

Hedge Fund Alert

THE WEEKLY UPDATE ON FUND MANAGEMENT INTELLIGENCE

Execs: FTC Non-Compete Ban Would Threaten Proprietary Protections, Lead to Staff Defections

Hedge fund industry executives are calling the **Federal Trade Commission's** proposal to ban non-compete provisions in employee contracts a potential "game changer" because many firms rely heavily on the tactic to protect time-sensitive securities positions and trading algorithms and to curb staff turnover.

Any new regulation will take time to draft and implement following a 60-day period of public comment that ends in early March. The lobbying group **Managed Funds Association**, for example, plans to submit comments opposing the ban. In addition, there are likely to be court challenges, which could take years to resolve.

Still, industry participants note the proposal could potentially tip the balance of leverage toward employees over C-suite executives trying to protect their competitive advantages – with quant shops perhaps most at risk.

As it stands, the proposal "would be a very significant game changer for hedge fund managers," said **Anne Patin**, a partner at **Seward & Kissel** in New York. "Despite non-competes coming under increasing disfavor by courts, they are still widely adopted in the financial industry, especially among hedge funds."

Furthermore, the proposed ban's scope calls into question other employment provisions that function similarly to non-compete clauses. They include non-solicit provisions and deferred compensation plans, which an employer can withhold until the former employee sits out the full duration of the non-compete. "We expect to see challenges and requests for clarification on that point, as employers would not want to test their clauses in court," Patin said.

The FTC is exceeding its jurisdiction in its broad outlawing of non-compete agreements, according to **Bryan Corbett**, president and chief executive of the MFA, based in Washington D.C.

"Non-compete agreements in the alternative asset management space are essential to protect intellectual property and play a fundamentally different role than in other industries," Corbett said. "MFA plans to submit comments to the FTC and work with other market participants to highlight the importance of non-competes for healthy competition in the industry."

The most vulnerable to such a ban appear to be quantitative investment shops, which tout proprietary algorithms designed by scores of software engineers and programmers. Also, large multi-strategy operations – which pick off one another's portfolio managers on a regular basis – are notorious for lengthy non-compete restrictions, recruiters said.

Non-competes at multi-strategy firms typically range from six months to a year but can stretch to two years, said executive recruiter **Brett Finer**, founder of **Finer Recruiting** in Harrington Park, N.J. Those restrictions severely hamstring people's careers, he said.

"Someone's aggressive non-compete may at times get in the way of my candidates receiving an offer. Most folks [employers] want someone to start right away," Finer said.

Another recruiter said he "could not imagine some of the bigger multi-strats not fighting this."

Indeed, a top executive at one multi-strategy firm, while acknowledging some abuse of non-competes by the industry, said companies need to protect their businesses in a competitive landscape.

"The blanket ban of non-competes demonstrates the lack of commercial mindset of the FTC," he said.

A portfolio manager at a fixed-income shop said hedge fund firms should be able to prevent departing managers from revealing active securities positions used by their former shops. A non-compete at least lets the positions become stale before they can be copied by another manager.

Recruiters – who often get paid on a commission tied to a candidate's first-year salary – largely were bullish on the proposal.

"Selfishly, I certainly hope it goes through as I see it being a potential boon for recruiting," one headhunter said. Such a ban would spur competition for talent and

drive up compensation, the recruiter said, while striking non-compete clauses from contracts would encourage more employees to risk exploring other opportunities.

“All else being equal, if this ban goes through, in my opinion it should push up compensation packages for candidates,” said **Natasha Moore**, a partner at recruiting firm **Atlantic Group** in Stamford, Conn.

Another recruiter, **Andrea Colabella** of **Cardea Group** in New York, noted that firms can still build into contracts language to protect confidentiality and trade secrets. Firms also can add wording to prevent departing employees from soliciting former colleagues.

The proposed ban contains – save for the sale of a business by an owner – no exceptions for specific industries, nor does it make a distinction between high-wage or low-wage employees. Also, the ban would be applied retroactively, which means existing employees would no

longer be subject to the non-competes they signed when they were hired. It’s likely this feature will be challenged as well, lawyers said.

Non-compete clauses long have been a source of contention. They have been tough for employers to enforce recently in several states including New York, lawyers said. Other states already are considering or enacting legislation to limit or obliterate non-competes and might feel emboldened by the FTC’s proposal, Patin said.

The proposal is the result of a Biden administration agenda to spur competition. Following the release of the FTC’s proposal, **President Joe Biden** tweeted on Jan. 5: “For decades, I’ve fought for the notion that if your employer wants to keep you, they need to make it worth your while with good pay and benefits. Consistent with my Executive Order, today’s FTC announcement ... is a huge win for workers.” ■