency

- Continue work on investment measures
  - Risk
  - Rates of return vs. cost of capital
  - Cooperation if productive

Private Equity – Focus on Carried Interest

- With "European Waterfall" large carry discount by VPs/Associates (and others)
  - Highlights importance of annual compensation
  - Potential for carry across funds
  - Increased differentiation of initial carried interest

- Two common interrelated but separate issues
  - Many senior professionals have not demonstrated ability to generate transactions
  - Carry is significant regardless of individual performance

- Need thoughtful but intensive analysis of senior professionals
  - Actual contribution and clear prospects of generating quality transactions. Reality, many will never be productive. Issue has been building for a decade
  - Differentiate carry to far greater extent

- In large funds, carry is very significant for principals and managing directors. Vested carry maintained by terminated employees
  - "Hold back" of carry for future grants (i.e. 20%)
  - No pro-rata regrant of forfeited carry

Banks – Need to Innovate

- Common view major banks have misaligned compensation. Overall value proposition not overly attractive for outstanding professionals

- Link compensation to business units/norms
  - Blend of discretion/structured incentive plans

- Finally stop overusing bank stock
  - Limit participation and equity mix
  - Replace with products/risk proxies

- Grant restricted stock and stock options to senior management

- Dramatically increase senior management stock ownership guidelines
  - Limit liquidity after leaving bank

- Heavier use of real analytics
  - Need deeper insights between business economics and market compensation across professional levels
  - <u>Far more</u> than year-over-year changes with existing headcount

Broader Issues with Compensation Implications

- Economic equality and fairness
  - Definitions and data
  - Societal issues vs. firm controllability
- Work / Life balance
  - Time vs. contribution
  - Career progression
- Behavioral standards
  - Changing norms
  - More discipline
  - Fair enforcement
  - Process

- Requires planning, clear objectives, and communication

Final Thoughts

- 2018 likely to be positive compensation year
- Base salary pressures build
- Use the opportunity for creativity/appropriate aggressiveness
- Need vision on needed staff quality and characteristics
- Simplified performance management works
- Costs and taxes hinder traditional money centers
- Partnership and ownership remain as focus points
- Carry can be used more effectively
- Address and communicate on broader cultural and societal issues
- Significant opportunities for change will reward the bold and creative