

MEMO# 25232

May 31, 2011

ICI Comment Letter on Proposed Rules on Incentive-Based Compensation Arrangements

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 40-11
COMPLIANCE MEMBERS No. 24-11
INVESTMENT ADVISER MEMBERS No. 12-11
RISK MANAGEMENT COMMITTEE No. 6-11
SEC RULES MEMBERS No. 61-11 RE: ICI COMMENT LETTER ON PROPOSED RULES ON
INCENTIVE-BASED COMPENSATION ARRANGEMENTS

In March, the Securities and Exchange Commission and six other federal financial regulators (collectively, the “Agencies”) proposed a rule relating to incentive-based compensation practices at certain covered financial institutions, including investment advisers. [\[1\]](#) The rule implements Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

ICI has submitted the attached comment letter on the proposal. The letter expresses our appreciation for the Agencies’ efforts to strike the right balance between flexibility and certainty in the proposed rules, and supports the principles-based approach generally taken in the proposal. Nevertheless, the letter expresses the following concerns:

- The standards for prohibited conduct are not clear. To improve that clarity without taking an overly prescriptive approach, we recommend including a rebuttable presumption in the final rules that compensation arrangements approved in good faith by a covered financial institution’s board are permissible. We also recommend that the Commission’s staff, separately from the other Agencies, provide supplementary FAQs that illustrate the types of arrangements or practices that it has identified as “inappropriate,” “excessive,” “unreasonable,” or “disproportionate.”
- There is very little, if any, meaningful discussion in the Release about the distinction between “appropriate” risks and “inappropriate” risks. While we believe that the Agencies should avoid prescriptive statements about precisely what risks may be inappropriate, the Agencies should make it very clear that there is a distinction

between taking risks with the firm's own assets and taking fully disclosed investment risk with client assets. The latter is quite simply not the behavior that this rule is meant to address.

- An overemphasis on comparators in determining the “excessiveness” of compensation could quell legitimate competition for talent. Although comparators are clearly relevant, the Agencies should expressly state that a firm positioning itself at the top of the compensation spectrum does not, by virtue of that fact alone, provide “excessive” compensation. Some firms choose to hold themselves out as providing better compensation packages than their competitors, and nothing in Section 956 or this rulemaking should prohibit them from competing for talent in the marketplace on that basis.
- Statements in the Release about the Agencies' expectations for risk management and internal control personnel are overly prescriptive. While many firms may use risk management and internal control personnel in much the way suggested by the Release, others may not. The Agencies need not, and should not, micromanage the process to the level suggested in the Release. Rather, each firm should be afforded the flexibility to determine the best way to utilize its staff to achieve the Agencies' goals on compensation.
- While we strongly support the use of a balance-sheet assets test for determining status as a “covered financial institution,” the definition could be improved in several respects. The final rules should clarify the status of bank and thrift subsidiaries and impart some flexibility for firms that temporarily may cross the \$1 billion or \$50 billion thresholds.
- Separate standards for “larger” firms are not warranted at this time. Nothing in Section 956 suggests a different standard for larger firms, and nothing requires the Agencies to propose explicit requirements on the deferral of executive compensation. We recommend that the Agencies reconsider the proposed requirements for larger covered financial institutions, and adopt them only after experience with the rule demonstrates that the general requirements are not sufficient to deal with incentive compensation practices at those firms.

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Securities Regulation - Investment Companies

[Attachment](#)

endnotes

[1] See SEC Release No. 34-64140 (March 29, 2011), avail. at <http://www.sec.gov/rules/proposed/2011/34-64140.pdf> (the “Release”).