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October 8, 2010

Via email (cp10_19@fsa.gov.uk)
Lindsey Dawkes
Remuneration Team
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Re: Consultation Paper 10/19 –Revising the Remuneration Code

Dear Ms. Dawkes:

The Investment Company Institute[1] welcomes the opportunity to comment on the proposals of the Financial Services Authority ("FSA") in Consultation Paper 10/19-Revising the Remuneration Code ("Paper") and, in particular, the FSA's proposed approach for asset managers. Indeed, the regulation of incentive-based compensation is a very important topic, and one that has generated much debate in both the US and UK.

This consultation comes at a time when US authorities are still developing their approach to the regulation of incentive-based compensation. US authorities will be working on regulations regarding the scope and nature of limits on incentive-based executive compensation arrangements for financial institutions over the next 9 months, as directed by the recently adopted Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[2]

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[1] The Investment Company Institute is the national association of US investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $11.51 trillion and serve over 90 million shareholders.

[2] Under Section 956 of the Dodd-Frank Act, US federal financial regulators have been directed to adopt regulations requiring financial institutions with more than $1 billion in assets, including investment advisers, to disclose all incentive-based compensation arrangements to their regulator. The legislation also empowers regulators to prohibit any type of incentive-based payment that regulators determine encourages inappropriate risks by federal financial institutions by providing a covered executive with excessive compensation, fees or benefits or could lead to material financial loss to the financial institution. Unrelated to the Dodd-Frank Act, US banking regulators issued guidance in June 2010 regarding sound incentive compensation policies for banks. *See* Final Guidance on Sound Incentive Compensation Policies, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance

Given the global nature of capital markets and financial institutions, we believe it is extremely important that regulators work in coordination with their international counterparts. US authorities have recognized the importance of international coordination regarding executive compensation regulation and have stated their intention to work with international counterparts to promote competitive balance and ensure that global organizations are subject to consistent requirements.[3] We describe our views on the scope of the revisions to the Remuneration Code ("Code") and the proportionality approach in more detail below.

Scope

The proposed revisions set forth the following for the application of the revised Code:

- UK groups should apply the revised Code globally to all their regulated and unregulated entities; and
- UK subsidiaries of third country groups must apply the revised Code in relation to all entities within the subgroup, including entities outside the UK.[4]

We are concerned that the proposed scope of this provision is so broad that it may subject US firms to multiple requirements that may be different or conflicting. For example, it appears that a US firm in a UK group, but with no activities in the UK, could be subject to both US and UK remuneration rules. As we noted above, under the Dodd-Frank Act, US financial regulators will soon be promulgating rules regarding incentive-based compensation for certain US financial institutions and have stated their commitment to coordinating with their international counterparts to foster sound compensation practices across the financial services industry.[5] Given that US regulators will be promulgating rules and are committed to working with their counterparts, the extra-territorial scope of the revised Code is unnecessary. While we understand the FSA's intent to help firms create consistent policies across a business group while also preventing firms from circumventing the rules, we believe the FSA should tailor the group and territorial application of the revised Code to avoid a result whereby firms are unnecessarily subject to multiple and possibly conflicting regulations.

Corporation, Office of Thrift Supervision, 75 FR 36395 (June 25, 2010), available at http://edocket.access.gpo.gov/2010/pdf/2010-15435.pdf.

[3] *See e.g.*, Testimony of Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System, Before the House Committee on Financial Services (September 24, 2010) ("Alvarez Testimony"), available at http://www.federalreserve.gov/newsevents/testimony/alvarez20100924a.htm.

[4] *See* Paper at 21 and Appendix 1 at 10 (19.3) (revised rule 19.3.1 states that firms must apply the requirements of the section at group, parent undertaking and subsidiary undertaking levels, including subsidiaries in a third country).

[5] *See e.g.*, Alvarez Testimony.

We are likewise concerned about the application of the revised Code to US personnel who are compensated by US entities and whose UK responsibilities only constitute a limited part of their overall job responsibilities. Many UK firms that are part of groups based in the US or in other jurisdictions may have group level management personnel approved by the FSA because (1) such individuals, though employed by the US or other jurisdiction parent company, perform controlled functions in the UK subsidiary, or (2) such individuals exercise "significant influence" over the decisions of the UK firm even though the US or other jurisdiction personnel are not technically members of nor employed by the UK firm. As described in the Paper, compensation of these non-UK personnel may fall within the scope of the proposed rules, even though they are compensated by the US or other jurisdiction entity and their UK responsibilities only constitute a limited portion of the individual's overall duties. In these and similar circumstances, we believe that a firm could conclude that such a person is not "Code staff" or, if a firm concludes that such a person should be viewed as "Code staff," that it should be able to apply the provisions of the revised Code in a proportionate manner. Because of the significant uncertainty regarding the impact of the revised Code on such personnel, we request further clarification on this point.

Proportionality

In the Paper, the FSA recognizes that risk in the context of an asset management firm is different from risk for a credit institution and states that the "key risks affecting the success or failure of an asset management firm are typically operational or legal risks."[6] In addition, the FSA also recognizes that, for asset managers, investment risk "is invariably assumed on an agency rather than a principal basis."[7] We agree that the unique circumstances of asset managers must inform the development of any regulations related to incentive-based compensation arrangements in financial institutions. In addition, it is important to recognize that the activities of asset managers vary dramatically as clients seek different expertise and services from asset managers. This characteristic of asset management relationships is well illustrated in the context of an investment manager to a US registered investment company, whereby the investment manager's activities and responsibilities – and its ability to take investment risks – are circumscribed by a written investment advisory contract as well as the Investment Company Act of 1940 ("1940 Act") and the Investment Advisers Act of 1940 ("Advisers Act").[8]

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[6] Paper at 16 (2.29).

[7] Id.

[8] For example, there are extensive risk-limiting provisions under the 1940 Act, including leverage limitations, prohibitions on transactions with affiliates and disclosure requirements regarding investment objectives, policies and strategies from which a manager cannot deviate without further disclosure or, if fundamental, without a shareholder vote. In addition, under the 1940 Act, investment advisory contracts must be in writing and precisely describe all compensation to be paid to

We strongly support the FSA's proposal to allow firms to apply a proportionate approach to the application of the remuneration principles "in a way and to the extent that is appropriate to their size, internal organization and the nature, scope and the complexity of their activities."[9] For asset managers, a proportionate approach is essential. For this reason, we believe that the FSA must emphasize for the benefit of FSA staff and industry that there is no single approach for structuring incentive compensation arrangements. As a consequence, it should be possible for asset managers that appear to be similarly situated to legitimately come to different conclusions on the applicability of certain principles and rules. We believe that the FSA should emphasize that it will be the responsibility of firms to determine through their governing bodies how best to structure any incentive based compensation arrangement and to manage the risks, if any, associated with the arrangement.

We also believe that guidance is needed with respect to the proposed approach to proportionality outlined in the Paper. The FSA sets forth the following in three tables in Annex 5:

- Proportionality Table 1: Code rules and remuneration principles, to be applied to all firms.
- Proportionality Table 2: Code rules and remuneration principles which apply in line with the nature, internal organization, scale, scope and complexity of a firm.
- Proportionality Table 3: Code rules and remuneration principles which firms may apply on a "comply or explain" basis, based on their nature, internal organization, scale, scope and complexity.

The tables are intended to illustrate how a proportionate approach could be taken in applying the revised Code to firms and staff. Table 1 represents the minimum rules for all firms and tables 2 and 3 set forth a framework for a more flexible application of the Code rules and principles. While we appreciate the concepts underlying these tables, we believe that additional guidance is required for asset managers to better understand how a proportionate approach could be structured and meet the requirements of the revised Code. Given FSA's recognition that asset managers invariably assume investment risk on an agency basis, some principles or rules may not even be applicable and guidance on such points would be useful. In particular, we urge FSA to confirm that asset managers will generally qualify to "explain" their remuneration policies, rather than "comply" with the prescriptive and in some cases, quantitative, provisions of certain principles, such as Principle 12.

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the investment adviser. The advisory contract also must be approved by a vote of shareholders and annually by the board of directors or the shareholders. The Advisers Act allows registered investment advisers to assess performance fees only in limited circumstances.

[9] Paper at 35 (4.2).

In addition, the tables in some cases are overlapping, although the standards for applying the principles or rules differ by table. It therefore may be helpful to better understand the expected framework for the approaches in tables 2 and 3 under which firms are expected to apply certain principles or rules in line with the nature, scope or complexity of their firm and/or on an "explain or comply" basis. We also believe that the approaches should be specifically set forth in the revised Code.[10]

Organizational Structures

Some asset managers are entities organized as partnerships or other legal structures, rather than corporations. Some are privately-held entities. Application of certain principles in the revised Code, such as Principles 8 and 12, in the context of these differing organizational structures will be especially challenging for many firms and may lead to disproportionate, and potentially undesirable, results.[11] We request, therefore, that the FSA recognize that organizational structures may pose unique challenges for firms and provide additional flexibility for such firms to comply with the principles and the revised Code.

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If you need any additional information, please contact the undersigned at 202-326-5813 (or solson@ici.org).

Sincerely,

/s/ Susan M. Olson

Susan M. Olson
Senior Counsel-International Affairs

[10] The FSA's authority to void contravening provisions of agreements makes it important that the principles and revised Code clearly set forth the proportionate approach.

[11] For example, some entities are structured as limited liability partnerships. Some of the principles, such as those regarding performance adjustments, deferrals, and share-based awards, could create significant tax consequences for partners in these partnerships.