MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

July 19, 2016

By email : labourmarket.consultations@bis.gsi.gov.uk

Ms. Paula Lovitt
Labour Market Directorate
Department of Business Innovation and Skills
1 Victoria Street
London
SW1H 0ET

Response to Department of Business Innovation and Skills "Call for Evidence" on UK Non-compete Clauses (May 2016)

Dear Ms Lovitt:

Managed Funds Association ("**MFA**")[1] welcomes the opportunity to provide evidence on behalf of its members on the operation and impact of non-compete provisions within the UK alternative investment industry. Our members are located globally, but a significant number of them have operations in the UK.

MFA believes that the judicious use of non-competes in employment contracts provides effective and necessary protection to employers for their proprietary information and their investment in client relationships and staff. MFA believes that the non-compete framework in the UK is generally consistent with the law in the other key jurisdictions in which the industry operates, and that the approach by the UK to employment practices, including on this topic, have contributed to its status as a leading global financial center.

We respond to the questions which are most relevant to our members as follows:

1. Examples of non-compete clauses

The examples given are all recognisable as non-compete clauses. In addition to the clauses listed we are also aware of a number of alternative restrictive mechanisms in operation:

- separate provisions prohibiting the "solicitation" of customers and clients. These are considered less restrictive than "non-deal" provisions;

[1] Managed Funds Association ("MFA") represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

- provisions prohibiting the interference with valuable supplier or other relationships;

- provisions in settlement agreements where secondary and tertiary tranches of settlement payments are forfeited if the employee joins a competitor; and

- the use of lengthy notice periods, often in conjunction with garden leave clauses.

2. The prevalence of non-competes in the UK

How often are non-competes used by the alternative investment industry?

Non-competes are commonly used in the industry for senior staff and, more occasionally, for junior staff particularly if those staff work in client or sector teams which handle valuable client and trade connections of the employer or are exposed to proprietary information.

Many of our members are established as limited liability partnerships ("**LLPs**") and routinely use non-competes in LLP agreements to restrict members. If the reference to 'workers' in this Call for Evidence is intended to extend its scope to cover LLP members, we would view that as potentially conflicting with one of the principal benefits of the LLP structure, which is the flexibility it allows to govern arrangements between partners.

Why does the industry use them?

Non-competes are used largely to protect confidential information, valuable client connections, and the stability of a highly trained and skilled workforce. Restrictions, particularly ones of any significant duration, are typically limited to the contracts of highly sophisticated senior staff with extensive experience in the industry. In entering into these agreements, these staff typically have the opportunity to consult, or are represented by, counsel who provide legal advice and negotiate the terms of the non-compete on their behalf.

- *Protecting confidential information*

  Many managers have invested substantial resources in the development of highly proprietary, confidential information that serves as a basis for their investment strategy. Such highly confidential information often cannot be protected through intellectual property law or with non-solicitation or non-dealing provisions. In cases where employees seek to join competitor fund managers, the confidential information they possess about their prior employer's business could allow them to compete unfairly and seriously damage the investment strategy of their previous employer. In these cases, it is impossible to police the use of confidential information and the only effective non-compete is one which prohibits the employee joining the competitor fund manager for a limited period.

- *Protecting investor (client) relationships*

  Certain staff also work directly with investors (essentially the client base) over long periods of time to develop an in-depth knowledge of their requirements. These relationships with institutional investors (e.g. pension funds) are built up using the

fund manager's resources and nurtured at the fund manager's expense. To a large extent these employees are the face of the business to these investors and the loss of these relationships can result significant economic harm to managers. The industry therefore views these connections as a proprietary interest which they are entitled to protect with provisions which prohibit the solicitation of, or dealing with relevant investors.

- *Maintaining a stable workforce*

The knowledge built up within the workforce and their teams is highly valuable to MFA members. The alternative investment industry requires managers with the skills to implement and oversee complex and bespoke investment strategies across a wide range of financial instruments. In addition to the extensive client knowledge employees build up during their employment, fund managers also invest substantial sums in training these staff. Often these highly-skilled teams are the sole or principal custodians of very valuable relationships, which means that maintaining and protecting the stability of these teams is a key concern for our members. The industry uses a combination of provisions to protect against staff poaching; for example clauses that prohibit senior staff from inducing staff to leave with them (team moves), together with provisions which prevent junior staff from joining competitors for a limited period. The use of these provisions can prevent a competitor from gaining an unfair advantage by recruiting unrestricted junior team members when only the more senior staff are bound by non-competes.

3. Have you as an employer used a non-compete?

The majority of our members use non-competes in some capacity. Please refer to the answer to 2 above for more details as to why.

4. Have you been influenced in a decision to hire or not hire someone by the terms of an existing non-compete?

The use of non-competes is standard practice in the industry particularly at the more senior level. This means our members are alive to the potential problems which might occur if a hire is made in breach of a non-compete.

Where there is a competitive scenario, members will abide by the non-compete and reach agreement as to the timing and the framework of any hire. In all but the most sensitive hires any delay on hiring is not likely to be more than 6 months (at the outside, 12) and, because they are so routinely used, this delay tends to be planned for in the hiring process. This means that while some hires may be delayed because of non-competes, it is seldom the case that they are not made at all.

5. Could there be any repercussions or unintended consequences if Government restricted some forms of non-compete clauses?

In the view of our members the answer to this is "yes".

There is an expectation among our members (and their employees) that non-competes will be used in employment contracts to protect business interests. This means that hiring processes will usually take account of this in terms of any effect on timing. Generally speaking, our members view any delay or difficulty caused by non-competes as appropriately

balanced by the comfort of knowing that the proprietary interests at risk when employees leave are protected to some degree.

In this sense it is the view of our members that non-competes promote an orderly and relatively efficient recruitment market in the industry. Non-competes mean that employers can entrust their staff with oversight of strategically important information in the knowledge that they will have some measure of protection if staff leave. Employers can also rely on non-competes to facilitate negotiations with departing employees (and/or their prospective employers) to achieve mutually satisfactory outcomes.

If managers were prevented from relying on non-competes businesses would be vulnerable to the loss of critical proprietary information and relationships. In many cases intellectual property law would not provide sufficient protection for certain business interests. It is therefore possible that managers could seek alternative methods to protect their proprietary interests, which could include an increase in the length of notice periods and garden leave provisions, a more monitored workplace, and additional efforts to protect confidential information.

6. In your experience are non-compete clauses transparent?

Yes. Employees in the alternative investment industry are highly knowledgeable about the effects and implications of non-competes and their use in contracts is standard and understood. Employees typically have the opportunity to consult, or are represented by, counsel with experience in the terms of non-competes.

Equally, employers understand the use of non-competes (and their limitations). They are often used as a platform for negotiation and are often offset by any period an employee has spent on "garden leave".

Generally non-competes are regarded as a useful tool which can protect connections and information that are not otherwise protectable under intellectual property law or the law of confidence. Except where they are clearly unreasonable, it is in the interests of our members recruiting staff to observe non-competes because this helps maintain a certain level of comfort and trust within the industry which can actually facilitate the recruitment process. We believe the existing framework is effective for employees and employers and is relied upon by the industry.

* * * * *

MFA appreciates the opportunity to provide comments on this Call for Evidence. We would welcome the opportunity to discuss further the relevant issues with the Department of Business Innovation and Skills. If you have any questions, please do not hesitate to contact Matthew Newell, Associate General Counsel, or the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director, General Counsel
Managed Funds Association