MAGELLAN
ADVISORY PARTNERS

Compensation Review 2020

Incentivisation & Deferral Report

Contents

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Executive Summary

Asset managers continue to struggle with several headwinds such as fund performance, fee margins and regulation. For the most successful business units, turnover of their best performing senior staff is another significant issue and firms with a short-term outlook on employee incentivisation schemes increasingly experience more unwanted departures.

As a result, the industry is focusing on improving retention levels through the use of deferral schemes. These schemes vary in design, implementation and execution and can be tied to various quantifiable and non-quantifiable metrics. With the current regulatory environment shining a spotlight on the industry, these schemes must adhere to remuneration policy and conduct while also ensuring that employees feel that they have significant “skin in the game” and are not just being locked in for the sole benefit of the employer.

In this compensation report we will explore the ways in which asset managers are tackling the issue of staff retention, looking at the following key points:

- How do different types of firm structure compensation packages?
- Does the size of firm have an impact on fixed and variable compensation levels?
- What types of deferral schemes exist?
- Is there a different approach to compensation between investments and distribution?

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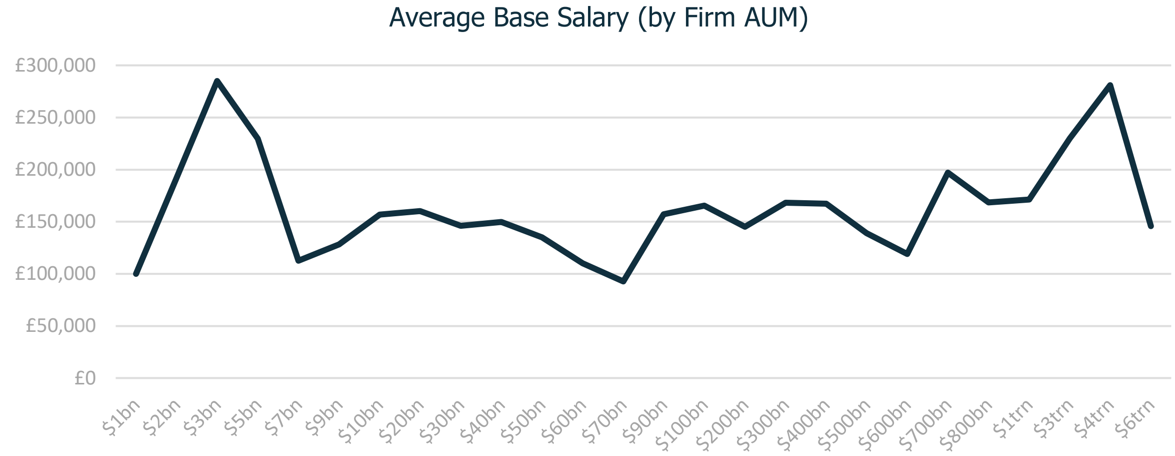
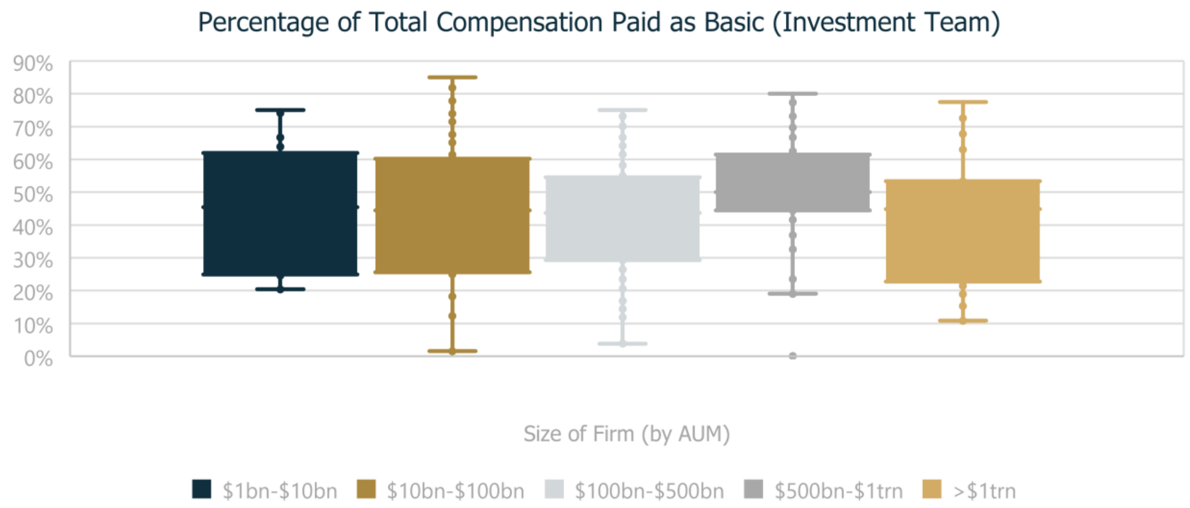
Basic vs Variable Compensation

Investment Teams

The industry assumption is that the smaller the asset manager, the more need to keep fixed costs low. According to our aggregated data on investment teams (PMs, Analysts, Strategist & Economists), there is a suggestion that smaller, specialist boutique managers that have reached critical mass are amongst the highest base salary payers. The data suggests that this is also the case for investment teams within the largest asset management firms. This supports the current narrative, that the firms under the most pressure from falling profit margins, "the squeezed middle", are unable to support as high a fixed cost base.





As a percentage of total compensation, there is no clear differentiator between house sizes. We see mean averages of basic salary float at around 50% of total compensation from the smallest firms right through to the $1 trillion+ asset managers.

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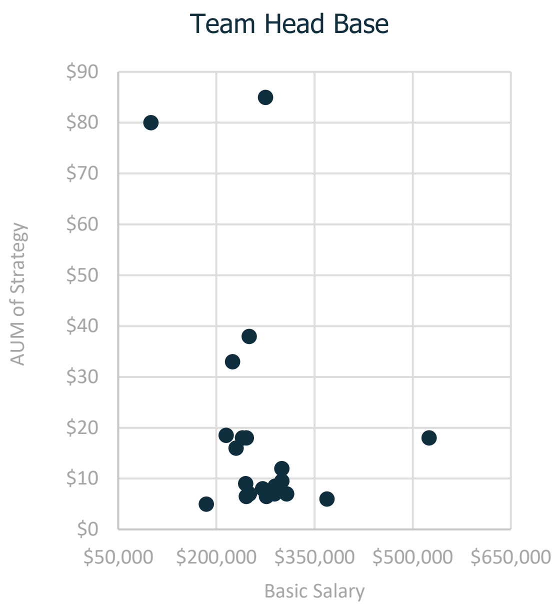
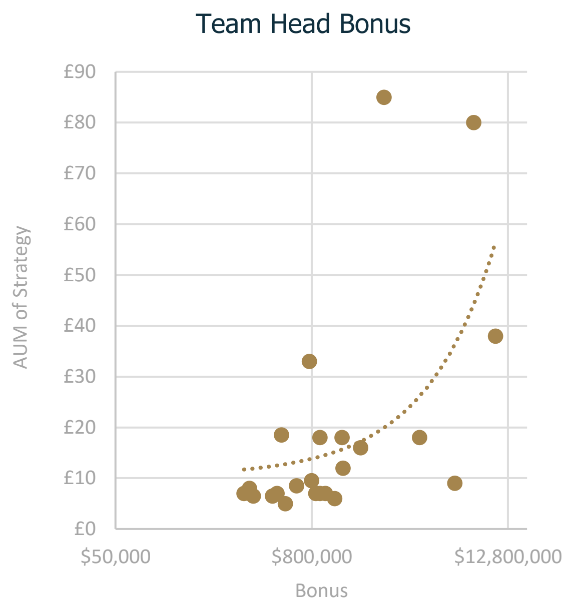
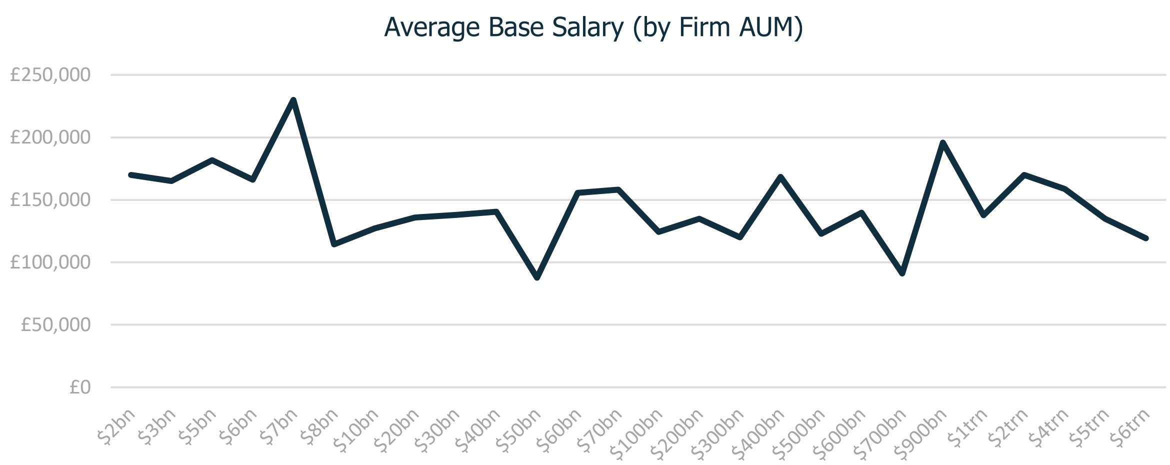
Using Fixed Income team head data as a case study, it is clear that there is no direct correlation between strategy size and basic salary, however there is a clear upward trend in strategy size and bonus. This is because a number of houses have ensured that there is a dynamic link between compensation and assets managed. The incentive of sharing in the strategy's success has been a key part of retaining key managers for flagship funds.





Distribution Teams

Similar to the trend we see on the investing side, distribution professionals seem to command higher base salaries in smaller boutique asset managers as well as larger asset managers, with a similar anomaly at the highest bracket. In general, the data once again supports the theory that it is those mid-sized asset managers that are most restricted when it comes to fixed compensation.



Unlike investment teams, compensation weight on distribution teams appear to be somewhat linked to AUM. Distribution teams (salespeople, client relationship managers, consultant relationship managers) typically have target based KPIs based on numerous factors such as sales performance, asset retention and company performance.

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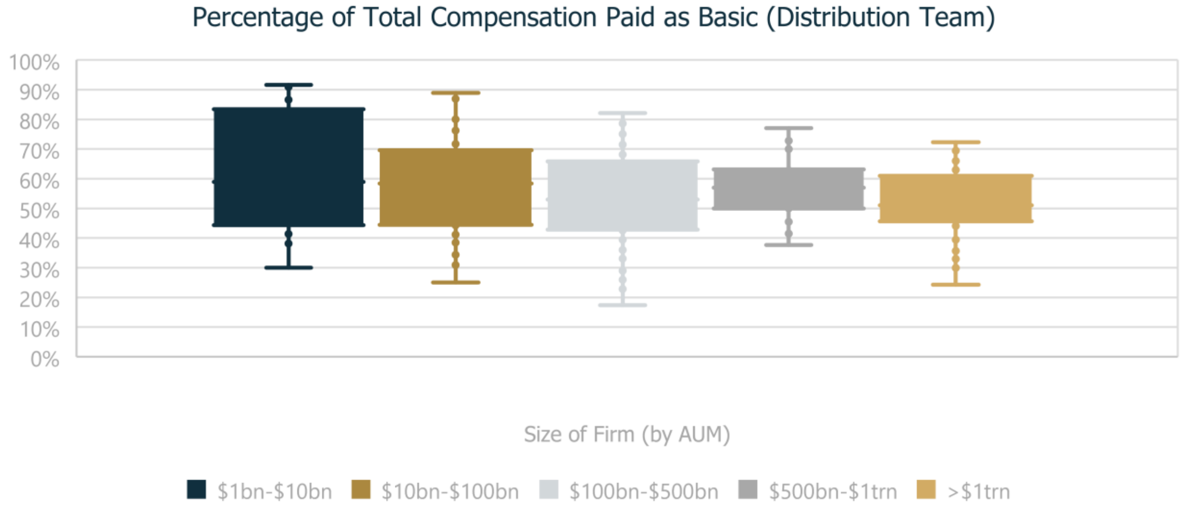
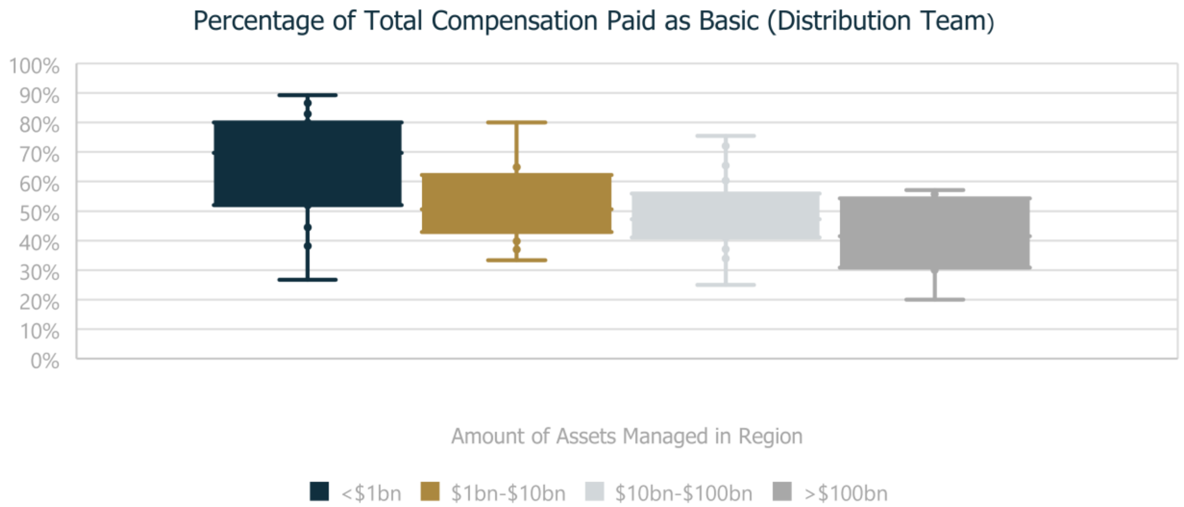
As seen in the chart below, larger firms weight total compensation far less on the basic element and focus more on increasing the bonus.



For heads of region e.g. Head of US or Head of Nordic Sales, and regional salespeople who manage a significant amount of assets, firms are offering a larger percentage of their compensation on the variable side. As seen below, the larger the asset base managed by a salesperson or client relationship manager in a given region, the higher the bonus element of their total compensation.



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Long Term Incentivisation

Retaining employees by compensating them outside of shorter-term base salary and bonus awards has been achieved by incentivising employees based on individual, team and firm-wide performance, as well as aligning employee values/goals with that of the broader organisation. Depending on the ownership structure of the firm, nuances/variations have been incorporated to make them distinct and/or fit their specific needs.

Performance Options

Performance Options is an incentive scheme that pays compensation based on increases in value of the firm's Common Shares.

Both publicly and privately-owned independent asset managers will use this scheme for their global investment teams. Publicly owned companies tend to issue public shares that are comparatively liquid, whereas privately-owned companies may offer alternatives such as shadow stock or phantom shares that require to be sold privately within the company.

Insurance-backed or bank-owned asset managers may also use this model and will offer Common Shares at the "Group" level.

Matched Shares

Similar to example one, Matched Shares is an incentive program that awards discretionary bonus shares based on firm or group performance. This programme has the additional option of a capped salary sacrifice that can also be invested in company funds or shares that will then be discounted or matched by the company.

This scheme is favoured by bank-owned and insurance-backed asset managers where optional buy in is offered at the Group level. While there are independent asset managers that use this scheme and will offer phantom shares or shadow shares, this is a less common approach as there is less incentive to purchase illiquid shares. The global footprint of these firms varies from domestic players to international groups that have global offices.

Fund Investment

Fund Investment is aimed at active investment managers in eligible teams that are decided annually through a Compensation Review Process. This typically includes investment managers, asset class heads and Chief Investment Officers.

Bonus awards are invested into funds managed by the team and a basket of flagship funds. This structure is becoming much more common across investment teams, as it aligns the team not only with the business result but the client base as well. It provides long term incentive to produce performance, while ensuring that teams are awarded in a collegial fashion as opposed to just the individual.

Carried Interest

Carried Interest is an incentive scheme that aligns the interests of the portfolio managers with Private Equity investors. This is typically defined as a percentage of the fund profits, as well as a percentage of management fees. At the discretion of the Administrative Committee or Remuneration Committee, a Carried Interest Share may take the form of a performance fee, which is directly linked to the success of the investment fund. This share typically amounts to c.15-20% of the net profit of the fund once a pre-determined performance hurdle has been met.

These schemes are essentially non-existent in traditional asset management houses and are found in Private Equity-backed asset managers or boutique Private Market asset managers where the scheme has historically been present due to the ownership structure. These firms either have global offices across EMEA, the USA or Asia or have a global team based in a European or North American headquarters.

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Deferred Stock

The data suggests that company type and ownership structure influence how bonuses are awarded. Generally speaking, if employees are awarded a deferred stock element to their bonus, they fall into two brackets.

Listed Companies

- Public shares are issued as part of a performance share scheme where performance is linked to the health and growth of the company.
- Group level shares are issued if the firm is a subsidiary of a bank or insurance company.

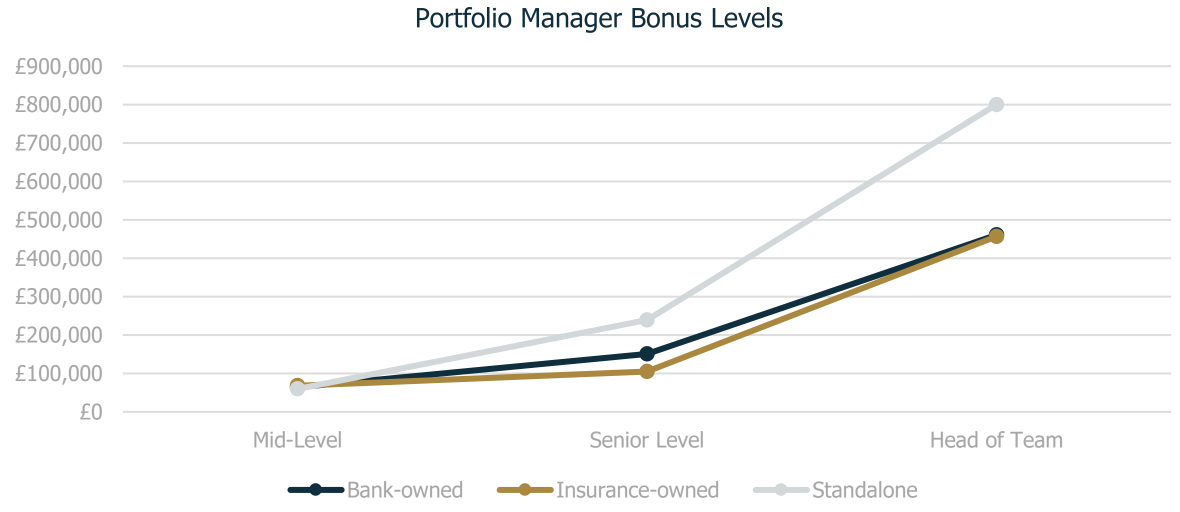
Private Companies

- Utilise a profit-share or investment into flagship/manager funds.
- Private or phantom shares offered that can be traded internally.

Ownership and Company Structure

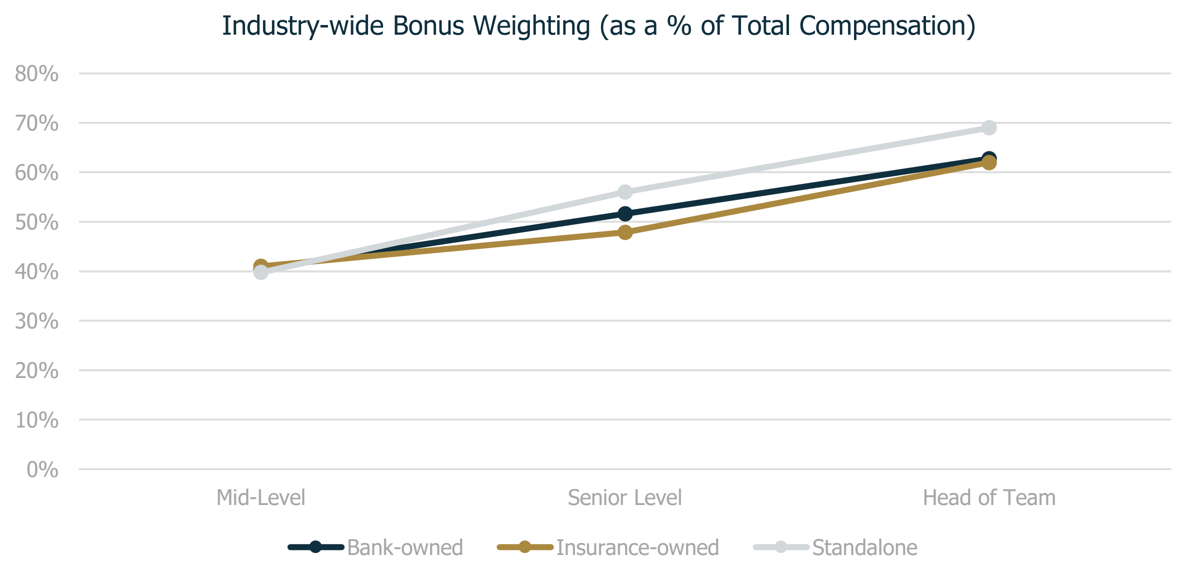
While company structure can define how variable compensation is paid out, ownership structure tends to affect how much is awarded. Insurance-backed and bank-owned asset managers are bound to the regulatory requirements of the parent group, so insurance-backed firms must comply with Solvency II measures and bank-owned firms must comply with Basel standards.

Bonuses are therefore capped significantly in subsidiary asset managers. As a case study, we have taken mean average of data collected from portfolio managers across the industry, and we can see that independent asset management houses pay out just under double that of subsidiary asset managers.



Given the disparity in average bonus levels between bank or insurance affiliated asset managers versus standalone firms, the subsidiary houses have tended to adopt more aggressive deferral tactics in an effort to lock in key staff.

The chart below indicates that as a percentage of total compensation, there is a slight preference from standalone asset managers to pay a higher proportion of total compensation in bonuses. At the senior level, insurance affiliated firms pay more of their compensation in fixed, rather than in variable.



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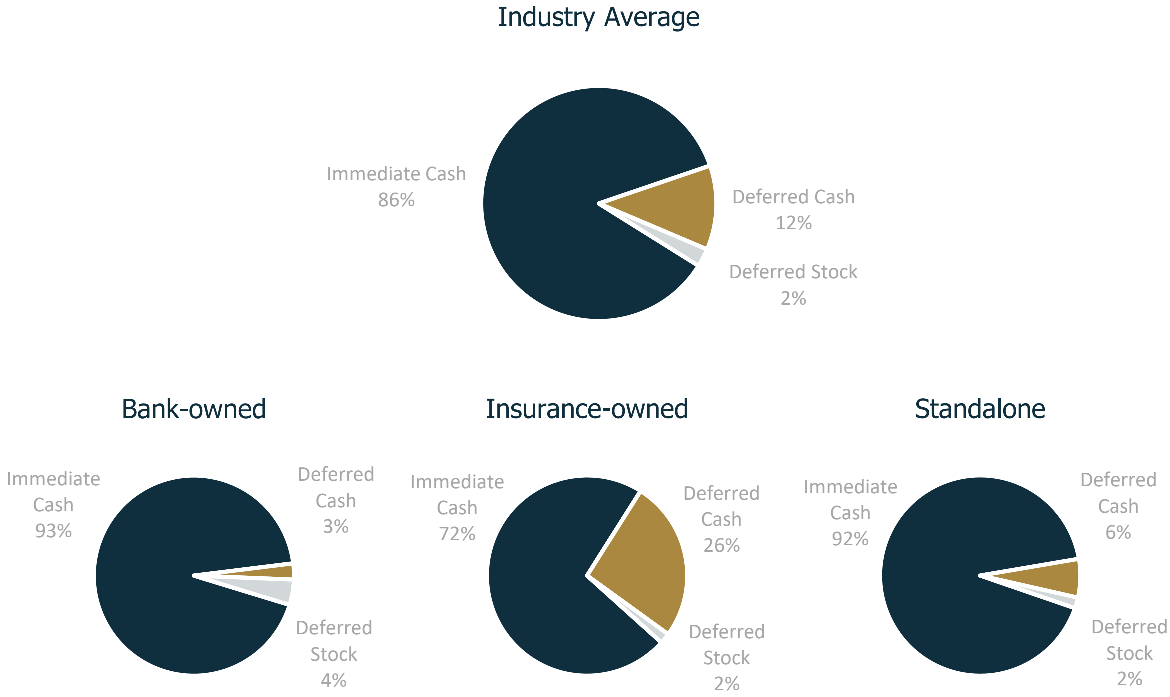
Deferral Weighting

Mid-Level Bonus Structures



At the mid-level it is common for a larger percentage of the bonus to be paid out in immediate cash, however deferrals increase as retention value increases. Insurance-owned asset managers, on average, are the biggest advocates of deferring bonuses at the mid-level. Based on the lower amount paid out in bonuses compared to independent or bank-owned asset managers, insurance-backed asset managers tend to be slightly more aggressive with their retention policies, locking in bonus awards with equal or a bullet payment over a three to five year horizon.

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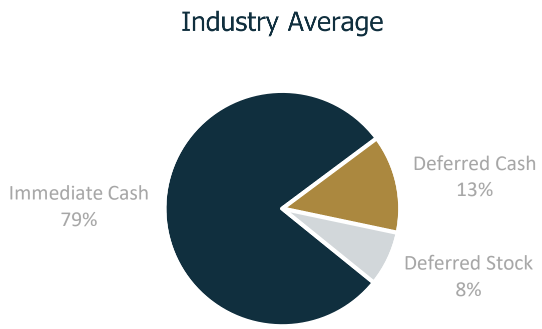
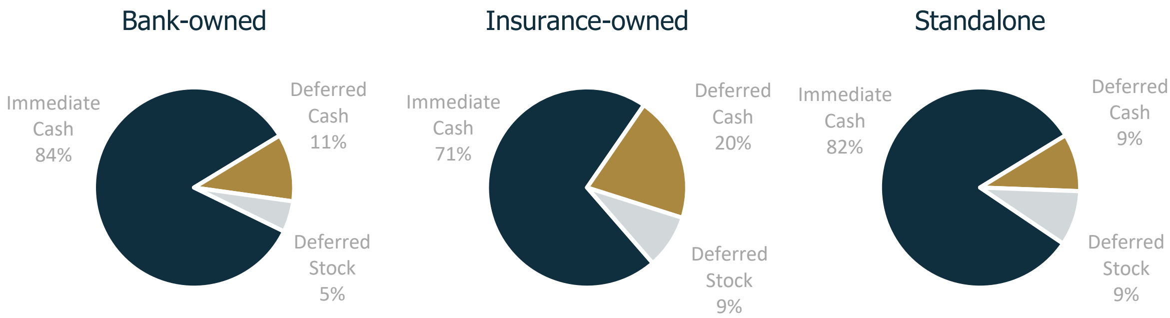
Senior Level Bonus Structures





As one would expect, the deferred element of senior level bonuses increases as firms attempt to retain business-critical staff. Insurance-owned companies retain the top spot for highest percentage paid in deferrals, which on average accounts for around 30% of the total bonus. Although these are indications of averages across the industry, there do exist anomalies in independent asset managers who match this level of deferrals and strongly push deferred compensation with final bullet payments after three to five years. As these accumulate, it becomes increasingly harder for competitor firms to buy them out, encouraging staff to wait out their deferral period to pick up their bonus.

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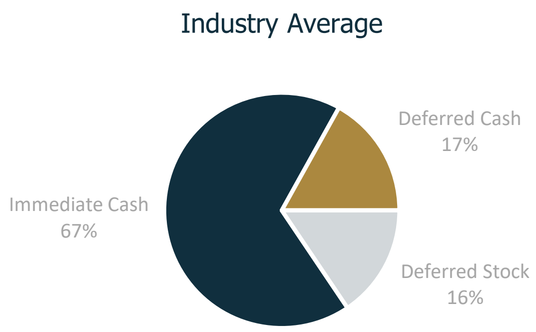
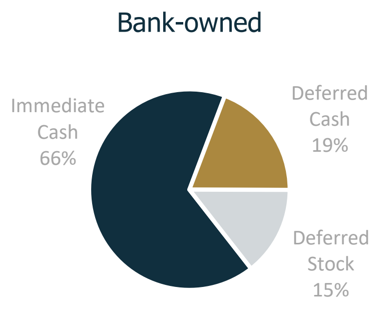
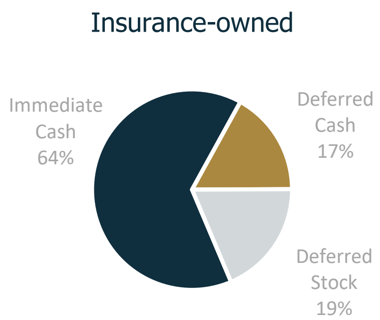
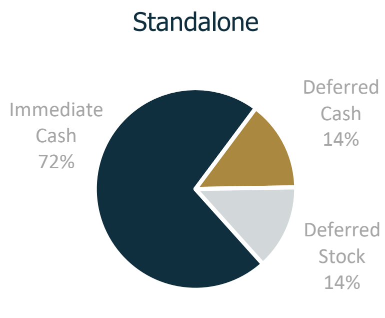
Team Head Bonus Structures









At the team head level, the tactics employed for bonus deferrals are largely similar across the three types of organisation. Depending on ownership structure of the firm, stock can be issued in public shares, phantom shares or partnership shares. The cash element can be subject to performance conditions that are linked either to the performance of the company or to the performance of the specific team. These performance indicators tend to be triggered once certain thresholds are surpassed and determine the acquisition level of the cash bonus. More commonly, it is paid out in equal tranches over a pre-specified time period however, there are some business that simply defer cash without any metric to increase the deferral value over time. This tactic is viewed particularly negatively by employees, who see this deferral method as a straightforward lock-in with no room for upside.

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Verdict

Strategically utilising compensation structures as a retention and incentivisation tool is not necessarily a new idea, as commission structures with long tails and sales targets have long been present in the industry. Traditional lock-in structures that defer payment of bonuses over three to five-year periods continue to be the industry standard.

Going forward, firms need to consider how they ensure that their deferral schemes are sufficiently differentiated from their competitors in order to avoid the scenario where one senior departure, and subsequent deferral claw-back, simply facilitates the buy-out of the target candidate's current retention package.

Conceptually, employees are more positively disposed towards deferral schemes that are linked to firm-wide, team or individual performance. Those schemes that have a dynamic link and, on the back of good long-term performance, appreciate significantly in value, tend to foster employee loyalty and improved morale amongst the workforce.

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