

NASAA Performance-Based Compensation Exemption for Investment Advisers
Model Rule 102(f)-3, under the Uniform Securities Act of 1956
Adopted 04/15/2013

This model rule supersedes and replaces Rule 102(f)-3, adopted 9/03/1987.

Rule 102(f)-3 Performance-Based Compensation Exemption

- (a) Notwithstanding Section 102(c)(1) of the Act, an investment adviser may enter into, extend or renew an investment advisory contract which provides for compensation to the investment adviser on the basis of a share of capital gains upon or capital appreciation of the funds, or any portion of the funds, of the client if:
- (1) The investment adviser is not registered and is not required to be registered pursuant to Section 201 of the Act; or
 - (2) The following conditions in subsections (a)(2)(A) and (a)(2)(B) are met:
 - (A) The client entering into the contract is a “qualified client”, as defined by Rule 205-3 under the Investment Advisers Act of 1940 (17 Code of Federal Regulations §275.205-3); and
 - (B) To the extent not otherwise disclosed on Form ADV Part 2, the investment adviser must disclose in writing to the client all material information concerning the proposed advisory arrangement, including the following:
 - a. That the fee arrangement may create an incentive for the investment adviser to make investments that are riskier or more speculative than would be the case in the absence of a performance fee;
 - b. Where relevant, that the investment adviser may receive increased compensation with regard to unrealized appreciation as well as realized gains in the client’s account;
 - c. The periods which will be used to measure investment performance throughout the contract and their significance in the computation of the fee;
 - d. 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 investment adviser believes that the index is appropriate; and
 - e. Where the investment adviser’s compensation is based in part on the unrealized appreciation of securities for which market quotations are not readily available within the meaning of Rule 2a-4(a)(1) under the Investment Company Act of 1940, 17 C.F.R. 270.2a-4(a)(1), how the securities will be valued and the extent to which the valuation will be independently determined.
- (b) In the case of a private investment company, as defined in subsection (d)(2) of this rule, 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 Investment Advisers Act of 1940 [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 subsection (a) of this rule.

(c) *Transition rules:*

- (1) If an investment adviser entered into a contract and satisfied the conditions of this rule that were in effect when the contract was entered into, the adviser will be considered to satisfy the conditions of this rule; 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 rule in effect when the person or company becomes a party to the contract will apply with regard to that person or company.
- (2) If an investment adviser was not required to register pursuant to Section 201 of the Act and was not registered, Section 102(c)(1) of the Act shall not apply to an advisory contract entered into when the investment adviser was not required to register and was not registered, provided, however, that the investment adviser was in compliance with all rules and regulations regarding performance based compensation in any jurisdiction in which the investment adviser was registered or required to be registered at the time of entering into the advisory contract.
- (3) Solely for purposes of subsections (c)(1) and (c)(2) of this rule, 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 102(c)(1) of the Act to apply to such transferee.

(d) The following definitions apply for purposes of this rule:

- (1) “Company” shall have the same meaning as in section 202(a)(5) of the Investment Advisers Act of 1940 [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.
- (2) “Private investment company” shall mean 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)].