Financial Services Compensation

Rising Tide Lifts 2024 Incentives Across Sectors

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Discussion Topics

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Johnson Associates is a leading independent financial services compensation consulting firm providing strategic advice, innovative design, and data-enhanced benchmarking. Much of our work is project-based for senior firm management covering a wide range of key issues. We also have extensive experience advising Compensation Committees across business cycles.

- **Range and Depth of Consulting Services / Expertise**
  - Annual / Long-term Incentive Design, Economics, and Metrics
  - Full Range of Competitive Market Benchmarking
  - Partnership and Equity Award Terms
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  - Leadership and Economic Transitions
  - Staffing Analyses Across Product Areas
  - Employment Terms and Agreements
  - Special Situations (Acquisitions, Bankruptcy, Litigation)

- **Global Clients across Financial Services**
  - Asset and Wealth Management
  - Hedge Funds / Alternative Products
  - Private Equity / Illiquid Strategies
  - Family Offices / Sovereign Wealth
  - Investment and Commercial Banks
  - Insurance Companies
  - FinTech
  - Institutional and Retail Brokerages

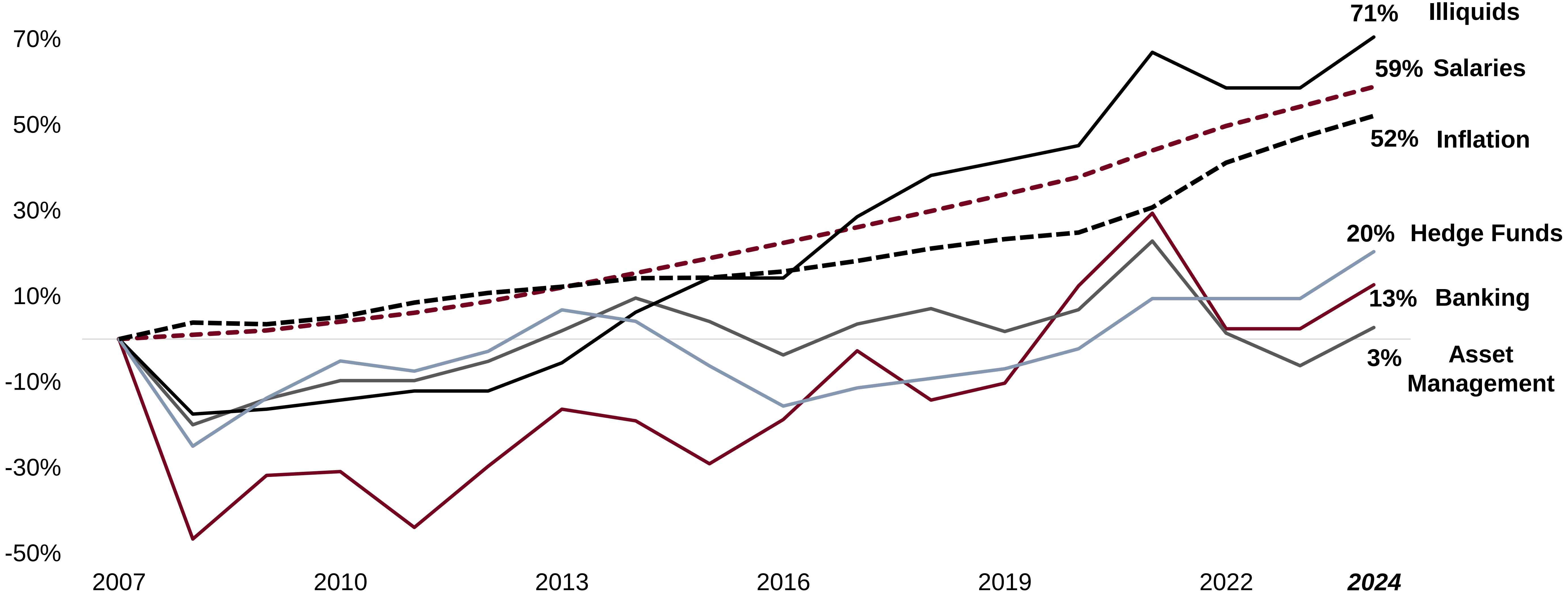
Year-End Incentives Broadly Positive

Sectors	% Change from 2023	Select Key Drivers
Banks		▪ Surprisingly positive economy
Hedge Funds		▪ Year-over-year comparisons from so-so 2022-2023
Asset Management		▪ Public market highs and new products
Wealth Management		▪ Private markets focus on multiple strategies
Illiquid Investments		▪ Stronger growth plans and consolidation (i.e., credit and infrastructure)
Insurance		▪ Firms continuing to optimize headcount after "fits and starts"

Longer-Term Annual Compensation Trends

- **Total real compensation hasn't really increased since 2007**
  - Base salaries have maintained purchasing power over time
  - Incentives have not matched inflation, leading to decreased real incentives
  - Illiquid alternatives the major exception
    - Long-term growth driver with giant pay impact of carry that can dwarf annual pay

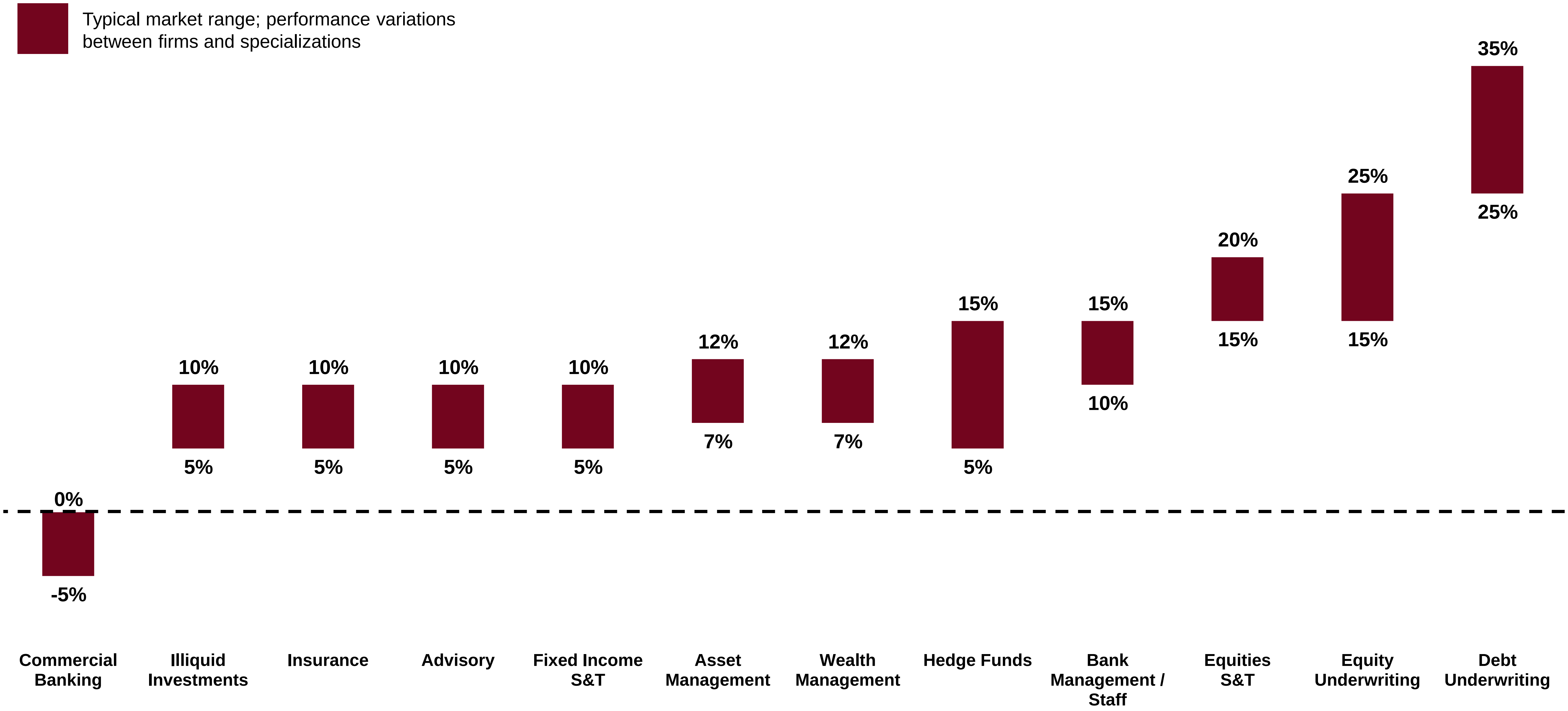
Cumulative Incentive Changes By Sector



2024 Projections: Positive Incentives across Sectors (same store % ▲)

Segment	YoY % Change	Commentary
Asset Management	*+7% to +12%*	▪ Strong AUM growth from market appreciation ▪ Inflows into passives with outflows in active (except "Active ETFs") ▪ Alternatives a strategic priority for diversification and to counter fee compression
Wealth Management	*+7% to +12%*	▪ Tailored advice in demand notwithstanding passive investment shift ▪ Strategic priority for banks and others ▪ Strong markets boost AUM and revenues
Illiquid Investments	*+5% to +10%*	▪ Fundraising challenges for smaller / mid-size funds; mega funds dominate ▪ Realizations and deals down. Outsized dry powder ▪ Private credit, infrastructure, and secondaries "hot sectors" with incentives up 10%+
Hedge Funds	*+5% to +15%* *(Wide Variations)*	▪ Hedge funds generally up with wide variation ▪ Stronger industry inflows vs. 2023 ▪ Strategies correlated with equity markets outperform ▪ Pass-through fees driving compensation levels higher
Major Banks	*+10% to +15%* *(Management)*	▪ Investment banking up, especially debt underwriting (up 25% to 35%) ▪ Equity underwriting up 15% to 25% ▪ Advisory up moderately but optimistic on pipeline (up 5% to 10%) ▪ Commercial banking down 5% to flat amid weaker lending ▪ Equity trading up 15% to 20% as market volatility boosts client activity
Insurance	*+5% to +10%* *(Moderate Variations)*	▪ Moderate underwriting growth for P&C partially offset by rising claims ▪ Life and annuities benefit from higher interest rates ▪ Investment income strong, lifting corporate performance ▪ Corporate functions mostly flat with select areas of higher focus

2024 Detailed Incentive Compensation Changes



* Excludes proxy executives with firm-specific circumstances and designs (i.e., KPIs)

Base Salary Increases Moderate

- **Base salary increases return to 3% to 3.5%**
  - Matches inflation but below employee expectations / hopes

- **Focus on base salary lessens as labor market cools**

- **Legacy remains of equating real fixed costs with base salary levels**
  - Incentives and staffing levels provide needed flexibility
  - Thoughtful salary positioning provides competitive advantage (i.e., key technology higher)

- **Differences in base salary increases by broad level but compressed from the "War for Talent"**

High-Level Illustrative Example	
Total Compensation Level	**Base Salary Change**
Greater than $750,000	Flat (select adjustments if below market)
$500,000 to $750,000	Flat to Up 2.5%
$250,000 to $500,000	Up 2.5% to 3.0%
$125,000 to $250,000	Up 3.0% to 3.5%
Less than $125,000	Up 3.5% to 5.0%+

Public Executive Compensation Evolves

- **Public executive compensation focuses on corporate KPI / scorecard results**
  - Opportunities are at least maintained even after disappointing year
  - Disconnect with other senior professionals where the starting point is last year's compensation
    - Has led to higher levels of executive pay

- **Private company executive compensation often in tandem with broader bonus pools**
  - No pressure from shareholder advisory firms for structured approach
  - More flexibility depending on shareholder base (i.e., executives with significant ownership / alignment with firm profit)

- **Common weakness of public programs are small ownership requirements**
  - Illustration: $800K base salary with 5x requirement
    - $4M requirement / $10M total compensation = 40%
  - 40% of total compensation less than one year equity deferral
  - Private firms often place greater focus on ownership

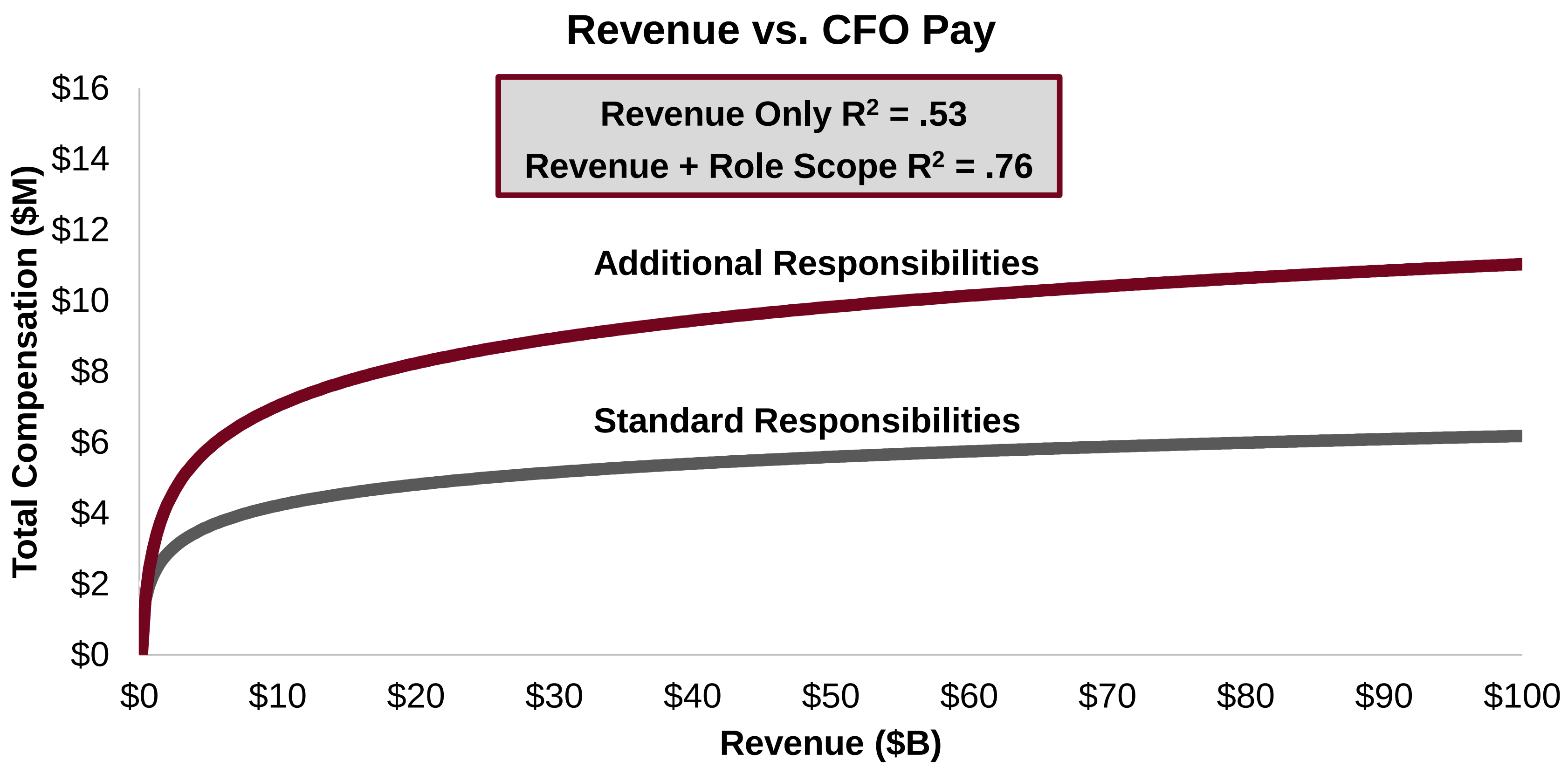
- **Market levels increasingly reflect complicated mix of direct and indirect comparators (i.e., "Knock-On Effect")**
  - Bank Example: General Counsel levels impacted by major alternatives and hedge funds
  - Role Example: Chief Technology Officer market levels can be driven both by the technology sector and broader economy

- **Increasingly apples, oranges, and grapes method of selecting peers**
  - Apples Business (Asset Managers) – 5 peers
  - Oranges Business (Alternatives) – 4 peers
  - Grapes Business (Private Credit / Lending) – 3 peers

Does the median of this group reflect market? Need to ensure competitiveness amongst key competitors

- **Diversity of actual role content makes solely title matching less accurate**
  - Issue compounded by multi-hatted roles where responsibilities are intertwined

- **Ideally balance of arithmetic with informed judgment**
  - CFO example: Revenues vs. CFO pay
    - Revenue + role complexity explains large amounts of variation in CFO pay (**R^2 = .76)** with 60+ data set



Type	CFO Total Compensation
Total Group (Raw Median)	**$5,050,000**
Additional Responsibilities (Projected)	**$6,875,000**
Standard Responsibilities (Projected)	**$4,025,000**

**Used data set median annual revenue of $13B to project compensation*

Common Annual Performance Measures

Sector	Individual	Team	Firm
Asset Management	▪ Portfolio performance ▪ Stock selection / sizing ▪ Qualitative (i.e., process, research)	▪ Absolute and relative long-term fund performance	▪ Investment performance ▪ Net flows ▪ Strategy ▪ Financial results
Wealth Management	▪ AUM growth ▪ Client acquisition / retention / satisfaction ▪ Investment performance ▪ Qualitative	▪ AUM growth ▪ Net flows ▪ Investment performance ▪ Team still has some impact, but more individual and firm focused	▪ Investment performance ▪ Net flows ▪ Strategy ▪ Financial results
Illiquid Investments	▪ Deal sourcing / execution ▪ Investment performance ▪ Qualitative	▪ IRR / MOIC ▪ Portfolio company performance ▪ DPI / RVPI / TVPI	▪ Investment performance ▪ Financial results ▪ Fundraising
Hedge Funds	▪ Portfolio performance ▪ Stock selection / sizing ▪ Qualitative (i.e., process, research)	▪ Absolute fund performance	▪ Investment performance ▪ Net flows ▪ Financial results ▪ Fundraising
Insurance	▪ Individual underwriting metrics ▪ Individual claims metrics ▪ Qualitative	▪ Team underwriting metrics ▪ Team claims metrics	▪ Firm underwriting metrics ▪ Combined ratio ▪ Net promoter score ▪ Strategy ▪ Financial results

Increasing recognition difficulty setting budget driven goals in market businesses. However, relative results imperfect due to uneven peer group and businesses

Accelerating Drive for Efficiencies

- **Firms focused on maximizing efficiencies and reducing costs**
  - Technology and regulatory / compliance costs
  - Headcount right-sizing / more conservative hiring plans
  - Concerns about economy over next 2 - 3 years

- **Headcount pressure and trends**
  - "Flat-ish" headcounts mask declines in legacy / same-store businesses
  - Offset by acquisitions and selective expansions (i.e., Wealth, Alternatives, Credit)
  - Learnings from "War for Talent" (i.e., over-hiring, over-paying)

- **Increased use of non-financial centers (i.e., India, Philippines, eventually Latin America) with many highly-skilled, lower-paid workers**

- **AI will have significant impact across businesses**
  - Significant impact felt over 3+ years
  - Analysis work and hiring / career plans
  - Equity research
  - Operations
  - Loan pricing
  - Legal

Different Approaches to GP Funding

- **Funding GP commitment a source of tension. Larger funds and elongated waterfalls often require loans or other funding sources**
  - An alternative is to allow professionals to choose between funding their GP commitment or receiving 10% to 15% less carry without a commitment

Example of Choices

Individual Door A: Fund $600K and receive $6M dollars-at-work

Individual Door B: Don't fund $600K and receive $5.1M to $5.4M dollars-at-work (i.e., 10% to 15% less)

→ **If firm funds the $600K, firm recoups $600K to $900K dollars-at-work. At a 2X MOIC, co-investment worth $1.2M and recouped carried interest worth $600K to $900K for an overall 3X – 3.5X multiple**

- **Many firms have resources to fund the GP commitment below the executive level. Giving most participants a choice would simplify process**
  - Senior Associates and Vice Presidents may lack liquidity to cover GP commitment
- **Other common funding alternatives:**
  - Internal and external loans
  - Fee waivers
  - Deferrals / carried interest payments

Private Firm Ownership Transitions

- **Less overwhelming to start program with only truly key professionals**
  - Reach clarity on opportunity / timeframe for 3 – 6 leaders
  - Provides framework for eventual broader program
- **Clarity key on real objectives**
  - Balance short-term vs. long-term value
  - Firm legacy and governance
- **Succession important to investors**
  - Communicating a concrete plan and timeframe
  - Particularly important for founder-led firms with key-man risk
- **Importance of ownership visibility has escalated**
  - Especially maturing firms with significant ongoing value
  - Meeting expectations / promises to senior professionals
- **Balanced programs often include full value and growth elements**
  - Moderate full value with long vesting
  - Large growth award on future value creation
  - Clear and fair terms that don't negate the opportunity
- **Useful guiding principles**
  - Owning smaller percentage of larger continuing value usually benefits founders
  - Sensible approaches aren't about "giving away" massive value
  - Linked to long-term retention and value creation
  - Balance economics and vesting

Highest Opportunity

Succession Plan / Ownership Transition

Long-tailed transfer timeline
Significant vesting
Multiple vehicles (higher focus on full shares)
Eventual transfer of final decision-making

Significant Economic Sharing

Moderate transfer timeline
Longer vesting
Multiple vehicles (full shares and growth units)
Evolved governance (committee participation)

Moderate Retention / Alignment Mechanism

Shorter transfer timeline
Standard vesting
Single vehicle / upside only (growth units)
No governance change

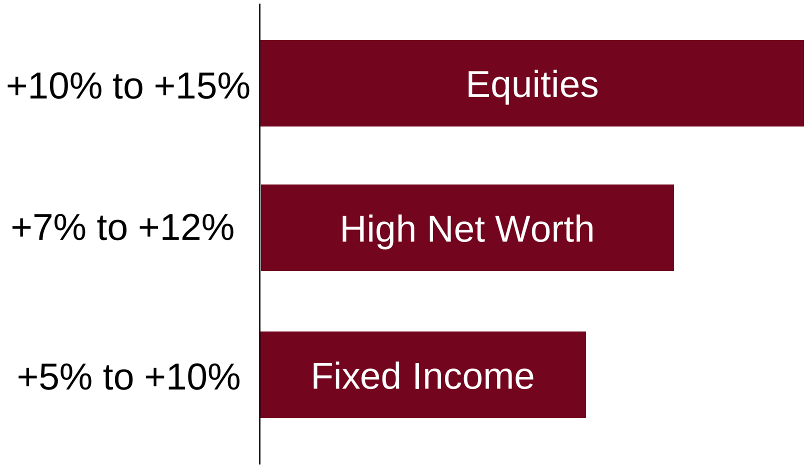
Lowest Opportunity

Sales Compensation Designs in Flux

- **Fundraising pressures create focus on sales design**
  - Continuing question whether current program is optimal
- **Movement away from pure commission models continues**
  - Hybrid programs - part formulaic, part discretionary
  - Often reflects significant assistance required to generate sales
- **KPI-based plans similar in feel to many corporate programs**
  - Budget driven (i.e., goal of $X) with factors for redemptions, new clients, contact activity, team sales, etc.
  - Effectiveness depends on ability to forecast / monitor
- **Much greater focus on salesperson quality in challenging environment**
  - Continues transition to greater expectations of product and client knowledge
- **Many attempting to develop deeper strategic relationships with clients**
  - Requires significant investments and patience
  - Value add beyond products
  - Compensation implications of forging deeper relationships and longer timelines

Asset and Wealth Management Prospects Diverge

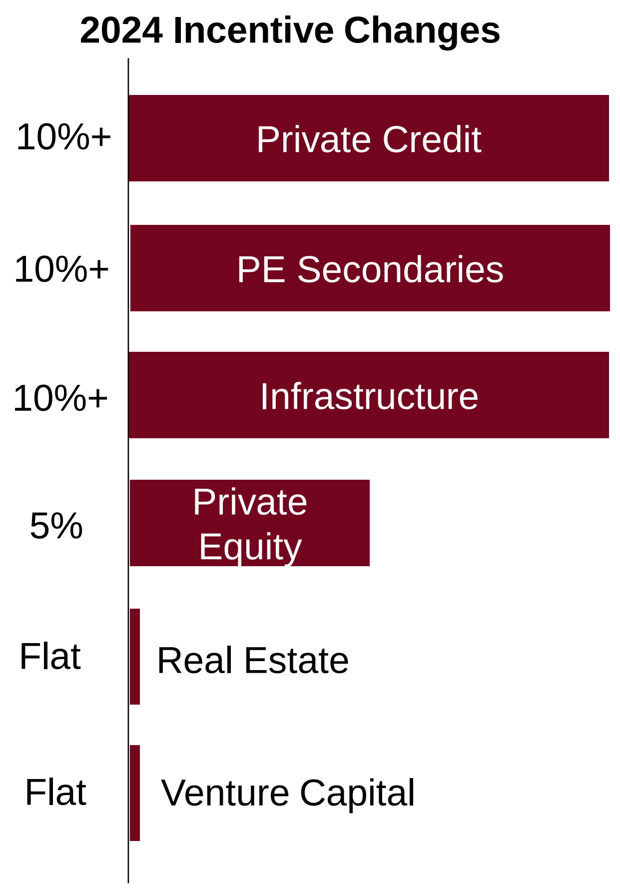
2024 Incentive Changes



- Active equities outflows continue
  - Outflows with move to cash and money market funds
  - Volatile markets stoke investor concerns
- Headcount continues to be under pressure
  - Need to manage costs to pay for technology and new products
  - Select hiring (i.e., high-end technology, alternatives)
- Expansion into asset / wealth management
  - Firms trying to diversify away from core business
    - i.e., Banks & Insurance
  - Existing competitors moving further into alternatives
- Wealth management has significant momentum
  - Tailored advice not “indexable”
  - Large and growing demographic opportunity
- Shift to lower fee products now old news
  - Net outflows for active products with passive shift
  - Trend reinforces fee pressure on asset managers
  - Active ETFs new “hot products”
  - Active fixed income flows positive amid interest rate activity

US Net Flows ($ in Billions)	YTD Sep 24	YTD Sep 23
Active Equity	-$357	-$271
Passive Equity	$427	$191
Active Fixed Income	$121	-$8
Passive Fixed Income	$265	$193

Source: Piper Sandler Asset & Wealth Management Report



- Fundraising slowdown and challenging environment
  - Mega funds capture 50%+ of total fundraising
  - Particular pressures on small / mid-sized firms

- Deal activity and exits suppressed
  - Interest rates stress projections
  - Carried interest impacted by low realizations and waterfalls
  - Pressure to realize at suboptimal valuations

- Continuing boom in private credit
  - Scalable opportunity
  - Talent shortages
  - Partnerships between banks and alternatives firms to scale direct lending

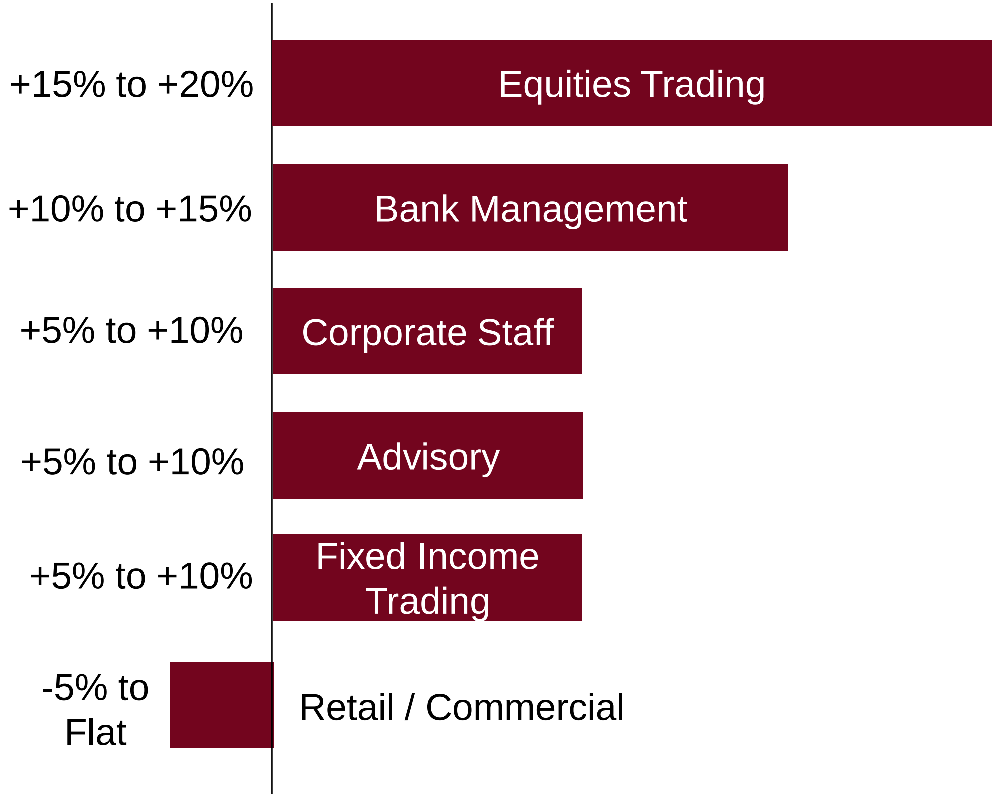
- Secondaries funds continue to grow as GPs seek liquidity
  - Especially in muted exit environment
  - GP-led strategy becomes about half of all secondaries transactions
    - Allows for fund life extension and a restructuring of assets while providing liquidity to LPs
    - Extends fundraising timeline

- For many, new fundraises smaller / same size
  - Growth has masked inconsistent performance management

First real headwinds in a decade. Upsets assumptions on returns, timing, and growth

- Results up with flows and market appreciation
  - Industry up 5% to 15%
  - Funds with positive equity market beta outperform
- Slowing outlier pay for successful portfolio managers
  - Hiring driven by performance
  - Star talent offered guarantees / favorable terms especially with pass-through fees
- Abu Dhabi becoming significant hub
  - Access to large sovereign wealth funds
  - Favorable tax treatment
  - Centrally located time zone to trade international markets
- Top-tier sales / investor relations and high-end recruiters in demand
  - Outsized compensation and incentive fee participation for sales / investor relations
- Blurring as large firms expanding into illiquid strategies
  - Private credit a strategic priority
  - Diversified product can lead to cross-selling
- Emphasis on non-competes with increasing lengths
  - Enforceability issues to evolve with legal / political climate

2024 Incentive Changes



- Better than expected economy lifts incentives across functions

- Investment banking revenues rise with particular strength in underwriting
  - Optimism on pipeline with activity rising but still below 10-year averages
  - Debt underwriting incentives up 25% to 35%
  - Equity underwriting incentives up 15% to 25%
  - Advisory activity muted but strong 2025 backlog

- Trading businesses up broadly
  - Equities trading incentives up 15% to 20% upon "re-risking" and market appreciation
  - Fixed income up 5% to 10%, stronger structured products and weaker commodities

- Headcount trending flat for 2024
  - Firms slow to react after activity drop in 2022
  - Select layoffs in areas offset by business expansion in others
  - "War for Talent" a distant memory

- Commercial banking flat to down slightly despite positive economy
  - Lending down slightly

- Investment and wealth management a growth driver for banks
  - Continue to become large players in alternatives

Outperforming Products / Areas:
Life & Annuities
Investments

Market Performing Products / Areas:
Property & Casualty
Select High Demand Support Functions

Underperforming Products / Areas:
General Corporate Staff

- Major insurance company incentives up 5% to 10%
  - Changes in payouts year-over-year
  - Reflects revenue / stock price performance and improved 2024 combined ratios
- Property & Casualty products show some improvement amidst challenges
  - Stronger underwriting and better financials
  - Slowing inflation / lower replacement cost increasing profitability as pricing remains high
  - Gains partially offset by rising claims from hurricane season
- Life & Annuities products outperforming
  - Buyers lock in higher rates on annuities before anticipated rate cuts
  - Moderate premium growth
- Majority of corporate functions about flat / slightly positive
  - Functions dampened due to cost cutting / continued outsourcing
  - Functions tied to business transformation stand out
    - i.e., product, strategy, select tech functions
- Growing impact of asset management units on the overall insurance company
  - Asset management a key growth area with a newer focus on alternatives
  - Difficulty integrating asset management pay with parent company performance
  - Cultural differences can be a roadblock
- AI a key strategic priority to streamline underwriting and claims processes
- 2025 outlook mildly optimistic with moderate expected growth

Fearless Predictions

Good Year-End 2024	▪ Incentives broadly positive and easier communication ▪ Some disappointment in underperforming sectors (i.e., commercial banking, select illiquids / insurance) ▪ New hires / juniors vs. incumbents
2025 Surprisingly Positive	▪ Economy continues on positive trajectory ▪ Firms optimize strategy and headcount effectively to increase pools
Continued Wealth Management Momentum	▪ Clear value and greater emphasis on service ▪ Need for many to grow talent pipeline ▪ Healthy fees and potential scale
Interest Rates Increase Along With Inflation	▪ Unchecked massive federal deficits ▪ Some portion of Trump's economic plan goes into effect (i.e., Tariffs, elimination of tax on tips / Social Security)
2025 Initial Cracks in Private Credit	▪ Overly expansive lending leads to losses ▪ Overly conservative / generous marks
Insurance Prospects	▪ Positive economy benefits overall sector ▪ Higher interest rates help life & annuity sales ▪ Asset management units grow and become increasingly integrated with parent
Demand for Compliance and Attorneys Spike	▪ Less regulatory enforcement ▪ Perception / reality competitors cheating
In Office Work	▪ Five days a week in office policy seemingly adopted but weak enforcement ▪ Can be used as a strategy for voluntary headcount churn ▪ Hybrid work used as inclusion strategy

Final Thoughts

- **2024 strong year after so-so 2022 and 2023**
  - Easier handling pay communication and implementation than previous years

- **Investors continue to look for excess returns even with passive trend**
  - Active / Alpha-Generating ETFs grow in popularity
  - Interest grows among retail investors to access alternatives and firms look to capitalize by offering private equity / credit

- **Firms continue right-sizing headcount and focus on operational efficiencies**
  - Continued hiring in “hot” areas and selective cuts in others
  - AI will reduce headcount substantially over coming years
  - Lower turnover among incumbents

- **2025 economy likely trending in positive direction**
  - Expectation of soft landing but timing of rate cuts key
  - Capital markets pipeline recovery in progress and optimism among market participants
  - Equity markets at record valuations

Firms seek to optimize in increasingly competitive environment. Headwinds remain but optimism for future across financial services.