2021 Year of Unusual Opportunity

Building on Transformative 2020

Financial Markets Total Rewards Group

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19 West 44th Street ▪ Suite 511 ▪ New York, NY 10036 ▪ (212) 221-7400 ▪ info@jaiconsulting.com

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Johnson Associates is a leading independent financial services compensation consulting firm specializing in strategic advice, innovative design, and a full range of data-enhanced solutions. We have extensive experience designing company programs and advising Compensation Committees as well as firm management across business cycles

- **Broad Range of Consulting Services**
  - Annual and Long-term Incentive Design
  - Competitive Market Benchmarking
  - Funding Rate / Fee Allocation Assessments
  - Partnership Structures and Equity Allocations
  - Generational Planning / Leadership Transitions
  - Turnover and Headcount Analyses
  - Special Situations (Transactions, Bankruptcy, Litigation)
  - Employment Agreements

- **Clients across Financial Services**
  - Asset Management
  - Hedge Funds / Alternative Products
  - Private equity style Investment Strategies
  - Wealth Management and Family Offices
  - Investment and Commercial Banks
  - Institutional and Retail Brokerages
  - Insurance Companies
  - Fintech

Transformative 2020

- Financial services industry was resilient (and lucky)
  - Fundamental business health
  - Robust technology
  - Ongoing recovery and surging markets

- Recognition of actionable efficiencies
  - Impact of technology had been underestimated
  - Outsourcing and relocation gain further traction

- Full realization of alternatives' impact (i.e. private equity, hedge funds, credit, etc.)
  - Scale and continuing fee levels
  - Investor receptivity
  - Important compensation challenges

- Remote working becomes mainstream concept
  - Unknown impact on labor markets

- Consolidation and competitive advantage
  - Economics of scale across strategies
  - Excellence increasingly rewarded in client decisions

- ESG and Diversity & Inclusion
  - Major impact on both product offerings and business operations

2021 Positioned for Excellent Year

Once in a decade opportunity but will be bumpy and messy, and signs of bubbles (i.e. housing, SPACs, tech)

- Stock Market
  - Current S&P 500 above 2020 average: ≅+15%
  - Current Nasdaq above 2020 average: ≅+25%
  - Current all-world (ex-US) above 2020 average: ≅+20%
  - Banks 4Q annualized: ≅+55%
  - Banks 1Q-3Q annualized: ≅-50%
- Continuing search for efficiencies
- 2020 Hedge Fund / Private Equity Total AUM: ≅$8T*
- Biden $1.9T massive relief package
- Global economy continues to reopen

* About 1/2 of the GDP of China

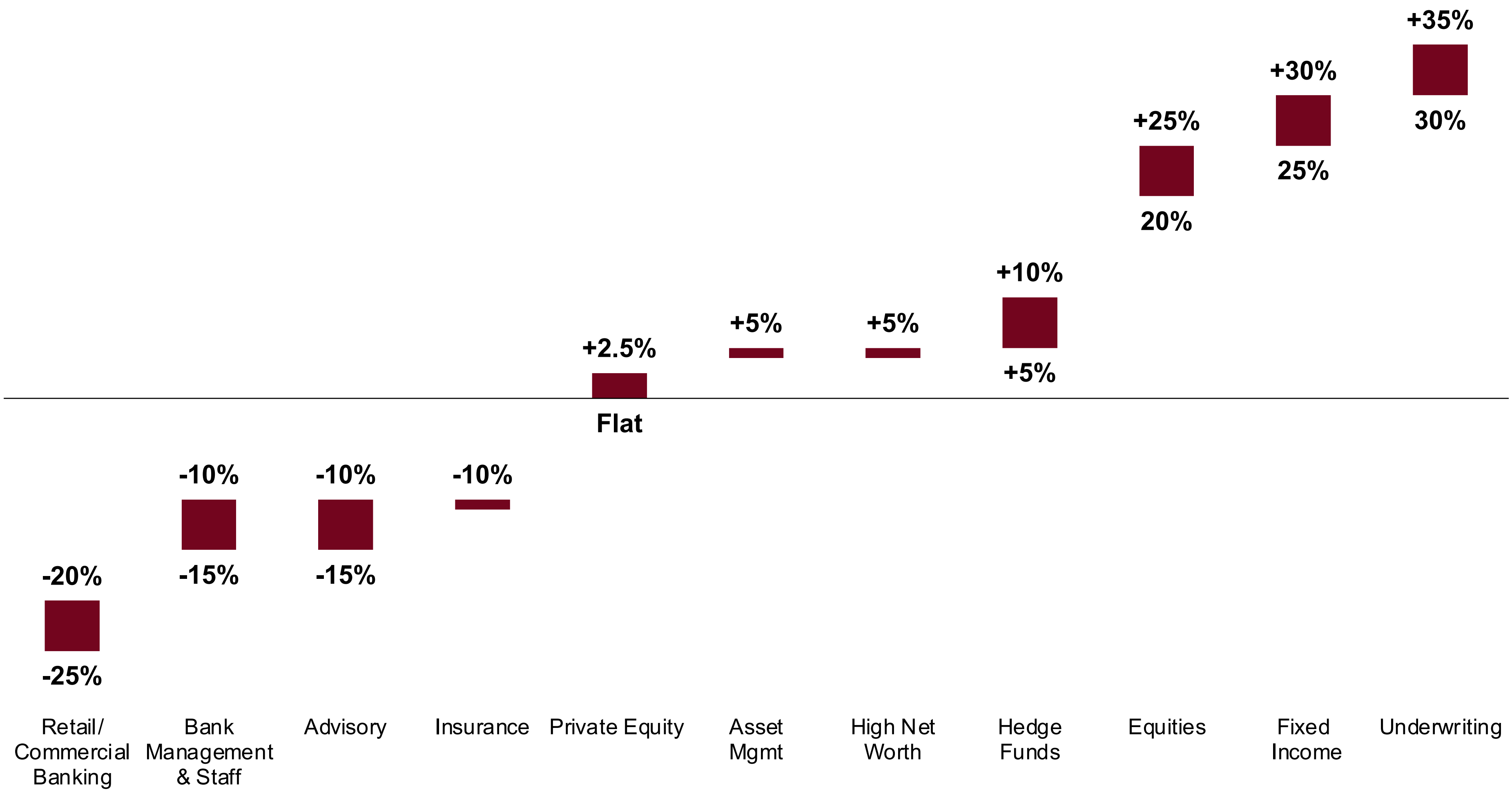
2020 Recap: Industry Incentive Changes (same store % Δ)

Remarkably, 2020 incentives about flat despite pandemic and competitive dynamics

Segment	YoY % Change	Commentary
Asset Management	*Up 5%*	▪ Market surge and cost management ▪ Shift to ETFs and index products
Hedge Fund	*Equity: Up 10%* *Credit: Down 5%*	▪ Very wide variation in performance ▪ Quant funds struggled
Private Equity	*Largest: Up 5%* *Others: Down 5%*	▪ Growing dichotomy between largest firms and others ▪ Largest benefitted from scale and capital flexibility ▪ Aggressive fundraising ▪ Increased investment opportunity
Real Estate	*Down 10%*	▪ Vast structural changes ▪ Full impact not yet realized
Major Bank	*Mixed Results on Business Mix*	▪ Incentives driven down by credit reserves ▪ Trading strongly positive (up 20%) ▪ Retail banking down 20% to 25%+

2020 Detailed Compensation Changes (Cash & Long-term / Equity)

Typical market range; noticeable variations in performance between firms and specializations



* Excludes proxy executives impacted by firm-specific circumstances

2021 Broad Landscape

- Consolidation is beyond M&A
  - Less traction for average products
  - Greater client mobility

- Advice becomes even more important
  - Complex / confusing product arrays and issues
  - Providing demonstrated value beyond products
  - Requires mindset change beyond words / slogans
  - Understanding how to measure success and timeframes

- Fee pressures continue
  - Alternatives have been significantly protected

- Compensation funding metrics become more creative / localized
  - Mixed strategies and businesses make high-level allocations far less workable
  - Increasingly results-driven funding needed to be successful

- Ground rules for remote working still to be determined
  - Reference points for pay unclear
  - Location-based market vs. national market vs. pay history
  - Increased expectation from employees for flexibility

- Abundant investment opportunities
  - Across risk spectrum and asset classes / geographies

- Massive fundraising by select firms, often larger ones
  - Continued difficulty to differentiate offerings by many firms

ESG / Diversity and Inclusion

- ESG has several dimensions including moral and economic
  - Direct ESG product offerings to clients (i.e. climate, health)
  - Managing business operations to achieve goals (i.e. carbon neutral)

- ESG action effectively a requirement for public companies and many private firms
  - Difficulties balancing practical implementation vs. philosophical beliefs
  - Additional complication as a relatively new initiative for many firms
  - Recognize not all initiatives are embraced by all investors / employees

- Important to communicate and understand organizational embrace of ESG initiatives
  - Philosophical / ethical beliefs of company
  - Client and employee expectations

- Measurement of D&I progress has long been hampered by fuzzy goals and weak analytics
  - Basic firm-wide averages may tell little about D&I progress
  - A simple average of clerical and portfolio managers may tell little about D&I progress
  - Meaningful objectives move beyond simple averages (i.e. x% across firm, 1% above last year)

- Illustrative example: Female / management level expectations over medium term
  - 43% management level in operations / general management
  - 15% in portfolio management
  - 18% in technology
  - 25% in sales

Executive Compensation and Equality

- Equality debate front and center
  - Political landscape
  - Business narrative
  - Lack of uniform definition / context (i.e. Equal income? Opportunity? Education? Wealth?)

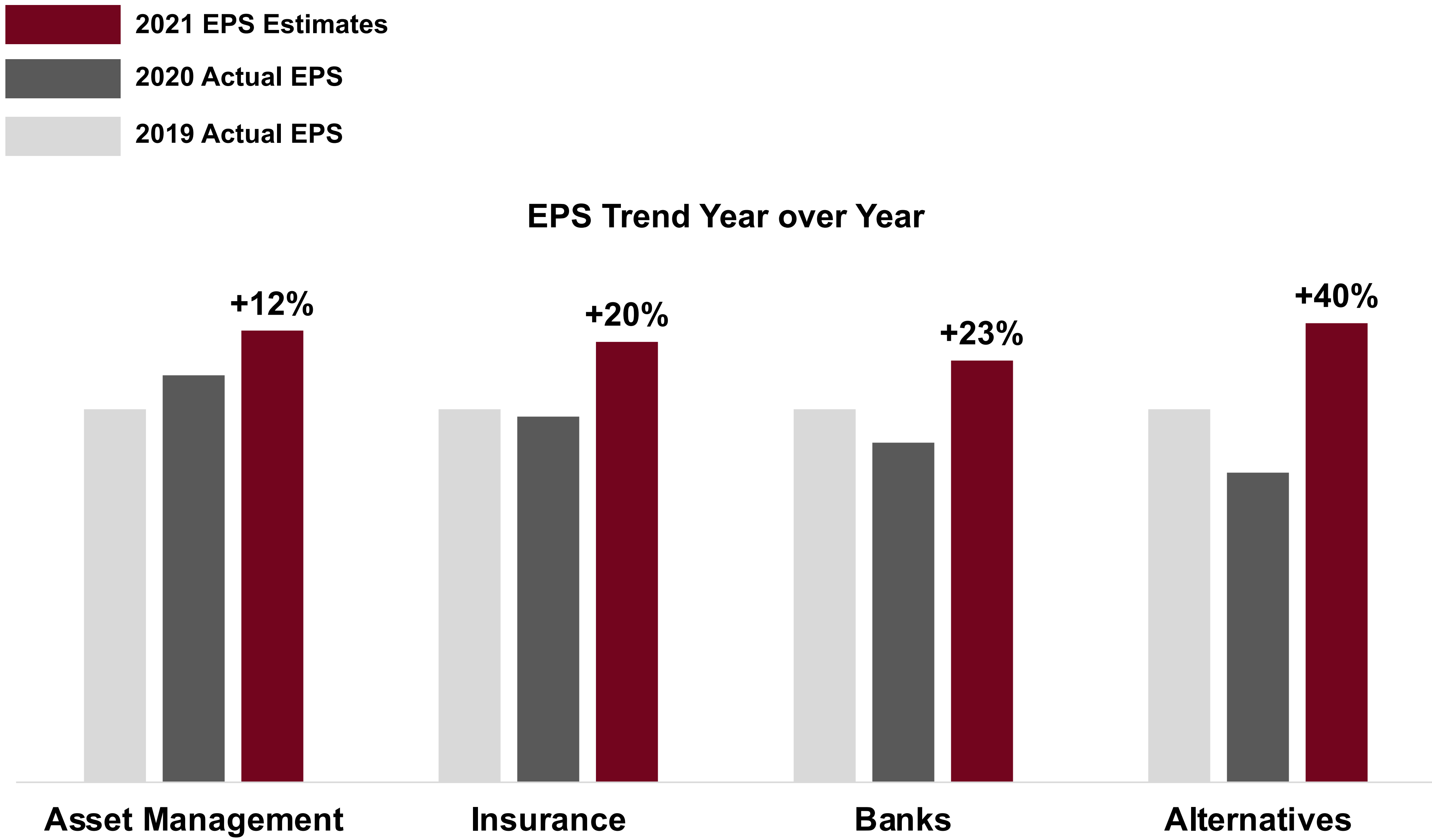
- Equality movement impact the direction of taxes
  - Wealth tax (i.e. .4% of wealth above $50m)
  - Estate tax (i.e. raise rate and reduce hurdles)
  - Federal and state income tax rates
  - Eventually increased taxes and narrative impacts relocation decisions. If my success is branded “bad,” why stay here?

- Non-compete agreements under scrutiny
  - Perception of limiting mobility of middle-income employees
  - Likely patchwork of local limitations and bans coming
  - Need clear objectives for plan provisions

- Required pay ratios gain greater prominence
  - Convenient political narrative
  - CEO to median worker
  - Male vs. female pay levels

- Proposals to increase effectiveness of “claw backs”
  - Greater and longer deferrals
  - Adverse impact and costly implementation likely

Market Sending Clear Signals of Progress



Headcount Changes Take Many Forms

- Outsourcing of operations and technology
  - Pandemic highlighted ability to have strong remote contributions
  - View that much of basic operations is a commodity

- Reducing management levels and bureaucratic behavior
  - Quality decisions can be made with less review / resources

- Product changes
  - Index products require less headcount
  - Alternatives are not headcount intensive per fee $

- Talent levels and recognition of new professionals' capabilities
  - Realization that fewer, better performers is an attractive model
  - Less experienced professionals often a relative bargain

- Geographic movements of business functions within U.S. and globally

2020-2021 Compensation Normality Continues

- Base salary ≅3% notional increases to continue but upward trend coming
  - Actual increases often much higher (i.e. promotions, equity adjustments, bonus changes, special increases for young professionals, etc.)
  - In second half of year, pressures mount as economy reopens

- Annual bonus process and timing continues
  - Normal evolution of programs
  - Funding approaches continue to be challenged (i.e. results vs. simple bottoms up)

- Few adjustments to outstanding long-term award cycles
  - 2019-2021 grants likely now viable
  - 2021-2023 grants have conservative targets

- Normal reviews and promotions
  - Less interactions but effort expended
  - 360-degree reviews become problematic

- Learning from pay levels and practices in other industries
  - Less insular approach, particularly in technology

Long-Term Incentive Plans Go Private

- Public firms often must have long-term performance plans
  - Views of large shareholders and ISS / Glass Lewis as well as Say-on-Pay
  - Overlapping 3- to 4-year performance cycles on financial / shareholder results
  - Questionable motivational impact and often complex / distracting designs
  - Little evidence of improving performance

- Surprisingly, private firms increasingly using LTIPs
  - Modeled after public firms
  - Perception of “best practice”
  - Often don’t understand why LTIPs truly exist for public firms
  - Lack of public market as reference point

- Array of better choices / combinations available
  - Blend of firm equity, options, and profit interests (mix and match)
  - Continued deferrals into products
  - All cash bonus below senior level
  - End-to-end significant award (i.e. large $ if transform business over 4-5 years)

Asset and Wealth Management

- Consolidation picks up steam (“double barbell”)
  - “Barbell” with growth of giants and remaining true boutiques
  - Second “barbell” with indexed products and alternatives
  - Continued pressure on the mid-tier to demonstrate ability and value-add

- Importance of advice increases
  - Industry historically underappreciated value to clients
  - Often “blind spot” from backgrounds of senior leaders
  - Value-add beyond product offering
  - Requires different expertise than traditional sales

- Meaningful headcount decline driven by technology
  - Operations, mid-level technology and other support functions most impacted

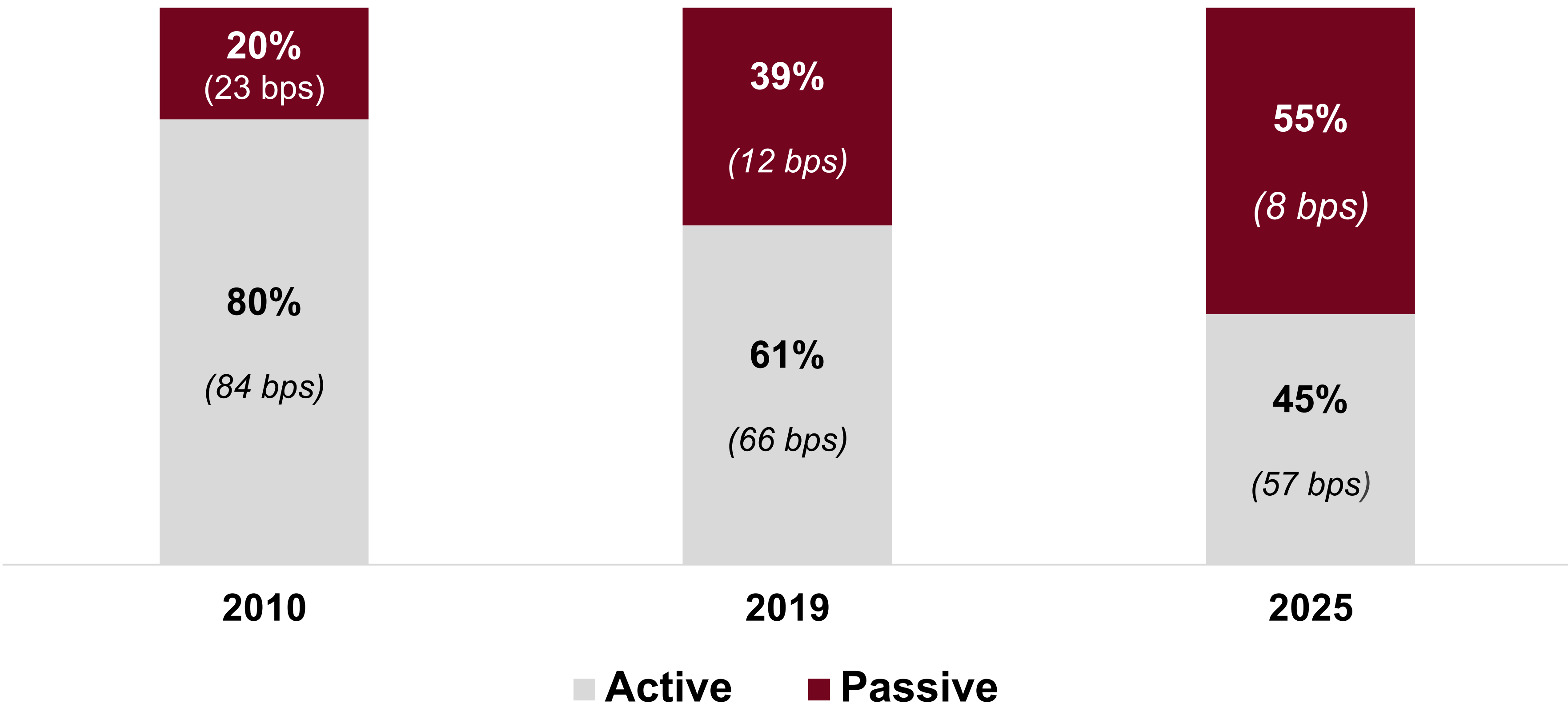
- Outsized importance of alternatives
  - Fee levels remain very high and avoidance of indexing
  - Now fully-recognized third asset class in addition to stocks and bonds
  - Different compensation norms present continued challenges (i.e. levels, carry, and timeframes)

- Continuing mix of portfolio management compensation models
  - Formulaic / revenue team share
  - Hybrid on revenues / returns / discretion
  - Discretionary but guided by market norms / history

Asset Management Product Profile Changes

- Chart highlights importance of alternatives going forward to subsidize fee levels. While fee levels will decline, would be much greater without assumed healthy alternative fee levels

Asset Growth in Passive Funds Moves Forward



* Source: PWC: Covid-19 and the Mutual Fund Industry

Private Equity Style Investments

- Plentiful investment opportunities across both mainstream / unorthodox investments
  - Credit fundraising and opportunities strengthen, particularly in distressed
    - Although pre-existing positions may limit flexibility

- Very strong fundraising environment with opaque short-term results, but positive long-term trends
  - Fundraising environment that principally benefits established, larger firms

- Performance management remains an issue with overly generous grading and rapid promotions

- Carry allocations blend “%” and dollars at work
  - Key to have reserves to recognize performance / promotions
  - Balance single fund / strategy focus with desired alignment across funds
  - Recognize funding of GP commitment and have a strategy
  - Aggregate team carry should recognize track record, fundraising, annual pay and ownership

- Major Issue: European Waterfalls a suboptimal incentive approach for both firms and investors
  - Behavioral economics has taught us that receiving payouts in 10 years is heavily discounted and does not drive the right focus
  - American Waterfall, with protections, is far superior
  - Evidence of some movement toward American Waterfalls to gain competitive advantage

Hedge Funds

- 2020 average returns ≈10% inclusive of massive outliers
  - 30%+ returns skew industry expectations, folklore, and eventually raw compensation data
- Credit / equity dislocations provide rich future opportunity akin to post-financial crisis
  - 2021 and 2022 will provide litmus test of potential value-add
  - Will test whether industry still attracting investment talent capable of generating alpha
- Movement will continue and accelerate toward formula-driven compensation
  - Continued difficulty in translating broad firm capabilities into returns
  - Reflects need to produce better investment results
  - For many, provides better alignment / accountability
  - However, requires addressing a host of cultural, measurement, and alignment issues
- Activist funds may have advantage in turbulent markets
  - Underperforming operating businesses perhaps easier to identify
- Volatile / unstable markets continue disrupting quantitative selection strategies
  - Have underlying relationships temporarily or permanently changed; and in what direction

Banks and Insurance

- Staff reductions continue with layoffs / buyouts
  - Headcount reductions continue quietly
  - Significant decline in physical footprint (i.e. branches)

- Economic reopening increases loan volumes / retail activity
  - Lower volatility reduces trading opportunities

- Ongoing challenge of varying compensation levels and trajectories by business segment

- Major insurance company 2020 incentives down 10%
  - Lower interest rates
  - Pandemic and broader economy
  - Heavy cost base

- Life and retirement faces substantial medium-term challenges
  - Lower interest rates
  - Volume challenges in a competitive / mature market

- Significant / "bubble level" activity in insurance company formations
  - Firm sizes and expectations increasing
  - Funded by private equity and hedge funds
  - Boutique firms focusing on specific risks and investment returns

Final Thoughts

- 2020 incentives about flat, reflecting fundamental industry health (and luck)
- Headcount issues are evolving, but downward trend continues
  - Voluntary turnover of average performers probably a good thing
- Often need for results orientation in incentive funding / allocations
  - Simple "bottoms up" can lack alignment
- Acceleration of current relocation trends out of NYC / Boston / SF / London
  - 2021 will both be instructive and the beginning of a learning curve
- Greater flexibility in work arrangements
  - Overdue, but implications both unclear and fascinating
- Continued movement toward awards in products
  - Moving away from overly broad company stock
- ESG and D&I move to the forefront
  - Requires thoughtfulness and goals shaped by analytics
- Growth and impact of alternatives are stunning
  - Industry continues to present difficult and interesting compensation challenges
- CEO / Executive compensation receives outsized scrutiny
- Increasing realization that Private Equity European Waterfall is suboptimal
  - American Waterfall can be better. Change to American Waterfall can be competitive advantage

- 2021 will be a year of rare opportunity and the chance to move forward