Operations and Compensation Metrics and Best Practices

Selected Highlights

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INTRODUCTION

Returning to our study of operations and compensation dynamics after a one year hiatus, we find the asset management industry at a crossroads. On the one hand strong markets are driving growth, creating a superficial sense of business as usual. Below the surface, however, a range of developments are quickly reshaping the industry, with profound implications for how businesses are run and people are paid.

There is of course the rampant growth of indexing and smart beta, which exerts fee pressure and simultaneously diminishes the ability of active managers to raise new assets. Robo-advice is having a similar effect on the advisory business. Regulatory complexity and pressure challenges many firms, who may also be facing skeptical investors who want more for less. One thing investors almost certainly want is more transparency, which managers of all stripes must come to grips with providing. Even as they focus on opening themselves up to their client, they need to lock themselves down against the growing yet often nebulous threat of cyber-attacks. To top it off, we find ourselves in a uniquely unsettled political situation which has the potential to quickly change the business environment in unexpected ways.

Some firms are faring better than others. Hiring continues at a slower pace, but there is still quite a lot of employee turnover at many firms. More importantly, a growing number of firms are struggling to find new clients or raise new assets, slowing revenue growth and threatening to pressure bonuses and margins. Meanwhile a lack of scale challenges some firms as the cost of technology, compliance, and distribution continue to rise. Technology and ops spending continues to rise inexorably as new priorities like cybersecurity join older initiatives like disaster recovery.

Compensation continues to rise across many roles, but it is not climbing as consistently as one might expect given the relatively benign market environment. We have yet to see the full effect of the underlying changes to the industry on compensation as firm economics are placed under greater pressure. Regardless of what happens to pay levels, it is virtually certain that *how* people are paid will change. Evaluation metrics are already evolving to reflect shifting priorities, with some firms now placing a greater emphasis on client retention, while others refocus on investment performance.

It is imperative during times of great change to keep a finger on the pulse of the industry, be committed to staying informed, and understand what your competitors are doing. Industry metrics are vital in attracting the right people to help you build the type of firm that can compete effectively. Competitive intelligence can also support crucial management decisions and help avoid costly operational missteps. SS&C Advent and the Investment Adviser Association co-sponsored the 2017 survey. The results represent one of the most comprehensive sets of industry metrics available. We are grateful to all those who took the time to participate. Your contribution is greatly appreciated, and we hope you find the results informative and useful as you plan for your firm's future.

NOTE TO READERS

This document contains selected highlights only. Survey participants receive an in-depth 45 page report along with a full set of data tables tabulated by asset size (see right).

Please refer to the end of this document for more information on the contents of the full report as well as information on how to participate in the next survey.

AUM Peer Groups

ALL	**All** Respondents
XL	**Extra Large:** More than $5 billion AUM
L	**Large:** $2 billion to $5 billion AUM
M	**Medium:** $1 billion to $2 billion AUM
S	**Small:** Less than $1 billion AUM

SELECTED FINDINGS

ASSETS

Asset flows in 2016 were more subdued than we have seen in recent years. Gross new assets accounted for a median 8% of assets under management, which is down from 13% three years earlier (Figure 1). Outflows remain relatively stable, but shrinking inflows caused net new assets to fall to 2% of overall assets this year. A number of secular trends are contributing to this trend, but the net result has been a growing emphasis on retention. This is especially true for the one out of every three firms already finding themselves in net redemptions.

Figure 1. Asset flows

Median % of AUM	ALL	XL	L	M	S
Gross new assets gained in 2016	8.3	11.0	5.4	7.4	6.8
Gross assets lost in 2016	4.8	5.5	6.5	3.9	3.5
Net new assets in 2016	2.1	5.2	0.2	2.8	3.6

CLIENTS

Firms are still adding new accounts, but client acquisition and retention are becoming more challenging. Median new client growth of 6.8% seems positive, but it is actually the lowest level since at least 2013 (Figure 2). Meanwhile, departing clients accounted for a median 4.8% of the total, which is the highest level in recent memory. As a result of these two factors, net new accounts only accounted for 2% of all clients, compared to almost 5% a few years ago. Approximately half of all firms experienced net client turnover in the 0% to 10% range, but some reported more extreme changes of +/- 20%. Amongst this considerable variability, the largest firms in this year’s survey demonstrated more success at getting new clients, even if they weren’t necessarily any better at retaining them.

Figure 2. Client turnover

Median client turnover

	ALL	XL	L	M	S
New clients in 2016 as % of total	6.8	11.3	6.8	6.4	6.4
Clients lost in 2016 as % of total	4.8	5.5	5.8	4.5	7.2
Change in number of clients as % of total	2.0	4.6	1.2	2.5	0.4

PERSONNEL

This survey has tracked assets, revenue, and profitability per employee for many years, and they have all risen fairly steadily ever since the financial crisis. Median revenue per employee, for example, has almost doubled since 2011, rising from $250,000 to 450,000. The largest firms in the survey now report a median $307 million of assets per employee, up from $264 million two years ago (Figure 3).

Figure 3. Employee ratios

Median	ALL	XL	L	M	S
AUM per employee ($ millions)	124.3	306.8	93.8	92.7	71.4
Revenue per employee ($000s)	447.0	805.9	441.6	355.3	384.7
EBITDA per employee ($000s)	130.8	523.8	131.3	100.1	71.4

FINANCIALS

Despite strong markets helping propel their businesses forward, many survey participants report slowing growth and deteriorating economics. Organic growth slowed dramatically enough that firms in this year's survey reported a median change of only 2.5% in revenue from the previous year (Figure 4). While positive, this is the slowest rate of growth since the financial crisis. Almost half of all firms actually reported declining revenue.

Personnel costs are almost always the single largest driver of expenses at investment firms. The cost of investment professionals alone averaged 11.4 basis points (bps) across all firms (Figure 5). This is in line with our 2015 findings. It is easy to see the effect of scale. While XL firms reported average investment labor costs of 7.0 bps, they topped 20 bps at small firms. Overall labor costs accounted for an average 18.8 bps across all firms, but ranged from an average of 11.1 bps at XL firms to 26.9 bps at the smallest.

Figure 4. Revenue

Median $000s	ALL	XL	L	M	S
2015	12,065.5	25,580.0	13,015.0	6,850.0	4,400.0
2016	11,805.5	20,500.0	13,856.0	7,228.5	4,700.0
1 Year % Δ	2.5	5.3	2.2	2.0	(3.4)

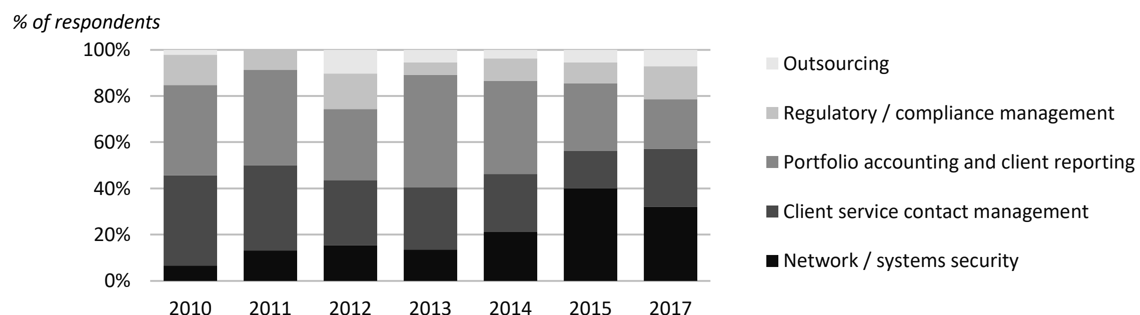
Figure 5. Labor costs by function as a percentage of AUM

Average basis points (bps)	ALL	XL	L	M	S
Investments	11.4	7.0	9.4	15.5	20.7
Marketing, Sales, and Client service	3.0	1.9	4.2	4.1	1.8
Administration	4.4	2.3	4.8	6.8	4.4
Total	18.8	11.1	18.4	26.4	26.9

IT BUDGET

Technology and operations costs seem to rise inexorably every year. In 2017, more than 76% of firms are planning to spend more on investment operations, up from an already high 74% in 2014 and 2015. Security is a major theme, rapidly moving up in the past several years to become the top priority at many firms (Figure 6). The emphasis on cybersecurity in particular should not surprise anyone, given widespread coverage of hacking incidents in recent years. Client service technology is also re-emerging as a top priority, which makes sense given the growing emphasis on client retention. Meanwhile, a steady stream of investment in disaster recovery and business continuity means many firms are taking this opportunity to shift gears and focus on other pressing needs.

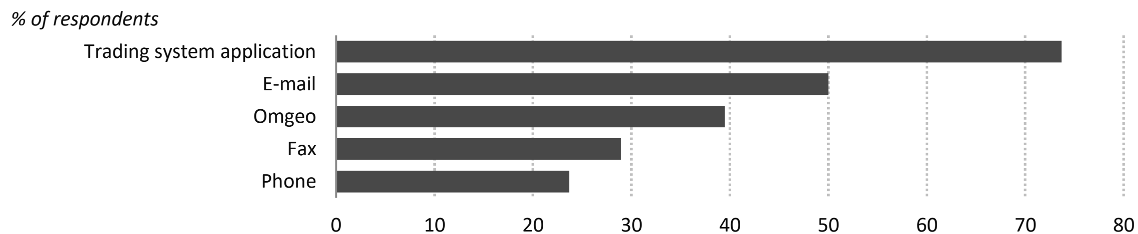
Figure 6. Top IT initiative over the coming year (selected choices only)



TRADING AND SETTLEMENT

Three out of four survey participants report using trading system applications for notifying brokers of allocations for executed trades, on par with the last survey conducted (Figure 7). Despite the growing popularity of trading applications, many firms use multiple modes of communication with their brokers and custodians. Email, phones, and faxes may not be as prevalent as they once were, but they continue to be used at a significant number of firms.

Figure 7. Method(s) of notifying brokers of allocations for executed trades



ACTIVITY METRICS

Operational efficiency is not something that was traditionally given much thought in the asset management industry. This has changed in recent years as client expectations rose, comparisons became easier, and switching costs declined. The bar has been raised, and more firms are now benchmarking themselves against their peers in order to deliver the desired experience.

Firms in the survey spend a median 40 hours monthly on reconciliation, although it can range from 30 hours at small firms to 70 hours at the largest (Figure 8). The total time spent on reporting every quarter ranges from a median of 40 hours at the smallest firms to 80 hours at the largest. This particular metric is highly variable, as evidenced by the much higher averages.

Despite devoting more resources to the task of reporting, the largest firms nevertheless take a median 14 days after quarter end to complete all of their reporting, compared to a more standard 10 days at small and mid-sized firms. Quarter end invoicing also takes longer at big firms.

Figure 8. Investment operations activity metrics

Median	ALL	XL	L	M	S
Hours per month spent reconciling	40.0	70.0	37.5	45.0	30.0
Hours per quarter spent on reporting	50.0	80.0	50.0	40.0	40.0
Hours per quarter generating bills and tracking receivables	24.0	30.0	25.0	16.0	15.0
Business days after quarter end to complete all reporting	10.0	14.0	10.0	10.0	10.0
Business days after quarter end to invoice all accounts	8.0	14.0	13.0	10.0	5.0

WEBSITES & SOCIAL MEDIA

With a few notable exceptions, investment firms as a group have not embraced social media like companies in some other industries. Nevertheless, only 37% of firms use no social media, compared to 72% in 2011 when this question was first included in the survey. Growing adoption suggests that social media is not a fad, but it is not necessarily easy to pinpoint its value. After a steady increase in people who said they saw long-term value for their firms, the shine may be coming off to some degree. Social media continues to be most highly valued as a way to raise brand awareness, followed by sharing thought leadership with clients and prospects (Figure 9). It is less often seen as a way to service clients or cultivate prospects.

Figure 9. Long-term value of social media, from 1 (not valuable) to 10 (extremely valuable)

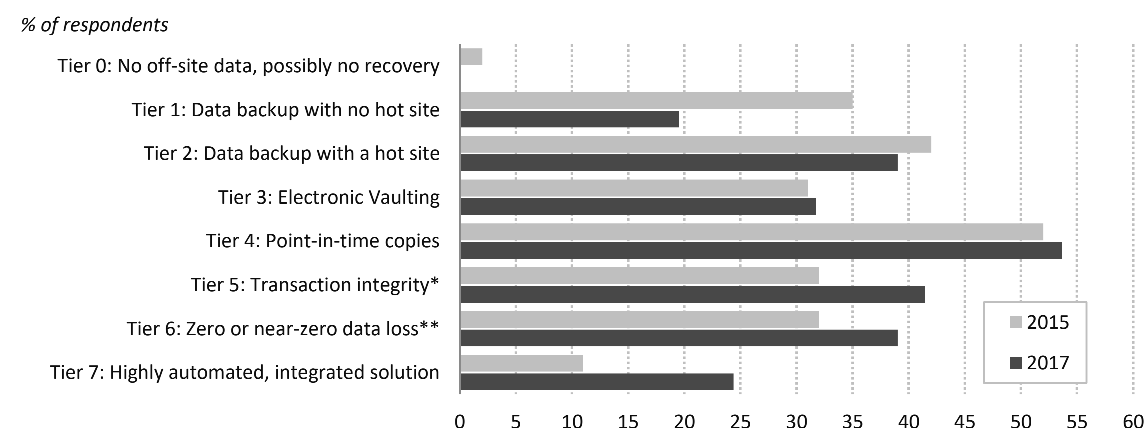
Average Rating	ALL	XL	L	M	S
Raising general brand awareness	4.7	4.5	6.1	3.7	5.0
Distributing expert commentary	4.0	3.4	5.4	3.2	4.8
Sharing news with clients and prospects	3.7	3.1	4.7	3.2	4.2
Developing sales pipeline	3.0	2.6	3.9	2.8	2.6
Dialogue with prospective clients	2.9	2.4	3.7	2.7	3.4
Servicing existing clients	2.5	1.9	3.3	2.8	2.0

DISASTER RECOVERY

Business continuity is a critical concept in the investment business, but it has been eclipsed by other initiatives when it comes to allocating IT budget dollars. Its relative decline in importance does not mean that disaster recovery is being de-emphasized. It is simply highlighting the fact that much of the hard work has already been done.

Most firms employ multiple approaches and redundant processes, but not every firm approaches disaster recovery solutions in an identical way. The general trend has been toward more sophisticated and often automated approaches aimed at zero loss of data. The percentage of firms employing the most sophisticated approaches rose considerably over the past several years to the point where almost one out of four firms now boasts a Tier 7 solution that provides a highly automated response to unforeseen events (Figure 10). About 40% say their solution guarantees virtually no data loss, and another 42% say transaction integrity will be preserved. At 54%, the single most often deployed solution is Tier 4, which creates point-in-time copies for subsequent recovery.

Figure 10. Disaster recovery solutions currently employed



EMPLOYEE BENEFITS

Health insurance is almost universally made available to the employees. Other types of insurance are also more prevalent than they have been in earlier surveys. Dental plans, for example, are now offered by 83% of firms, while vision insurance can be found at 61% of firms. All types of insurance are generally more likely to be found at larger companies than smaller ones.

The families of employees are almost always covered by insurance plans, but premiums may be subsidized to a lesser degree than they are for employees. On average, 88% of employee health insurance is paid for by companies, compared to 70% for family members (Figure 11). Employee subsidies rose slightly from the previous survey, while subsidies for families slipped.

Figure 11. Percentage of insurance paid by company

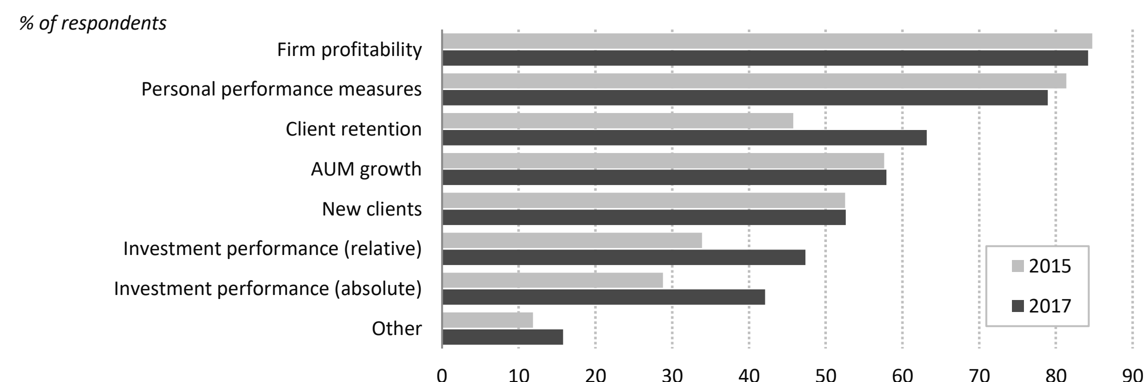
Average %	ALL	XL	L	M	S
Health insurance - employee	88.4	92.4	83.7	86.7	90.0
Dental insurance - employee	68.1	76.7	62.8	47.5	86.7
Vision insurance - employee	59.7	66.5	51.6	51.4	80.0
Health insurance - employee family	70.3	67.0	70.9	65.6	90.0
Dental insurance - employee family	53.7	53.8	59.3	35.0	86.7
Vision insurance - employee family	47.6	48.1	48.0	37.1	80.0

COMPENSATION STRUCTURE

It is not unusual for bonuses to be entirely discretionary, but 44% of firms also use concrete metrics to help determine the size of their bonus pool and/or individual awards. Key performance indicators differ from one firm to another, but they are - in aggregate - reasonably consistent from one year to the next. The emphasis on firm profitability, personal performance measures and asset growth seen this year is virtually identical to what we saw two years ago.

There are also some interesting shifts taking place. A growing emphasis on client retention, for example, is manifest here in the form of firms that increasingly choose to measure client retention as they award bonuses (Figure 12). Investment performance is also getting more attention as slowing growth puts pressure on bonus pools and makes it more critical to objectively measure individual and team contributions.

Figure 12. Objective (non-discretionary) measures used to award incentive pay



COMPENSATION DATA

Detailed compensation information was collected for forty positions ranging from CEOs to receptionists. Salary information, incentive pay, and ownership distributions were captured to arrive at total cash compensation figures. Experience levels and changes in compensation from the previous year are also captured. Data for the 2016 compensation cycle was gathered for approximately 1,000 individuals.

Despite headwinds across the business overall, compensation continues to trend upward across virtually all positions. The vast majority of investment personnel, for example, say their compensation rose over the past year. Declines remain relatively uncommon, although there was a notable increase in senior executives and sales professionals with lower compensation.

Firm size is loosely correlated to total compensation for some senior management positions, but is not a major contributing factor for most jobs. Portfolio managers and analysts can generally expect to earn just as much or more at small firms as they would at much larger organizations. When it does occur, higher compensation at smaller firms can also reflect dual roles, ownership status, or both.

Rather than size, the type of firm in question is more likely to have a material bearing on senior management compensation levels. CEOs of asset management firms, for example, reported average total compensation 19% higher than that of CEOs of firms identifying themselves as Independent RIAs. The difference in median compensation is equally striking.

Average compensation for all CEOs slid 8% from two years earlier while median compensation was effectively flat, slipping on 4%. Despite these decreases, the upper quartile climbed. More than any other position, CEO pay is closely linked to AUM. Median compensation for CEOs at the largest firms is almost three times the amount paid to CEOs of small and mid-sized firms.

Most investment professionals reported gains in the value of their compensation packages from the prior year, but these were not necessarily reflected in side-by-side comparisons of this year's survey data with figures from two years ago. Medians and averages were either stable or slightly below levels seen in our last survey. Median total compensation for portfolio managers, for example, was unchanged from the 2015 survey. Average total compensation, however, slipped to 12% over that period of time.

Despite widely reported increases, median compensation for many sales and marketing positions are also lower than what was reported by respondents to the last survey. Compensation for distribution professionals is some of the most variable, so year-over-year changes could reflect any number of environmental factors as well as a slightly different survey universe. Some of the biggest decreases in compensation between 2015 and 2017 can be found among heads of sales, whose average total compensation fell 26% from two years ago. Meanwhile, sales professionals reporting to them saw significantly larger pay packages.

Both junior and senior client service professionals continue to see their value increase, posting solid gains to median and average compensation. The only exceptions were Heads of client service and relationship management, who saw median and average compensation slip slightly.

Compensation for operational and administrative roles tends to be more stable year over year. The most notable change can be found among Operations Managers, who collectively experienced a meaningful bump in median compensation over the past two years.

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