

MEMO# 30070

July 22, 2016

ICI Submits Comment Letter to SEC on Incentive-Based Compensation Proposal

[30070]

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TO: CHIEF RISK OFFICER COMMITTEE No. 19-16
CLOSED-END INVESTMENT COMPANY MEMBERS No. 12-16
COMPLIANCE MEMBERS No. 23-16
INVESTMENT ADVISER MEMBERS No. 13-16
RISK ADVISORY COMMITTEE No. 4-16
SEC RULES MEMBERS No. 38-16
SMALL FUNDS MEMBERS No. 33-16 RE: ICI SUBMITS COMMENT LETTER TO SEC ON
INCENTIVE-BASED COMPENSATION PROPOSAL

ICI recently submitted the attached comment letter to the Securities and Exchange Commission on proposed rules regarding incentive-based compensation arrangements. The SEC jointly issued these proposed rules with five other federal agencies. [\[1\]](#) As previously reported, [\[2\]](#) the proposed rules would prohibit incentive-based compensation arrangements that encourage inappropriate risk by providing excessive compensation or that could lead to material financial loss. [\[3\]](#) ICI's letter is briefly summarized below.

Our comment letter notes our disappointment that the proposal goes too far in several respects, restricting compensation arrangements that do not encourage and, in some cases, even mitigate against risk. The letter goes on to state that, while we generally believe that the proposal goes much further than necessary to achieve its stated goals, we do support the proposal's risk-based approach, which avoids applying certain excessively prescriptive requirements to certain investment advisers.

The remainder of our comments primarily address the application of the proposal to investment advisers and portfolio managers of registered investment companies.

The letter points out that an investment adviser's business is far different from that of a bank, broker-dealer, or any of the other financial institutions that would be subject to the proposed rule. The letter applauds the SEC for recognizing this and taking some steps to customize the rule to investment advisers. The letter strongly supports, for example, the proposal to include only an adviser's proprietary assets when determining if the adviser meets the proposed asset thresholds.

The letter also recommends a change that is crucial to designing appropriately any final rule for investment advisers. Specifically, it urges the SEC to treat an investment adviser as a standalone institution for purposes of any final rule unless that adviser is operationally integrated with a bank holding company parent or other covered institution.

The letter then offers for the SEC's consideration additional recommendations to:

- Use discretion to treat a Level 1 or Level 2 investment adviser as a Level 3 adviser where appropriate;
- Exclude, in appropriate circumstances, chief compliance officers and heads of control functions from the definition of "senior executive officer;"
- Refine the definition of "significant risk taker" so that it does not inadvertently include portfolio managers;
- Better tailor the definition of incentive-based compensation to exclude compensation practices that do not occasion inappropriate risk;
- Revise the proposal's treatment of long-term incentive plans to avoid tacking on a second deferral period which unintentionally would encourage short-term, over long-term, incentive compensation;
- Clarify that Level 3 investment advisers would not be required to adjust downward certain individuals' incentive compensation due to a downturn in company performance not related to the individual's conduct;
- Enhance investment advisers' ability to award options as deferred compensation; and
- Clarify the definition of "excessive compensation."

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Counsel

[Attachment](#)

endnotes

[1] Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the SEC, the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, National Credit Union Administration, and Federal Housing Finance Agency to jointly prescribe regulations or guidelines with respect to incentive-based compensation practices at covered financial institutions.

[2] See ICI Memorandum No. 29869 (April 26, 2016), available at https://www.ici.org/my_ici/memorandum/memo29869.

[3] Incentive-based Compensation Arrangements, SEC Rel. No. 34-34-77776 (May 6, 2016), 81 Fed. Reg. 37769 (June 10, 2016), available at <https://www.sec.gov/rules/proposed/2016/34-77776.pdf>. The proposed rule incorporates many of the elements of an incentive-based compensation proposal issued in 2011. Incentive-Based Compensation Arrangements, SEC Rel. No. 34-64140 (Mar. 29, 2011),

available at <https://www.sec.gov/rules/proposed/2011/34-64140.pdf>.

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