The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 9441

November 21, 1997

SEC PROPOSES AMENDMENTS TO PERFORMANCE FEE RULE

* See Investment Advisers Act Release No. 1682 (Nov. 13, 1997). [9441] November 21, 1997 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 48-97 SEC RULES COMMITTEE No. 114-97 RE: SEC PROPOSES AMENDMENTS TO PERFORMANCE FEE RULE _____ The Securities and Exchange Commission has issued a release proposing amendments to Rule 205-3, the rule that permits investment advisers to charge certain clients performance fees (copy attached).* The proposed amendments would eliminate Rule 205-3s provisions that specify required contract terms and disclosures. In addition, the amendments would increase the current criteria for clients eligible to enter into performance fee arrangements. Under the proposed amendments, to be eligible a client would be required to have assets under management with the adviser of at least $750,000 or net worth of more than $1,500,000. (The current requirements are $500,000 and $1,000,000 respectively). The proposed increases are intended to reflect the effects of inflation on the dollar figures in the rule, not to reduce the number of or to alter the types of clients with which an adviser may enter into a performance fee arrangement. Further, the proposed amendments would add as a new category of eligible client "qualified purchasers," as defined in section 2(a)(51)(A) of the Investment Company Act of 1940. The proposed amendments raise one issue of particular interest to investment companies. Rule 205-3 currently provides that with respect to certain clients entering into performance fee contracts with an adviser -- private investment companies, registered investment companies, and business development companies -- the adviser must "look through" the legal entity to determine whether each equity owner of the company would satisfy the new eligibility criteria ("qualified client"). The proposed amendments would retain the "look-through" provision and clarify that any equity owners that are not charged a performance fee would not be required to meet the qualified client test. The proposed amendments would retain the provision in Rule 205-3 that an equity owner who is the investment adviser entering into the performance fee contract need not be a qualified client. Comment is requested on whether this "look-through" provision should continue to be included in rule 205-3. Comment also is requested on whether the rule should specifically address the application of the "look through" provision to other entities. Comments are due to the SEC on the proposed amendments by January 20, 1998. Please provide me with comments on the proposed amendments by December 10, 1997. You can reach me by phone at 202/326-5821, fax at 202/326-5827, or e-mail at donohue@ici.org. Dorothy M. Donohue Associate Counsel Attachment

abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.