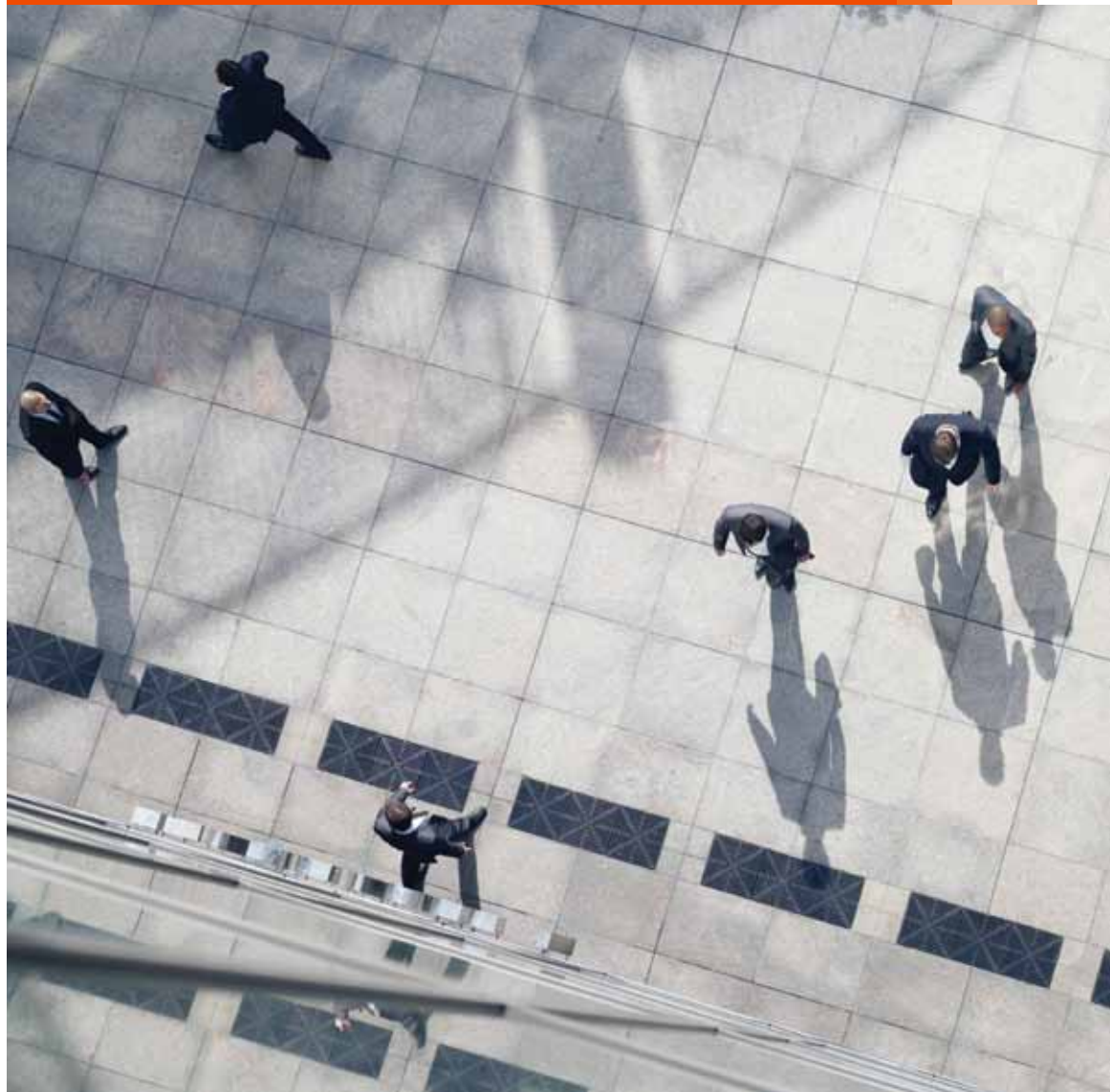


Paying a premium for the best investment professionals

Asset Management Reward Survey 2011

*In a difficult year for
asset managers, pressures
to attract and retain
talent have returned at
a time when regulation
is restricting their ability
to compete.*

October 2011



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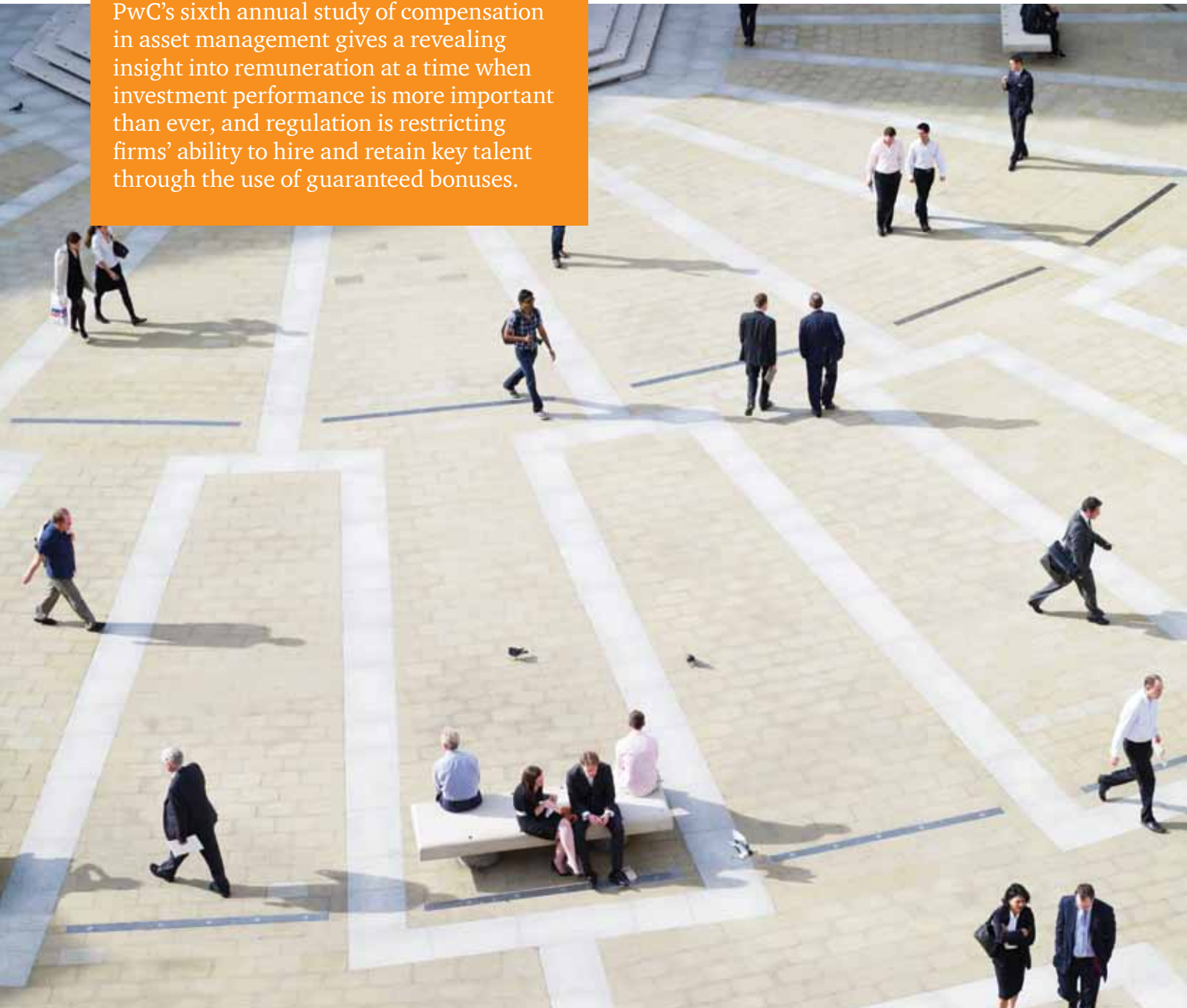
Executive summary

- Competition for talented fund managers during a period when future profitability is particularly dependent on delivering sustained investment performance has led to some significant increases in remuneration.
- While not as restrictive as originally feared, implementation of the third EU Capital Requirements Directive (CRD III) is placing Europe's asset managers at a disadvantage in world markets, especially Asia. 85% of survey respondents were worried about the new regulations, citing practical difficulties when competing for staff.
- The new rules have been introduced at a time when some asset managers have been growing their workforces, compensation costs are rising and people appear more prepared to move firms than they have been for several years.
- Compensation is rising at an even faster rate in Asia, where the asset management industry is expanding and inflation is high, as well as in specific niche product areas such as ETFs, global emerging markets and global equities.
- Constructively, in the UK at least, Europe's largest centre for asset management firms, the implementation of CRD III has encouraged better risk management. More than 70% of our survey respondents reported explicitly considering risk when setting bonuses or making changes to long-term incentives.
- Looking forward, current uncertainty in financial markets and instability in the banking sector is likely to ease upwards pressure on pay, and to provide an opportunity to hire staff from related sectors.

Adapting to change

Introduction

PwC's sixth annual study of compensation in asset management gives a revealing insight into remuneration at a time when investment performance is more important than ever, and regulation is restricting firms' ability to hire and retain key talent through the use of guaranteed bonuses.





The survey this year places particular focus on the aftermath of the financial crisis together with the impact of regulatory developments on remuneration practices. 25 well established asset management organisations from across Europe took part in the study, both contributing data and relating their insights in interviews, allowing us to give both retrospective and prospective analysis.

Complying with new pay regulations is beginning to have practical implications for Europe's asset managers at a time when compensation has been rising. While company salary bills increased by an average of 4% in the past year, and bonus and compensation spend is growing even faster, regulation continues to restrict the ability of some firms to compete for staff.

At the same time volatility in the global banking industry is providing asset managers with unexpected opportunities to recruit high calibre staff on reasonably priced pay packages, where an entrepreneurial culture can be provided in a comparatively stable environment, bringing sharper focus on a non-financial dimension to the employment offering.

Compensation levels have increased for a second successive year, with 2010/2011 total compensation spend on average 18% higher than 2009/2010. As we predicted last year, corporate performance in terms of revenue and profitability improved in line with financial markets to support higher levels of remuneration, resulting in cost ratios which remained relatively stable over the last 12 months and fell a little in some cases.

Overall investment staff appear to have benefited from greater pay rises than their distribution colleagues, with market pay levels for chief investment officers (CIOs) increasing by more than any other senior executive position (including the CEO). This supports a view that firms were looking to preserve their investment track records and provide stability for investors at a time when asset flows were stagnant or negative.

Finally, we note that some of our survey findings will have been overtaken by the dramatic financial markets falls of the late summer and autumn 2011. When we carried out our interviews, participants expected to carry on increasing reward. In an industry where compensation levels are closely tied to firm results and investment performance, clearly subsequent events will have altered their views.

Supplementing this survey we also give a detailed analysis of the compensation arrangements for senior executives. This is only available to participating organisations.

If you would like to discuss any of the issues raised in this report please feel free to give me a call.

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Tight market for investment talent

At a time when protecting investment performance has become more important than ever to protect profitability, competition for the experienced fund managers with strong track records is leading to substantial rises in compensation for key investment staff.

The median base pay of CIOs is 20% up on the last financial year and when combined with incentives, median total compensation for this role is up 38%.

By comparison, median CEO base salary was up 4% and total compensation was 13% higher. Other senior management roles such as CFOs, COOs and heads of distribution experienced a similar trend.

After several years of restraint, asset managers' compensation costs rose last year and continued to do so this year. Base salary rises outstripped general wage inflation at the last salary round and bonuses grew significantly in some firms. After two years of market recovery, rising asset manager profitability began to feed through to remuneration.

"The market for talented individuals is incredibly tight, not just for fund managers but for senior people generally," noted one head of HR.

"Some of the numbers in terms of deferred compensation are very off putting. If you focus on global or emerging markets, there are not many people with attractive track records, partly because of length of time in the market, but also companies are becoming much cuter in terms of the retention they put in place. We have been looking at a number of people recently and the base line now is about £500,000 of lock in."

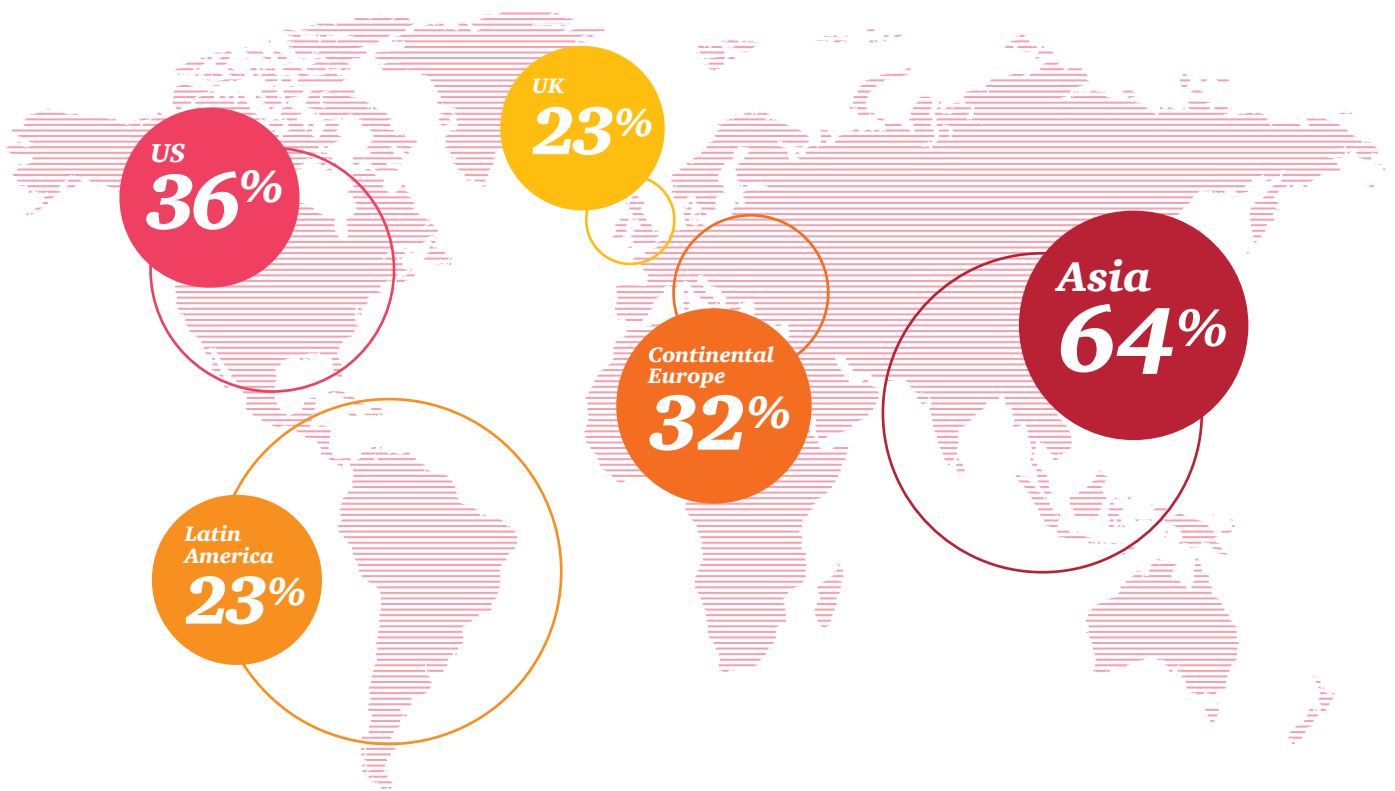
Total compensation spend generally rose in line with senior executive compensation. Survey respondents reported base salary levels rose by an average of 4% in aggregate at the last year end. This broad average masks considerable variations, depending on ability, role and geography. Additionally, bonus pools were 30% higher on average and total compensation costs rose by an average of 18%.

Fig 1.1 Compensation cost relative to company performance

	Total compensation spend as a percentage of net revenues			Annual bonus costs as a percentage of pre-bonus operating profit		
	2011	2010	2009	2011	2010	2009
Upper quartile	51%	53%	49%	45%	56%	36%
Median	42%	42%	38%	34%	38%	29%
Lower quartile	35%	33%	29%	22%	21%	19%

- Aggregate annual cash bonus costs including any deferred bonus and social security costs for the last financial year = Annual bonus costs
- Total employment costs for the last financial year which includes salary, bonus, pension, long-term incentive and social security costs = Total compensation spend

Fig 1.2 Regions highlighted for business development in next 12 months



Competition for staff was particularly fierce in Asia, where many asset managers are looking to grow their businesses. Across the board, the median base salary rise averaged over 7%.

Compared with our 2010 survey results, compensation as a percentage of net revenues, and bonus costs as a percentage of pre-bonus operating profit, have remained fairly constant. The median for the former is 42% (42% in 2010) and for the latter is 34% (38% in 2010). As financial markets rose, asset managers paid higher compensation from increased profits.

While we predicted this result in our last survey, current volatility in financial markets makes next year's position much more difficult to estimate. Given some reports of strong performance in the first half of 2011 firms may feel the need to pay staff to reflect this even in the event that challenging market conditions in the second half of the year result in poor corporate results for the financial year as a whole. This gives rise to a risk that

compensation cost ratios will rise again in 2011/2012.

Competition for staff was particularly fierce in Asia, where many asset managers are looking to grow their businesses. Across the board, the median base salary rise averaged over 7%. Geographies such as Brazil and India also saw high salary rises, as did product areas including exchange-traded funds, global emerging markets and global equities.

But with financial market volatility set to continue, base salary pressures appear set to abate somewhat, even if the high cost of recruiting senior staff remains. Since our interviews some investment banks are reportedly reducing base salaries in areas of their businesses. These anecdotes suggest that salary pressures are likely to recede somewhat.

Mounting talent mobility

Higher compensation for investment staff reflects rising competition for staff in certain products and geographical areas. As a result, individuals moved between employers more frequently in the period under review than they had at any time in the previous few years.

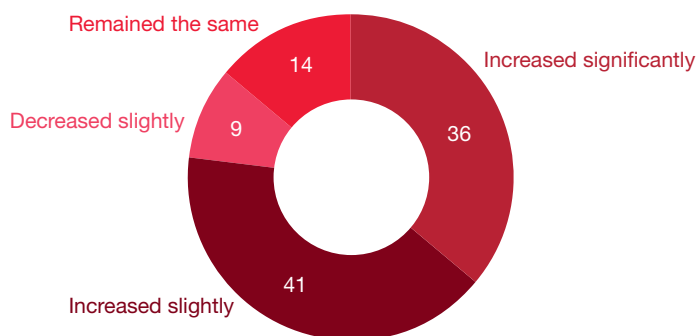
As predicted in our 2010 report, investment bank salary increases (as part of a pay rebalancing exercise) added to upwards pressure on base pay. In particular investment bank-owned asset managers, and hedge fund managers that recruit from banks' trading and research desks, moved some way towards matching these rises. Anecdotally, market volatility is already feeding through to investment bank cost cuts and salary rises are unlikely to be substantial in 2012.

Asset managers have tried to avoid matching bank salary rises. "Salaries have been an issue post Lehman," explained one head of HR. "Investment banks have been increasing salaries and we have tried not to get pulled in."

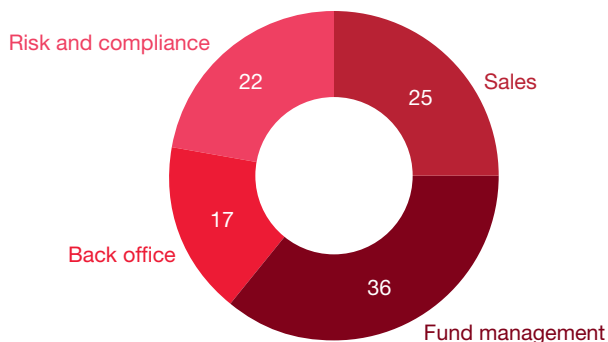
More generally, salary rises reflect a shortage of experienced staff in key areas. Talent is not only at a premium in the front office but also in some parts of the middle office. For example, regulation is driving demand for experienced risk and compliance staff, while growing investment in derivatives is creating a need for staff with derivatives trade processing experience.

Fig 1.3 Headcount increasing with a focus on fund managers

Headcount movements in the last 12-18 months



Roles that have required the most focus in terms of recruitment and talent retention



Note: Survey respondents allowed to give multiple answers

Compensation and culture are equally important in the war for talent.

Culture as important as compensation

As competition for key investment staff rises, firms increasingly view not only compensation but also culture as important for attracting the talent they need for the future. They are encouraging the long-term career development of promising individuals, seeking to build centres of excellence, and to tie staff to the business through significant equity ownership.

As a result, survey respondents named compensation and culture as equally important for attracting and retaining talent.

Fig 1.4 Key areas of focus to attract and retain talent

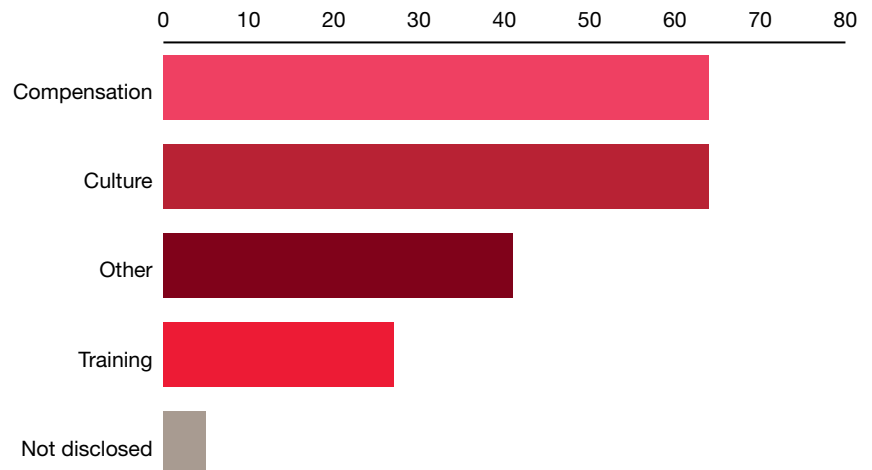


Table note: Survey respondents allowed to give multiple answers.

What this means for you

- In the context of what is happening in the banking world, investment professional compensation pressures are likely to abate.
- Asset managers should continue to resist pressure to increase base salaries. You should look to major on your firm's culture as a way of recruiting and retaining key staff and not just focus on financial remuneration.
- Financial market volatility is easing the pressure on remuneration. Asset managers can take the opportunity to recruit key talent from other sectors.

***Regulation brings
both challenges
and opportunities***



The CRD III regulatory framework is beginning to restrict asset managers' ability to compete for staff in international markets. While it is less restrictive than originally feared in the UK, just a few months after the directive was fully implemented asset managers are experiencing practical difficulties when bidding for talented fund managers, sales people and other staff.

In total, 85% of those interviewed said they were concerned that the new rules would harm their global competitiveness. In particular, asset management organisations report difficulties competing for investment professionals in hot markets.

Several UK-based respondents to our survey stated that their inability to offer guaranteed bonuses for more than one year was impeding their attempts to hire talented investment staff. A number reported difficulties bidding for staff against rival firms based in Asia, the United States and Switzerland.

In some continental European countries respondents reported that the problem was even more severe, especially where asset managers have to defer large percentages of bonuses for several years.

Under CRD III, European Union countries have recently become the first to implement national regulations designed to reduce incentives for financial services professionals to take risk. As a result, Europe's asset managers have less freedom over how they pay bonuses than those based elsewhere.

Even within Europe different countries offer varying degrees of flexibility. The UK's Financial Services Authority (FSA) has moderated the pay rules intended primarily for banks in its Remuneration Code, granting most asset management firms 'tier 4' status under its 'proportionality' approach. Some other European regulators have made asset managers subject to the same rules as banks, while others have not applied CRD III to them at all.

Concerns about guaranteed bonuses

In the UK, asset managers are already finding that not being able to offer new hires guaranteed bonuses for more than one year is placing them at a disadvantage in markets such as Asia and the United States. Furthermore, they cannot counter-bid with any kind of guaranteed bonus if a staff member receives an offer from a rival firm.

Commenting on CRD III and the FSA Remuneration Code, the head of reward at a large international asset manager stated: "It really is only Europe that cares about these compensation issues. No one else sees systemic risk. Given that we are not headquartered in Europe this is not a major problem for us, as it only affects our UK operations. But if we were UK-headquartered we would be competitively disadvantaged."

UK-based firms shared his opinion. The head of reward at a large UK-based asset manager stated: "This is definitely an issue. Our inability to offer more than one year's guarantee means that, particularly in Asian markets, local companies are in a much better place when it comes to hiring. Also, the more regulatory hoops and hurdles there are, the more the recruitment process is slowed down and the longer it takes to put a package in place. All of this means we are fighting with one hand behind our backs."

‘AIFMD would give us the same level of prescriptive requirements as a tier 1 organisation’

Illustrating the regulatory differences even within Europe, in the Netherlands the De Nederlandsche Bank regulator has taken a particularly rigid approach, subjecting many asset management organisations to rules on pay primarily designed for banks without an equivalent of the FSA’s proportionality approach.

The pace at which Europe’s regulators have had to translate the EU-wide CRD III regulatory framework into national pay rules has led to considerable ambiguity and confusion.

For example, UK asset management organisations have interpreted the rules over who needs to be designated as so-called Code staff in different ways. In summary, the FSA Code says that Code staff should include:

- significant influence functions (SIFs)
- senior managers, and
- material risk takers.

Yet our survey found different interpretations of who qualifies under each of the above, with most firms adopting the spirit of the rules based on each individual’s role, responsibility and impact on risk profile, rather than including large groups of employees based on a cursory analysis of responsibilities. Respondents’ designated Code staff ranged from as few as seven to as many as 70, with an average of 26. While the implications of designating large numbers of Code staff within a tier 4 firm are currently not overly onerous, there is a risk that they could become greater if regulations change in future.



Another significant area of ambiguity is the status of bank-owned asset management organisations under the FSA proportionality system. At the time of writing, several bank-owned asset managers had not been cleared as tier 4 organisations. Being classified as tier 1 or 2 would put them at a serious disadvantage when bidding for staff against the majority of other asset managers who are tier 4, given the requirements to defer at least 40% of bonuses for Code staff as well other prescriptive requirements.

AIFMD’s future implications

Those running hedge funds were also worried about the impact of the Alternative Investment Fund Managers Directive (AIFMD) in Europe. The Solvency II and Undertakings for Collective Investment in Transferable Securities (UCITS) V directives will only add to difficulties triggered by regulation.



The head of reward at one asset manager with hedge fund operations stated that they were spending most of their time explaining to line managers why they could not guarantee bonuses for new hires beyond a year. Yet they found the prospect of AIFMD in its currently proposed form far more disturbing. “AIFMD would give us the same level of prescriptive requirements as a tier 1 organisation. Our ability to compete in an area like Asia if we had to say that only 20% of your bonus can be in cash would be terrible. We would have to compensate with higher base salaries, so base costs would go up. This is very significant.”

The FSA and Europe’s other national regulators have been given a challenging task interpreting the CRD III in a way that is appropriate for asset managers. As a result, the way the directive has been adopted at national level has created scope for confusion and unintended consequences.

What this means for you

- While global regulators are trying to ensure a level playing field, the reality is this will not happen worldwide or even within Europe.
- Although the use of proportionality in the UK has led to a collective sigh of relief by asset management firms, there is an air of complacency around how some firms are viewing regulation. The implications of getting this wrong are more serious than people believe – you should treat it as more than simply a compliance exercise.
- Accept new regulation for what it is, while looking both to mitigate the challenges and to take advantage of the opportunities. Doing so may require introducing flexibility into your compensation model region by region.
- Give thought to potential future developments including AIFMD and UCITS V and avoid setting precedents now that may come back to bite later.

Evolving remuneration practice



Asset managers have taken the line of least resistance when adapting to regulatory and commercial practice. Few have made wholesale changes to compensation models, but most have introduced measures to comply with CRD III regulation, and some are looking to modify the ways they incentivise investment professionals.

Survey respondents are introducing a range of measures in reaction to the CRD III measures aiming to match reward to long-term performance, adjusted for risk. Some have deferred bonuses over longer periods of time, while a minority have introduced claw-backs, and others now explicitly consider risk when setting bonuses. In total, over 70% of survey respondents have changed the basis of variable remuneration to reflect one or more of these factors.

At the same time, a number of asset managers are seeking to change the way they calculate investment professionals' incentive funding, by tying it to fund, or desk, performance rather than the company's overall profitability. Firms are doing this in order to link investment professionals' reward more directly to their performance, so that they do not receive low rewards in years when they have performed well but the overall corporate bonus pool may be low.

The degree to which such changes prove to be a positive move will depend to a large extent on the culture of the organisation. For businesses where corporate results are essentially the aggregation of the results for a number of sub-businesses operating with a degree of autonomy, tying fund manager reward to the financial performance of their own product range can engender strong behaviours around both revenue growth and cost control. However for a firm that promotes groupwide investment processes or looks to nurture an ethos of teamwork and cross-working such a move could prove detrimental through encouraging silo behaviours.

Connecting pay, performance and risk

Exactly how asset managers are choosing to connect pay with performance and risk varies. Unlike investment banks, asset managers have some flexibility under the CRD III and the types of risk considered are not solely financial. Because investment mandate guidelines set financial risk parameters, asset managers also take into account risks such as operational risk.

Some respondents have changed the terms of deferred bonuses or introduced claw-backs, while others have formalised the process of looking at risk when setting annual bonuses. In some cases, chief risk officers now have a role in deciding the level of bonuses.

Changes introduced by one of our interviewees typify the trend. "The role of the chief risk officer has significantly changed in the last couple of years and he has become central to some of the debates going on in the business. We have recently integrated some risk controls within the compensation measures for employees. When looking at rewards for fund managers, we examine Sharpe Ratios, the risk taken within the portfolio, and how that ties up with published risk targets for the fund."

In many cases, the frequency of remuneration committee meetings has increased as firms have prepared for new regulation, but this is expected to fall back now the first wave of changes have been made. Many asset managers have had long-term remuneration structures in place for several years. But even they used the CRD III as an opportunity to formalise the supporting processes and make them more transparent.

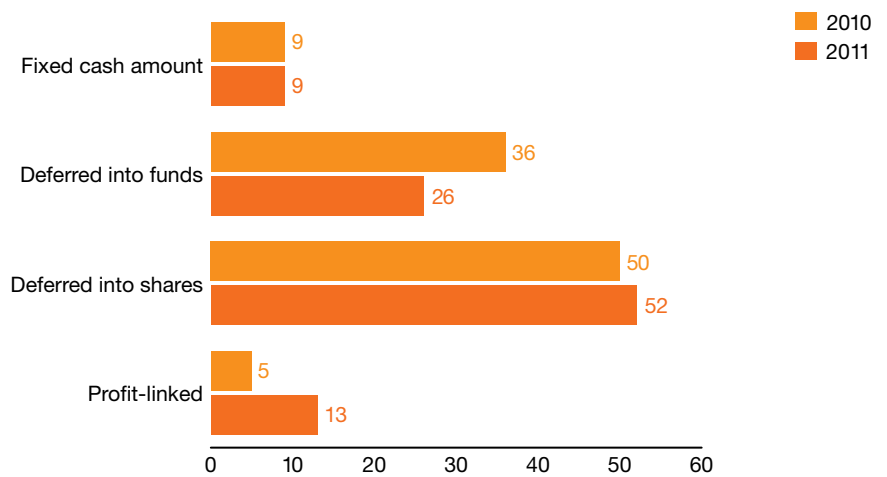
‘The role of the chief risk officer has significantly changed in the last couple of years and he has become central to some of the debates going on in the business’

“We have had a very strong remuneration committee for a long time,” reported one global head of HR. “There is a huge degree of scrutiny. Additionally, those on the remuneration committee are also on the risk committee. Already the remuneration committee is talking about the cross over into risk and how to fulfil their responsibility.”

This new focus on risk is joining with commercial considerations to change the way firms pay their staff. When deciding on long-term remuneration and deferral for investment professionals, firms are tending to look specifically at how their funds have performed. In the case of sales professionals, fixed commissions are becoming less common, with discretionary awards taking their place. The regulators’ dislike of remuneration based solely on financial performance and particularly revenues has reinforced firms’ wishes to replace commissions with more flexible incentives.

The majority of participants operate a deferred annual bonus scheme for at least some of their employees. These are typically deferred into funds or company equity.

Fig 1.5 – Bonus deferral mechanism



Interestingly, just under half of long-term incentive plans in our survey are still not linked to performance conditions although the number has reduced slightly from last year. Those that do carry performance conditions are almost equally split between using single or multiple performance measures. By introducing multiple measures, firms encourage staff to meet a range of performance objectives. They also smooth the variation in payout levels, reducing the probability that they will either have to pay out an award in full or not at all.

Although pay levels rose over the survey period, staff remain dissatisfied with remuneration levels. In part, comparisons with higher pay levels at more successful asset managers or investment banks might have prompted this.

The tax effect

A number of respondents said tax was becoming an issue, especially when seeking to attract staff from overseas. As a result, tax is continuing to influence how firms remunerate staff and is even sparking a debate about the best corporate structures.

In the UK, the significant differential between income and capital gains tax rates means firms continue to look for opportunities to minimise the effective tax rate of reward for both shareholders and employees. Some firms have looked into structuring incentive awards in a flexible manner, anticipating that income tax rates might fall in a few years. Additionally, they continue to use special classes of equity as commercially-driven, tax-efficient remuneration.

Fig 1.6 Long-term performance conditions

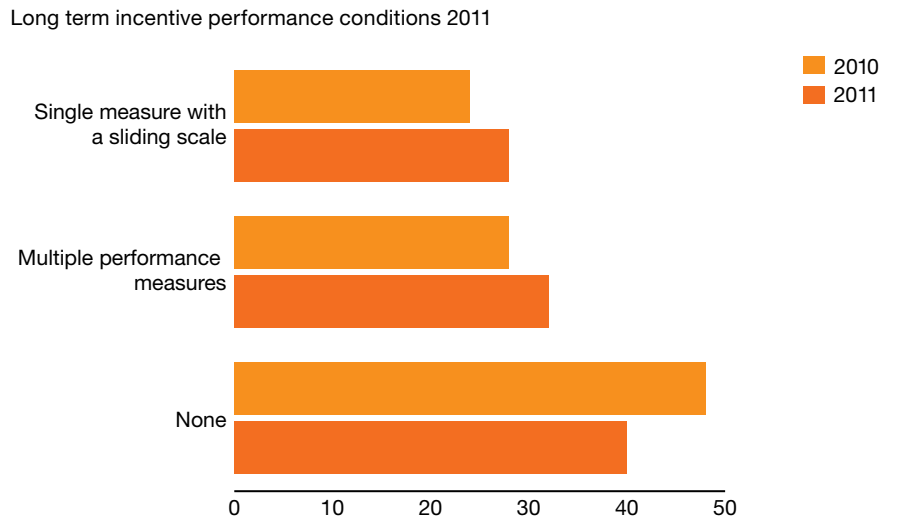
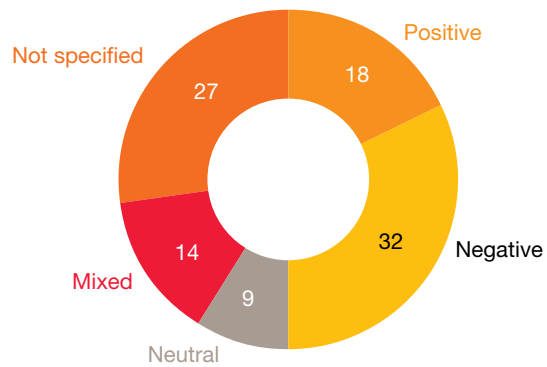


Fig 1.7 Feedback from staff on incentives



Tax is continuing to influence how firms remunerate staff and is even sparking a debate about the best corporate structures.

The number of asset management businesses exploring whether to adopt Limited Liability Partnership (LLP) structures, rather than remaining corporate entities, has increased noticeably. The LLP's suitability to a culture of collaboration and partnership, combined with financial efficiencies around tax and regulatory capital requirements, has led a number of corporate asset managers to engage in feasibility studies around LLP conversions in 2011. We expect a number of these to convert to LLPs in the next 12 months.

Finally, Royal Assent of the Finance Act 2011 has now finalised the UK's disguised remuneration rules. The original rules, published in December 2010, were very wide reaching and would have taxed much more than

intended. Fortunately, the UK government has listened to industry representations and included many more exemptions, meaning that most day-to-day transactions will now be outside the disguised remuneration charging provisions. That said, with 69 pages of complex legislation, organisations should still look at the rules in detail to make sure existing arrangements do not fall foul of them.

What this means for you

- As new regulations and high amounts of locked-in compensation make it more difficult to recruit staff, long-term talent strategies that include a broad range of incentives are becoming more important. You should seek to maximise your ability to develop talent internally and to tie in valuable staff with financial and other incentives.
- You should examine your model for compensating staff in international markets, analysing how you can compete for talented individuals in markets such as Asia and the US. Uneven introductions of new regulations globally mean that global compensation policies have to be adapted to different markets.
- With tax rates changing in many countries, and flexibility being limited, you should examine the tax efficiency of remuneration.
- In some cases, it might be worth analysing your business structure and considering whether some degree of corporate restructure would give you an advantage over others when attracting and retaining staff.

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