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SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

INVESTMENT COMPANY ACT OF 1940  
Release No. 7484  
INVESTMENT ADVISERS ACT OF 1940  
Release No. 347

ADOPTION OF RULE 205-2 UNDER THE INVESTMENT ADVISERS  
ACT OF 1940, AS AMENDED, DEFINING "SPECIFIED PERIOD"  
OVER WHICH THE ASSET VALUE OF THE COMPANY OR FUND  
UNDER MANAGEMENT IS AVERAGED

On July 13, 1972, the Securities and Exchange Commission published notice (Investment Advisers Act Release No. 323 (37 F.R. 15007)) that it had under consideration the adoption of Rule 205-2 under the Investment Advisers Act of 1940 ("Act"), as amended by the Investment Company Amendments Act of 1970. All interested persons were invited to comment on the proposal. The Commission has considered all of the comments and suggestions received and has determined to adopt Rule 205-2 in the form set forth below. The Rule is adopted pursuant to the authority granted the Commission in Sections 205, 206A and 211 of the Act.

Under Section 205 of the Act, as amended, performance fees are prohibited unless compensation based on the asset value of the company or fund under management is averaged over a specified period and increases and decreases proportionately with investment performance of the company over a specified period in relation to the investment record of an appropriate index of securities prices or such other measure of investment performance as the Commission by rule, regulation or order may specify. The point from which increases and decreases in compensation are measured must be the fee which is paid or earned when the investment performance of the company is equivalent to that of the index.

Section 211 of the Act gives the Commission authority to issue such rules and regulations as are necessary or appropriate to the exercise of the functions and powers conferred upon it under the Act.

Section 206A of the Act authorizes the Commission by rules and regulations to conditionally or unconditionally exempt any transaction from any provision of the Act or of any rule or regulation thereunder if and to the extent such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policies and provisions of the Act.

The rule requires that, under a contract containing an incentive fee arrangement, assets should be averaged over the same period performance is computed. An exemption from contracts providing for a "rolling period" is contained in paragraph (c) of the rule. It permits the specified period over which the asset value of the company or fund is averaged for computing the "fulcrum fee" to differ from the period over which asset value is averaged for computing the performance related portion of the fee. Under this exemption the fulcrum fee may be computed on the basis of asset values averaged over the most recent subperiod of the rolling period. For example, this exemption would permit a fee structure under which the performance related portion of the fee could be based upon a 12 quarter "rolling period" and the "fulcrum fee" could be computed on the basis of the most recent quarter of such rolling period. It would also permit a rolling period of 365

days and daily computation of the performance related portion of the fee and of the fulcrum fee. Of course, as stated in Investment Company Act Release No. 7113, interim payments greater than the minimum fee are not permitted under any incentive arrangements.

Although the rule would permit the fulcrum fee to relate more closely to current assets than the interpretation contained in Investment Company Act Release No. 7113, the rule, like the interpretation, requires that the performance portion of the fee be based upon the assets upon which such performance was achieved and that the amount of compensation paid for performance not be influenced unduly by the amount of sales (or redemptions).

The Commission action is as follows:

Rule 205-2 under the Investment Advisers Act of 1940 is adopted in the form set forth below:

Rule 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), 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.

In order not to disrupt existing contractual relationships and to permit an orderly change in existing incentive fee arrangements consonant with this rule and with Rule 205-1 under the Act, the rule will become effective on December 1, 1973, or, with respect to any particular investment company, within 60 days after its next regular meeting of shareholders held after December 1, 1972, whichever is sooner.

By the Commission.

Ronald F. Hunt  
Secretary