



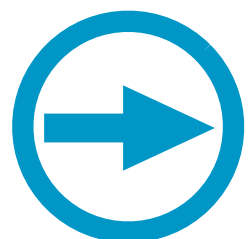
FEELING THE SQUEEZE?

WHAT'S HAPPENING WITH PAY AT INVESTMENT BANKS AND ASSET MANAGERS

February 2015

by William Wright

> Average pay per employee at investment banks has fallen by a quarter since before the financial crisis. At asset management firms, average pay has increased by a fifth over the same period - and is catching up fast.



Getting pay right

Pay in the financial markets is an emotive subject, but too much of the debate takes place in the dark. This report is an attempt to cut through some of the confusion, put some hard numbers on what has been happening to pay at investment banks and asset management firms over the past decade, and help navigate some of the inconsistent and often misleading disclosure from the industry.

The question of pay and bonuses is not just about the numbers. Instead, it is an important barometer of the shifting balance in how the capital markets industry thinks about itself in relation to its shareholders, to its clients, and to society. At New Financial, we believe that getting pay right is an essential part of the industry's rehabilitation.

This report does not pretend to provide a definitive set of proposals to improve pay. Instead it is a flag in the ground that raises some of these questions:

- What is happening to pay at investment banks and how has that changed over time?
- How does pay in the asset management industry compare?
- How does pay fit in with and reflect the changing economics and regulatory environment of the industry?

This report focuses on two sectors: first, investment banks, rather than 'banking'. This is because more than 80% of the pay and bonuses earned by those staff at banks who are designated as 'high earners' by European regulators goes to people who work in the corporate or investment bank divisions of their firm.

On average, staff at investment banks earn two to four times what their colleagues in the rest of the bank make. When people complain about pay at banks, what they really mean is *pay at investment banks*.

Second, we looked at asset management firms to test the consistency and comparability of disclosure, and to understand what is happening to pay in a sector that is moving up the regulatory agenda.

The sample for the report was defined by the relatively small number of firms that have comparable disclosure around pay. It includes 12 investment banks or corporate / investment banking divisions of larger groups, and 18 asset managers. All of the numbers are from publicly available sources and have been converted into US dollars at average annual exchange rates.

This report is a work in progress. Comparing firms across sectors is difficult, but we believe the report provides a directional guide to what is happening with pay. We would welcome any feedback and suggestions on our approach.

Acknowledgements:

I would like to thank Laurence Bax at New Financial for his diligent research and data mining. Any errors are entirely my own.

NEW FINANCIAL

Rethinking capital markets

New Financial is a think tank and forum that believes Europe needs bigger and better capital markets to help drive its recovery and growth.

We think this presents a huge opportunity for the industry and its customers to embrace change and rethink how capital markets work.

We are a social enterprise that launched in September 2014. We are self-financed and will seek financial support from institutions and individuals this year.

For more information on New Financial, contact us on:

william.wright@newfinancial.eu

+44 203 743 8269

Definitions

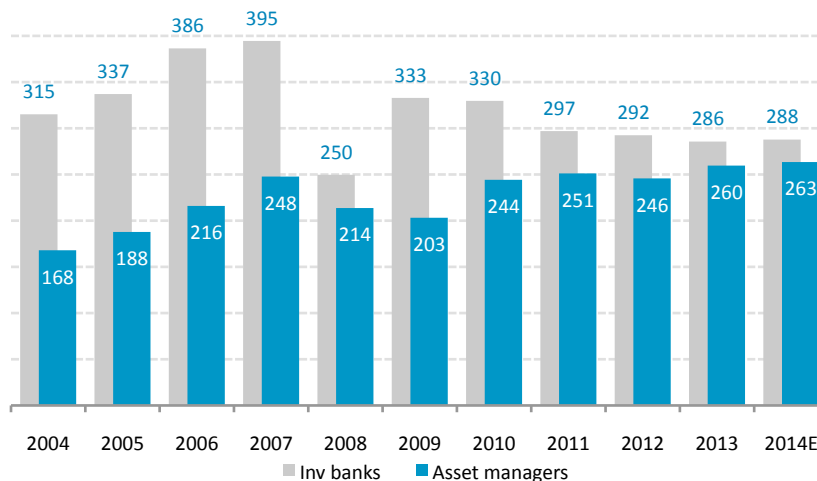
When it comes to pay, definitions are important. This report uses 'compensation cost per employee' as an imperfect but constant proxy for pay. This number divides 'compensation and benefits' or 'staff costs' in the accounts by the average number of staff employed by the firm during the year. It is not the same as 'pay per employee' because it includes other costs such as social security, pensions and severance costs (actual pay would be about 15% to 20% lower). It also includes some elements of deferred bonuses from previous years but it's about as close to 'pay per employee' as is possible under current disclosure.

> Pay at investment banks is taking up a shrinking portion of a shrinking pot. At asset management firms, it is taking a constant portion of a growing one.

What is going on with pay at banks and asset managers?

Chart 1: Warning - pay can go up as well as down

Compensation cost per employee at asset managers & inv banks 2004 to 2014 \$'000



- Pay at investment banks has fallen sharply. **Pay per employee has dropped by more than a quarter since before the financial crisis** and has fallen by more than 40% in real terms. But the rate of decline has slowed and last year average pay per employee increased slightly.
- Pay is still very high compared with the real world. **Average compensation cost per employee at investment banks of \$288,000** last year translates into actual pay of about \$245,000 (€185,000 or £150,000), That's six times median full-time earnings in the UK and just above the level of earnings needed to qualify for the top 1%, according to the ONS.
- The fall in pay marks a step change in the economics of the industry. Pay has fallen from roughly half of revenues at investment banks in the five years before the crisis to around 40% since. As a result, **profits in 2013 were more than 50% higher than they otherwise might have been.**
- Not everyone in the industry is feeling the pain: average **pay per employee at asset management firms has increased by one fifth to \$263,000** since before the crisis and has been rising steadily for the past decade. Pay in asset management used to be half the level of investment banks. Last year it was more than 90%.
- There is some evidence that pay is beginning to increase for the most senior bankers. **Average pay for 6,000 'code staff' (senior management or risk takers) increased by 6% in 2013** from the year before to just under \$2m (it fell by 2% for all staff across the industry)
- There is a huge concentration of income at the very top. On average, between one quarter and **one third of the bonus pool at investment banks is paid out to just 1% of the staff.**
- Asset managers and investment banks could significantly improve the division of reward between staff and shareholders. **There is significant scope for further reductions in pay and staffing, and for sharing some of the efficiency and scale gains of the past decade with clients in the form of lower fees.**

THE DECLINE AND FALL OF BANKERS' PAY

Feeling the pinch

It can be difficult to feel sorry for investment bankers, but in relative terms at least they have had a tough time over the past few years. Average pay per employee across the industry fell by 27% to about \$288,000 between 2007 and 2014. In real terms, that's a drop of more than 40% (see chart 2).

In absolute terms, if you strip out estimated social security and other costs of around 15%, that translates into actual pay of around \$245,000 (or €185k or £150k). That means that average pay for the nearly 200,000 staff at the investment banks in our sample automatically qualifies for the top 1% in the UK.

The rate of decline has slowed in the past few years and in 2014 we estimate that average pay increased slightly by 1% (mainly because of significant increases in the investment banks at Credit Suisse and UBS).

At some firms the fall in pay has been even steeper: average pay per employee at Goldman Sachs has tumbled by more than 40% since 2007 from a high of \$661k (see chart 3). At JP Morgan, the largest corporate and investment bank in the world, average pay has flatlined through the crisis.

Leading by example

The most senior staff in the industry have taken their share of the pain. The data for so-called 'code staff' in Europe only goes back to 2010, but since then, their average pay has fallen by one fifth (see chart 4) - a steeper fall than for more junior staff over the same period. Banks are showing greater differentiation in pay: in 2013, pay for the most senior staff increased by 6% to an average of just under \$2m.

Chart 2: That sinking feeling

Average compensation cost per employee at inv banks 2004 to 2014 \$'000

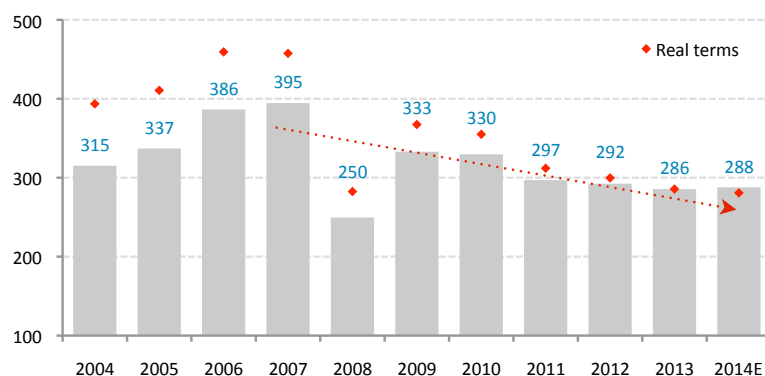
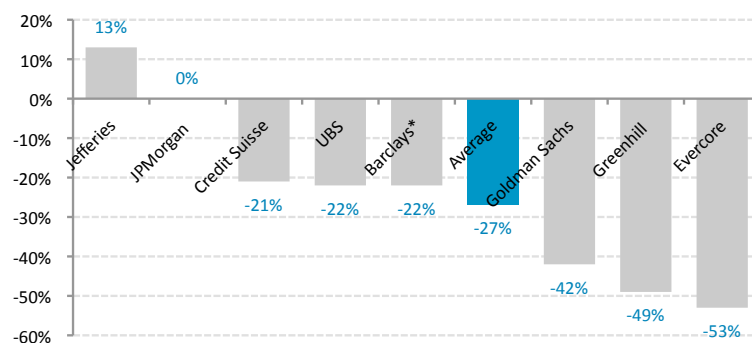


Chart 3: The impact of the crisis on pay

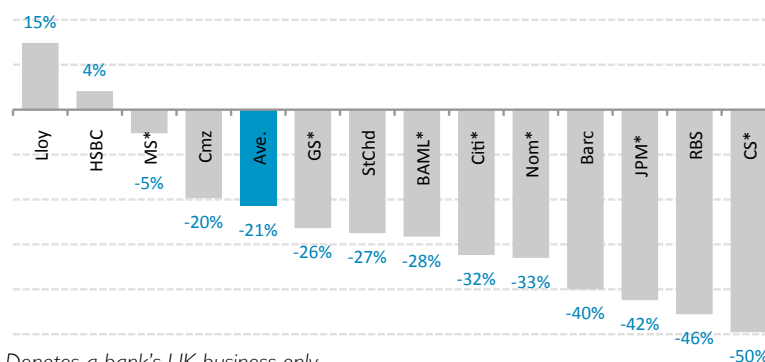
Change in compensation costs per employee at investment banks 2014 vs 2007 %



* For Barclays, the chart shows 2013 vs 2007

Chart 4: Tough at the top

Change in pay and bonuses for code staff at investment banks 2013 vs 2010 %



* Denotes a bank's UK business only.

Note: data for code staff pay only goes back to 2010

A STEP CHANGE AT INVESTMENT BANKS

Sharing the reward

Whatever else you may think about bankers' pay and bonuses, there has been a step change in the economics of the industry and in the division of reward between staff and shareholders since the financial crisis.

In the years running up to the financial crisis, investment banks spent an average of nearly half of their revenues on pay (chart 5). In a good example of misleading financial jargon, this percentage is known in the industry as the 'compensation ratio' (or the 'comp ratio').

Since the financial crisis, pay has fallen to an average of 40% of revenues. If you roll this shift out across the entire industry, it translates into a reduction in costs of around \$25bn in 2013. That means pretax profits were around 50% higher than they otherwise would have been if pay had remained at the same relative levels as before the crisis.

Value for money

The same trend is apparent when it comes to pay relative to pretax profits although it is less pronounced (see chart 6). The ratio of pay to profits is more volatile because profits are so variable. When the industry has a bad year - such as in 2007, 2008 or 2011 - profits drop sharply but pay stays relatively constant (hence the ratio shoots up). This is not a new phenomenon so it is hard to pin on recent regulations.

It suggests that variable pay stopped being genuinely variable some time ago. Notwithstanding recent regulations about deferred bonuses, there seems to be significant scope for increasing the variability of individual pay across the industry.

Chart 5: A smaller slice of the pie

Average compensation ratio at investment banks 2002 to 2014 %

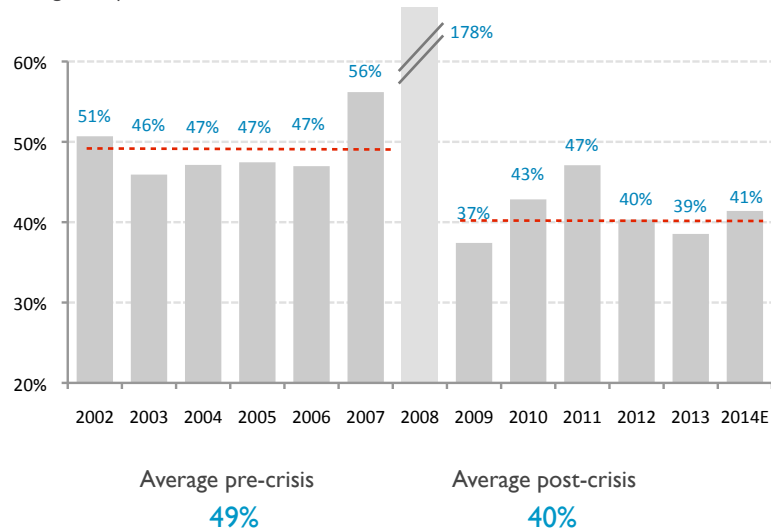
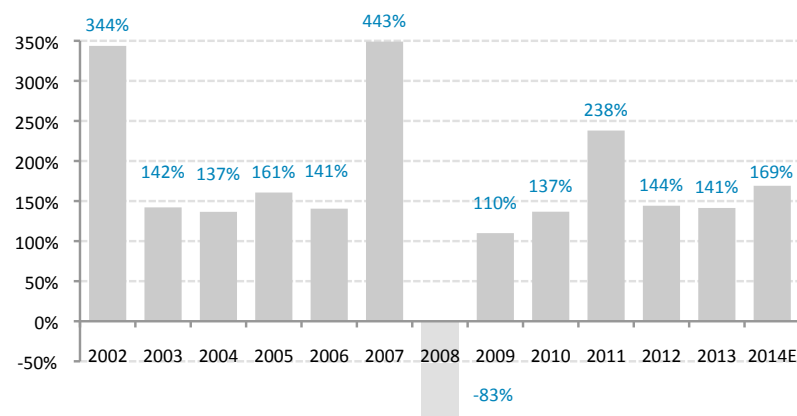


Chart 6: Dividing the spoils

Average ratio of pay to pretax profits at inv banks 2002 to 2014 %



A long-term game

Not everyone is feeling the pain. While average pay at investment banks has been falling since the financial crisis, in the lower profile world of asset management it has been steadily rising.

Since 2006 - the last full year before the financial crisis - pay per employee at asset management firms has increased by 22% compared with a fall of 25% over the same period at investment banks (chart 7). We estimate that it increased slightly in 2014 to \$263,000, not far short of the \$288,000 average at investment banks.

Over the past decade, pay at asset management firms has almost caught up with pay at investment banks. In 2004 average compensation cost per employee was just over half that at investment banks (chart 8). We estimate that it rose to 92% in 2014 and may soon overtake average pay at investment banks.

Of course, asset managers and investment banks are not the same. They have different business models and there is a huge difference in scale: the 12 investment banks in our sample employed 185,000 staff in 2013, while the 18 asset managers only employed 80,000 staff. BlackRock, the largest asset manager in the world, employs just one third as many staff as Goldman Sachs.

It pays to be patient

One reason for the increase in pay in asset management is that it has remained constant relative to revenues over the past decade (chart 9). Revenues have also remained fairly constant relative to assets under management, which have grown strongly.

At investment banks, staff are taking a shrinking portion of a shrinking pot. At asset managers, they are taking a constant portion of a growing one.

Chart 7: Warning - pay can go up as well as down

Compensation cost per employee at asset managers 2004 to 2014 \$'000

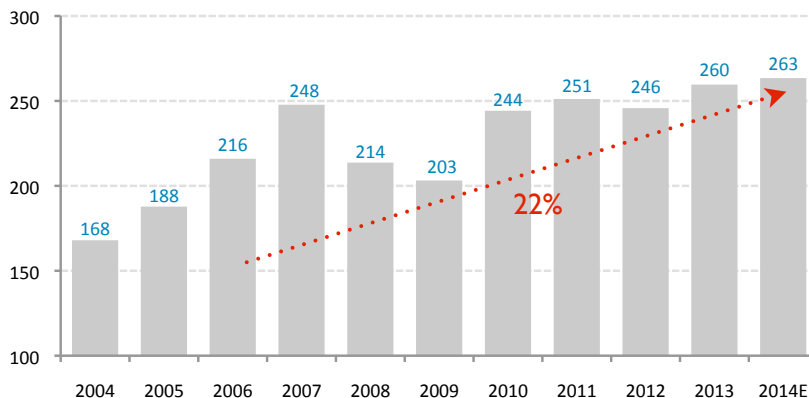


Chart 8: Closing the gap

Comp cost per employee at asset managers as a % of inv banks 2004 to 2014

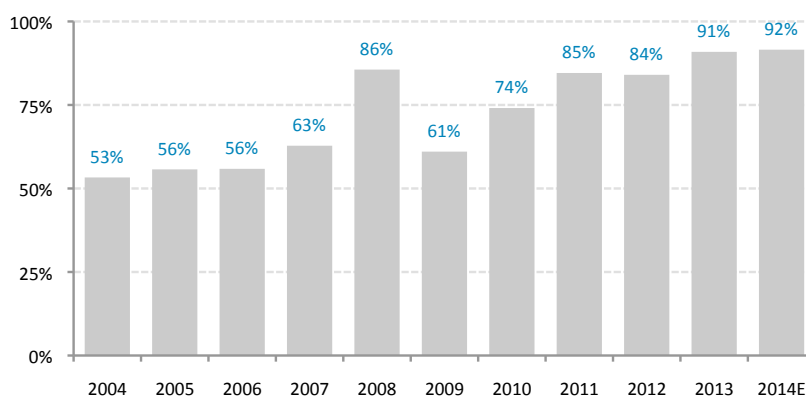
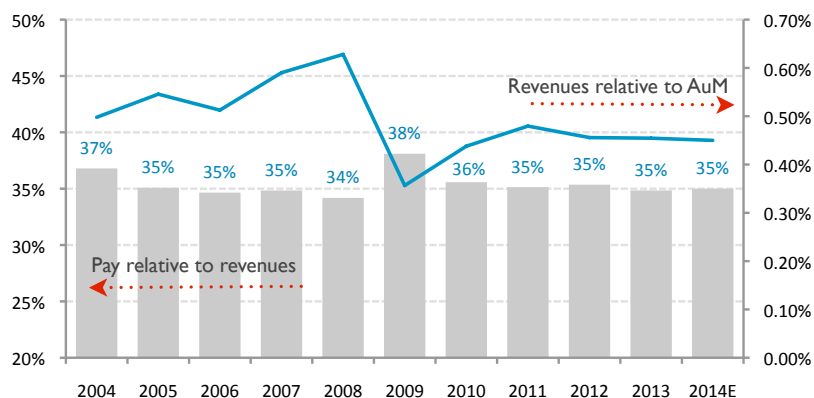


Chart 9: Riding out the storm

Pay relative to revenues (LHS) & revenues relative to AuM (RHS) at asset managers 2004 to 2014 %



HOW PRODUCTIVE ARE BANKERS AND ASSET MANAGERS?

Because you're worth it

It is unlikely that many people working at investment banks will feel that they deserve to be paid less than before the crisis. And it is equally unlikely that people in asset management would think they don't deserve the increases in pay that they have enjoyed over the past decade.

One way of judging this is to compare the change in pay per employee over the past decade with productivity in terms of revenue per employee and profits per employee.

On the face of it, bankers look a little hard done by: average pay has fallen by 6% over the past decade but they generate more revenue and more profit per employee than before (see chart 10).

At the same time, asset managers could argue that they more than deserve their pay rise. While average pay per employee has increased by nearly 60% (chart 11), revenues and profits per employee have increased at a faster rate and asset under management per employee have increased twice as much. In other words, staff are a lot more productive than they used to be.

Show me the money

A better indicator would be to adjust these metrics for inflation to measure any improvements in real terms.

On that basis, staff at investment banks have become less productive over the past decade (see chart 12), suggesting there is significant scope for further cuts in both staffing and pay - although their pay has fallen proportionately more. Staff at asset managers have become much more productive, suggesting that they might be able to share more of the gains they have made in efficiency and scale with their clients in the form of lower fees.

Chart 10: How productive are bankers?

Pay, revenues and profits per employee at inv banks 2004 to 2014
Rebased to 100 in 2004



Chart 11: How productive are asset managers?

Pay, revenues, profits & AuM per employee asset managers 2004 to 2014
Rebased to 100 in 2004

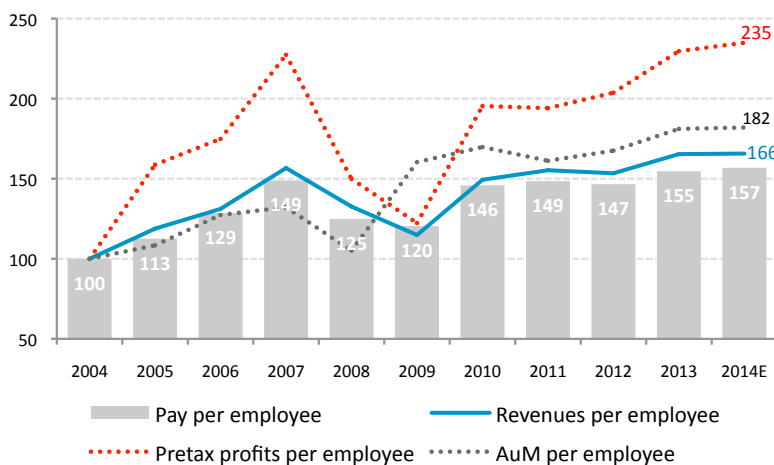
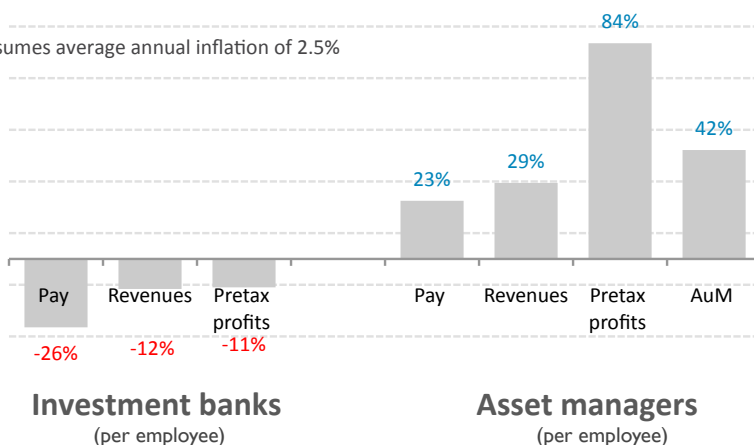


Chart 12: Earning their keep

Change in productivity per employee at asset managers and inv banks in real terms %
2004 to 2014

* Assumes average annual inflation of 2.5%



THE UNEVEN DISTRIBUTION OF BANKERS' PAY

We are the 1%

When it comes to pay at investment banks, there is no such thing as 'average'. Even though 'average' pay across the industry is high enough to automatically qualify for the 1%, at most banks pay is so heavily concentrated at the very top that it could merit the attention of Thomas Piketty.

At Deutsche Bank, for example, the top 1,100 staff in the investment bank - just 4% of the total - shared half of the total bonus pool in 2013 (see chart 13). At other banks the allocation of bonuses may be less extreme, but at group level, the top 1% of earners share one quarter to one third of the bonus pool between them.

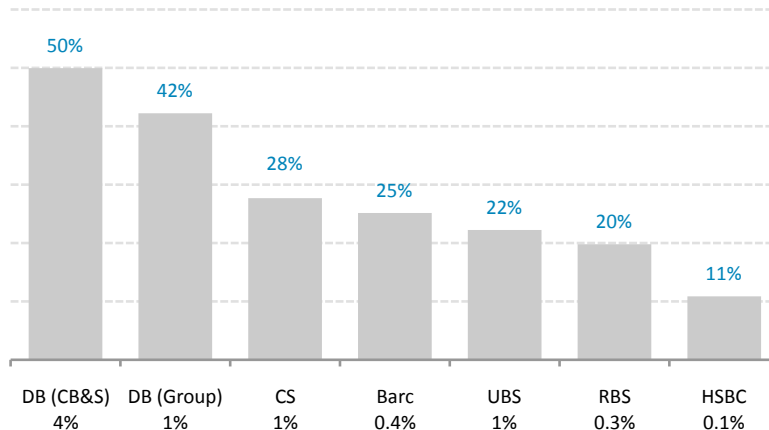
Well above average

These numbers make a mockery of 'average' pay. For example, in the investment bank at Deutsche Bank, average compensation cost per employee in 2013 was \$283,000 (about the same as the investment bank at Barclays) (see chart 14).

However, the top 4% of staff in Deutsche Bank's investment bank earned roughly 10 times the average pay for the remaining 96%. If we assume that the top third of staff at investment banks earn two thirds of total pay (which seems conservative), it means that the average pay for the bottom two thirds of staff at investment banks is around \$110,000 (€83k or £70k), which is still high in relative terms, but much closer to most people's frame of reference.

Chart 13: Inequality, banker style

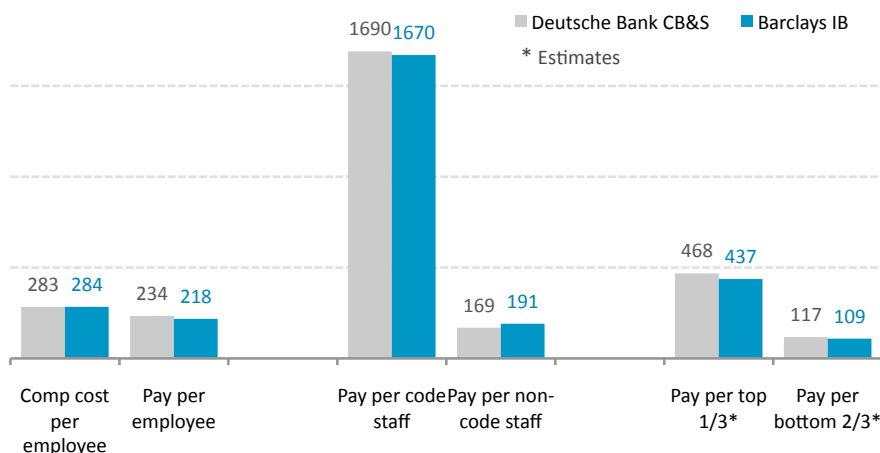
Proportion of total bonus pool paid to code staff



(code staff as a % of total staff in brackets)

Chart 14: The tyranny of averages

Breaking down 'average' pay at investment banks in 2013 \$'000



HOW FLEXIBLE IS PAY AT INVESTMENT BANKS?

Capping the flow

In the debate around pay, few things have generated as much controversy recently as the bonus cap, the EU legislation that limits bonuses to twice the level of fixed pay at banks.

Based on the latest available data (from 2013) the industry still has a lot of work to do to comply for 2014. The average ratio of variable to fixed pay for 'code staff' at banks in 2013 was 3.1 times (see chart 15). That was a slight increase on the year before but a big fall from nearly five times in 2010.

Several big firms such as Goldman Sachs, Bank of America and JP Morgan, had ratios of four or five times. Only a handful of firms, including Citi, Lloyds and RBS, already comply. Banks will have to raise fixed pay for their code staff by an average of one third to meet the new rules (assuming they don't cut the overall level of pay instead).

Minimal impact

Lots of banks and some policymakers have warned that this increase in fixed costs will reduce the banks' cost flexibility and increase systemic risk. These warnings look overblown.

For example, Barclays and Deutsche would have to raise fixed pay for the code staff in their investment banks by about half to comply with the new rules (see chart 16). But this cost is only about 2% of the wage bill and just 1% of the total costs in each investment bank, and adds up to less than 1% of total group costs. If a bank struggles to absorb a 1% increase in fixed costs, it probably has deeper problems than the bonus cap.

Chart 15: What bonus cap?

Ratio of variable to fixed pay for code staff at banks in 2013

* denotes UK business only

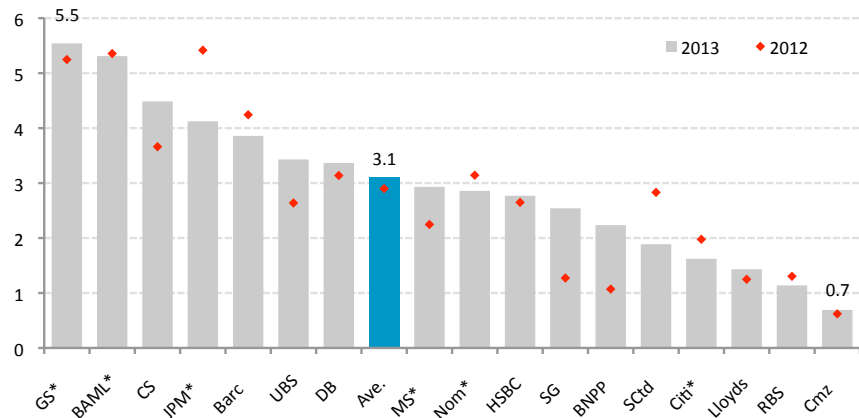
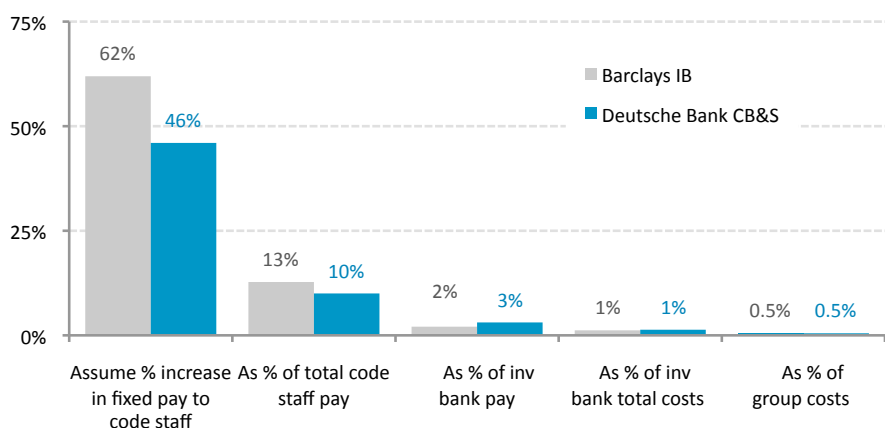


Chart 16: A rounding error

The impact of increasing fixed pay for code staff to meet the bonus cap as a % of costs



Juggling act

The real measure of whether investment banks and asset managers can 'get pay right' is whether they can strike the right balance in sharing rewards between customers, staff and shareholders. All three groups are demanding and need to be fed.

A rough rule of thumb might be an equal division of revenues of one third to staff, one third on other costs, and one third to shareholders, chart 17 shows how close (or far) different firms are from this balance based on the average of the past three years.

Just six firms in the sample give more to their shareholders in the form of pretax profits than they pay to their staff.

In order to bring pay into line with pretax profits at investment banks, it would have to come down by another 15% or so. That implies a drop in pay per employee to around \$245,000.

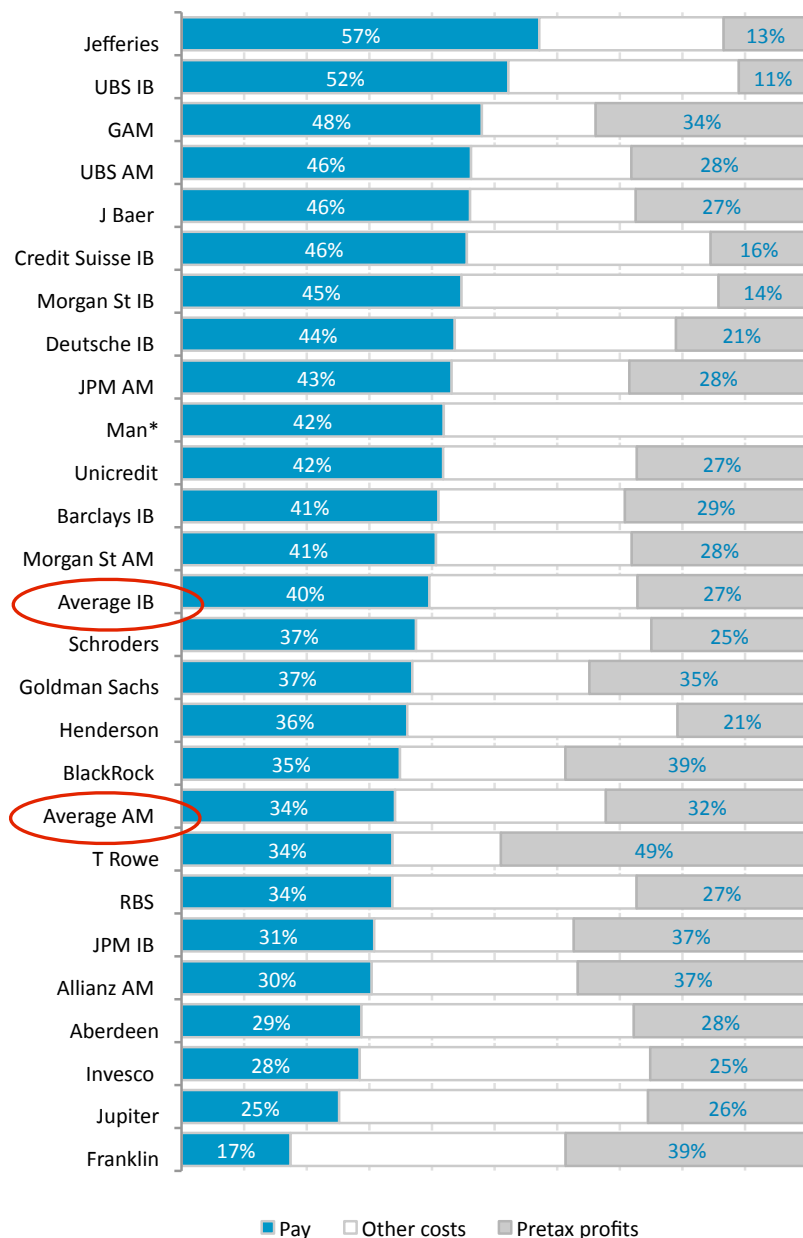
The balance is closer in asset management (34% on pay and 32% on profits) but the fact that pay has remained relatively constant compared with growth in revenue and assets under management suggests there is significant scope for change.

If one third of the gains in efficiency and scale over the past decade had been shared with customers at the expense of pay, pay would be some 15% lower than today.

Chart 17: The balance of reward

How revenues were divided up at investment banks and asset managers between pay, other costs, and pretax profits

Average 2012 to 2014 %



* Man Investments made an aggregate pretax loss in 2012 and 2013

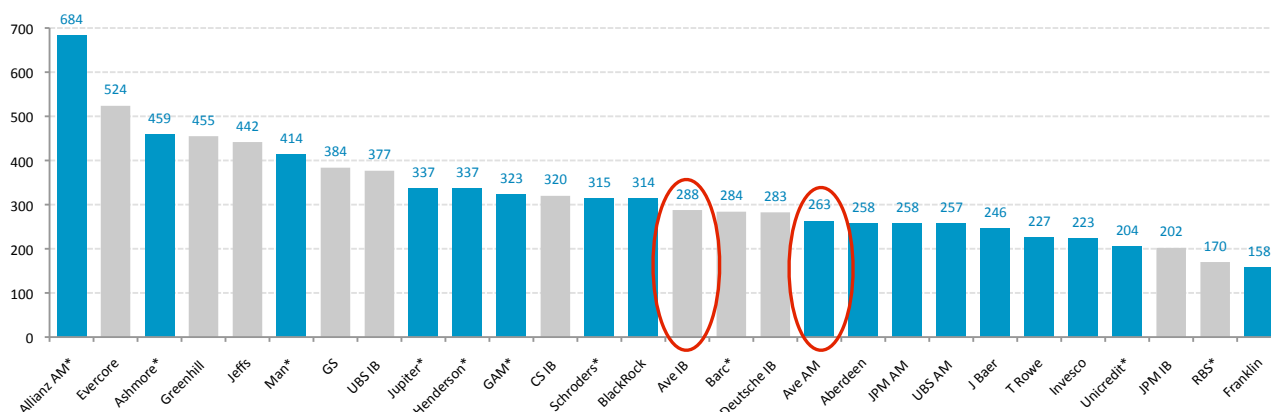
** Note: we have used gross revenues for asset management firms

The distribution of pay at asset managers and investment banks

This chart shows the wide range of pay per employee across the asset management and investment banking industry. While asset management firms dominate the lower end of the table, it is worth noting that how high pay per employee is at many asset managers (at Allianz Asset Managers, the umbrella for Pimco and Allianz Global Investors, the numbers are heavily distorted by the senior management's stake in Pimco).

Pick a number...

Average compensation cost per employee at asset managers and investment banks in 2014 \$'000
(* denotes 2013 data because 2014 not yet disclosed)



Sample and methodology:

Our sample included 18 asset management firms or asset management divisions of larger groups which have comparable disclosure on pay, and 12 investment banks or corporate / investment banking divisions of larger groups.

All of the numbers have come from public disclosures, and have been converted into USD at average annual exchange rates. We have used average headcount (reported or estimated) to calculate compensation cost per capita, and year end reported AuM, and all of the results are weighted. The estimates for 2014 are based on the those firms that had reported their full year 2014 results as of 12th February.

Those firms marked with an asterisk are included in the 2014 numbers.

Asset managers

Aberdeen Asset Management*
 Affiliated Managers Group *
 Allianz Asset Management (Pimco + AGI)
 Ashmore
 BlackRock *
 Franklin Templeton *
 GAM Holding
 Henderson
 Invesco *
 JP Morgan Chase (AM division) *
 Julius Baer *
 Jupiter
 Man Investments
 Morgan Stanley (AM division)*
 Schroders
 T. Rowe Price *
 UBS (AM division) *
 Unicredit (AM division)

Investment banks

Barclays (investment bank)
 Credit Suisse (investment bank) *
 Deutsche Bank (corporate banking and securities) *
 Evercore *
 Goldman Sachs (group) *
 Greenhill *
 Jefferies *
 JP Morgan (corporate and investment bank) *
 Morgan Stanley (Institutional securities) *
 RBS (markets division)
 Rothschild (Paris Orleans)
 UBS (investment bank) *

Getting pay right...

'You should never confuse the size of your talent with the size of your pay cheque', said Marlon Brando. Here are 10 suggestions and questions to feed the debate on how to help asset management firms and investment banks avoid that confusion:

Disclosing pay:

1. An excellent place to start would be for the asset management and investment bank divisions of larger firms to disclose what they pay their staff (many of them don't). Given the regulatory and political focus on pay - which is often more than half of all costs - the reluctance of many firms to disclose it does not encourage trust.
2. Attempts by different regulatory bodies in different countries to improve transparency have led instead to a confusing and inconsistent range of disclosure. What could the industry do to create a single, comparable template for pay disclosure? What is stopping the industry from adopting this approach?
3. Several firms such as Barclays have set a high bar in terms of voluntary disclosure on pay and bonuses. It publishes a detailed breakdown of fixed pay and bonuses in its investment bank. What is preventing other firms from following suit?
4. Disclosure around deferred bonuses is particularly patchy and inconsistent (the data is so poor that we have ignored it in this report). Given the political prominence of deferred bonuses, how can the industry improve disclosure in this area?
5. When it comes to pay disclosure, the distribution of pay is more important than detail on individuals. How can banks and asset managers use greater transparency to address the myth that all of their staff are paid millions of dollars a year?

Awarding pay:

6. What role can pay and bonuses play in helping the industry develop more of a partnership culture? How can the allocation and structure of pay encourage employees to adopt a longer-term and collective approach with more personal risk?
7. What is the right amount of pay? To what extent does high pay reflect a genuinely competitive market for talent? Instead of focusing on pay, should customers, shareholders and regulators instead be focusing more on overall levels of revenue and fee structures off which pay is based?
8. The process of calculating and awarding pay can be surprisingly informal and discretionary. How could a process that allocates bonuses on clear financial metrics - say, a combination of group, divisional, desk and individual performance - as well as incorporating non-financial individual targets - improve pay?
9. Much of the regulatory pressure on pay and bonuses has focused on increasing the proportion of pay that has to be deferred and the length of time it is deferred for. How could the period over which pay is calculated be extended backwards (so that pay is not awarded on a calendar year, but perhaps instead on a rolling three or even five year basis)?
10. Every asset management firm and investment bank says they are committed to the best interests of their clients. How could pay in the industry be more closely aligned with client outcomes instead of being based on often blunt metrics such as revenue, growth and market share?