

**CHAPTER 2875**  
**DEPARTMENT OF COMMERCE**  
**REGULATION OF SECURITIES**

2875.1010 INVESTMENT ADVISORY  
CONTRACTS

**2875.1010 INVESTMENT ADVISORY CONTRACTS.**

*[For text of subpart 1, see M.R. 1987]*

Subp. 1a. **Exception.** Subpart 1, item A, does not apply to 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 if all the conditions in items A to D are satisfied.

A. The client entering into the contract subject to this subpart must be:

(1) a natural person or a company, as defined in subpart 2, who immediately after entering into the contract has at least \$500,000 under the management of the investment adviser; or

(2) a person who the investment adviser and any person acting on behalf of the adviser entering into the contract reasonably believes, immediately before entering into the contract, is a natural person or a company, as defined in subpart 2, 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 the person's spouse.

B. The compensation paid to the investment adviser under this subpart with respect to the performance of any securities over a given period must be based on a formula which:

(1) includes, in the case of securities for which market quotations are readily available, the realized capital gains and losses and unrealized capital appreciation and 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 gains and losses of 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 investment adviser under this subpart is based on the gains less the losses computed in accordance with item B, subitems (1) and (2), in the client's account for a period of not less than one year.

C. The investment adviser shall disclose to the client, or the client's independent agent, before entering into an advisory contract under this subpart, all material information concerning the proposed advisory arrangement including the following:

(1) 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;

(2) 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;

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

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(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 investment adviser believes the index is appropriate; and

(5) where an investment 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 independently determined.

D. The investment adviser and any person acting on behalf of the adviser who enters into the contract must reasonably believe, immediately before 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 subpart 2, 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 in subpart 2, item C.

Subp. 2. **Definitions.** As used in this part:

A. "Assignment" includes any direct or indirect transfer or hypothecation of an investment advisory contract by the assignor or of a controlling block of the assignor's outstanding voting securities by a security holder of the assignor; but, if the investment adviser is a partnership, no assignment of an investment advisory contract is considered to result from the death or withdrawal of a minority of the members of the investment adviser having only a minority interest in the business of the investment adviser, or from the admission to the investment adviser of one or more members who, after admission, will be only a minority of the members and will have only a minority interest in the business.

B. "Affiliate" has the same meaning as in section 2(a)(3) of the Investment Company Act.

C. "Client's independent agent" means a person agreeing to act as the client's agent in connection with the contract other than:

(1) The investment adviser acting in reliance upon this part, 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 item E.

(2) 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 item E.

(3) A person with any material relationship between himself or herself, or an affiliated person of the 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.

D. "Company" has the same meaning as in section 202(a)(5) of the Investment Advisers Act of 1940, but does not include a company that is required to be registered under the Investment Company Act of 1940, but is not registered. Further, the term "company" as used in subpart 1a, item A, does not include (i) a private investment company as defined in item G, (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 subpart 1a of any such company is a natural person or company described in this item.

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E. "Interested person" as used in item C means:

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

(2) 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 percent of any class of outstanding securities of the investment adviser or a controlling person of the investment adviser; or (b) exceeds five percent of the total assets of the person seeking to act as the client's independent agent.

(3) Any person, 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.

F. "Investment advisory contract" means any contract or agreement where a person agrees to act as an investment adviser or to manage any investment or trading account for a person other than an investment company as defined in the Investment Company Act of 1940.

G. "Private investment company" means a company that 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 the act.

H. "Securities for which market quotations are readily available" in subpart 1a, item B, have the same meaning as in Rule 2a-4(a)(1) under the Investment Company Act of 1940.

I. "Securities for which market quotations are not readily available" in subpart 1a, item B, means securities not described in item H.

**Statutory Authority:** *MS s 45.023; 80A.06 subd 5; 80A.25*

**History:** *12 SR 1335*