

§ 275.205-2

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$$\frac{4.43 + 1.50}{47.41} = 12.51 \text{ percent}$$

(Secs. 205, 211, 54 Stat. 852, 74 Stat. 887, 15 U.S.C. 80b-205, 80b-211; sec. 25, 84 Stat. 1432, 1433, Pub. L. 91-547)

[37 FR 17468, Aug. 29, 1972]

§ 275.205-2 Definition of “specified period” over which the asset value of the company or fund under management is averaged.

(a) For purposes of this rule:

(1) *Fulcrum fee* shall mean the fee which is paid or earned when the investment company’s performance is equivalent to that of the index or other measure of performance.

(2) *Rolling period* shall mean a period consisting of a specified number of subperiods of definite length in which the most recent subperiod is substituted for the earliest subperiod as time passes.

(b) The specified period over which the asset value of the company or fund under management is averaged shall mean the period over which the investment performance of the company or fund and the investment record of an appropriate index of securities prices or such other measure of investment performance are computed.

(c) Notwithstanding paragraph (b) of this section, the specified period over which the asset value of the company or fund is averaged for the purpose of computing the fulcrum fee may differ from the period over which the asset value is averaged for computing the performance related portion of the fee, only if:

(1) The performance related portion of the fee is computed over a rolling period and the total fee is payable at the end of each subperiod of the rolling period; and

(2) The fulcrum fee is computed on the basis of the asset value averaged over the most recent subperiod or subperiods of the rolling period.

(Secs. 205, 106A, 211; 54 Stat. 852, 855; 84 Stat. 1433, 15 U.S.C. 80b-5, 80b-6a, 80b-11)

[37 FR 24896, Nov. 22, 1972]

§ 275.205-3 Exemption from the compensation prohibition of section 205(a)(1) for investment advisers.

(a) *General.* The provisions of section 205(a)(1) of the Act (15 U.S.C. 80b-5(a)(1)) will not be deemed to prohibit an investment adviser from entering into, performing, renewing or extending an investment advisory contract that provides for compensation to the investment adviser on the basis of a share of the capital gains upon, or the capital appreciation of, the funds, or any portion of the funds, of a client, *Provided*, That the client entering into the contract subject to this section is a qualified client, as defined in paragraph (d)(1) of this section.

(b) *Identification of the client.* In the case of a private investment company, as defined in paragraph (d)(3) of this section, an investment company registered under the Investment Company Act of 1940, or a business development company, as defined in section 202(a)(22) of the Act (15 U.S.C. 80b-2(a)(22)), each equity owner of any such company (except for the investment adviser entering into the contract and any other equity owners not charged a fee on the basis of a share of capital gains or capital appreciation) will be considered a client for purposes of paragraph (a) of this section.

(c) *Transition rules—(1) Registered investment advisers.* If a registered investment adviser entered into a contract and satisfied the conditions of this section that were in effect when the contract was entered into, the adviser will be considered to satisfy the conditions of this section; *Provided*, however, that if a natural person or company who was not a party to the contract becomes a party (including an equity owner of a private investment company advised by the adviser), the conditions of this section in effect at that time will apply with regard to that person or company.

(2) *Registered investment advisers that were previously not registered.* If an investment adviser was not required to register with the Commission pursuant to section 203 of the Act (15 U.S.C. 80b-3) and was not registered, section 205(a)(1) of the Act will not apply to an advisory contract entered into when the adviser was not required to register

and was not registered, or to an account of an equity owner of a private investment company advised by the adviser if the account was established when the adviser was not required to register and was not registered; *Provided*, however, that section 205(a)(1) of the Act will apply with regard to a natural person or company who was not a party to the contract and becomes a party (including an equity owner of a private investment company advised by the adviser) when the adviser is required to register.

(3) *Certain transfers of interests.* Solely for purposes of paragraphs (c)(1) and (c)(2) of this section, a transfer of an equity ownership interest in a private investment company by gift or bequest, or pursuant to an agreement related to a legal separation or divorce, will not cause the transferee to “become a party” to the contract and will not cause section 205(a)(1) of the Act to apply to such transferee.

(d) *Definitions.* For the purposes of this section:

(1) The term *qualified client* means:

(i) A natural person who, or a company that, immediately after entering into the contract has at least \$1,000,000 under the management of the investment adviser;

(ii) A natural person who, or a company that, the investment adviser entering into the contract (and any person acting on his behalf) reasonably believes, immediately prior to entering into the contract, either:

(A) Has a net worth (together, in the case of a natural person, with assets held jointly with a spouse) of more than \$2,000,000. For purposes of calculating a natural person’s net worth:

(1) The person’s primary residence must not be included as an asset;

(2) Indebtedness secured by the person’s primary residence, up to the estimated fair market value of the primary residence at the time the investment advisory contract is entered into may not be included as a liability (except that if the amount of such indebtedness outstanding at the time of calculation exceeds the amount outstanding 60 days before such time, other than as a result of the acquisition of the primary residence, the

amount of such excess must be included as a liability); and

(3) Indebtedness that is secured by the person’s primary residence in excess of the estimated fair market value of the residence must be included as a liability; or

(B) Is a qualified purchaser as defined in section 2(a)(51)(A) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(51)(A)) at the time the contract is entered into; or

(iii) A natural person who immediately prior to entering into the contract is:

(A) An executive officer, director, trustee, general partner, or person serving in a similar capacity, of the investment adviser; or

(B) An employee of the investment adviser (other than an employee performing solely clerical, secretarial or administrative functions with regard to the investment adviser) who, in connection with his or her regular functions or duties, participates in the investment activities of such investment adviser, provided that such employee has been performing such functions and duties for or on behalf of the investment adviser, or substantially similar functions or duties for or on behalf of another company for at least 12 months.

(2) The term *company* has the same meaning as in section 202(a)(5) of the Act (15 U.S.C. 80b-2(a)(5)), but does not include a company that is required to be registered under the Investment Company Act of 1940 but is not registered.

(3) The term *private investment company* means a company that would be defined as an investment company under section 3(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(a)) but for the exception provided from that definition by section 3(c)(1) of such Act (15 U.S.C. 80a-3(c)(1)).

(4) The term *executive officer* means the president, any vice president in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions, for the investment adviser.

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(e) *Inflation adjustments.* Pursuant to section 205(e) of the Act, the dollar amounts specified in paragraphs (d)(1)(i) and (d)(1)(ii)(A) of this section shall be adjusted by order of the Commission, on or about May 1, 2016 and issued approximately every five years thereafter. The adjusted dollar amounts established in such orders shall be computed by:

(1) Dividing the year-end value of the Personal Consumption Expenditures Chain-Type Price Index (or any successor index thereto), as published by the United States Department of Commerce, for the calendar year preceding the calendar year in which the order is being issued, by the year-end value of such index (or successor) for the calendar year 1997;

(2) For the dollar amount in paragraph (d)(1)(i) of this section, multiplying \$750,000 times the quotient obtained in paragraph (e)(1) of this section and rounding the product to the nearest multiple of \$100,000; and

(3) For the dollar amount in paragraph (d)(1)(ii)(A) of this section, multiplying \$1,500,000 times the quotient obtained in paragraph (e)(1) of this section and rounding the product to the nearest multiple of \$100,000.

[63 FR 39027, July 21, 1998, as amended at 69 FR 72088, Dec. 10, 2004; 77 FR 10368, Feb. 22, 2012]

§ 275.206(3)-1 Exemption of investment advisers registered as broker-dealers in connection with the provision of certain investment advisory services.

(a) An investment adviser which is a broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934 shall be exempt from section 206(3) in connection with any transaction in relation to which such broker or dealer is acting as an investment adviser solely (1) by means of publicly distributed written materials or publicly made oral statements; (2) by means of written materials or oral statements which do not purport to meet the objectives or needs of specific individuals or accounts; (3) through the issuance of statistical information containing no expressions of opinion as to the investment merits of a particular security; or (4) any combination of the

foregoing services: *Provided, however,* That such materials and oral statements include a statement that if the purchaser of the advisory communication uses the services of the adviser in connection with a sale or purchase of a security which is a subject of such communication, the adviser may act as principal for its own account or as agent for another person.

(b) For the purpose of this Rule, publicly distributed written materials are those which are distributed to 35 or more persons who pay for such materials, and publicly made oral statements are those made simultaneously to 35 or more persons who pay for access to such statements.

NOTE: The requirement that the investment adviser disclose that it may act as principal or agent for another person in the sale or purchase of a security that is the subject of investment advice does not relieve the investment adviser of any disclosure obligation which, depending upon the nature of the relationship between the investment adviser and the client, may be imposed by subparagraphs (1) or (2) of section 206 or the other provisions of the federal securities laws.

[40 FR 38159, Aug. 27, 1975]

§ 275.206(3)-2 Agency cross transactions for advisory clients.

(a) An investment adviser, or a person registered as a broker-dealer under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) and controlling, controlled by, or under common control with an investment adviser, shall be deemed in compliance with the provisions of sections 206(3) of the Act (15 U.S.C. 80b-6(3)) in effecting an agency cross transaction for an advisory client, if:

(1) The advisory client has executed a written consent prospectively authorizing the investment adviser, or any other person relying on this rule, to effect agency cross transactions for such advisory client, provided that such written consent is obtained after full written disclosure that with respect to agency cross transactions the investment adviser or such other person will act as broker for, receive commissions from, and have a potentially conflicting division of loyalties and responsibilities regarding, both parties to such transactions;