Quarter ending	Dividend yield quarterly percent	Rate for each month of quarter (1⁄12 of annual)
Mar. 1971	.72	.24
June 1971	.70	.23
Sept. 1971	.71	.24
Dec. 1971	.70	.23

Accumulated value of dividends reinvested:
December =1.0026
January–March =1.0072
April–June =1.0070
July–September =1.0071
October–November =1.0047 [4]
Dividend yield:

$$(1.0026 \times 1.0072 \times 1.0070 \times 1.0071 \times 1.0047) - 1.00 = .0289$$

Aggregate value of dividends paid computed consistently with the index:

$$.0289 \times 51.84 = 1.50$$

Investment record of the NYSE Composite Index for the 12 months ended November 30, 1971:

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

(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 registered investment advisers.

(a) *General.* The provisions of section 205(a)(1) of the Act (15 U.S.C. 80b–5(a)(1)) shall not prohibit any 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* all the conditions in this section are satisfied.

(b) *Nature of the client.* (1) The client entering into the contract subject to this rule must be (i) a natural person or a company, as defined in paragraphs (b)(2) and (g)(1) of this section, who immediately after entering into the contract has at least $500,000 under the management of the investment adviser; or (ii) a person who the registered investment adviser (and any person acting on his behalf) entering into the contract reasonably believes, immediately prior to entering in to the contract, is a natural person or a company, as defined in paragraphs (b)(2)

[4] The rate for October and November would be two thirds of the yield for the quarter ended September 30 (i.e. .667×.71=4736), since the yield for the quarter ended December 31 would not be available as of November 30.

and (g)(1) of this section, whose net worth at the time the contract is entered into exceeds $1,000,000. (The net worth of a natural person may include assets held jointly with such person's spouse.)

(2) The term *company* as used in paragraph (b)(1) of this section, does not include (i) a private investment company, as defined in paragraph (g)(2) of this section, (ii) an investment company registered under the Investment Company Act of 1940 or (iii) a business development company, as defined in section 202(a)(22) of the Investment Advisers Act of 1940, unless each of the equity owners (other than the investment adviser entering into a contract under the rule) of any such company is a natural person or company described in this paragraph (b) of this section.

(c) *Compensation formula.* The compensation paid to the adviser under this rule with respect to the performance of any securities over a given period shall be based on a formula which:

(1) Includes, in the case of securities for which market quotations are readily available, the realized capital losses and unrealized capital depreciation of the securities over the period;

(2) Includes, in the case of securities for which market quotations are not readily available, (i) the realized capital losses of the securities over the period; and (ii) if the unrealized capital appreciation of the securities over the period is included, the unrealized capital depreciation of the securities over the period; and

(3) Provides that any compensation paid to the adviser under this rule is based on the gains less the losses (computed in accordance with paragraphs (c) (1) and (2) of this section) in the client's account for a period of not less than one year.

(d) *Disclosure.* In addition to the requirements of Form ADV, the adviser shall disclose to the client, or the client's independent agent, prior to entering into an advisory contract under this rule, all material information concerning the proposed advisory arrangement including the following:

(1) That the fee arrangement may create an incentive for the adviser to make investments that are riskier or more speculative than would be the case in the absence of a performance fee;

(2) Where relevant, that the adviser may receive increased compensation with regard to unrealized appreciation as well as realized gains in the client's account;

(3) The periods which will be used to measure investment performance throughout the contract and their significance in the computation of the fee;

(4) The nature of any index which will be used as a comparative measure of investment performance, the significance of the index, and the reason the adviser believes the index is appropriate; and

(5) Where an adviser's compensation is based in part on the unrealized appreciation of securities for which market quotations are not readily available, how the securities will be valued and the extent to which the valuation will be determined independently.

(e) *Arms-length contract.* The investment adviser (and any person acting on its behalf) who enters into the contract must reasonably believe, immediately prior to entering into the contract, that the contract represents an arm's-length arrangement between the parties and that the client (or in the case of a client which is a company as defined in paragraph (g)(1) of this section, the person representing the company), alone or together with the client's independent agent, understands the proposed method of compensation and its risks. The representative of a company may be a partner, director, officer or an employee of the company or the trustee, where the company is a trust, or any other person designated by the company or trustee, but must satisfy the definition of client's independent agent set forth in paragraph (g)(4) of this section.

(f) *Transition rule.* (1) The proviso of paragraph (a) and paragraphs (b), (c) and (e) of this section do not apply to any advisory contract (or renewal or extension thereof) between an investment adviser and a client where (i) the contract was entered into prior to and continued in force after November 14, 1985; and (ii) the adviser, at the time the contract was entered into, was not registered or required to be registered as an investment adviser under the

Act; provided however, that all provisions of this rule shall apply with respect to any natural person or company who is not a party to the contract prior to and becomes a party to the contract after the effective date of this rule.

(2) Notwithstanding paragraph (f)(1) of this section, the renewal or extension of a contract described therein will be subject to paragraph (e) of this section.

(g) *Definitions*. For the purposes of this rule:

(1) The term *company* has the same meaning as in section 202(a) (5) of the Act, but does not include a company that is required to be registered under the Investment Company Act of 1940 but is not registered.

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

(3) The term *affiliated person* has the same meaning as in section 2(a)(3) of the Investment Company Act.

(4) The term *client's independent agent* means any person agreeing to act as the client's agent in connection with the contract other than:

(i) The investment adviser acting in reliance upon this rule, an affiliated person of the investment adviser, an affiliated person of an affiliated person of the investment adviser, or an interested person of the investment adviser as defined in paragraph (g)(5) of this section;

(ii) A person who receives, directly or indirectly, any compensation in connection with the contract from the investment adviser, an affiliated person of the investment adviser, an affiliated person of an affiliated person of the investment adviser or an interested person of the investment adviser as defined in paragraph (g)(5) of this section; or

(iii) A person with any material relationship between himself (or an affiliated person of such person) and the investment adviser (or an affiliated person of the investment adviser) that exists, or has existed at any time during the previous two years.

(5) The term *interested person* as used in paragraph (g)(4) of this section means:

(i) Any member of the immediate family of any natural person who is an affiliated person of the investment adviser;

(ii) Any person who knowingly has any direct or indirect beneficial interest in, or who is designated as trustee, executor, or guardian of any legal interest in, any security issued by the investment adviser or by a controlling person of the investment adviser if the beneficial or legal interest of the person in any security issued by the investment adviser or by a controlling person of the investment adviser (A) exceeds one tenth of one percent of any class of outstanding securities of the investment adviser or a controlling person of the investment adviser; or (B) exceeds 5% of the total assets of the person (seeking to act as the client's independent agent).

(iii) Any person or partner or employee of any person who at any time since the beginning of the last two years has acted as legal counsel for the investment adviser.

(6)(i) The term *securities for which market quotations are readily available* in paragraph (c) has the same meaning as in Rule 2a–4(a) (1) under the Investment Company Act of 1940 (17 CFR 270.2a–4(a)(1)).

(ii) The term *securities for which market quotations are not readily available* in paragraph (c) of this section means securities not described in paragraph (g)(6)(i) of this section.

(h) An investment adviser entering into or performing an investment advisory contract under this rule is not relieved of any obligations under section 206 of the Adviser Act or of any other applicable provisions of the Federal securities laws.

(i) Nothing in this rule relieves a client's independent agent from any obigations to the client under applicable law.

(Sec. 206A (15 U.S.C. 80b–6A))

[50 FR 48561, Nov. 26, 1985, as amended at 62 FR 28135, May 22, 1997]

§ 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;

(2) The investment adviser, or any other person relying on this rule, sends to each such client a written confirmation at or before the completion of each such transaction, which confirmation includes (i) a statement of the nature of such transaction, (ii) the date such transaction took place, (iii) an offer to furnish upon request, the time when such transaction took place, and (iv) the source and amount of any other remuneration received or to be received by the investment adviser and any other person relying on this rule in connection with the transaction, *Provided, however,* That if, in the case of a purchase, neither the investment adviser nor any other person relying on this rule was participating in a distribution, or in the case of a sale, neither the investment adviser nor any other person relying on this rule was participating in a tender offer, the written confirmation may state whether any other remuneration has been or will be received and that the source and amount of such other remuneration will be furnished upon written request of such customer;

(3) The investment adviser, or any other person relying in this rule, sends to each such client, at least annually, and with or as part of any written statement or summary of such account from the investment adviser or such other person, a written disclosure