The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 9579

January 7, 1998

DRAFT COMMENT LETTER ON SEC'S PROPOSED AMENDMENTS TO PERFORMANCE FEE RULE

* See Memorandum to Investment Advisers Committee No. 33-97, dated November 19, 1997 and Memorandum to Closed- End Investment Company Committee No. 48-97, SEC Rules Committee No. 114-97, dated November 21, 1997. [9579] January 7, 1998 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 1-98 INVESTMENT ADVISERS COMMITTEE No. 2-98 SEC RULES COMMITTEE No. 2-98 RE: DRAFT COMMENT LETTER ON SEC'S PROPOSED AMENDMENTS TO PERFORMANCE FEE RULE

_____ As we previously reported, the Securities and Exchange Commission proposed amendments to Rule 205-3 under the Investment Advisers Act of 1940, the rule that permits investment advisers to charge certain clients performance fees.* A copy of the InstituteGs draft comment letter on the proposal is attached and briefly summarized below. The letter supports the proposed amendments to Rule 205-3 that would permit investment advisers to enter into performance fee arrangements with any client with a net worth in excess of $1,500,000 or assets under the management of the investment adviser of at least $750,000 (“qualified clients”). (The current requirements are $500,000 and $1,000,000 respectively.) The letter states that it is reasonable to revise the thresholds in the current rule, as proposed, to reflect the effects of inflation since Rule 205-3 was adopted in 1985. The letter also recommends that the Commission revise the meaning of qualified clients to include certain “knowledgeable employees” of the investment adviser even if they do not meet the ruleGs criteria regarding net worth or assets under management. Because of their financial acumen and experience in working in the investment advisory industry, these persons should be capable of protecting their own interests in negotiating performance fees. The letter also states that the Institute would not object to the Commission eliminating the look- through requirement with respect to registered investment companies. The letter points out that investment company shareholders would be adequately protected because a majority of the companyGs directors and a majority of the companyGs disinterested directors would approve the performance fee, as required by Section 15 of the Investment Advisers Act. In addition, the investment adviser of a registered investment company has a fiduciary duty with respect to any performance fees from the company, as set forth in Section 36(b) of the Investment Company Act. The letter strongly supports the proposed elimination of several conditions in current Rule 205-3 that prescribe the methodology for computing a performance fee and that require advisers to make certain specific disclosures about performance fees. The letter points out that qualified clients are capable of protecting their own interests and therefore, the particulars of any performance fee arrangement are best left to negotiation between the client and the

adviser. The letter also requests clarification regarding whether Rule 205-3 permits a trust, governmental plan, collective trust fund, or separate account referred to in section 3(c)(11) of the Investment Company Act to be charged a “fulcrum fee.” Comments are due to the SEC by Tuesday, January 20, 1998. Please provide me with your comments on the draft letter by Tuesday, January 13, 1998 by phone at 202/326-5821, fax at 202/ 326- 5827, or e-mail at donohue@ici.org. Dorothy M. Donohue Associate Counsel Attachment

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