BDA Bond Dealers of America

2011 Bond Dealers of America Fixed-Income Compensation Survey

Executive Summary

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Transmittal Letter from BDA

September, 2011

As the only organization representing the unique interests of securities dealers and banks focused primarily on the U.S. fixed income markets, the Bond Dealers of America (BDA) is pleased to present the results of the third annual Fixed Income Dealer Compensation Survey *("compensation survey")*.[1] It is our hope that the BDA 2011 compensation survey will serve as a valuable tool to enhance and inform your compensation management, strategic planning process and decision making.

At the outset, we wish to gratefully acknowledge the leadership of our Steering Committee for its continued support and advice in the development of the survey instrument and presentation of the results, as well as the regional and the middle-market fixed-income dealers who participated in the survey. Their input enables the Compensation Survey to remain a relevant document that serves the needs of the fixed-income industry, BDA members and the marketplace. I am pleased to report that this year's survey had the highest number of responding regional and middle-market fixed-income bond dealers since the inception of the compensation survey series three years ago. The survey definitions and methodology may be found as Annexes to the report.

Based on the success of the first two reports, there was strong agreement to continue with the series and produce the third annual compensation survey report. As was the case each of the last two years, the decision to produce the compensation report was a member-driven one. Once again, we consulted with our members. Our members communicated to us that the BDA Compensation Survey was both unique and of high value as it addresses both compensation (including salary, commission, and bonus) by position trends and broader strategic and financial management issues, as they relate to staffing and compensation policies of the middle market fixed-income securities dealer industry.

The Compensation Survey's value extends across our membership to the industry and the marketplace. The BDA Compensation Survey is the only compensation and strategic survey specifically tailored to the needs of regional and middle-market fixed-income dealers and their managements.

The timing of each of the first two survey reports covering 2007-2010 was propitious and perhaps uniquely valuable to the regional bond dealer community. The first BDA compensation survey covered the period during which the firms began to plan for the fixed-income market recovery from the 2008 crisis. The second survey last year covered the period at the peak of the strong bond market recovery from the ashes of the 2008 crisis. The 2009 into 2010 period covered in the second survey was generally a much stronger one for the fixed-income markets and regional dealers. Both employment – full-time equivalents or FTEs – and fixed-income revenues were higher in 2010 than 2009 among the survey participants that reported such information for both years by 3 percent and 5 percent,

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[1] The terms BDA Regional Dealer Fixed-Income Compensation Survey and Compensation Survey may be used as substitutes for each other.

respectively. The second annual survey was the second consecutive year in which employment and revenues increased over the previous year among our survey participants.

This third survey period extended into a more challenging period (2010-2011) but one that shows the resiliency of the fixed-income markets and growing and integral role of regional and middle-market dealers in the markets. The year 2010 ended with dire predictions for the municipal market but the municipal market came back strongly as 2011 ensued. Similarly, as of this writing, the government and taxable markets are showing stability and strength in the face of U.S. government debt outlook uncertainty. The last several years provide ample evidence that the middle-market fixed-income dealer industry will respond and flourish as the marketplace challenges and operating environment evolve.

There are indeed new sets of strategic challenges awaiting the industry today in the wake of the new financial regulation law and constantly shifting market conditions. We expect this year's survey to be equally useful – if not more so – in the new emerging environment punctuated by the potential for additional market volatility and transition as the markets move into unchartered waters affected by the recent rating downgrade of long-term U.S. debt and the implications for benchmark yields.

Regional firms may perhaps be better positioned in the developing marketplace and the evolving regulatory and operating environment to continue to grow and maintain and capture market share. Within this environment, insights about compensation levels, trends and policies would appear to be valuable tools for the middle-market dealers as their securities firms develop, fine-tune and implement strategies; decide how to allocate resources; and grow and manage capital and staffing in 2011 and beyond.

To enhance the value to regional firms, responses, where appropriate, are presented nationally and segmented by primary geographic region, revenue level and Full-Time Equivalent (FTE) staff size and compare the results to previous years as appropriate. We are collecting the same information as in last year's survey. There are no changes to the original questions asked although, as noted above, the survey results reflect results from a larger number of participating regional and middle-market fixed-income dealer firms. That we are asking the same questions as last year reflects the success of the format and that the survey questionnaire has achieved stability and critical mass. It also reflects the fact that BDA member firms appear to be satisfied with the data and questions requested and the results reported. The increased participation and survey structure stability also speaks to the fact that the industry finds value in the survey structure and reported results. Of course, as the industry and markets evolve and change, we are looking to further enhance the BDA compensation product in future years based on input from the fixed-income market participants, the BDA membership.

The results are divided into 12 topical areas within six report sections summarized below which include two new sets of questions on retirement programs and the composition of regional dealers' fixed income revenues. We encourage you to read the methodology and definitions annexes at the end of the report in conjunction with the tables and results. By doing that, you will have a fuller understanding of our approach, the definitions used in the tables and how we arrived at the reported data.

- **Compensation by position:** 46 positions, including executive management and departments: compliance, trading, sales, investment banking, public finance, operations and technology research, risk management and accounting. Within each department, compensation results are separated between senior, intermediate and junior positions, generally based on level of responsibility and seniority.
  - Averages, medians, maximums, minimums and medians are provided by position, including total 2010 compensation, and by bonus (2009 and 2010), salary (2010), commission (2010), and sum of commission, salary and bonus (2010). Where appropriate, comparisons are made to 2007-2008 bonus data based on information collected in the first two surveys.

  - Data were presented nationally and by region (three regions - West, Midwest, and South & East), FTE (two peers, up to 100 and above 100) and revenue (two peers, above $50 million and below $50 million in 2010 fixed-income revenue) peer groups.

  - Comparison of median bonus levels by position from 2007 to 2010.

- **Trader compensation by market:** Average, median, maximum, and minimum salary, commission, bonus and total compensation for municipal, agency and government, securitization, corporate bond and money markets for senior and mid-level trading professionals nationally. Averages are presented for trading by market sector depending on whether sufficient responses were received by FTE (2 groups, above and below 100) and fixed-income revenue (2 groups, above and below $50 million annually) peer groups**.** This section was incorporated to provide more detailed breakdown for trader compensation among market sectors than is provided in the general compensation tables.

- **Compensation policies**
  - **Payout Trends:**
    - Sales: Percentage payout of all net transaction revenues and separated by primary market and secondary market transactions segmented by market sectors – municipal, corporate bond, treasury/Federal agency and securitization. As appropriate, the responses are divided between the retail and institutional sales segments.
    - Municipal Market/Public Finance Banking and Trading: Percentage payout for primary market and, as appropriate, broken out between negotiated and competitive sales.

- **Bonus payment frequency:**
  - Whether sales professionals are paid by commission only. Salary/bonus only or commission and salary/bonus.
  - Whether traders are paid bonus in equity, cash or other form, and frequency of compensation (quarterly, semiannually or annually). Results are presented in percentage terms.
- **Bonus criteria:**
  - Whether based on objective quantitative basis, subjective basis, or combination of subjective and objective factors.
  - Responses are divided by trading – traders and trading desk managers; sales – sales professionals and managers; investment banking and public finance.
- **Retirement/deferred compensation programs *(new section)***
  - Whether the firm has a program.
  - Whether the program is based on a formula and what the formula is.

- **Revenue & Staffing Trends**
  - Whether staffing will change and in what direction it will change in 2011 by department (compliance, sales, trading, investment banking, research, operations)
  - Whether revenues changed in 2010 and are expected to change in 2011 and in what direction by market sector (government, Federal agencies, municipal bonds, corporate bonds, and securitization).
  - Composition (percentage) of fixed income revenues by market sector
    - Market sectors include agency, treasury, high-yield and investment grade corporate bonds and municipal bonds.
    - Calculated on a median, average and trading revenue weighted average basis.
    - Maximum percentage of trading revenues generated from a particular sector.

- **Operating & Technology Expense Ratios**
  - Operational expenses as a percentage of revenues: Total non-interest operating expenses, technology expenses, Bloomberg terminal and other data service expenses, presenting the minimums, maximums, medians and averages at the national level.
    - Responses broken out by FTE and fixed-income revenue peer groups presenting medians and averages.
  - Whether technology and operations functions are outsourced.

- **Annexes provide detailed explanations about the methodology and definitions used in the survey.**

We hope you find the information useful. We welcome any comments, questions or suggestions for future surveys.

Sincerely,

Michael Nicholas
Chief Executive Officer, Bond Dealers of America

I. *Executive Summary*

COMPENSATION POLICY HIGHLIGHTS

- **Compensation Data for 46 Positions from Senior to Entry-Level Provided**
  Data on 46 positions are provided including medians, averages, maximum and minimum levels of compensation across departments at the national level, and by primary geographic region, FTE (full-time equivalent) and fixed-income revenue peer groups to the extent there were sufficient responses to tabulate meaningful compensation statistical trends. The following compensation measures are included: 2009 bonus, 2010 bonus, 2010 salary, 2010 commission, 2010 total compensation and comparison of median bonus by position from 2007 to 2010.

- **Chief/Senior Fixed-Income Business Executive Total Compensation (Compensation by Position Section III)**
  As described above, compensation metrics are provided for 46 positions within twelve departments at middle-market fixed-income dealer businesses including sales, trading, compliance, operations and technology, research, public finance, investment banking and accounting. Median executive level total compensation was $568,000 for the head of the broker-dealer (maximum of $4.3 million), $477,253 for the head of fixed-income (maximum of $2.4 million), and $288,832 (maximum of $2.2 million) for the chief financial officer (CFO).

- **Average Bonus Levels Continue to Rise in 2010 Compared to 2009, Higher than 2007 and 2008 Levels. Trends Reflect Market Conditions, Industry Profitability (Bonus Trends By Position, 2007-2010 Section III-A)**
  Bonus trends from 2007 to 2010 are presented for all 46 positions to the extent that the statistical comparison was meaningful. Reflecting business conditions, the average median bonus across positions and departments decreased by 26% from 2007 to 2008, increased by 51% from 2008 to 2009, and by 23% in 2010. Looking at multi-year trends, the average 2010 median bonus was 8% higher than 2007 and 46% higher than 2008, the year of the financial market crisis. Keep in mind that the survey responding firms may change slightly from survey to survey, and this is the third year of the BDA Fixed Income Dealer Survey.

- **Trader Bonus is Higher Than Base Salary in Most But Not All Fixed-Income Asset Classes (National Bonus Trends By Positions Trader Compensation – Section IV)**[2]
  The average median 2010 salary across fixed-income asset classes was about $120,142 (slightly lower than in $129,000 in 2009 and the first year's survey of $125,000) and bonus about $262,094 (lower by about 8 percent from the previous two years)[3] for all

[2] There may be a small number of firms that provided aggregate trader compensation by position data but did not provide a response to this section in which trader compensation is segmented by market sector which would explain any small discrepancies in trader data between the two sections (Sections III and IV).
[3] Comparisons between this year and previous years' survey results should be made with care. The survey populations (or firms responding to the survey among years) differ slightly year-to-year. That is, a small number of some firms that participated this year did not participate last year and *vice versa*.

senior traders with dispersion above and below that average depending on the market sector – municipal, corporate, money market, securitization and Federal agency/government. Where sufficient data were available for the market sector (typically in the case of municipal and corporate bond sectors), data were provided for mid-level and junior traders, as well. For the second consecutive year, a statistically meaningful number of firms reported paying traders commissions as well as bonus and salary. The average median senior trader level commission across markets among the firms that paid commissions was about $240,507. Frequently, firms paying commissions did not pay salaries. (Note that only firms paying a commission were included in the trader commission metrics, and not all firms were included in the commission statistical calculations.) Average median total senior level trader compensation was $495,688, ranging from $240,000 in the money market sector to $685,000 in the ABS/MBS sector.[4](See Methodology Annex for the definition of "total" compensation.)

- **Range of Payouts on Transactions (Compensation Policies – Section V)**
  Responses indicate a wide range of compensation practices on payouts to sales professionals from net transaction/trade revenues[5] typically between 25% and 40%. Average compensation to institutional sales professionals on all trades (primary and secondary market) was typically in the 30% to 40% range. Retail trade compensation focused on 35% to 40% range across fixed-income market sectors. New issue trade sales compensation for both institutional and retail trades was concentrated in the 35% to 40% "bucket" in the taxable market markets but with a wide range from 15% to 50% depending on sector with the highest reported sales professional/manager compensation payout in the U.S. government sector. For municipal institutional primary market trades, about 60% of the competitive sector sales were between 30% to 40%. The heaviest concentration of responses in the 35% to 40% compared to less than 30% payout for the majority of the negotiated sector responses with the competitive sector compensation more concentrated at the upper 35% to 40% range. Note that there was a wide dispersion of payout practices from 15% to 40% among those revealing specific percentages.[6] For primary market retail sales, most firms reported 35% to 40% payouts for both negotiated and competitive municipal bond trades. Relative to last year, payouts appeared to be slightly higher for total, secondary market and primary market. Secondary market trade sales compensation was concentrated in the 30% to 40% range with roughly 80% to 90% of the responses falling in that range. There appeared to be somewhat less dispersion (with the exception of the primary or new issue municipal market) in trade sales compensation practices generally this year than in previous years.

  There was a wide range of practices regarding public finance banker payouts (12% to 50% dependent on the type of sale, negotiated vs. competitive) with a median in the 25%

[4] More generally, apparent inconsistencies between the sum of the average commission, bonus and salary relative to average total compensation reflects the inclusion of all firms in the "total" compensation calculation but only those firms that pay commissions (bonus) in the commission (bonus) averages. As noted above, some firms will pay a bonus (more frequently) or a commission but not both a bonus and commission. See the Methodology annex for a fuller explanation.

[5] A small number of firms used alternative metrics for payout based on a firm-wide calculation of profits rather than on a transaction basis and are excluded from this calculation.

[6] Some responded "other" to the payout question when it did not fall within the 25% to 40% range.

range for negotiated municipal bond sales and a narrower range for competitive sector with the median at around 40%. Among firms that do not distinguish between competitive and negotiated sales, the average payout was in the 15% to 20% range with responses ranging from 10% to 50%.[7] For traders, the median competitive primary market municipal sales payout was 16% and 20% for the negotiated sector and slightly lower for the firms that do not distinguish between competitive and negotiated payout practices (13% to 15%). For both sectors, there was wide dispersion in payout practices from less than 5% to 40%.

- **Diverse Policies Regarding Trader Bonus Pay (Compensation Policies – Section V)**
  Of those reporting such information, about 81% paid institutional traders cash bonuses (with the balance paying bonuses in equity or undisclosed "other" forms) and all of the firms that paid retail traders bonuses paid the bonus in cash. The responses were virtually unchanged from last year. On the institutional side, 54% of the cash bonuses are paid annually (compared to 61% last year) and balance pay bonuses either on a quarterly, semiannual or "other" basis with the non-annual responses showing no statistically significant pattern unlike last year when most of the balance of the responses indicted a quarterly bonus payment schedule. Firms generally pay retail traders cash bonuses annually according to the survey responses.[8]

- **Most Firms' Sales Professionals are Paid Commission Only; Fewer Firms Report Paying Sales Professionals both Commissions and Salary/Bonus (Compensation Policies – Section V)**
  Dealer firms pay their sales force on a commission only basis at 87% of the reporting middle-market fixed income dealer firms, and a combination of salary/bonus and commission is paid at 13%. Last year, 77% reported paying on a commission-only basis (and 23% salary and bonus only) and 90% reported paying commission-only two years ago. This year, none of the fixed-income dealer firms reported that they paid sales professionals exclusively on a salary/bonus structure. That is, virtually all of the firms paid their sales force commissions, and a minority of the dealer paid their sales force on both a salary/bonus and commission basis.

- **Bonus Metrics Trends Indicate Diverse Practices but Fixed-Income Dealer Firms Typically Base Bonuses on Objective and Measurable Criteria (Compensation Policies – Section V)**
  The majority of firms pay bonuses across professions in the trading, investment banking and public finance groups based on measurable objective criteria or a combination of subjective and objective criteria. Less than half of the firms pay sales professionals (27% compared to 40% last year) and sales managers (28% compared to 44% last year) solely on objective, measurable criteria with the same percentages base bonus payments on subjective criteria. These responses exclude firms that pay in a commission-only basis but not a bonus. The balance based bonuses on a combination of subjective and objective

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[7] There were insufficient responses to report results on the taxable investment banking side.

[8] Note that some firms do not differentiate between retail and institutional as they are responsible for both institutional and retail trades. In these cases, the trader bonus frequency is included in the institutional trader calculation of bonus frequency.

criteria. Last year, no firms indicated using subjective criteria with the balance of last year's responses (slightly more than 50%) reporting using a combination of subjective and objective criteria.

The other departments tend to focus bonus criteria more than on objective or a combination of objective and subjective criteria. Trader bonuses at 38% of the firms are based solely on objective criteria, and 80% either on objective measurable criteria or a combination or objective and subjective criteria. In public finance, the percentages are about 60% and 80% and 40% and 80% for investment banking, respectively.

- **Most Firms Have Deferred Compensation Programs (Deferred Compensation/Retirement Programs – Section V)**

Virtually all firms (91% compared to 80% last year) have deferred compensation retirement programs and those that do not have such programs offer profit sharing. The deferred compensation is generally based on a formula rather than a fixed amount, and most formulas are typically tied to compensation. Last year, the deferral formula was more typically reported to be tied to return on equity.

- **Staffing Growth for 2010 (Revenue & Staffing Trends – Section VI)**
  Unlike much of the financial services industry, middle-market fixed income dealer staffing was either increasing or flat across market functional and departmental areas in 2010. These trends are consistent with the reported average higher FTE levels among survey respondents last year. There was a similar trend in last year's survey results – that is, an increase in FTE levels in 2009. Despite reported financial staffing cuts especially at some large global banks, the majority of the dealer firms expected the staffing level to stay the same for 2011. The exceptions were institutional sales and retail sales where the majority expected increased staffing. These trends reflect a staffing focus on revenue generating profit centers and expectations of greater operational staffing efficiencies at cost centers. Nearly half of the firms (43%) expect higher headcounts in institutional trading and half expect higher headcounts in public finance (and 8% expect a decline). The common themes in these three groups are that they are revenue generating departments. Furthermore, these trends indicate that middle-market dealer firms are growing and increasingly competitive across market sectors, especially in public finance, trading and sales. There was no indication of a net decline in any department among the survey participants.

- **Revenue Trends: Total Revenues Up But Majority of Sectors Weaker in 2010; Trends Expected to Moderate in 2011 (Revenue & Staffing Trends – Section VI)**
  The vibrant fixed-income market recovery in 2009 translated into strong revenue growth with the majority of trading sectors reporting stronger revenues. A large majority of the firms reported revenue increases in every product sector in 2009 across credit market sectors ranging from 77% in mortgage-backed securities to 100% of the firms in the municipal bond sector. As market trends moderated in 2010, most firms reported lower revenue across many fixed-income sectors in 2010 compared to 2009. The revenue growth in the rising sectors exceeded the decline in the slowing sectors as average total revenues of responding firms were higher in 2010 relative to 2009. The best performing

sector was municipal bonds where 42% reported higher revenues in 2010 and the worst was corporate bonds where only 25% reported higher revenues. These trends across sectors are expected to moderate somewhat in 2011. The strongest expectation of revenue growth is in MBS/ABS reflecting the sector's recovery with half of the firms expecting higher revenues, 20% expecting a decline and 30% expecting flat revenues in 2011. More expect declining revenues than increasing revenues in each of the other market sectors.

- **Operations and Technology Expenses Trending Lower (Operations & Expense Trends – Section VII)**
  Middle-market firms have generally reduced operating and technology expenses significantly as a percentage of fixed-income revenues each year between 2007 and 2010, according to most of the survey's statistical measurements, with median ratios declining to less than 1.0% from 3.2% for technology expenses from 2007-10 and 2.6% (but higher in 2010 than 2009) from 5.2% for operations expenses. Most firms (89%) do not outsource the technology function. There were year-to-year fluctuations with some increase in peer group overhead expense ratios in 2010 from 2009.