

August 2009

House Passes Bill Regulating Investment Adviser Incentive-Based Compensation Arrangements

On July 31, 2009, the House of Representatives approved the “Corporate and Financial Institution Compensation Fairness Act of 2009” (H.R. 3269). Although the Bill primarily relates to “say on pay” practices for public companies, the Bill also requires the Securities and Exchange Commission and other Federal regulators to adopt rules requiring investment advisors and other covered financial institutions with assets of at least \$1 billion to disclose incentive-based compensation arrangements and prohibiting certain incentive-based payment arrangements. A copy of the Bill, which was initially introduced by House Financial Services Committee Chairman Barney Frank (D-MA) on July 21, 2009, is available [here](#).

Overview

The Bill provides that the “appropriate Federal regulators” jointly will prescribe regulations to require each “covered financial institution” to disclose the structures of all incentive-based compensation arrangements offered by that institution sufficient to determine whether the compensation structure:

→ is aligned with sound risk management;

- is structured to account for the time horizon of risks; and
- meets such other criteria as the appropriate Federal regulators jointly may determine to be appropriate to reduce unreasonable incentives offered by that institution for employees to take undue risks that could:
 - threaten the safety and soundness of covered financial institutions; or
 - have serious adverse effects on economic conditions or financial stability.

In addition, the Bill requires the appropriate Federal regulators to jointly prescribe regulations that prohibit any incentive-based payment arrangement, or any feature of any such arrangement, that the regulators determine encourages inappropriate risks by covered financial institutions that could:

- threaten the safety and soundness of covered financial institutions; or
- have serious adverse effects on economic conditions or financial stability.

In addition to the SEC, the “**appropriate Federal regulators**” include the Federal Reserve, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration and the Federal Housing Finance Agency.

“**Covered financial institutions**” include investment advisors (as defined by Section 202(a)(11) of the Investment Advisers Act of 1940) as well as depository institutions, registered broker-dealers, credit unions, Fannie Mae, Freddie Mac and any other financial institution that the appropriate Federal regulators, jointly, by rule determine should be treated as such.

The Bill does not apply to covered financial institutions with assets of less than \$1 billion. It is unclear whether this exemption refers to the direct assets of investment advisers or to the assets under management by investment advisers. In addition, disclosure is not required for the actual compensation of particular individuals and for covered financial institutions that do not have incentive-based payment arrangements. The Bill also prohibits recovery of incentive-based compensation under compensation

arrangements in effect on the date of enactment, as long as those compensation arrangements are for a period of no more than 24 months.

Status
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Although the Bill passed the House by a vote of 237–185, the prospects for the Bill being enacted into law are uncertain. The Bill has now been referred to the Senate Banking, Housing and Urban Affairs Committee. Although say-on-pay legislation (S.1074) was introduced in the Senate in May, the earlier Senate proposal remains in committee and does not include provisions relating to incentive compensation of investment advisors.

Given the Senate’s workload in advance of the August recess, it is unlikely that the Senate will take up the measure until after the August recess. If enacted into law, the SEC and other appropriate Federal regulators would have nine months to issue rules providing for additional guidance.

Additional Information
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The Hunton & Williams Private Investment Fund practice group regularly represents funds, sponsors and a variety of investors in all types of private investment fund matters, including structuring, formation, offerings and compliance. We will continue to monitor the progress of these proposals as

well as other relevant trends in private investment fund regulation.

The Hunton & Williams Government Relations team is equipped with the know-how and relationships to assist you in outreach to Congress if you would like to discuss your concerns regarding, and/or offer alternatives to, the proposals.

For additional information on recent proposals relating to regulation of private investment funds and their advisers, see our [prior memoranda](#) available on www.hunton.com.

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