



Review of the Reward Environment in the Banking Industry

Prepared for the Association for Financial Markets in Europe

May 2017

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McLagan is a part of Aon Hewitt, a business unit of Aon plc.

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Executive Summary

Throughout the report, McLagan has highlighted several insights and findings with respect to the evolution of the reward environment in the banking and capital markets (BCM) industry since the crisis. In particular, we have noted the following:

- Industry pay has in general become much more stable since 2007 and will continue to remain so in 2016, in line with more sustainable industry performance.
- Total compensation within EMEA has continued to fall since last year's report and has decreased significantly over past years, dropping by 35% from 2009 to 2015. This trend is expected to continue into 2016. Total compensation within the UK at MD level is significantly below that of the US (-26% in 2015).
- The portion of fixed pay in total compensation continued to increase from last year's report and has grown from 30% in 2007 to 66% in 2015.
- 2016 bonus pools are expected to decline faster within EMEA than on a global basis, with the gap between European and US total compensation widening further.
- Bonus pay-out ratios (bonus as a percentage of net revenue) have decreased more at European banks versus US banks (-19 vs -13 percentage points for European vs US banks, from 2007 to 2015).
- Since 2007, bonus deferral rates have continued to increase, especially for higher earners.
- BCM MD total compensation below that of Asset Management sector and on par with the private Equity sector. When looking at total cash compensation for BCM, this is below both Asset Management and Private Equity (less 22% and 17% respectively).

Introduction

This report focuses on the key trends in remuneration in banking and capital markets (BCM) activity in 2015* and provides 2016 estimates where available, based on a detailed study conducted by McLagan. For the analysis McLagan used data from 18** of the AFME Board-members firms, which have a combined 2015 BCM revenue of €173bn (from published accounts) and make up 87% of the 2015 BCM revenue of all AFME Board-members firms.

This study aims to give insight into how the following have changed in the period since the financial crisis:

- Size of total compensation and bonus pool, and the total compensation and bonus pool per capita.
- How remuneration is structured between various pay elements – make up of bonus; variable to fixed ratio.
- A clear understanding of how the nature of that variable remuneration has changed in recent years in response to regulation. For example, the variable to fixed ratio, the size of deferral, and how deferral compares for different firms.
- The global context – how does total and variable remuneration compare, in other financial centers across the world and other industries?
- The relationship of remuneration with bank performance – looking at compensation to income ratio.

* 2015 remuneration has been used, as remuneration paid out in relation to 2016 performance year was not available at the time of this report.

** 18 AFME member firms have approved the release of the data in aggregate format.

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Definitions

- **APAC** – Asia Pacific geographical region.
- **BCM** – Banking and Capital Markets (primarily equities, fixed income and investment banking), also described as the Investment Bank.
- **Bulge** (bracket) – Comprises of the industry recognised largest top 9 global banks.
- **EMEA** – Europe, Middle East and Africa geographical regions.
- **MD** – Managing Director or equivalent level within an organisation.
- **Net Revenue** – All revenue including nonrecurring, net of interest expense.
- **Officer Levels** – Staff with corporate titles of Vice President (or equivalent) and above.
- **Total Cash** – Is the summation of base salary and non deferred cash bonus in a given year.
- **Total Compensation** – Total compensation is the summation of all applicable compensation elements (base salary, cash bonus, long-term/deferred incentives). This amount should reflect the total amount communicated to an employee for a given performance year.
- **Total Compensation / Total Bonus Pay out Ratio** – Is the total compensation / total bonus pool as a percentage of net revenue.

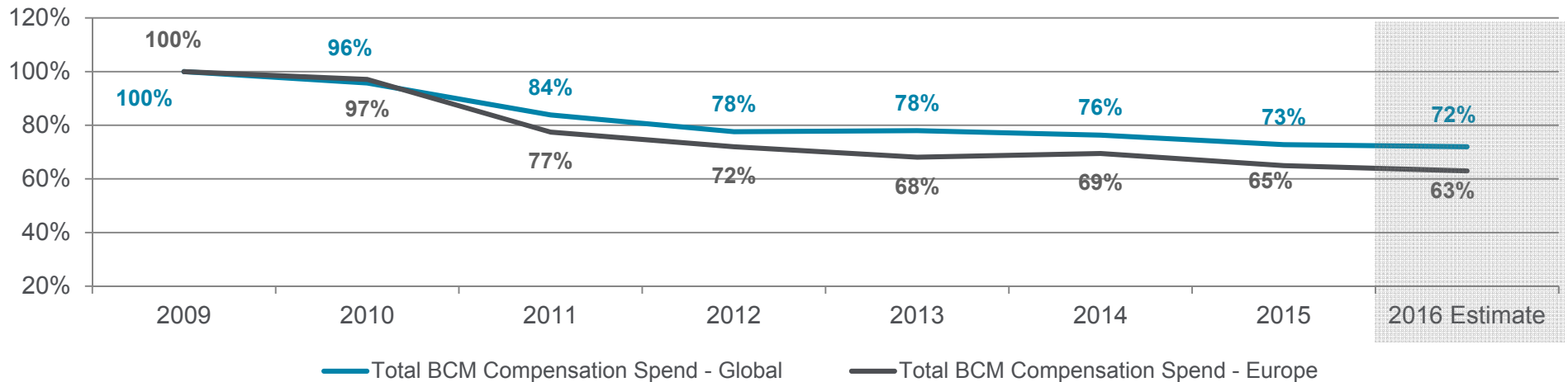


Compensation Pools

Change in the size of Total Compensation

- On a global BCM-wide basis, total compensation awarded for the 2015 performance year is down 5% (3pp) from the 2014 level, which is driven by the reduction in headcount and the bonus pool.
 - This is 27% below the level of total compensation awarded in respect of the performance year 2009, with the average year-on-year decline at approximately 5%.
- EMEA basis BCM-wide total compensation awarded in 2015 is down 7% (4pp) versus 2014.
 - With total compensation down 35% from 2009 and the average year-on-year decline at approximately 7%.
- In 2016 we expect the total compensation spend to decrease slightly due to flat revenues, with EMEA affected more than global total compensation.

Total Compensation: Largest Global Banks - BCM Wide (2009 Index)

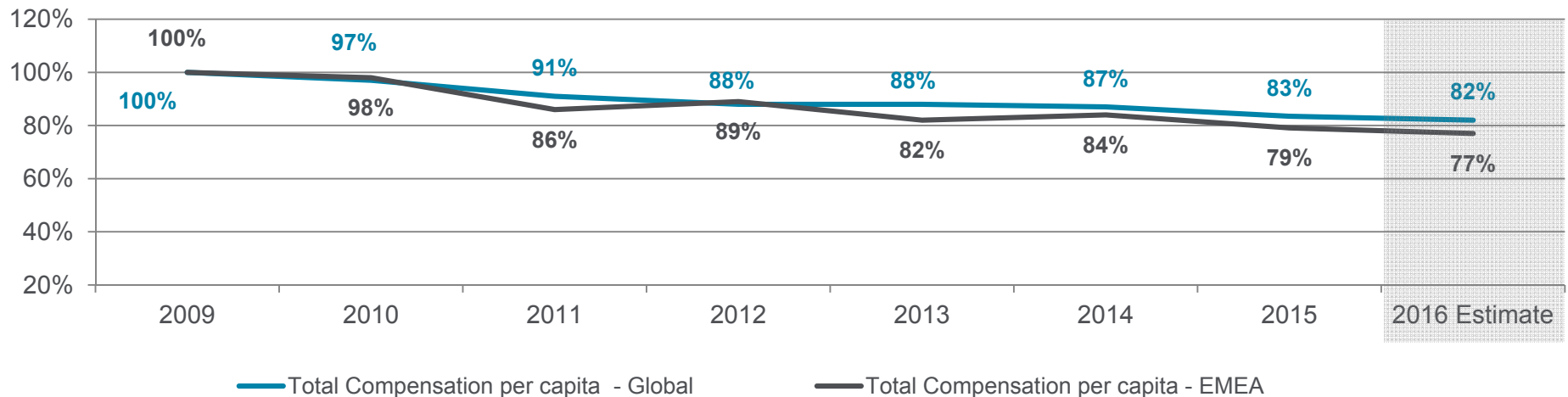


Scope: 8 AFME firms with combined 2015 Global BCM revenue of €107bn.

Change in the size of Total Compensation per capita

- On a global BCM-wide basis total compensation awarded per capita, in respect of the 2015 performance year has dropped to 17% compared to 2009.
 - This is 4% (4pp) lower than the level of total compensation per capita seen in 2014 and represents an average year-on-year decline of 3% since 2009.
- EMEA BCM-wide total compensation per capita levels have fallen sharper compared to global levels, down 21% since 2009. And this represents an average year-on-year decline of 4% since 2009.
- We expect with total compensation predictions being slightly down and small reductions in headcount, that total compensation per capita will decrease for 2015.

Total Compensation per Capita: Largest Global Banks – BCM Wide (2009 Index)

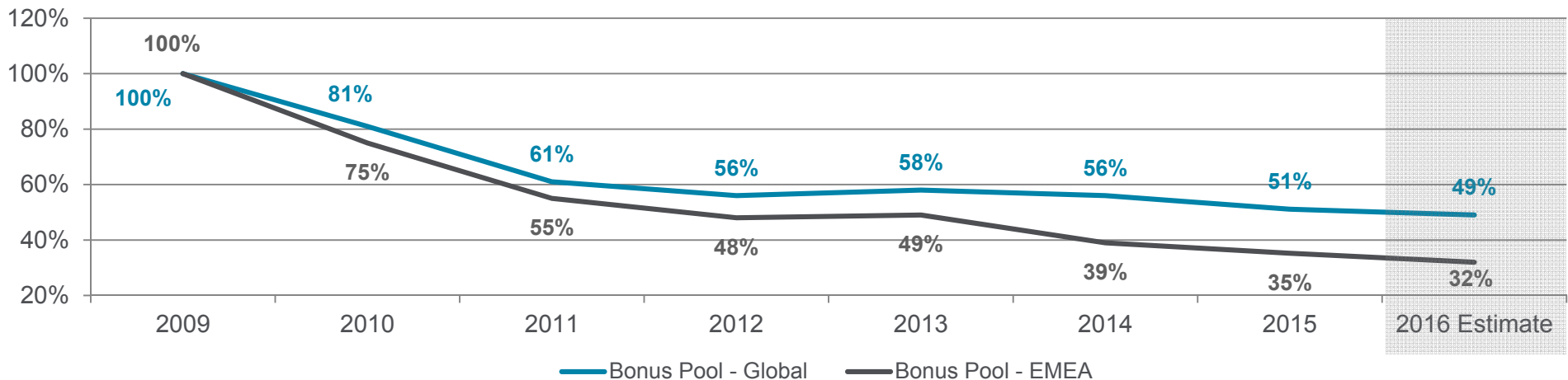


Scope: 8 AFME firms with combined 2015 Global BCM revenue of €107bn.

Change in the size of Bonus Pool

- Global BCM-wide bonus pools have seen a rapid decline in their size since 2009, with the 2015 bonus pools down 49% from 2009.
 - The Bonus pool dropped 40% in size between 2009 and 2011 and had been relatively stable until 2014, but experienced a further drop in 2015 of 9% (5pp) in comparison to 2014.
- EMEA BCM-wide bonus pools have declined even further from 2009 levels, with 2015 bonus pools 65% lower than in 2009.
- With revenues flat in 2016 and fixed pay increasing slightly, we expect to see bonus pools decrease. The impact of this will be seen more in EMEA, due to lower revenues and higher proportion of fixed pay.

Bonus Pool: Largest Global Banks - BCM Wide (2009 Index)

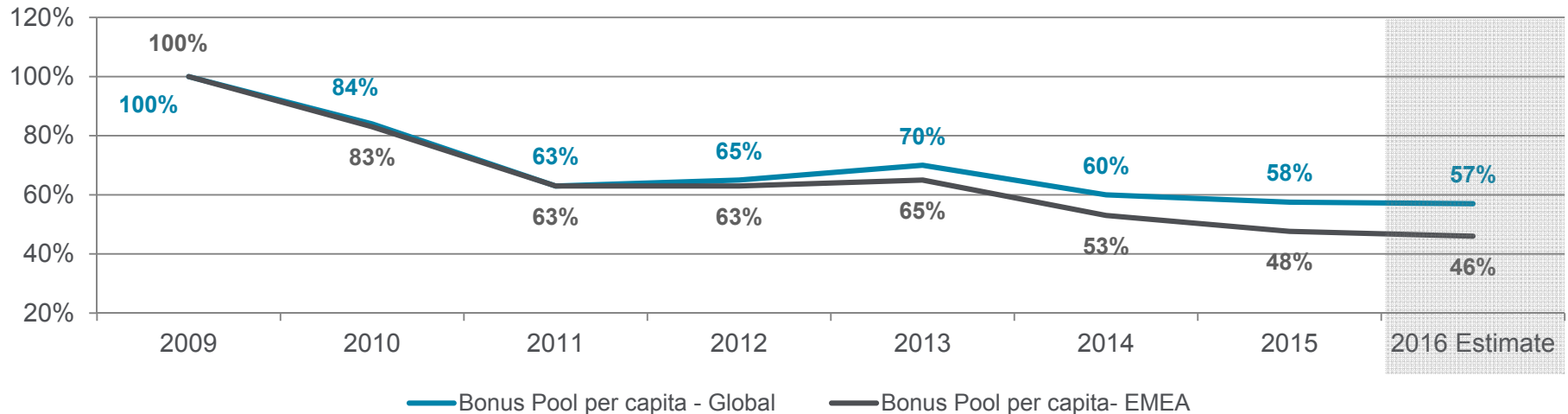


Scope: 8 AFME firms with combined 2015 Global BCM revenue of €107bn.

Change in the size of Bonus Pool per capita

- The global BCM-wide bonus pool awarded per capita in respect of the 2015 performance year, has declined by 42% since 2009.
 - 2009 indexed levels increased from 63% in 2011 to 70% in 2013 after sharp year-on-year falls between 2009 and 2011.
- The bonus pool awarded per capita in EMEA, has seen a very similar decline from 2009 performance year to 2011. But since 2011 the gap between them increased steadily.
- In line with bonus pools coming down slightly and only small reductions in headcount, we expect to see a slight decrease in the bonus pool per capita.

Bonus Pool per Capita: Largest Global Banks - BCM Wide (2009 Index)



Scope: 8 AFME firms with combined 2015 Global BCM revenue of €107bn.

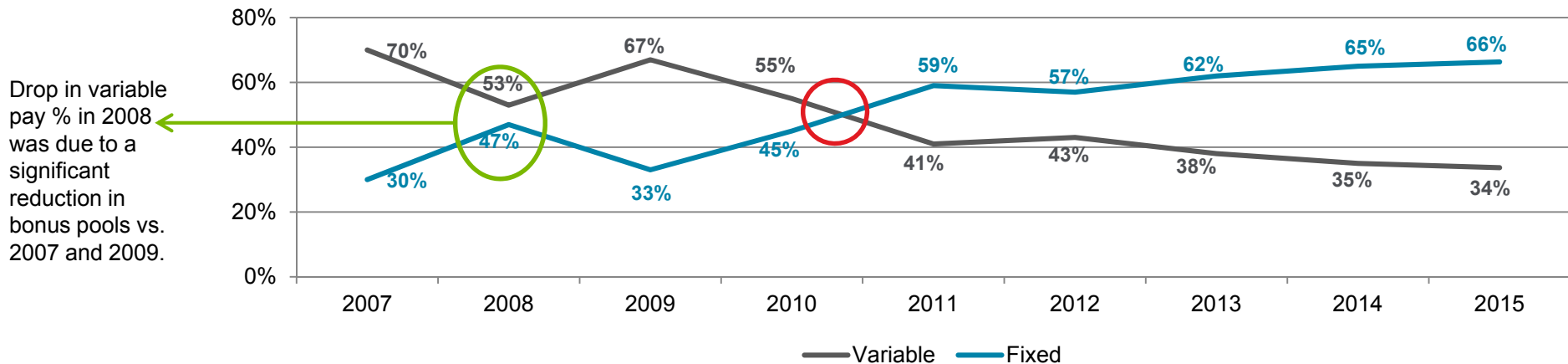


Structure of Compensation

Total Compensation awarded in Fixed Pay has rapidly increased from 2007

- Pay has become much more stable since 2007 and has continued to do so in 2015, in line with more sustainable and predictable performance.
- Fixed pay as a proportion of total compensation has increased from 2013 as a result of heightened regulatory pressure to limit variable compensation. With the percentage of total compensation that is paid as fixed pay in 2015 up to 66%, from 62% in 2013.
- After implementing the regulations in previous years the ratio between fixed pay and variable pay in 2015 is at a similar level to 2014
- This is a significant increase to the levels of fixed pay seen in 2007, when fixed pay constituted 30% of total compensation.

Proportion of Total Compensation awarded in Fixed vs Variable Pay for AFME Members



Drop in variable pay % in 2008 was due to a significant reduction in bonus pools vs. 2007 and 2009.

Scope: 18 AFME firms with combined 2015 Global BCM revenue of €173bn.

Higher deferral rates seen since 2007

- Since 2007 effective deferral rates have increased significantly across all levels of bonus and in particular for higher paid staff.
- Effective deferral rates in 2015 remain similar to the levels seen from 2011 to 2013 for most staff, due to the majority of firms not having made wholesale changes to their broad-based mandatory deferral programs. There has been a shift in the deferral rates at the highest earners in 2015 vs. 2014, with staff receiving a bonus of above 1.9M seeing an increase of 2-3%.
- UK / EMEA headquartered firms typically have higher deferral rates than firms that are headquartered in the US and Asia Pacific.
- UK / EMEA based firms generally defer ~10-25% more than their peers (up from ~5-10% in 2013) in other locations and this differential is even more significant at the highest incentive levels.

Median Mandatory Deferral as a Percentage of Bonus

	Bonus in Euros			
	100k	500k	1M	2M
2007	0%	23%	26%	29%
2015	12%	40%	56%	62%

Scope: 16 AFME firms with combined 2015 Global BCM revenue of €154bn.

2015 Median Mandatory Deferral as a Percentage of Bonus by Firm HQ Location

	Bonus in Euros			
	100k	500k	1M	2M
UK / EMEA	0%	48%	68%	73%
Non UK / EMEA	0%	28%	35%	40%

Source: McLagan mandatory deferral / LTIP study.

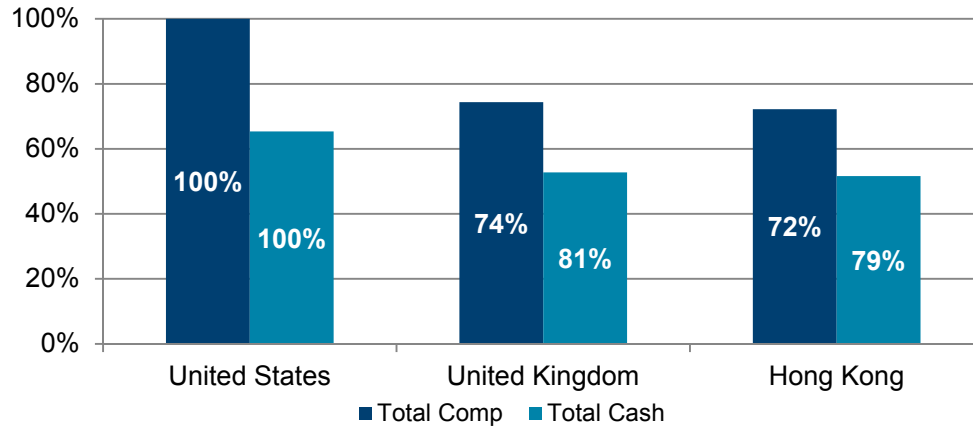
Scope: 43 firms, with a mixture of US, European and Asian headquartered banks.



The Global Context – Regions and Financial Sectors

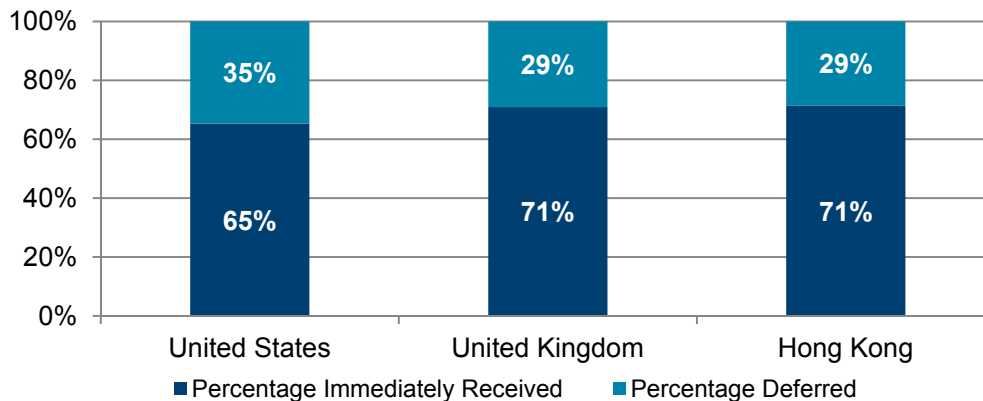
2015 Regional differentials in pay for AFME members

2015 BCM-wide Remuneration Differentials for AFME Members Managing Directors



Note: United States indexed to 100%

2015 Percentage of Total Compensation Deferred for AFME Members Managing Directors



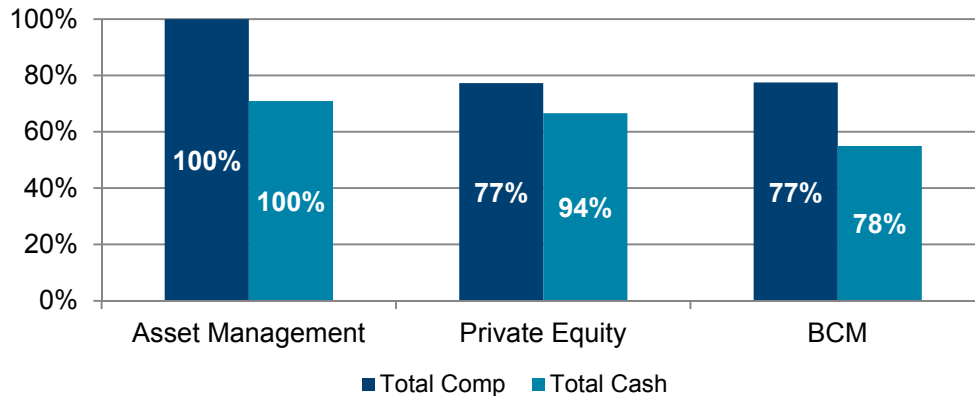
Scope: 18 AFME firms with combined 2015 Global BCM revenue of €173 bn.

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- MDs used for analysis, as they are the most comparable title commanding the largest proportion of total compensation.
- BCM-wide total compensation varies significantly across the different regions, with the United States seeing the highest levels of total compensation across the MD population.
 - US BCM-wide total compensation 26% above the UK.
 - UK BCM-wide total compensation 3% above Hong Kong.
- BCM-wide total cash varies less significantly than total compensation across the different regions, due to higher variable awards being subject to higher deferrals.
 - UK BCM has lower levels of deferred pay vs. the US. This is due to the lower pay levels in the UK.
- The highest rate of income tax in Hong Kong is 17% compared to the 45% in the UK.

2015 Differentials in pay versus other Financial Sectors

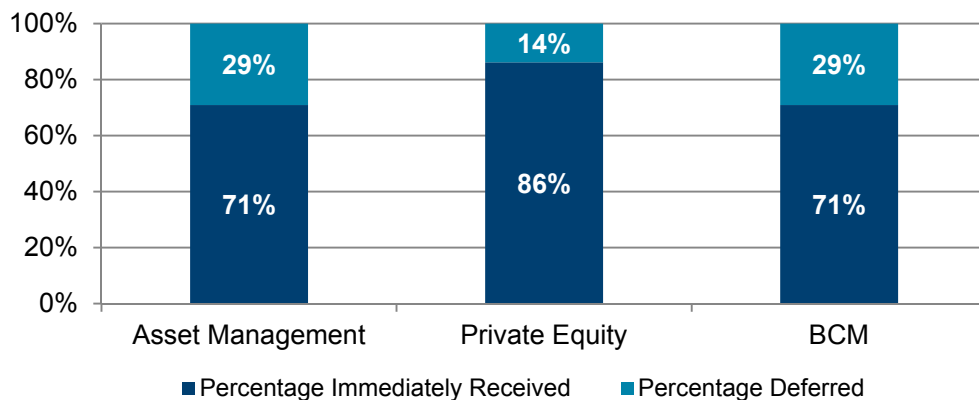
UK Managing Director Remuneration BCM comparison to other Financial Sectors



Note: Asset Management indexed to 100%

- BCM total compensation for UK MDs is on the same level as Private Equity firms and 23% below Asset Management firms.
- Whereas the BCM total cash compensation trails Private Equity firms and Asset Management firms, which is due to the impact of higher deferral rates within BCM.
- UK BCM MDs within the AFME member firms have on average 29% of total compensation deferred, versus only 14% in Private Equity firms and 29% in Asset Management firms.

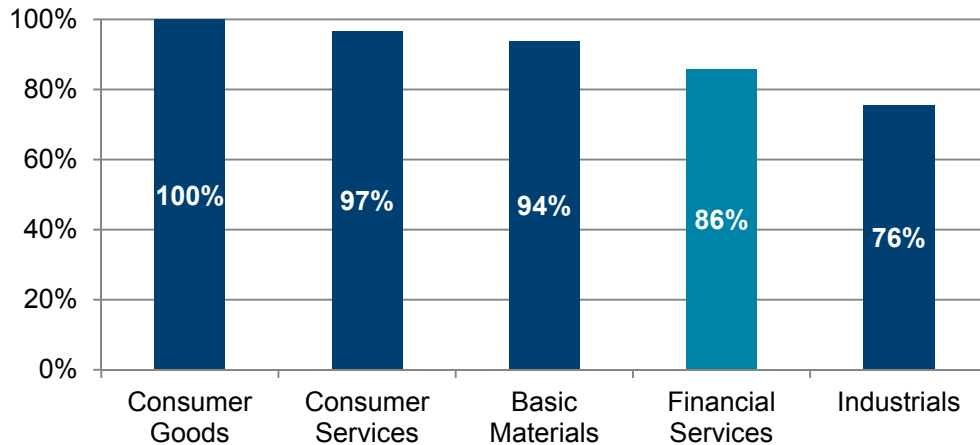
UK Managing Director Percentage of Remuneration Deferred, BCM comparison to other Financial Sectors



Scope: 18 AFME firms with combined 2015 Global BCM revenue of €173bn. 70 Private Equity firms and 80 Asset Management firms.

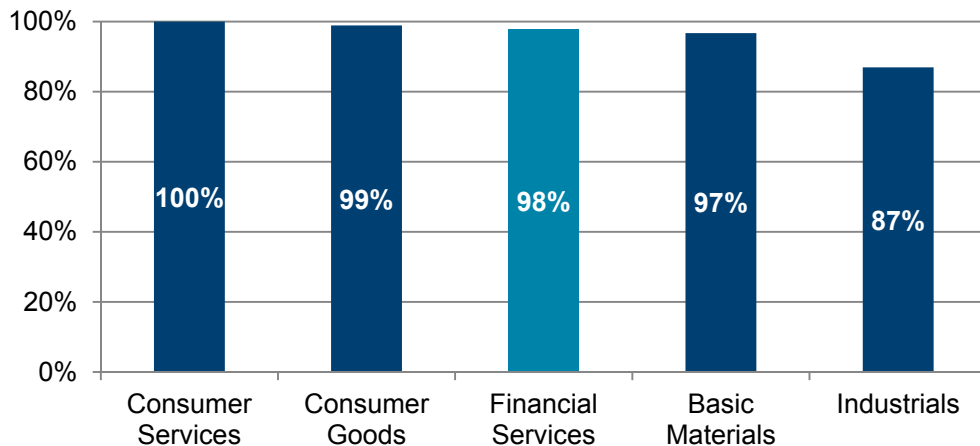
FTSE 100 Pay Levels for the Highest Paid Director (HPD) by Industry

2016 Target Total Compensation



Note: Consumer Goods indexed to 100%

2015 Target Total Compensation



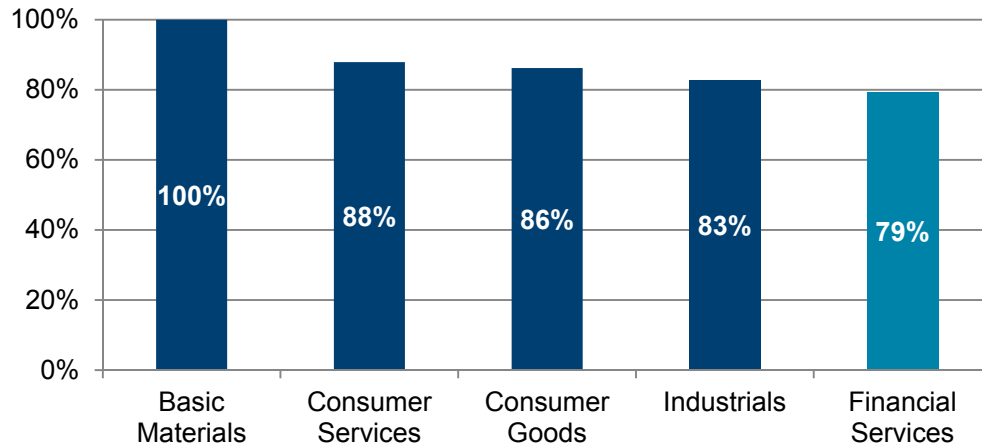
Note: Consumer Services indexed to 100%

- Comparison of pay for HPD roles in the FTSE 100 brings into question the premium for financial services
- Target total compensation is 8 – 14pp lower than Consumer Goods, Consumer Services and Basic Materials levels, but 10pp above Industrials.
 - Which is down from 2015 when target total compensation is 1 – 2pp lower than Consumer Goods and Consumer Services levels, but 5pp above Basic Material
- Leaders in other industries do not face the same issues as banking executives:
 - Regulation
 - Risk / Personal Liability
 - Claw-backs / Downside only of LTI's

Source: New Bridge Street - FTSE 100 Report on Directors Remuneration 2016 and 2015

FTSE 100 Pay Levels for the Highest Paid Director (HPD) by Industry (continued)

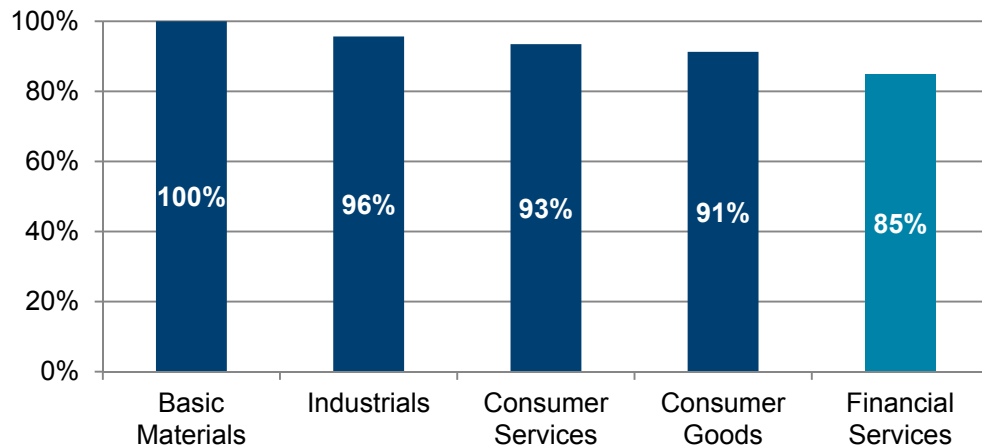
2016 Base Salary



- Base salaries are 4 – 21pp lower in Financial Services vs. other industries
- With the gap widening versus Basic Material in 2015, when the gap was 15pp.
- The gap between Industrials has declined from 11pp in 2015 to 4pp in 2016.

Note: Basic Materials indexed to 100%

2015 Base Salary



Note: Basic Material indexed to 100%

Source: New Bridge Street - FTSE 100 Report on Directors Remuneration 2016 and 2015

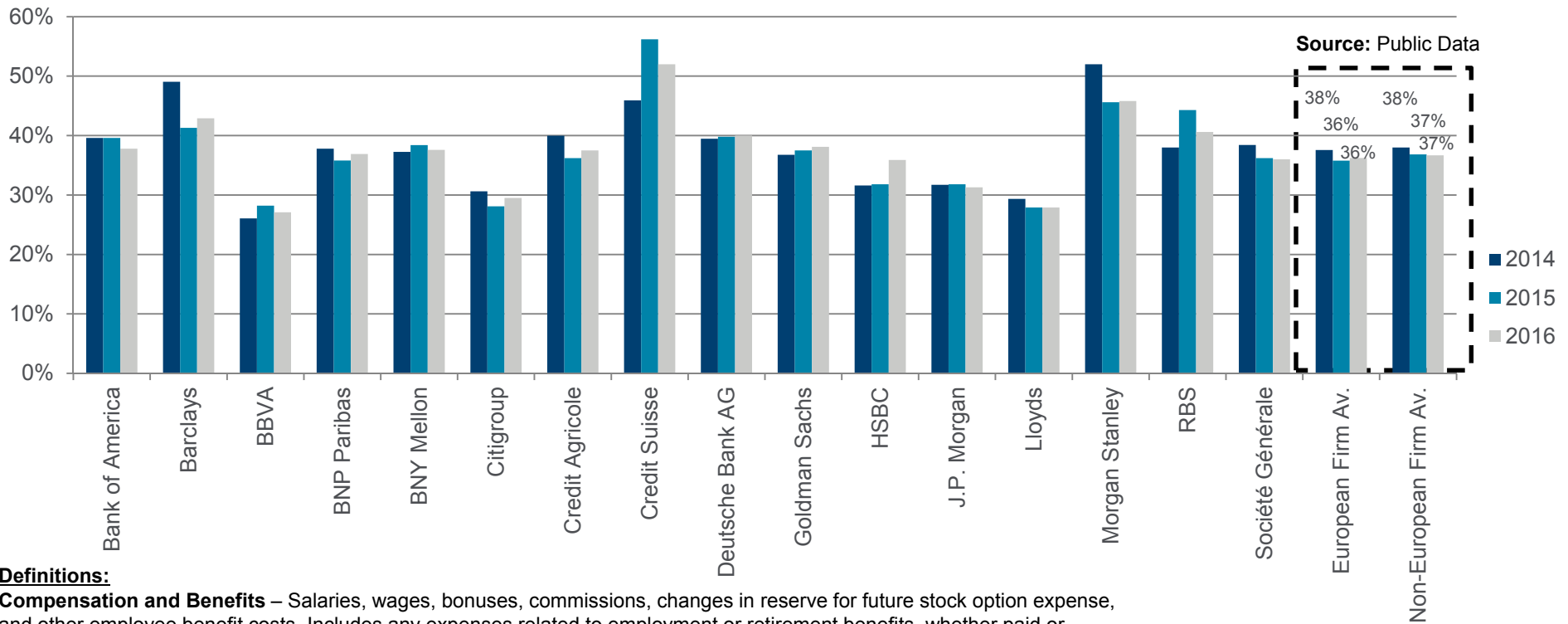


Compensation Relationship with Performance

Compensation as a % of Revenue has remained flat in 2016

- Net revenues were down in 2016, coupled with compensation and benefits spend following the same trend led to the percentage of net revenue paid out in compensation and benefits to remain constant from 2015 and 2014.

Compensation and Benefit Expenses as a % of Net Revenue



Definitions:

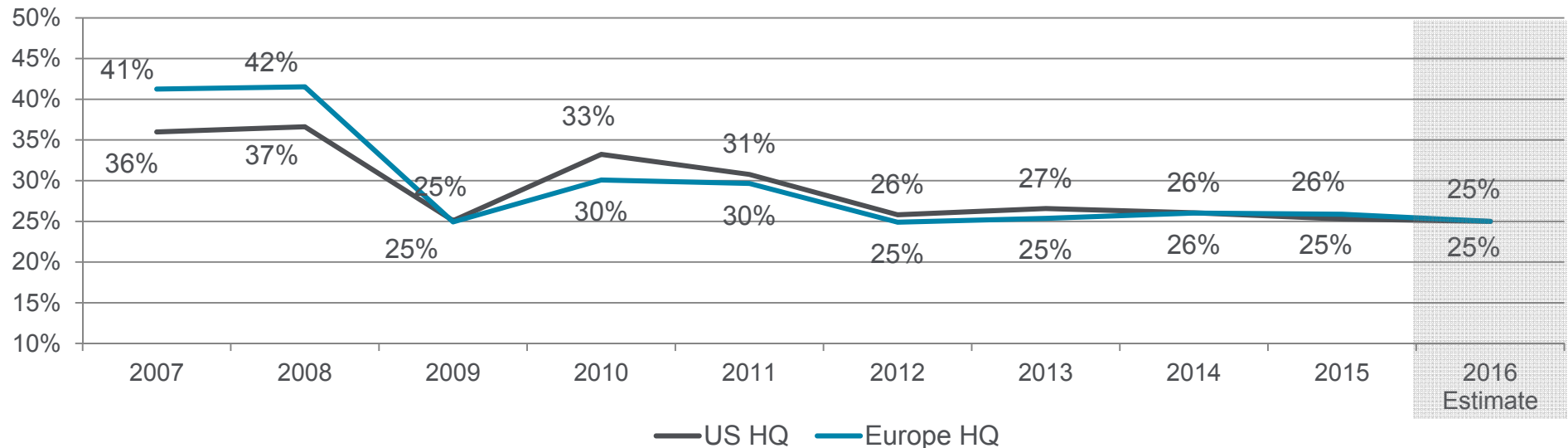
Compensation and Benefits – Salaries, wages, bonuses, commissions, changes in reserve for future stock option expense, and other employee benefit costs. Includes any expenses related to employment or retirement benefits, whether paid or deferred, recognized during the period.

Net Revenue – All revenue including nonrecurring, net of interest expense.

Total Compensation Pay-out Ratios have decreased more at European banks

- Global total compensation as a percentage of revenue have decreased by 13 percentage points since 2007.
 - European banks have seen a larger decline compared to the US banks (15 vs. 11 percentage points).
 - The rapid decrease seen from 2008 to 2009, was largely due to the large increases in revenue in 2009. This trend did not continue in 2010 / 2011 and with total compensation spending declining at a slower rate, the percentage of revenue spent on total compensation increased.
- For 2016 we expect the trend to be flat against 2015 for US firms and down slightly for European firms. This is due to expectations that total compensation spend will be in line with the revenue trend.

Total Compensation as a Percentage of Net Revenue

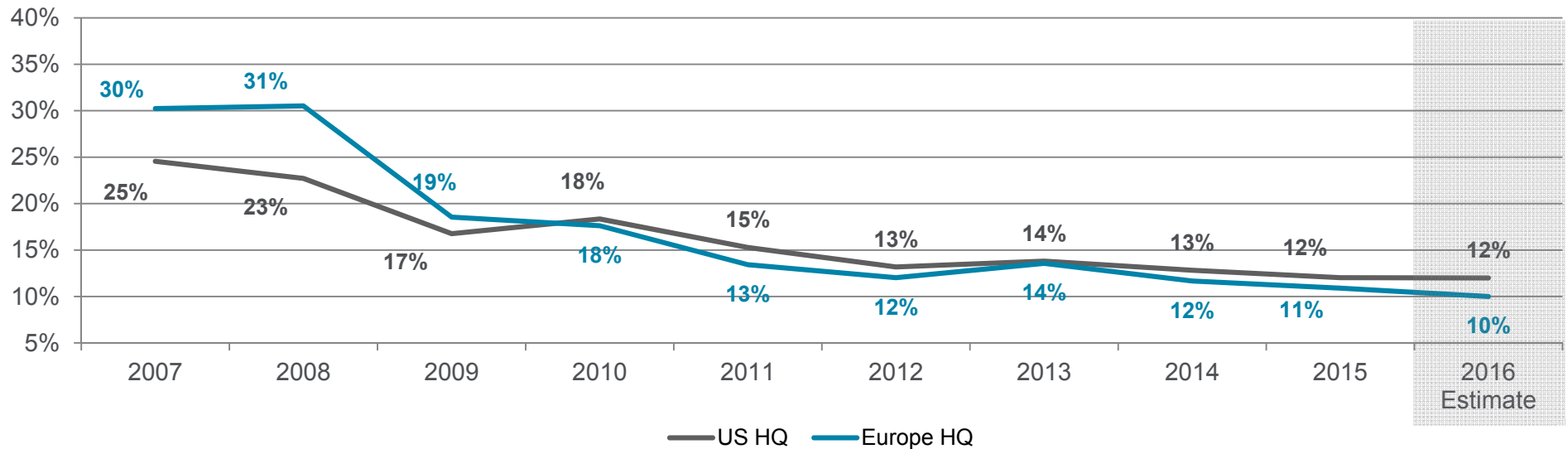


Scope: 8 AFME firms with combined 2015 Global BCM revenue of €107bn.

Bonus Pay-out Ratios have decreased more at European banks vs. US

- Global bonus pools as a percentage of revenue have decreased by 17 percentage points since 2007.
 - European banks have seen a larger decline in pay-out ratios than US banks (19 vs. 13 percentage points).
- For 2016 we expect the trend to be flat or down marginally against 2015. This is mainly due to revenue being flat overall and the anticipation that bonus pools will be reduced for European firms, due to poorer performance.

Total Bonus as a Percentage of Net Revenue

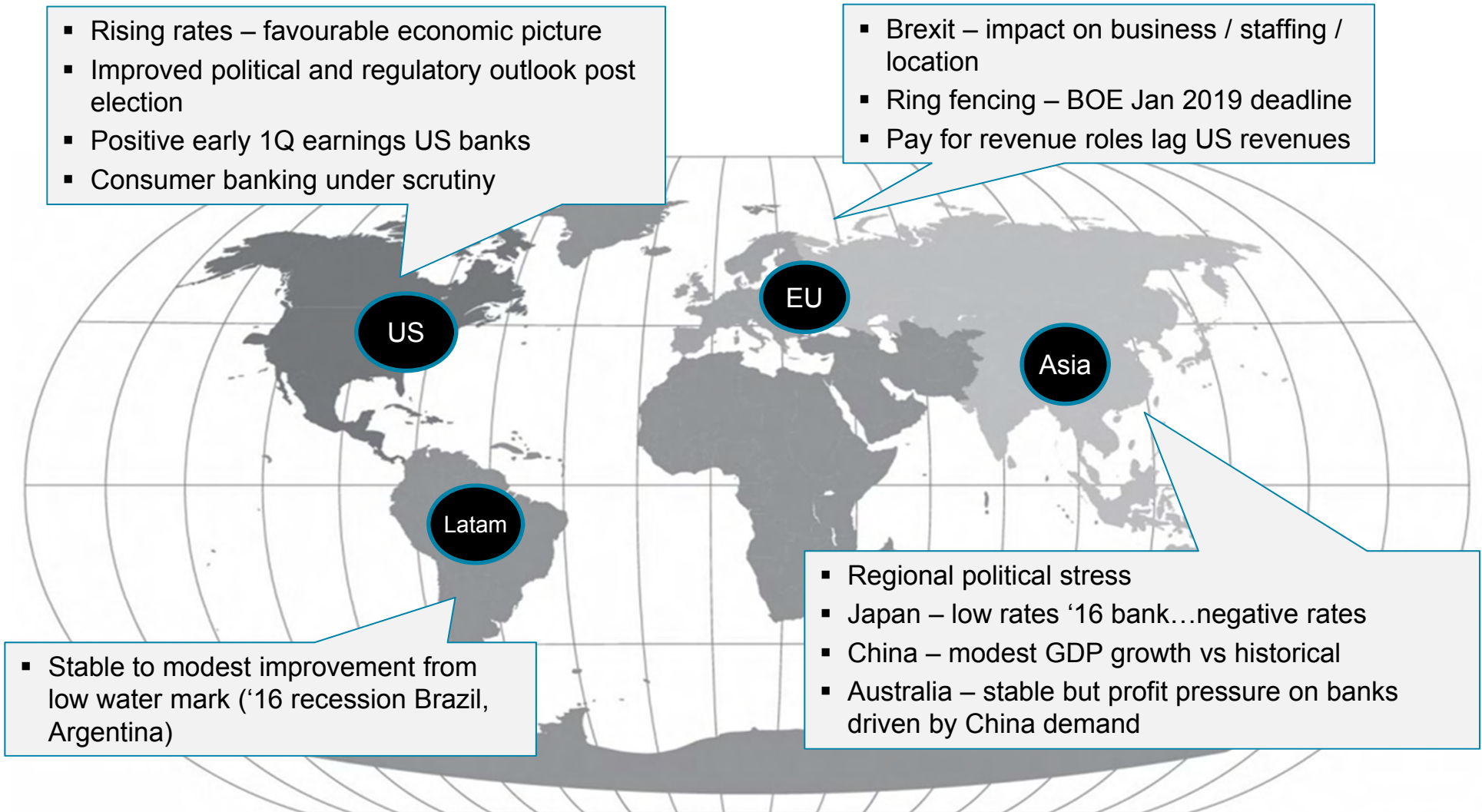


Scope: 8 AFME firms with combined 2015 Global BCM revenue of €107bn.



2016 Trends

2017 Outlook - Regional variances in global banking environment



Fixed Income Pay and Business Trends

Business Trends

- Revenues through 2016 trending 5 to 10% up on average for the largest firms as Q4 activity lifts results for most banks.
- US rates uncertainty and Brexit volatility benefits most firms' trading activities
- Headcount expected to decline mid single digits on full year basis

Pay Trends

- Large pay differences across the market based on FI results and product mix
- Pay trend may lag performance in a few cases, as part of the FI incentive pool may be used to lift under-performing Investment Banking
- Trend impacted by competitive position and prior year pay at a couple of firms resulting in pay trend > performance at these organizations
- Variances by product aligned to results; Rates pay on upper end

Equities Pay and Business Trends

Business Trends

- Divisional revenues for the largest firms down ~12% through 2016, with Q4 performance lifting YOY results (Q4'16 activity above low Q4'15)
- Post- US election trading activity improved and gives some lift to firms early Q4 activity
- Global cash commissions down ~11% through 2016; US down 3%; Europe down 13%; Asia down 20%
- Europe and Asia have seen biggest declines as stronger results last year create difficult year-over-year targets
- Greater concentration of revenues towards top banks leaves many lower tier firms struggling
- Global Equity issuance running at lowest levels in five years

Pay Trends

- Derivatives results and pay trend better than Cash for most firms and coming off a strong 2015
- US product coverage pay trends better than Europe and APAC

Investment Banking Pay and Business Trends

Business Trends

- Q4 banking results showed some improvement from 1st half trend. IBD publically reported revenues down 5% through 2016 for largest banks: M&A & DCM flat to down ~5%; ECM down 30%+
- Investment Banking 'fees' down (M&A, ECM, DCM, Loans); Europe down to '04 levels
- Global announced M&A volume down ~15% through 2016; US down off 2015 high water mark.
- Record US Investment Grade debt levels (+10% YOY); High Yield down with lower risk appetite in the market; ECM down materially
- Independent IB's & boutiques continue to win share and grow. Revenues at high water mark

Pay Trends

- Tech & Energy on higher end; Consumer, Retail, and Telecom on lower end
- FX pressures in emerging locations (Russia, Turkey, LATAM) and UK following currency devaluation
- Associates/ VP more protected on a class year basis than MD/DIR's. Differentiation remains a key focus at all levels.



Appendix

Appendix A: Summary Table of Key Metrics with Year Comparisons

Metric	Performance Year 2007	Performance Year 2009	Performance Year 2015	Estimate for Performance Year 2016	Slide
Global BCM Total Compensation Pool as a proportion of 2009	-	100%	73%	72%	7
EMEA BCM Total Compensation Pool as a proportion of 2009	-	100%	65%	63%	7
Global BCM Total Compensation Pool per Capita as a proportion of 2009	-	100%	83%	82%	8
EMEA BCM Total Compensation Pool per Capita as a proportion of 2009	-	100%	79%	77%	8
Global BCM Bonus Pool as a proportion of 2009	-	100%	51%	49%	9
EMEA BCM Bonus Pool as a proportion of 2009	-	100%	35%	32%	9
Global BCM Bonus Pool per Capita as a proportion of 2009	-	100%	58%	57%	10
EMEA BCM Bonus Pool per Capita as a proportion of 2009	-	100%	48%	46%	10
Fixed pay as a proportion of Total Compensation for AFME members	30%	-	66%	-	12
Variable pay as a proportion of Total Compensation for AFME members	70%	-	34%	-	12
Proportion of pay deferred at €2M	29%	-	62%	-	13
Europe HQ firms, Total Compensation as a % of Net Revenue	41%	25%	26%	25%	21
US HQ firms, Total Compensation as a % of Net Revenue	36%	25%	25%	25%	21
Europe HQ firms, Bonus as a % of Net Revenue	30%	19%	11%	10%	22
US HQ firms, Bonus as a % of Net Revenue	25%	17%	12%	12%	22

Note: The basis of calculation for some of the figures above differs depending on the metric / availability of data and therefore the scope / source can be found in the body of the report.

Appendix B: 2015 Other Metrics

Regional differentials in pay (slide 15)

Metric	US	UK	HK
2015 BCM Managing Directors Total Compensation	100%	74%	72%
2015 BCM Managing Directors Total Cash	100%	81%	79%
2015 BCM Total Compensation Deferred	35%	29%	29%
2015 BCM Total Compensation Immediately Received	65%	71%	71%

Financial Sector differentials in pay (slide 16)

Metric	Asset Management	Private Equity	BCM
2015 BCM Managing Directors Total Compensation	100%	77%	77%
2015 BCM Managing Directors Total Cash	100%	94%	78%
2015 BCM Total Compensation Deferred	29%	14%	29%
2015 BCM Total Compensation Immediately Received	71%	86%	71%

Note: The basis of calculation for some of the figures above differs depending on the metric / availability of data and therefore the scope / source can be found in the body of the report.

Appendix C: Corporate title level guidelines (Officer levels)

	Managing Director	Director	Vice President
Core Functional Responsibilities	<p>Incumbent has the highest level of relevant experience and / or skill of all staff that is not primarily management-focused.</p> <p>In client relationship management roles, incumbent has primary responsibility for developing, maintaining and generating revenue from the most important clients. Handles all aspects of client interaction, including directing and coordinating execution of transactions.</p> <p>In trading / capital commitment roles, incumbent is the most seasoned incumbent in assigned securities, independently handles the most complex transactions and may be viewed as a partner by management in establishing commitment limits.</p> <p>In research roles, incumbent has extensive knowledge and experience / skill that enables independent company-specific, economic or trend analysis. Publishes written research and strategy reports.</p>	<p>Responsibilities are similar to Senior I, however incumbent has less relevant experience and / or skill and smaller scope of activities.</p> <p>In client relationship management roles, incumbent has primary responsibility for medium and smaller sized clients, but is often No. 2 on relationships with larger clients.</p> <p>In trading / capital commitment roles, incumbent may contribute to the formation of firm's strategy. Has primary responsibilities for the firm in assigned securities and works with a large degree of independence.</p> <p>In research roles, incumbent has seasoned and proven judgment in research sector and publishes written research and strategy reports. Continues to develop sources of research information on topics covered.</p>	<p>Works with a large degree of independence, however, requires management oversight on most complicated issues / situations.</p> <p>In client relationship management roles, incumbent may be the No. 2 or No. 3 on relationships with the most important clients, but may be the key contact with mid-sized clients. Has begun to assume some important business development responsibilities.</p> <p>In trading / capital commitment roles, incumbent may have primary responsibilities in a given security but will have less relevant experience and/or skill than Senior II. Increasingly assumes responsibility for independently handling complex transactions.</p> <p>In research roles, incumbent is developing seasoned and proven judgment in research sector and may publish written research and strategy reports. May provide ideas and help to enhance client relationships.</p>
Supervisory	<p>May oversee staff within the business area.</p>	<p>Limited staff management responsibilities.</p>	<p>May supervise more junior staff. Manages day-to-day work of associates and analysts.</p>
Experience Guideline	<p>An individual in this position typically has a minimum of 10 years of experience since graduation from an MBA program or has an equivalent combination of experience and education.</p>	<p>An individual in this position typically has a minimum of 7 years of experience since graduation from an MBA program or has an equivalent combination of experience and education.</p>	<p>An individual in this position typically has more than 5 years of experience since graduation from an MBA program or has a comparable combination of education and related industry experience.</p>