Dechert LLP

Incentive Compensation Back Under the Regulatory Spotlight

A legal update from Dechert's Financial Services Group

June 2016

Incentive Compensation Back Under the Regulatory Spotlight

Six U.S. federal agencies[1] in late April and May revised and re-proposed rules that were originally proposed in 2011, to govern the incentive compensation practices at financial institutions with consolidated assets of at least $1 billion (covered institutions). The proposed rules include new – and more stringent – requirements, especially for the largest institutions. The rules will impact the compensation practices at a wide variety of financial institutions, including banks, broker-dealers and investment advisers, as well as the U.S. operations of foreign banking organizations.[2]

The proposed rules are designed to ensure that the interests of certain "covered persons" who receive incentive-based compensation at a financial institution are aligned with the longer-term health of the institution. Toward this end, under the proposed rules, a certain percentage of incentive compensation offered to "senior executive officers" and "significant risk-takers" at the largest organizations (*i.e.*, institutions with assets in excess of $50 billion) would generally be subject to forfeiture, downward adjustment and/or clawback for specified periods of time, so as to expose such persons to the same longer-term risks that may ultimately affect the financial institution.

In addition, covered institutions would be required to adopt robust corporate and risk management practices governing their incentive compensation programs, and comply with disclosure and recordkeeping requirements. This *OnPoint* provides a brief summary of the proposed rules and their impact on covered institutions, in a question and answer format.

Comparison to 2011 Proposal

What are the key differences from the 2011 proposed rules? The proposed rules differ from the Agencies' original proposal with respect to some essential features, including:

- The expansion of covered persons;
- The requirement that incentive-based compensation arrangements include non-financial measures of performance;
- Restrictions on the form and relative amount of incentive-based compensation;
- Expanded deferral and new clawback requirements;
- The replacement of annual reporting requirements with recordkeeping requirements; and
- Clarification that an investment adviser should not consider non-proprietary assets (*e.g.*, client assets under management) in determining the adviser's size for purposes of the proposed rules' thresholds, notwithstanding consolidation on the adviser's balance sheet.

---

1 The agencies are those responsible for implementing Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (collectively, Agencies): the Federal Deposit Insurance Corporation (FDIC); Federal Housing Finance Agency (FHFA); Board of Governors of the Federal Reserve System (FRB); National Credit Union Administration (NCUA); Office of the Comptroller of the Currency (OCC); and Securities and Exchange Commission (SEC).

2 While the Agencies have adopted a joint preamble that describes the background and purpose of the proposed rules, the Agencies have each proposed their own individual regulations.

Applicability

The proposed rules would govern the incentive-based compensation practices of covered institutions with respect to executive officers, employees, directors and principal shareholders (covered persons) – with progressively more rigorous and prescriptive requirements applying to "senior executive officers" and "significant risk-takers" at the largest institutions. As a general matter, the Agencies have found that incentive-based compensation programs may encourage inappropriate risk-taking at covered institutions if such entities do not sufficiently expose covered persons to the consequences of their risk decisions over time.

What compensation would be "incentive-based"? Under the proposed rules, "incentive-based compensation" would include any variable compensation, fees, or benefits that serve as an incentive or reward for performance, whether in the form of cash or non-cash payments. This definition does not include compensation that is paid "for reasons other than to induce performance," such as signing bonuses, compensation for continued employment, compensation related to the achievement of professional certifications, and dividends paid or appreciation realized on stock owned outright by an employee.

Which institutions would be "covered institutions"? The Agencies specify in their respective proposed rules which entities under their supervisory authority would be "covered institutions" subject to the proposed rules' requirements. Specifically, the following institutions would be governed by their appropriate Agency's proposed rule:

OCC	National banks, federal savings associations, and federal branches and agencies of foreign banks.
FRB	State member banks, bank holding companies, savings and loan holding companies, edge and agreement corporations, state-licensed uninsured branches and agencies of foreign banks, and the U.S. operations of foreign banks.
FDIC	State nonmember banks, state savings associations, and insured branches of foreign banks.
FHFA	Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.
NCUA	Credit unions.
SEC	Investment advisers[3] and registered broker-dealers.

Under each Agency's definition, an institution would be a covered institution only if it has $1 billion or more in "average total consolidated assets," as calculated below.

How would the proposed rules distinguish between different sizes of covered institutions? The proposed rules would distinguish between smaller and larger institutions based on their asset size. Specifically, the proposed rules would divide institutions into three asset levels as follows:

---

[3] The SEC's proposed rule would apply to any institution that meets the definition of "investment adviser" under the Investment Advisers Act of 1940, as amended, regardless of whether that institution is registered or exempted from registration.

	Average total consolidated asset amounts
Level 1	$250 billion or more
Level 2	At least $50 billion and less than $250 billion
Level 3	At least $1 billion and less than $50 billion

Many of the more detailed and rigorous requirements under the proposed rules would be reserved for larger institutions that fit within Level 1 or Level 2, including mandatory deferral, forfeiture and clawback requirements, as described in further detail below.

While the proposed rules would not apply to institutions with assets of less than $1 billion, over time the rules are likely to become viewed by the Agencies as "best practices" and, as often happens with size-based regulation, eventually may be applied on a *de facto* basis to smaller, community institutions.

How would an institution calculate its "average total consolidated assets"? For covered institutions other than investment advisers, average total consolidated assets would be calculated by averaging the total consolidated assets disclosed in regulatory reports for the four most recent consecutive quarters or, if less than four reports are available, for the most recent quarter(s).

How would an investment adviser calculate its "average total consolidated assets"? For investment advisers, average total consolidated assets would be the adviser's total assets as of its most recent fiscal year-end. Total assets would exclude non-proprietary assets, such as client assets under management. In clarifying that investment advisers should include only proprietary assets, the SEC responded to concerns that the 2011 proposed rules would have reached more investment advisers than seemingly intended by, for example, including third-party assets in private funds consolidated on the adviser's balance sheet pursuant to GAAP. In light of this clarification, only a relatively small percentage of investment advisers would be subject to the SEC's proposed rule.[4]

However, the preamble to the proposed rules notes that separate investment advisers that are operationally integrated would be treated as a single entity, and the assets of the investment advisers would be consolidated for purposes of determining whether the entity is a covered institution.

Historically, the SEC staff position provided a safe harbor from the consolidation of an investment adviser with an affiliated adviser if the entities: (i) have a buffer, such as independent boards of directors, boards of managers or separate managing members; (ii) have employees, officers and directors who, if engaged in providing advice in the day-to-day business of the investment adviser, are not otherwise engaged in an investment advisory business of the affiliated adviser; (iii) are adequately capitalized and operated as independent businesses; (iv) have adequate information security policies and procedures in place to protect investment advisory information from disclosure to the affiliated adviser; and (v) maintain physical separation.[5] Notably, these factors only constitute a traditional safe

---

4 The SEC estimates that of the 11,702 investment advisers registered as of December 31, 2014, 669 would be covered institutions and, of that number, only 18 would be Level 1 covered institutions and 21 would be Level 2 covered institutions. See Incentive Compensation Arrangements, Securities Exchange Act of 1934 Release No. 77,776, 81 Fed. Reg. 37670 (June 10, 2016) (SEC Rule) at 37,753.

5 *See, e.g.,* Richard Ellis, SEC No-Action Letter (pub. avail. Sept. 17, 1981); Mark A. Bush, SEC No-Action Letter (pub. avail. Aug. 8, 1995); Hoguet, Muzinich, Keller Asset Mgmt. Co., Inc., SEC No-Action Letter (pub. avail. Feb. 24, 1988); and Thomson Advisory Group L.P., SEC No-Action Letter (pub. avail. Sept. 26, 1995).

harbor, and failing to meet them would not necessarily mean that two or more entities would be integrated. Instead, the preamble cites directly to a recent administrative enforcement action, where the SEC treated two affiliated investment advisers as operationally integrated in light of three similar considerations: (i) the entities were under common control; (ii) they shared employees, including individuals who provided investment advice on behalf of both entities; and (iii) they had significantly overlapping operations, without policies and procedures designed to keep such operations separate, as reflected in the entities' combined marketing efforts.[6]

The SEC's views on operational integration are important with respect to investment advisers of private equity and hedge funds that often organize special purpose vehicles (SPVs) to serve as general partners and/or investment advisers to specific funds. In addition, investment advisers with families of SPVs will need to be mindful of the fact that, to the extent the SPVs are operationally integrated with the parent entity, carried interest held by an SPV will need to be consolidated with the investment adviser's total assets.[7] Accordingly, investment advisers of private equity and hedge funds will need to be especially attentive in calculating their total assets to determine compliance under the proposed rules.

Do the proposed rules make distinctions between different types of covered persons? Certain prohibitions and requirements in the proposed rules would apply to all executive officers, employees, directors, and principal shareholders who receive incentive-based compensation at a covered institution. However, most of the more stringent requirements, including the deferral, forfeiture and clawback provisions, would apply only to "senior executive officers" and "significant risk-takers" at Level 1 and Level 2 covered institutions.

- **Senior executive officers:** A "senior executive officer" would include any covered person who, for a period of time during the relevant performance period, held the title or performed the functions of one or more of the following positions: president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, chief compliance officer, chief audit executive, chief credit officer, chief accounting officer, or head of a major business line or control function.

- **Significant risk-takers:** A "significant risk-taker" generally would include a covered person, other than a senior executive officer, who received at least one-third of his or her compensation for the last calendar year in incentive-based compensation, and (i) was among the top 5% (for Level 1 covered institutions) or top 2% (for Level 2 covered institutions) of the most highly compensated covered persons (excluding senior executive officers) at the entire consolidated organization or (ii) had authority to commit or expose 0.5% or more of the capital of a covered institution to market or credit risk. An Agency may designate additional covered persons as significant risk-takers if the Agency determines such persons could expose a covered institution to the risk of material financial loss.

Basic Prohibitions Applicable to all Covered Institutions

The proposed rules would prohibit any covered institution from establishing or maintaining incentive-based compensation arrangements (arrangements) that encourage inappropriate risks at the covered institution (i) by

6 *See* TL Ventures Inc., Investment Advisers Act Release No. 3859 (June 20, 2014).

7 As explained below, investment advisers that are affiliated with depository institution holding companies and that are covered institutions will have to take into account the total consolidated assets of their affiliates when determining whether the adviser is a Level 1, Level 2 or Level 3 institution.

providing a covered person with "excessive" compensation or (ii) that could lead to "material financial loss" at the institution.[8]

When is compensation "excessive"? An arrangement would be considered excessive when amounts paid are unreasonable or disproportionate to the value of the covered person's services, taking into consideration all relevant factors, including, but not limited to:

- The combined value of all compensation, fees or benefits provided to the covered person;
- The compensation history of the covered person and other individuals with comparable expertise at the covered institution;
- The financial condition of the covered institution;
- The compensation practices at comparable institutions;
- For post-employment benefits, the projected total cost and benefits to the covered institution; and
- Any connection between the covered person and any fraudulent act or omission, breach of trust or fiduciary duty, or insider abuse with regard to the covered institution.

What arrangements could lead to "material financial loss"? An arrangement would be deemed to encourage inappropriate risks that could lead to material financial loss at the covered institution unless the arrangement: (i) appropriately balances risk and reward; (ii) is compatible with effective risk management and internal controls; and (iii) is supported by effective corporate governance by the institution's board of directors (board).

- **Balancing risk and reward in the arrangement.** An arrangement achieves balance between risk and financial reward when the amount of incentive-based compensation ultimately received by a covered person depends not only on his or her performance, but also on the risks taken in achieving that performance. For example, an arrangement that determined compensation amounts based upon performance measures that are closely tied to short-term revenue or profit generated by a covered person, without any adjustment for the longer-term risks associated with obtaining such revenue or profit, would impermissibly encourage inappropriate risks that could lead to material financial loss. The proposed rules would require a properly structured arrangement to: (i) include financial and non-financial measures of performance, including considerations of risk-taking; (ii) allow non-financial measures of performance to override financial measures when appropriate; and (iii) allow downward-adjustment of any amounts awarded to reflect actual losses, inappropriate risks taken, compliance deficiencies or other measures or aspects of performance.
- **Effective risk management and internal controls**. An arrangement must be reinforced by effective risk management and internal controls that act as separate checks on a covered person's risk-taking. Specifically, institutions must appropriately design, implement, and monitor compliance processes that ensure the balance

8 In formulating standards to implement these prohibitions, the Agencies have been guided by standards relating to excessive compensation contained in Section 39(c)(2) of the Federal Deposit Insurance Act, as well as joint guidance published by the banking agencies in 2010 with respect to arrangements that could lead to the risk of material financial loss. See Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36,395 (June 25, 2010).

of risk and reward of their arrangements. The Agencies expect the nature of these functions to vary by the size and complexity of the institution, as well as the activities of the covered persons.

- **Effective governance by the board.** An arrangement must be supported by an effective governance framework. Under the proposed rules, a covered institution's board (or a committee thereof) would be required to: (i) conduct oversight of the institution's incentive-based compensation program; (ii) approve arrangements for senior executive officers (including the amounts *and*, at the time of payment, the release of the awards to the senior executive officers); and (iii) approve any material changes to incentive-based compensation policies and procedures for senior executive officers.

Notably, the above factors are only minimum requirements that the Agencies would jointly establish under the proposed rules. Each Agency may establish additional factors going forward.

Disclosure and recordkeeping. Each covered institution would be required to create annually, and maintain for at least seven years, records that document the structure of its arrangements and demonstrate their compliance with the proposed rules. These records would need to include, at a minimum: copies of all incentive-based compensation plans; a list of persons subject to each plan; and a description of how the incentive-based compensation program is compatible with effective risk management and internal controls. The required records would not need to state the actual amounts of compensation received by individual covered persons. An institution would be required to disclose records to its appropriate Agency upon request.

Additional Requirements Applicable to Level 1 and Level 2 Covered Institutions

The proposed rules would impose additional requirements on all Level 1 and Level 2 covered institutions, which more generally rely on incentive-based compensation programs than Level 3 institutions.[9] Namely, Level 1 and Level 2 covered institutions would need to include a number of features that allow for the reduction of an award or payment in light of information that develops during and after the arrangement's specified performance period. To this end, the proposed rules would require arrangements for senior executive officers and significant risk-takers at Level 1 and Level 2 covered institutions to include: (i) deferral; (ii) downward adjustment and forfeiture; and (iii) clawback features with respect to any incentive-based compensation amounts.

Deferral features. Under the proposed rules, a portion of the incentive-based compensation to senior executive officers and significant risk-takers must be deferred for a period of time after the relevant performance period. Level 1 covered institutions would be required to defer a greater amount of incentive-based compensation for a longer period than Level 2 covered institutions, reflecting the view of the Agencies that arrangements of the largest organizations generally present the greatest risks to the financial system.

- **Level 1 covered institutions:** Each Level 1 covered institution would be required to defer at least 60 percent of a senior executive officer's and 50 percent of a significant risk-taker's incentive-based compensation for at least four years from the end of the arrangement's performance period. If the applicable performance period is

[9] It is important to note that the appropriate Agency could require a Level 3 institution with average total consolidated assets of at least $10 billion to comply with some or all of the additional requirements imposed on Level 1 and 2 institutions, if the Agency determines that the complexity of its operations (e.g., due to off-balance sheet activities) or compensation practices of the Level 3 institution are consistent with those of a Level 1 or 2 institution. The proposed rules note that the Agencies would expect to use this authority infrequently.

at least three years (thereby constituting a "long-term incentive plan" under the proposed rules), then the deferral period would be reduced to two years from the end of the performance period.

- **Level 2 covered institutions**: Each Level 2 covered institution would be required to defer at least 50 percent of a senior executive officer's and 40 percent of a significant risk-taker's incentive-based compensation for at least three years after the end of the arrangement's performance period. For long-term incentive plans, this deferral period would be reduced to one year. For a summary of the required deferral features, see the Appendix.

Deferred compensation could "vest" – in the sense that it would no longer be susceptible to reduction except through the clawback feature summarized below – no faster than on a *pro rata* annual basis during the deferral period.[10] Institutions would not be able to accelerate the payment of deferred incentive-based compensation amounts, except in the case of death or disability of the covered person.

For institutions that issue equity or are affiliated with institutions that issue equity, deferred compensation would need to be composed of at least "substantial portions" of both deferred cash and equity-like instruments. The Agencies believe that having incentive-based compensation in the form of equity-like instruments can align the interests of senior executives and significant risk-takers with the interests of the covered institution's shareholders. The Agencies have not defined the meaning of "substantial portion" in this context, so as to provide institutions with flexibility in designing their incentive-based compensation programs, but have requested comment on whether they should do so.

Additionally, if a senior executive officer or significant risk-taker receives incentive-based compensation in the form of options, such options may not account for more than 15 percent of the total incentive-based compensation used to meet the minimum required deferral amounts stated above. This limitation would have the effect of reducing the attraction of using options as a form of incentive-based compensation, but does not limit the amount of options a covered institution may grant to its employees.

Institutions should take care to structure the required compensation deferrals in accordance with Section 409A of the Internal Revenue Code of 1986, which comprehensively governs the taxation of nonqualified deferred compensation. Failure to do so could result in a senior executive officer or significant risk-taker becoming subject to accelerated income taxation plus a 20 percent additional tax.

Downward adjustment and forfeiture features. The proposed rules would require that all deferred incentive-based compensation to senior executive officers and significant risk-takers at Level 1 or Level 2 covered institutions be susceptible to reviews for (i) downward adjustment during an arrangement's performance period prior to an award being made and (ii) forfeiture of an unvested amount during its deferral period. An institution would be required to consider reducing some or all of a senior executive officer's or significant risk-taker's un-awarded and unvested

---

10 For example, applying the above framework, a senior executive officer at a Level 1 covered institution receiving $100,000 in incentive-based compensation for a single-year performance period would have $60,000 of his or her compensation deferred, with: a maximum of $15,000 vesting upon the first-year anniversary of the performance period's end; a cumulative maximum of $30,000 vesting upon the second-year anniversary; a cumulative maximum of $45,000 vesting upon the third-year anniversary; and a cumulative maximum of $60,000 vesting upon the fourth-year anniversary.

deferred incentive-based compensation upon the occurrence of certain adverse events affecting the institution.[11] In considering such a reduction, the institution must consider a variety factors, including:

- The intent of the senior executive officer or significant risk-taker to operate outside the institution's board-approved risk governance framework or to depart from the institution's policies and procedures;
- The senior executive officer's or significant risk-taker's level of participation in, awareness of, and responsibility for, the events triggering the review;
- Any actions the senior executive officer or significant risk-taker took or could have taken to prevent the events triggering the review;
- The financial and reputational impact of the events triggering the review on: the institution; the line or sub-line of business; and individuals involved, as applicable, including the magnitude of any financial loss and the cost of known or potential subsequent fines, settlements, and litigation;
- The causes of the events triggering the review, including decision-making by other individuals; and
- Any other relevant information, including past behavior and risk outcomes linked to past behavior attributable to the senior executive officer or significant risk-taker.

Clawback features. The proposed rules would require that all vested incentive-based compensation to senior executive officers and significant risk-takers at Level 1 or Level 2 covered institutions be susceptible to clawback for a period of no less than seven years following the date on which such compensation vests, regardless of whether the senior executive officer or significant risk-taker remains an employee at the institution. In order to exercise clawback of vested compensation, the institution would need to determine that the senior executive officer or significant risk-taker engaged in: (i) misconduct resulting in significant financial or reputational harm to the institution (whether in the eyes of customers, shareholders, creditors or even the general public); (ii) fraud; or (iii) intentional misrepresentation of information involved in determining the senior executive officer's or significant risk-taker's incentive-based compensation.

Additional prohibited practices at Level 1 and Level 2 covered institutions. In addition to the features summarized above, the proposed rules would impose a number of prohibitions on Level 1 and Level 2 covered institutions with respect to certain practices that could expose a covered institution to material financial loss, including:

- **No hedging to offset losses in incentive-based compensation.** Institutions would not be able to purchase hedging or similar instruments on behalf of a covered person to offset decreases in his or her compensation amounts.

[11] At a minimum, adverse events at a covered institution triggering a review would include: (i) poor financial performance attributable to a significant deviation from the risk parameters set forth in the institution's policies and procedures; (ii) inappropriate risk-taking, regardless of the impact on financial performance; (iii) material risk management or control failures; and (iv) non-compliance with statutory, regulatory or supervisory standards that results in an enforcement action brought by a federal or state regulator or a restatement of the institution's financial statements to correct a material error.

- **Maximum awards would be capped relative to established target amounts.** For senior executive officers, compensation awards could not exceed target amounts (as established by the institutions) by more than 125 percent; for significant risk-takers, awards could not exceed target amounts by more than 150 percent.

- **Some performance measures would need to be absolute rather than relative.** With respect to all covered persons, arrangements could not be based solely on industry peer performance comparisons. Relative performance measures could be used only in combination with absolute performance measures.

- **Incentive-based compensation amounts could not be based solely on volume**. Arrangements that are based on volume would also need to consider transaction quality or compliance with sound risk management as factors in the determination of incentive-based compensation amounts.

Additional risk management, governance, and recordkeeping requirements. The proposed rules would impose additional requirements on Level 1 and Level 2 covered institutions with respect to risk management, governance and record-keeping requirements. In particular:

- **Independent risk management and monitoring framework.** Arrangements would need to be supported by independent risk management and monitoring frameworks, staffed by individuals both appropriately insulated from, and with the authority to influence risk-taking in, business areas they monitor.

- **Board compensation committee.** Arrangements would need to be further supported by a board compensation committee composed solely of directors who are not senior executive officers. The compensation committee would assist the board in carrying out its responsibilities under the proposed rules and would need to be informed by written assessments from management.

- **Additional disclosure and recordkeeping.** In addition to the disclosure and recordkeeping requirements applicable to all covered institutions, a Level 1 or Level 2 covered institution would need to create annual records that include: (i) a descriptive list of its senior executive officers and significant risk-takers; (ii) certain information about all arrangements for senior executive officers and significant risk-takers; (iii) any adjustment, forfeiture, or clawback review and decision (including rationale) regarding senior executive officers and significant risk-takers; and (iv) any material changes to the institution's incentive-based compensation arrangements or policies.

Policies and procedures. Under the proposed rules, Level 1 and Level 2 covered institutions would be required to develop and maintain detailed policies and procedures that implement all of the above-mentioned requirements and prohibitions.

Applicability to Multiple Covered Institutions within the Same Organization

Would the rules apply to subsidiaries of "covered institutions"? As a general matter, subsidiaries of covered institutions would be subject to the proposed rules if the subsidiary itself was a covered institution. For example, a $1.5 billion asset broker-dealer subsidiary of a large depository institution holding company would be subject to the proposed rules, whereas a $500 million asset broker-dealer subsidiary of the holding company would not be. As discussed below, the subsidiary would generally be subject to the same requirements as its parent holding company, depending on the asset size of the parent.

How would the rules consider subsidiaries and other affiliates in determining the sizes of covered institutions? A covered institution governed by the FRB's proposed rule would become a Level 1, Level 2, or Level 3 covered institution when its average total consolidated assets *or* the average total consolidated assets of any of its affiliates equals or exceeds $250 billion, $50 billion, or $1 billion, respectively. Under the OCC's proposed rule, a covered institution that is a subsidiary to either a depository institution holding company or another covered institution governed by the OCC's rule would be considered as the same level as its parent covered institution. Similarly, under the FDIC's proposed rule, a covered institution that is a subsidiary to a depository institution holding company or another covered institution governed by the FDIC's rule would be considered the same level as its parent covered institution. Under the SEC's proposed rule, however, a covered institution would generally be considered the same level as its parent *only if* the parent is a depository institution holding company.

As an example with respect to the above rules, consider a bank holding company (BHC) with $300 billion in total consolidated assets with the following subsidiaries: a national bank with $100 billion in assets, an investment adviser with $1 billion in assets, and another investment adviser with $100 million in assets. In this scenario, the subsidiary investment adviser with $1 billion in assets and the national bank with $100 billion in assets would each be a Level 1 rather than a Level 3 or Level 2 covered institution, respectively, as they adopt the level of their parent depository institution holding company. However, the subsidiary investment adviser with $100 million in assets would not be a covered institution, unless the SEC determined that its operations were sufficiently integrated with the operations of the investment adviser with over $1 billion in assets.

How would the rules affect asset managers and investment companies? The SEC's proposed rule could affect portfolio manager compensation. The proposed rule would prescribe certain limitations and conditions on incentive-based compensation for the chief investment officer of an investment adviser and any employees whose compensation is in the top 2% to 5% (depending on the size of the adviser) of the entire consolidated organization. To the extent portfolio managers fit either of those categories, their compensation could be affected. The proposed rule would generally not impact investment companies because they are not covered institutions, nor are they generally viewed by the FRB as controlled by a bank-affiliated adviser. However, an investment company could be indirectly affected to the extent its portfolio manager is a covered person and his or her compensation is subject to the rule. The Agencies also specifically requested comment as to the treatment of investment companies under the proposed rule.

Comment Period and Proposed Compliance Date

The comment period for the proposed rules closes on July 22, 2016. If adopted, the proposed rules would have a compliance date of the first calendar quarter that begins at least 540 days after the final rules are published in the Federal Register. Thus, if the final rules were published on November 1, 2016, covered institutions would be required to begin complying with them on July 1, 2018.

APPENDIX

REQUIRED DEFERRAL OF INCENTIVE COMPENSATION

Type of Covered Institution/Person	Qualifying Incentive-based Compensation[1]		Incentive-based Compensation Awarded Under Long-term Incentive Plan[2]	
	% Deferred	Deferral Period	% Deferred	Deferral Period
Level 1 Covered Institution				
Senior Executive Officer[3]	60%	4 years	60%	2 years
Significant Risk-taker[4]	50%	4 years	50%	2 years
Level 2 Covered Institution				
Senior Executive Officer[3]	50%	3 years	50%	1 year
Significant Risk-taker[4]	40%	3 years	40%	1 year

1 Qualifying Incentive-based Compensation means the amount of incentive-based compensation awarded to a covered person for a particular performance period, excluding amounts awarded to the covered person for that particular performance period under a long-term incentive plan.

2 Long-term Incentive Plan means a plan to provide incentive-based compensation that is based on a performance period of at least three years.

3 Senior Executive Officer means a covered person who, for a period of time during the relevant performance period, held the title or performed the functions of one or more of the following positions: president, chief executive officer, executive chairman, chief operating officer, chief financial officer, chief investment officer, chief legal officer, chief lending officer, chief risk officer, chief compliance officer, chief audit executive, chief credit officer, chief accounting officer, or head of a major business line or control function.

4 Significant Risk-taker means a covered person other than a senior executive officer who received at least one-third of his or her compensation for the last calendar year in incentive-based compensation and (i) was among the top 5% (for Level 1 covered institutions) or top 2% (for Level 2 covered institutions) of the most highly compensated persons (excluding senior executive officers) at the entire consolidated organization (*i.e.*, the covered institution and its affiliated covered institutions) or (ii) had authority to commit or expose more than 0.5% or more of the capital of a covered institution to market or credit risk.

This update was authored by:

David L. Ansell
Partner
Washington, D.C.
+1 202 261 3433
Send email

David J. Harris
Partner
Washington, D.C.
+1 202 261 3385
Send email

David A. Vaughan
Partner
New York/Washington, D.C.
+1 212 698 3540 (NYC)
+1 202 261 3355 (WAS)
Send email

Robert J. Rhatigan
Associate
Washington, D.C.
+1 202 261 3329
Send email

Erica Evans
Associate
Washington, D.C.
+1 202 261 3383
Send email

Talita Kiper
Associate
Washington, D.C.
+1 202 261 3319
Send email

Neema Nassiri
Associate
New York
+1 212 641 5633
Send email