

MEMO# 30035

July 13, 2016

ICI Draft Comment Letter on Federal Agency Proposal on Incentive-Based Compensation Arrangements; Your Comments Requested by July 19

[30035]

July 13, 2016

TO: CHIEF COMPLIANCE OFFICER COMMITTEE No. 15-16
CHIEF RISK OFFICER COMMITTEE No. 17-16
CLOSED-END INVESTMENT COMPANY MEMBERS No. 11-16
COMPLIANCE ADVISORY COMMITTEE No. 7-16
INVESTMENT ADVISERS COMMITTEE No. 12-16
RISK ADVISORY COMMITTEE No. 3-16
SEC RULES MEMBERS No. 32-16 RE: ICI DRAFT COMMENT LETTER ON FEDERAL AGENCY PROPOSAL ON INCENTIVE-BASED COMPENSATION ARRANGEMENTS; YOUR COMMENTS REQUESTED BY JULY 19

As previously reported, [\[1\]](#) the Securities and Exchange Commission and five other federal agencies [\[2\]](#) jointly issued proposed rules regarding incentive-based compensation arrangements in late April and early May, with comments due by Friday, July 22. 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 draft comment letter is attached and briefly summarized below.

Please provide comments as soon as possible, but, in any event, no later than end of day on Tuesday, July 19. Please send your comments to Linda French at linda.french@ici.org.

Our comments address the application of the proposal to investment advisers, with a particular focus on how the proposed rule would impact funds. An investment adviser's business is far different than that of a bank, broker-dealer, or any of the other financial institutions that would be subject to the proposed rule. We applaud the SEC for recognizing this and taking some steps to customize the rule to investment advisers. We strongly support, for example, the proposal to include only an adviser's proprietary assets when determining if the adviser meets the proposed asset thresholds. [\[4\]](#)

We also recommend a change that is crucial to designing appropriately any final rule for

investment advisers. Specifically, we urge 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 [5] or other covered institution. Our recommended approach would permit non-operationally integrated investment advisers to comply with the provisions of the proposed rule at a level commensurate with the investment adviser's actual risk profile. Otherwise, the proposed rule effectively would apply an excessively stringent, prescriptive framework to an investment adviser whose risk profile does not warrant this level of regulation and whose size does not support the expense and onerous nature of regulation tailored for a much larger, more complex institution.

The proposed rule would apply stringent requirements to incentive-based compensation paid to two categories of individuals—"senior executives" and "significant risk-takers"—at Level 1 and Level 2 covered institutions. We recommend that the SEC exclude, in appropriate circumstances, chief compliance officers and heads of control functions from the definition of "senior executive officer." We also urge the SEC to refine the definition of "significant risk taker" so that it does not inadvertently include portfolio managers.

We make several other recommendations specific to the SEC's portion of the proposed rule. We recommend the SEC better tailor its definition of incentive-based compensation to exclude compensation practices that do not create inappropriate risk. Lastly, we urge the SEC to allow investment advisers to award options as deferred compensation and to clarify the definition of "excessive compensation."

Linda M. French
Counsel

[Attachment](#)

endnotes

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

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

[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>.

[4] The proposed rule would divide covered financial institutions into three tiers, with "Level 1" institutions defined as those with assets equal to or greater than \$250 billion, "Level 2"

institutions with assets between \$50 billion and \$250 billion, and “Level 3” institutions with assets between \$1 billion and \$50 billion.

[\[5\]](#) The proposed rule otherwise would automatically assign the tier of a parent bank holding company to its covered investment adviser subsidiaries.

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.