

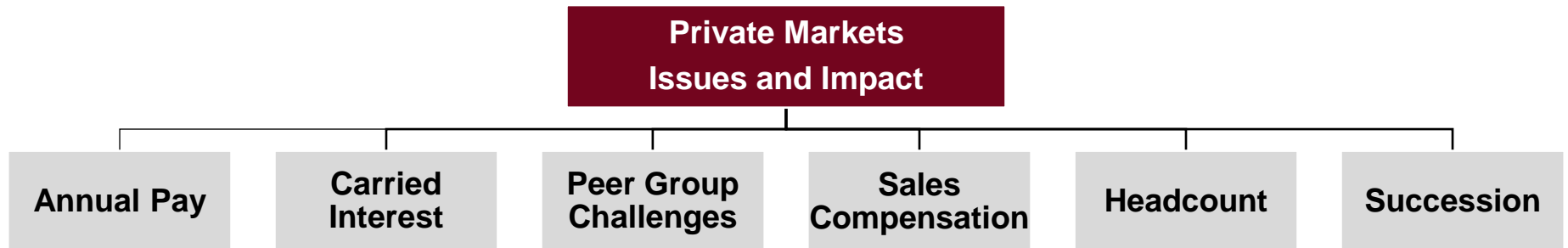
Johnson Associates

Private Markets Compensation Challenges and Opportunities

Discussion Outline | July 11, 2024

Introduction

The expansion of private markets has created compensation challenges and opportunities across independent alternatives firms, captive units, traditional asset managers, insurance companies, family offices, and more. This outline highlights common issues and considerations in a rapidly evolving sector.



Private markets impact felt across financial services. For firms with private market exposure, clear direct challenges and opportunities. For other firms, awareness of private market dynamics increasingly important in shaping compensation philosophy and talent management.

Range of Paradigms and Considerations

Topic	Paradigm / Continuum	Considerations
Alignment (Platform vs. Silo)	Firm vs. team	Integrate desired behaviors into compensation program
	Source of economics matters	Carry pools / cross-fund sharing / equity levers for driving desired “firm” focus
Carry Participation	Broad vs. narrow	Determine best “use” of compensation tools
	Investment vs. non-investment staff	Are carry splits competitive? How is carry valued by non-investment / junior employees? Cultural factors?
Role of Equity	Economic transition vs. deferral program	Defining philosophy and desired outcomes critical
	Vehicles, amounts, timeframes, terms	Economic participation across vehicles important
Market Data	Competitive annual pay and carried interest allocations	Truly relevant peer data (i.e., strategy, firm / fund scale, fee structure, team size)
	Market data often “noisy” and confusing / misleading	Refined data needed for better decision-making and enhanced year-end process
Performance Management / Staffing	Enhance performance management (historically weak in private markets)	Expectations and exit strategies for underperformers
	Create staffing model that adapts with business	Staffing model enhances accountability and evolves with business changes
Founder and Management Succession	Both an economic and governance topic	Founder(s) desires can be key. Must first define goals
	Who? Timeframes? Entitlements?	Transferring ownership (grant vs. purchase) and decision-making transitions often necessitates long runway

Private Markets Environment and Implications

Multi-Year Fundraising Decline

- Lower fundraising impacts carry opportunity, annual pay, appropriate staffing levels
- Small / mid-sized firms forced to reduce headcount and pay if environment persists

GP Commitment

- GP commitment funding a “hot topic” as commitment requirements have increased
- Source of funding and employee affordability key factors

Fewer Exits

- Environment has resulted in managers holding investments longer
- Uncertainty of carry payouts / lower IRR (employee expectations / discounting)

Headcount

- Many firms staffed for larger fundraises than current reality
- Large firms focus on efficiencies and product diversification
- Less backfilling with “like for like” (i.e., hire two mid-level to replace a senior departure)

Sales Compensation

- Sharing percentages for formulaic / hybrid plans in focus; new products, team staffing, etc.
- Carried interest participation in focus. Larger firms use aggressively as recruiting tool

Competition for Talent

- Crowded market (pure alternatives firms, traditional asset managers, banks, family offices, insurance companies)
- New strategy buildouts often require “overpay” and subsidization to acquire the right talent

Despite long-term positive outlook near-term challenges. Factors both nuanced and interrelated.

Carried Interest Trends

Participation

- Shift towards more carry sharing to teams
- Increasingly common to grant carry to mid/senior non-investment staff
- Largest funds share carry with broader group of non-investors (recent focus on sales staff)
- Broad participation not best “bang for buck” as carry heavily discounted and support staff have little impact on returns
- Fund size, carry rates, “team” split, and philosophy / culture factors for determining participation
- Increasing prevalence of carry programs in family offices, insurance companies, and non-traditional illiquid firms

Valuing / Communicating Awards

- Approaches for valuing and communicating carry evolving
- Traditional “dollars at work” remains most prevalent shorthand
- Annualized “dollars at work” another refinement (recognizes investment period / fundraising cadence)
- Difficult to aggregate with traditional annual compensation, reliant on return assumptions and does not reflect present value
- Present value calculation similar to stock option valuation and adjusts for time and risk
- See link below for carried interest white paper

Vesting

- Prevalence varies by strategy and fund size
- Solely time vesting vs. combination of time and realization vesting
- Shift towards realization vesting (more retentive)
- European waterfall most prevalent but American waterfall / hybrid approaches increasingly observed
- Lack of creativity in carried interest vesting design (i.e., interim carry payouts unfortunately remain rare)
- Carry treatment for retirement / other leaver scenarios important

[Carried Interest White Paper: Assessing Current and New Methodologies on Valuation](#)

Public Firms vs. Privately-Owned Firms

	<u>Public Firms</u>	<u>Privately-Owned Firms</u>
Annual Compensation	<p>More compensation parity across firms</p> <p>Prioritization of fee-related earnings and ongoing trade-off between annual pay and carry. Trend still evolving</p>	<p>Largest firms often at market high-end while mid-sized and small firms pay on affordability</p> <p>More flexibility in fee-related earnings (often concentrated ownership)</p>
Carried Interest Splits	<p>Shift towards more carried interest sharing with teams</p>	<p>Some movement to share more carry with teams and more variation</p> <p>Employee-owners “double dip” in team and firm share</p>
Non-Investment Staff Carried Interest Participation	<p>Broader participation including mid and senior level non-investment professionals</p> <p>Sales participation / magnitudes noticeably higher than private firms</p>	<p>Mixed practice on how deep firms share carry</p> <p>Some include support function heads only (i.e., CFO, GC, Head of Sales) and others include mid/senior support professionals</p>
Executive Compensation	<p>Shift from heavy carry participation to larger stock awards (often time and performance-based)</p> <p>Alignment with firm-level economics (i.e., TSR, FRE Growth) instead of strategy / business unit economics</p>	<p>Firm level economics often through ownership and/or “basket” carry participation</p>

Non-Compensation Trends

Implications / Commentary

Examples

Traditional Asset Managers and Insurance Companies Move Further into Private Markets

- Traditional asset managers, banks, and insurance companies rapidly expanding alternatives strategies
 - Acquisitions expensive but organic growth outside traditional expertise can have long runway
 - Scaling private markets a critical strategic initiative at many firms
- BlackRock → Global Infrastructure Partners
 - AllianceBernstein → CarVal Investors
 - Franklin Resources → Lexington Partners
 - T. Rowe Price → Oak Hill Advisors
 - Macquarie → Central Park Group
 - PIMCO → Columbia Property Trust
 - Voya → Czech Asset Management

Permanent Capital Coveted by Alternatives Firms

- Alternatives firms seeking long-term capital which can be leveraged in direct lending / investments
 - Permanent capital reduces fundraising costs and provides investment flexibility (i.e., assets unconstrained by time)
 - Attractive scale potential. Traditional life and annuity insurers hold trillions in assets
- Apollo Global → Athene
 - KKR → Global Atlantic
 - Leonard Green → Hub International
 - Blackstone → Resolution Life
 - Stone Point Capital → Truist Insurance
 - Carlyle Group → NSM Insurance

Artificial Intelligence

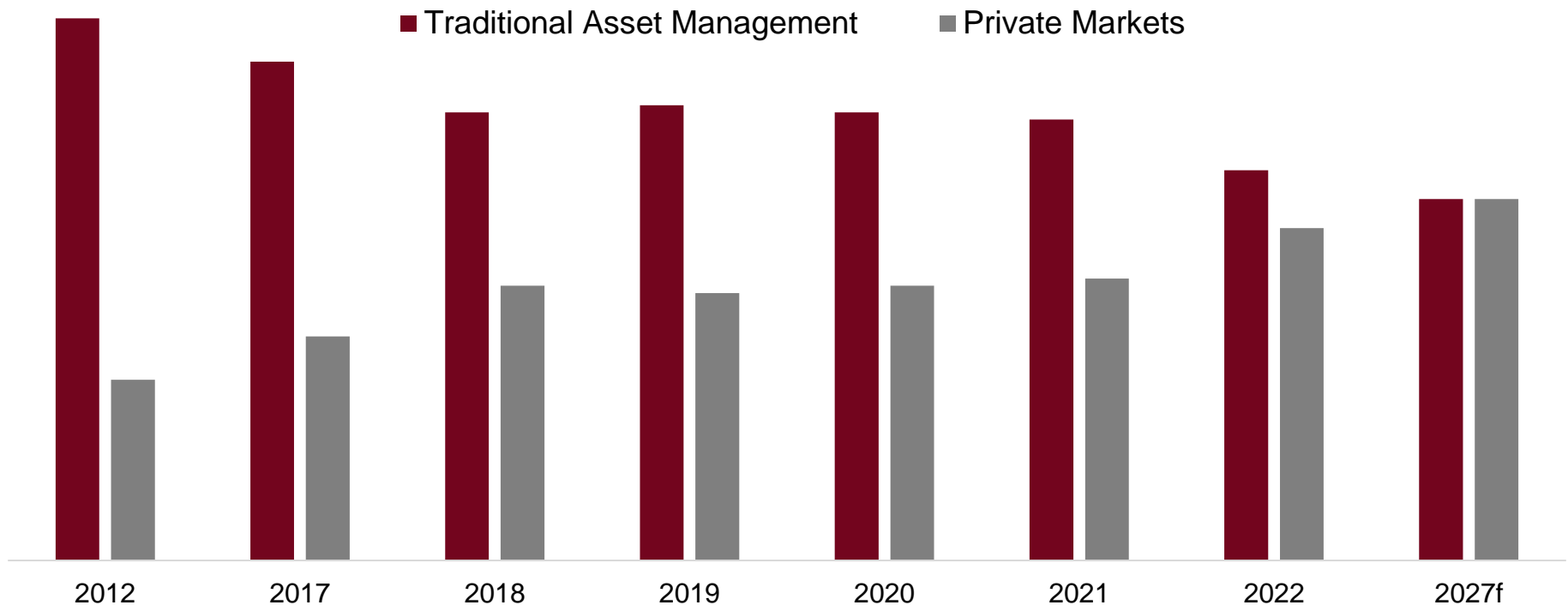
- AI “hottest” topic across private markets. Near to intermediate term impact on headcount / investment processes
 - Firm level optimization including research, product development, data aggregation / synthesis, back-office functions
 - Portfolio company impact including predictive analyses, sales growth, strategy / execution
 - Due diligence / deal sourcing optimization including data strategy, target company analyses, profitability potential, etc.
- AI implementation now a certainty
 - Firm-level implementation
 - Portfolio optimization
 - Due diligence / deal sourcing

Key Scale and Fundraising Statistics

Global Asset Management Revenues: Market Share

- **Private markets revenue and traditional asset management revenue projected to be equal share of global asset management revenues by 2027**
 - Expands well beyond traditional private equity (i.e., private credit, infrastructure, real estate, climate, etc.)
 - Illustration excludes hedge funds

Global Asset Management Revenues (Share of Total Revenues %)

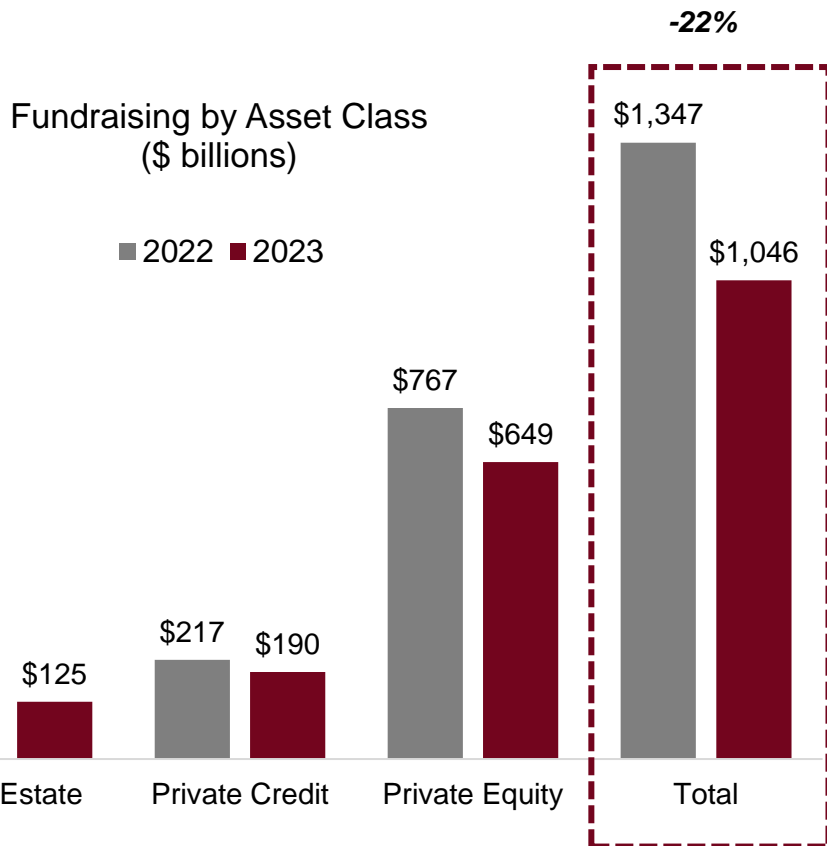


NOTE: Private markets revenue includes management fees and carried interest. Private markets and public markets excludes hedge funds.

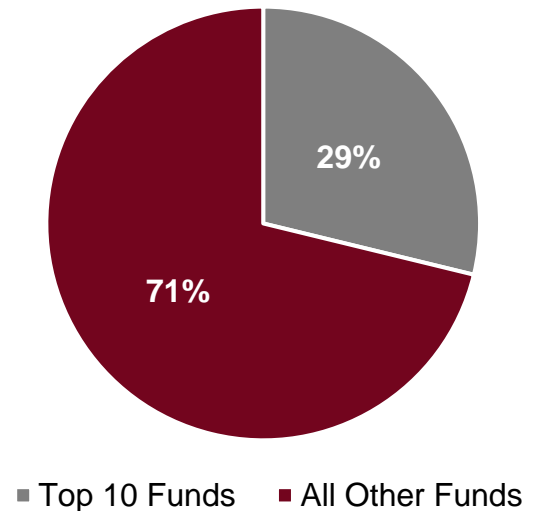
Sources: PWC Global AWM & ESG Research Center, Lipper, Preqin, Pitchbook

2023 Private Markets Fundraising Recap

- **Private markets fundraising declined across all asset classes**
 - Higher cost of capital and fewer exits
 - Longer fundraising cycles and LPs with limited allocation capacity
- **Clear bifurcation between largest funds and all others**
 - Top 10 fundraisers raised ≈30% of all capital
 - Total number of funds closed -60% vs 2022
 - Number of funds closed with <\$1B declined to decade low



% of Total Capital Raised in 2023



Sources: McKinsey Global Private Markets Review 2024 (Preqin Data Referenced)