power and responsibilities among the various levels of government.

For the reasons discussed above, I certify that the proposed regulation:

1. Is not a "significant regulatory action" under Executive Order 12866;

2. Is not a "significant rule" under the DOT Regulatory Policies and Procedures (44 FR 11034, February 26, 1979); and

3. Will not have a significant economic impact, positive or negative, on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

We prepared an economic evaluation of the estimated costs to comply with this proposed AD. See the AD docket to examine the economic evaluation.

Authority for This Rulemaking

Title 49 of the United States Code specifies the FAA's authority to issue rules on aviation safety. Subtitle I, section 106, describes the authority of the FAA Administrator. Subtitle VII, Aviation Programs, describes in more detail the scope of the Agency's authority.

We are issuing this rulemaking under the authority described in subtitle VII, part A, subpart III, section 44701, "General requirements." Under that section, Congress charges the FAA with promoting safe flight of civil aircraft in air commerce by prescribing regulations for practices, methods, and procedures the Administrator finds necessary for safety in air commerce. This regulation is within the scope of that authority because it addresses an unsafe condition that is likely to exist or develop on products identified in this rulemaking action.

List of Subjects in 14 CFR Part 39

Air transportation, Aircraft, Aviation safety, Safety.

The Proposed Amendment

Accordingly, under the authority delegated to me by the Administrator, the FAA proposes to amend 14 CFR part 39 as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. 106(g), 40113, 44701.

§ 39.13 [Amended]

2. Section 39.13 is amended by adding a new airworthiness directive (AD) to read as follows:

Bell Helicopter Textron Canada: Docket No. FAA–2011–0449; Directorate Identifier 2010–SW–021–AD.

Applicability: Model 206A, 206B, and 206B3 helicopters, with Litter Kit, part number 206–706–122 or 206–706–324, installed, certificated in any category.

Compliance: Within 6 months, unless accomplished previously.

To add an operating limitation when a litter kit is installed to prohibit flight, including hover, with the litter doorpost removed to prevent loss of structural integrity of the fuselage, do the following:

(a) Revise the Rotorcraft Flight Manual (RFM) by inserting into the Operating Limitations, Section 1, of the RFM the following statement: "Flight, including hover, with the litter doorpost removed is prohibited." This revision may be made by pen and ink changes, inserting a copy of this AD into the RFM, or inserting a copy of the RFM Supplement (RFMS) dealing with Litter Kits as follows: For Model 206A helicopters—inserting RFMS BHT–206A–FMS–8, dated December 30, 2009, into RFM BHT–206A–FM–1, dated July 2, 2009; for Model 206B helicopters—inserting RFMS BHT–206B–FMS–8, dated December 30, 2009, into RFM BHT–206B–FM–1, dated July 2, 2009; and for Model 206B3 helicopters—inserting RFMS BHT–206B3–FMS–2, dated December 30, 2009, into RFM BHT–206B3–FM–1, dated March 24, 2010.

(b) To request a different method of compliance or a different compliance time for this AD, follow the procedures in 14 CFR 39.19. Contact the Manager, Safety Management Group, ATTN: Mark Wiley, Aviation Safety Engineer, FAA, Rotorcraft Directorate, Regulations and Guidance Group, 2601 Meacham Blvd., Fort Worth, Texas 76137, telephone (817) 222–5134, fax (817) 222–5961, for information about previously approved alternative methods of compliance.

(c) The Joint Aircraft System/Component (JASC) Code is 5300: Fuselage structure (general).

Issued in Fort Worth, Texas, on January 31, 2011.

Kim Smith,

Manager, Rotorcraft Directorate, Aircraft Certification Service.

[FR Doc. 2011–11753 Filed 5–12–11; 8:45 am]

BILLING CODE 4910–13–P

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

[Release No. IA–3198; File No. S7–17–11]

RIN 3235–AK71

Investment Adviser Performance Compensation

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule; notice of intent to issue order.

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") intends to issue an order that would adjust two dollar amount tests in the rule under the Investment Advisers Act of 1940 that permits investment advisers to charge performance based compensation to "qualified clients." The adjustments would revise the dollar amount tests to account for the effects of inflation. The Commission is also proposing to amend the rule to: provide that the Commission will issue an order every five years adjusting for inflation the dollar amount tests; exclude the value of a person's primary residence from the test of whether a person has sufficient net worth to be considered a "qualified client;" and add certain transition provisions to the rule.

DATES: Comments on the proposed rule should be received on or before July 11, 2011.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/proposed.shtml*); or
- Send an e-mail to *rule-comments@sec.gov.* Please include File Number S7–17–11 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–17–11. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/proposed.shtml*). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

Hearing Request: An order adjusting the dollar amount tests specified in the definition of "qualified client" will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the

Commission's Secretary. Hearing requests should be received by the SEC by 5:30 p.m. on June 20, 2011. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested.

FOR FURTHER INFORMATION CONTACT: Adam B. Glazer, Senior Counsel, or C. Hunter Jones, Assistant Director, at 202–551–6792, Office of Regulatory Policy, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–8549.

SUPPLEMENTARY INFORMATION: The Commission intends to issue an order, and is proposing for public comment amendments to rule 205–3 [17 CFR 275.205–3], under the Investment Advisers Act of 1940 ("Advisers Act" or "Act").[1]

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I. Background

Section 205(a)(1) of the Investment Advisers Act generally prohibits an investment adviser from entering into, extending, renewing, or performing any investment advisory contract that provides for compensation to the adviser based on a share of capital gains on, or capital appreciation of, the funds of a client.[2] Congress prohibited these compensation arrangements (also known as performance compensation or performance fees) in 1940 to protect advisory clients from arrangements it believed might encourage advisers to take undue risks with client funds to increase advisory fees.[3] In 1970, Congress provided an exception from the prohibition for advisory contracts relating to the investment of assets in excess of $1,000,000,[4] if an appropriate "fulcrum fee" is used.[5] Congress subsequently authorized the Commission to exempt any advisory contract from the performance fee prohibition if the contract is with persons that the Commission determines do not need the protections of that prohibition.[6]

The Commission adopted rule 205–3 in 1985 to exempt an investment adviser from the prohibition against charging a client performance fees in certain circumstances.[7] The rule, when adopted, allowed an adviser to charge performance fees if the client had at least $500,000 under management with the adviser immediately after entering into the advisory contract ("assets-under-management test") or if the adviser reasonably believed the client had a net worth of more than $1 million at the time the contract was entered into ("net worth test"). The Commission stated that these standards would limit the availability of the exemption to clients who are financially experienced and able to bear the risks of performance fee arrangements.[8]

In 1998, the Commission amended rule 205–3 to, among other things, change the dollar amounts of the assets-under-management test and net worth test to adjust for the effects of inflation since 1985.[9] The Commission revised the former from $500,000 to $750,000, and the latter from $1 million to $1.5 million.[10]

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[11] The Dodd-Frank Act, among other things, amended section 205(e) of the Advisers Act to state that, by July 21, 2011 and every five years thereafter, the Commission shall adjust for inflation the dollar amount tests included in rules issued under section 205(e).[12] Separately, the Dodd-Frank Act also required that we adjust the net worth standard for an "accredited investor" in rules under the Securities Act of 1933 ("Securities Act")[13] to exclude the value of a person's primary residence.[14]

II. Discussion

Pursuant to section 418 of the Dodd-Frank Act, today we are providing notice that the Commission intends to issue an order revising the dollar amount tests of rule 205–3 to account for the effects of inflation. We also are proposing for public comment amendments to rule 205–3 to provide that the Commission will subsequently

[1] 15 U.S.C. 80b. Unless otherwise noted, all references to statutory sections are to the Investment Advisers Act, and all references to rules under the Investment Advisers Act, including rule 205–3, are to Title 17, Part 275 of the Code of Federal Regulations [17 CFR 275].

[2] 15 U.S.C. 80b–5(a)(1).

[3] H.R. Rep. No. 2639, 76th Cong., 3d Sess. 29 (1940). Performance fees were characterized as "heads I win, tails you lose" arrangements in which the adviser had everything to gain if successful and little, if anything, to lose if not. S. Rep No. 1775, 76th Cong., 3d Sess. 22 (1940).

[4] 15 U.S.C. 80b–5(b)(2). Trusts, governmental plans, collective trust funds, and separate accounts referred to in section 3(c)(11) of the Investment Company Act of 1940 [15 U.S.C. 80a–3(c)(11)] are not eligible for this exception from the performance fee prohibition under section 205(b)(2)(B) of the Advisers Act.

[5] 15 U.S.C. 80b–5(b). A fulcrum fee generally involves averaging the adviser's fee over a specified period and increasing or decreasing the fee proportionately with the investment performance of the company or fund in relation to the investment record of an appropriate index of securities prices. *See* rule 205–2 under the Advisers Act; Definition of "Specified Period" Over Which Asset Value of Company or Fund Under Management is Averaged, Investment Advisers Act Release No. 347 (Nov. 10, 1972) [37 FR 24895 (Nov. 23, 1972)]. In 1980, Congress added another exception to the prohibition against charging performance fees, for contracts involving business development companies under certain conditions. *See* section 205(b)(3) of the Advisers Act.

[6] Section 205(e) of the Advisers Act. In 1996, Congress included in the National Securities Markets Improvement Act of 1996 ("1996 Act") two additional statutory exceptions from the performance fee prohibition and new section 205(e) of the Advisers Act. The 1996 Act added exceptions for contracts with companies excepted from the definition of "investment company" in the Investment Company Act of 1940 ("Investment Company Act") [15 U.S.C. 80a] by section 3(c)(7) of the Investment Company Act [15 U.S.C. 80a–3(c)(7)] and contracts with persons who are not residents of the United States. *See* sections 205(b)(4) and (b)(5). Section 205(e) of the Advisers Act authorizes the Commission to exempt conditionally or unconditionally from the performance fee prohibition advisory contracts with persons that the Commission determines do not need its protections. Section 205(e) provides that the Commission may determine that persons do not need the protections of section 205(a)(1) on the basis of such factors as "financial sophistication, net worth, knowledge of and experience in financial matters, amount of assets under management, relationship with a registered investment adviser, and such other factors as the Commission determines are consistent with [section 205]."

[7] Exemption To Allow Registered Investment Advisers to Charge Fees Based Upon a Share of Capital Gains Upon or Capital Appreciation of a Client's Account, Investment Advisers Act Release No. 996 (Nov. 14, 1985) [50 FR 48556 (Nov. 26, 1985)] ("1985 Adopting Release"). The exemption applies to the entrance into, performance, renewal, and extension of advisory contracts. *See* rule 205–3(a).

[8] *See* 1985 Adopting Release, *supra* note 7, at Sections I.C and II.B. The rule also imposed other conditions, including specific disclosure requirements and restrictions on calculation of performance fees. *See id.* at Sections II.C–E.

[9] *See* Exemption To Allow Investment Advisers To Charge Fees Based Upon a Share of Capital Gains Upon or Capital Appreciation of a Client's Account, Investment Advisers Act Release No. 1731 (July 15, 1998) [63 FR 39022 (July 21, 1998)] ("1998 Adopting Release").

[10] *See id.* at Section II.B.1.

[11] Pub. L. 111–203, 124 Stat. 1376 (2010).

[12] *See* section 418 of the Dodd-Frank Act (requiring the Commission to issue an order every five years revising dollar amount thresholds in a rule that exempts a person or transaction from section 205(a)(1) of the Advisers Act if the dollar amount threshold was a factor in the Commission's determination that the persons do not need the protections of that section).

[13] 15 U.S.C. 77a *et seq.*

[14] *See* section 413(a) of the Dodd-Frank Act.

issue orders making future inflation adjustments every five years.[15] In addition, we are proposing to amend rule 205–3 to exclude the value of a person's primary residence from the determination of whether a person meets the net worth standard required to qualify as a "qualified client." Finally, we propose to modify the transition provisions of the rule to take into account performance fee arrangements that were permissible when they were entered into, so that new dollar amount thresholds do not require investment advisers to renegotiate the terms of arrangements that were permissible when the parties entered into them. These proposals are discussed in more detail below.

A. Order Adjusting Dollar Amount Tests

We intend to issue an order revising the dollar amounts of the assets-under-management test and the net worth test in the definition of "qualified client" in rule 205–3. As discussed above, the Commission last revised these dollar amount tests in 1998 to take into account the effects of inflation. At that time, the Commission revised the assets-under-management test from $500,000 to $750,000 and revised the net worth test from $1 million to $1.5 million. Pursuant to section 418 of the Dodd-Frank Act, which requires that we revise the dollar amount thresholds of the rule by order not later than July 21, 2011, and every five years thereafter, today we are providing notice [16] that we intend to issue an order to revise the assets-under-management and net worth tests of rule 205–3 to $1 million [17] and $2 million respectively.[18]

These revised dollar amounts would take into account the effects of inflation by reference to the historic and current levels of the Personal Consumption Expenditures Chain-Type Price Index ("PCE Index"),[19] which is published by the Department of Commerce.[20] The PCE Index is often used as an indicator of inflation in the personal sector of the U.S. economy.[21] The Commission has used the PCE Index in other contexts, including the determination of whether a person meets a specific net worth minimum in Regulation R under the Securities Exchange Act of 1934 (15 U.S.C. 78a) ("Exchange Act").[22]

B. Proposed Amendments to Rule 205–3

1. Inflation Adjustment of Dollar Amount Thresholds

We also are proposing to amend rule 205–3 under the Advisers Act. We would add a new paragraph (e) stating that the Commission will issue an order every five years adjusting for inflation the dollar amounts of the assets-under-management and net worth tests of the rule, as required by the Dodd-Frank Act.[23] Our proposed amendment would specify that the PCE Index will be the inflation index used to calculate future inflation adjustments of the dollar amount tests in the rule.[24] We believe the use of the PCE Index is appropriate because, as discussed above, it is an indicator of inflation in the personal sector of the U.S. economy and is used in other provisions of the Federal securities laws.[25] We also intend to revise paragraph (d) of rule 205–3, which sets forth the assets-under-management and net worth tests, to reflect the revised thresholds that we establish by the order discussed

[15] Rule 205–3 is the only exemptive rule issued under section 205(e) of the Advisers Act that includes dollar amount tests, which are the assets-under-management and net worth tests.

[16] *See* section 211(c) of the Advisers Act (requiring the Commission to provide appropriate notice of and opportunity for hearing for orders issued under the Advisers Act).

[17] An investment adviser could include in determining the amount of assets under management the assets that a client is contractually obligated to invest in private funds managed by the adviser. Only bona fide contractual commitments may be included, *i.e.,* those that the adviser has a reasonable belief that the investor will be able to meet.

This approach to calculating assets under management conforms with the approach we took in our recent release proposing to implement certain exemptions from registration with the Commission under the Advisers Act. In that release, we proposed to include uncalled capital commitments in the calculation of assets under management used to determine whether an adviser qualifies for the private fund adviser exemption. *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3111 (Nov. 19, 2010) [75 FR 77190 (Dec. 10, 2010)] at nn.192–94 and accompanying text.

[18] As discussed further below, we also would revise the definition of "qualified client" in rule 205–3(d) to reflect the updated thresholds.

[19] The revised dollar amounts in the tests would reflect inflation as of the end of 2010, and are rounded to the nearest $100,000 as required by section 418 of the Dodd-Frank Act. The 2010 PCE Index is 111.123, and the 1997 PCE Index was 85.395. Assets-under-management test calculation to adjust for the effects of inflation: 111.123/85.395 × $750,000 = $975,962; $975,962 rounded to the nearest multiple of $100,000 = $1 million. Net worth test calculation to adjust for the effects of inflation: 111.123/85.395 × $1.5 million = $1,951,923; $1,951,923 rounded to the nearest multiple of $100,000 = $2 million.

[20] The values of the PCE Index are available from the Bureau of Economic Analysis, a bureau of the Department of Commerce. *See http://www.bea.gov. See also http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=64&ViewSeries=NO&Java=no&Request3Place=N&3Place=N&FromView=YES&Freq=Year&FirstYear=1997&LastYear=2010&3Place=N&Update=Update&JavaBox=no#Mid.*

[21] *See* Clinton P. McCully, Brian C. Moyer, and Kenneth J. Stewart, "Comparing the Consumer Price Index and the Personal Consumption Expenditures Price Index," Survey of Current Business (Nov. 2007) at 26 n.1 (PCE Index measures changes in "prices paid for goods and services by the personal sector in the U.S. national income and product accounts" and is primarily used for macroeconomic analysis and forecasting). *See also* Federal Reserve Board, Monetary Policy Report to the Congress (Feb. 17, 2000) at n.1 (available at *http://www.federalreserve.gov/boarddocs/hh/2000/february/ReportSection1.htm#FN1*) (noting the reasons for using the PCE Index rather than the consumer price index).

[22] *See* Definitions of Terms and Exemptions Relating to the "Broker" Exceptions for Banks, Securities Exchange Act Release No. 56501 (Sept. 24, 2007) [72 FR 56514 (Oct. 3, 2007)] ("Regulation R Release") (adopting periodic inflation adjustments to the fixed-dollar thresholds for both "institutional customers" and "high net worth customers" under Rule 701 of Regulation R). *See also* Amendments to Form ADV, Investment Advisers Act Release No. 3060 (July 28, 2010) [75 FR 49234 (Aug. 12, 2010)] (increasing for inflation the threshold amount for prepayment of advisory fees that triggers an adviser's duty to provide clients with an audited balance sheet and the dollar threshold triggering the exception to the delivery of brochures to advisory clients receiving only impersonal advice). The Dodd-Frank Act also requires the use of the PCE Index to calculate inflation adjustments for the cash limit protection of each investor under the Securities Investor Protection Act of 1970. *See* section 929H(a) of the Dodd-Frank Act.

[23] Proposed rule 205–3(e) would provide that the Commission will issue an order effective on or about May 1, 2016 and approximately every five years thereafter adjusting the assets-under-management and net worth tests for the effects of inflation.

[24] Proposed rule 205–3(e) would provide that the assets-under-management and net worth tests will be adjusted for inflation by (i) dividing the year-end value of the PCE Index for the calendar year preceding the calendar year in which the order is being issued, by the year-end value of the PCE Index for the calendar year 1997, (ii) multiplying the threshold amounts adopted in 1998 ($750,000 and $1.5 million) by that quotient, and (iii) rounding each product to the nearest multiple of $100,000. For example, for the order the Commission would issue in 2016, the Commission would (i) divide the 2015 PCE Index by the 1997 PCE Index, (ii) multiply the quotient by $750,000 and $1.5 million, and (iii) round each of the two products to the nearest $100,000.

[25] *See supra* notes 21–22 and accompanying text.

above.[26] Finally, we anticipate that, if we adopt these proposed amendments to rule 205–3, we would delegate to our staff the authority to issue inflation adjustment orders every five years in the future.[27]

We request comment on the proposed amendments to rule 205–3 concerning the adjustment of the dollar amount thresholds to account for inflation.

• Is the proposed use of the PCE Index as a measure of inflation appropriate? Is there another index or other measure that would be more appropriate?

• The rule would establish the dollar amount tests we adopted in 1998 as the baseline for all future adjustments, as a consistent denominator for all future calculations. Should we instead establish each future adjustment of the dollar amount tests as a new baseline for the next calculation of the dollar amount tests? If we were to adopt that approach, because the Dodd-Frank Act requires that revised thresholds be rounded to the nearest $100,000, could the establishment of new baselines at the rounded amounts, each time the thresholds are adjusted, result in the underestimation or overestimation of the effects of inflation in subsequent periods?

2. Exclusion of the Value of Primary Residence from Net Worth Determination

We also are proposing to amend the net worth standard in rule 205–3, in the definition of "qualified client," to exclude the value of a natural person's primary residence and debt secured by the property.[28] This change, although not required by the Dodd-Frank Act, is similar to that Act's requirement that we exclude the value of a natural person's primary residence in the definition of "accredited investor" in rules under the Securities Act.[29] The value of a person's residence may have little relevance to an individual's financial experience[30] and ability to bear the risks of performance fee arrangements, and therefore little relevance to the individual's need for the Act's protections from performance fee arrangements.[31] The Commission took a similar approach when it excluded the value of a person's primary residence and associated liabilities from the determination of whether a person is a "high net worth customer" in Regulation R under the Exchange Act[32] and from the determination of whether a natural person has a sufficient level of investments to be considered a "qualified purchaser" under the Investment Company Act.[33]

Our proposed amendment would exclude the value of a natural person's primary residence and the amount of debt secured by the property that is no greater than the property's current market value.[34] Therefore a mortgage on the residence would not be included in the assessment of a natural person's net worth, unless the outstanding debt on the mortgage, at the time that net worth is calculated, exceeds the market value of the residence. If the outstanding debt exceeds the market value of the residence, the amount of the excess would be considered a liability in calculating net worth under the proposed amendments to rule 205–3.

We request comment on the proposed exclusion of the value of a person's primary residence from the calculation of a natural person's net worth under rule 205–3.

• Should we, as proposed, exclude the value of a natural person's primary residence from the calculation of net worth? Or should we include the value of a person's primary residence? Does such ownership evidence financial experience and the ability to bear risks associated with performance fee contracts? Should we, as proposed, also exclude from the net worth standard in rule 205–3 debt secured by a person's primary residence, up to the market value of the residence? Does such debt affect the ability to bear risks associated with performance fee contracts or investments that often are associated with such contracts?

• We note that although the Dodd-Frank Act requires the Commission to exclude a natural person's primary residence from the net worth standard for an "accredited investor" in rules under the Securities Act, the Dodd-Frank Act does not require the Commission to exclude a natural person's primary residence from the standards for a "qualified client" in rules under section 205(e) of the Advisers Act. Instead, the Dodd-Frank Act requires that the dollar amount tests of "qualified client" be adjusted for inflation every five years. Should our amendment of rule 205–3 accomplish only what the Dodd-Frank Act mandates (*i.e.,* inflation-adjustment of the dollar amount tests) and not revise the net

[26] As discussed above, we would revise the assets-under-management test to $1 million and the net worth test to $2 million.

[27] To delegate this authority to the staff, we would amend our rules of organization and program management to delegate to the Director of the Division of Investment Management the authority to issue notices and orders revising the dollar amount thresholds in rule 205–3(d)(1)(i) (assets-under-management) and 205–3(d)(1)(ii)(A) (net worth) for the effects of inflation pursuant to amended section 205(e) of the Advisers Act every five years after 2011. *See* rule 30–5 of the Commission's Rules of Organization and Program Management [17 CFR 200.30–5] (delegating authority to the Director of the Division of Investment Management). We also anticipate that future changes to the dollar amount tests that are issued by order, will be reflected in technical amendments to rule 205–3(d).

[28] Proposed rule 205–3(d)(1)(ii)(A) (excluding from the assessment of net worth the value of a natural person's primary residence "calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property").

[29] *See* section 413(a) of the Dodd-Frank Act (requiring the Commission to adjust any net worth standard for an "accredited investor" as set forth in Commission rules under the Securities Act of 1933 to exclude the value of a natural person's primary residence). The Dodd-Frank Act does not require that the net worth standard for an accredited investor be adjusted periodically for the effects of inflation, although it does require the Commission at least every four years to "undertake a review of the definition, in its entirety, of the term 'accredited investor' * * * [as defined in Commission rules] as such term applies to natural persons, to determine whether the requirements of the definition should be adjusted or modified for the protection of investors, in the public interest, and in light of the economy." *See* section 413(b)(2)(A) of the Dodd-Frank Act. In a separate release, we proposed rule amendments to adjust the net worth standards for accredited investors in our rules under the Securities Act. *See* Net Worth Standard for Accredited Investors, Securities Act Release No. 9177 (Jan. 25, 2011) [76 FR 5307 (Jan. 31, 2011)] ("Accredited Investor Proposing Release").

[30] We stated in 2006, when we proposed a minimum net worth threshold for establishing when an individual could invest in hedge funds pursuant to the safe harbor of Regulation D, that the value of an individual's personal residence may bear little or no relationship to that person's financial knowledge and sophistication. *See* Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles, Investment Advisers Act Release No. 2576 (Dec. 27, 2006) [72 FR 400 (Jan. 4, 2007)] at Section III.B.3.

[31] For example, an individual who meets the net worth test only by including the value of his primary residence in the calculation is unlikely to be as able to bear the risks of performance fee arrangements as an individual who meets the test without including the value of her primary residence.

[32] *See, e.g.,* Regulation R Release, *supra* note 22, at Section II.C.1 (excluding primary residence and associated liabilities from the fixed-dollar threshold for "high net worth customers" under Rule 701 of Regulation R, which permits a bank to pay an employee certain fees for the referral of a high net worth customer or institutional customer to a broker-dealer without requiring registration of the bank as a broker-dealer).

[33] A qualified purchaser under section 2(a)(51) of the Investment Company Act [15 U.S.C. 80a–2(a)(51)] includes, among others, any natural person who owns not less than $5 million in investments, as defined by the Commission. Rule 2a51–1 under the Investment Company Act includes within the meaning of investments real estate held for investment purposes. 17 CFR 270.2a51–1(b)(2). A personal residence is not considered an investment under rule 2a51–1, although residential property may be treated as an investment if it is not treated as a residence for tax purposes. *See* Privately Offered Investment Companies, Investment Company Act Release No. 22597 (Apr. 3, 1997) [62 FR 17512 (Apr. 9, 1997)] at text accompanying and following n.48.

[34] Proposed rule 205–3(d)(1)(ii)(A).

worth test by excluding the value of a primary residence?

• Should the rule require, as proposed, that debt secured by the residence in excess of the market value of the residence at the time the advisory contract is entered into be included as a liability in the determination of the person's net worth? Should the rule instead require that all debt that is secured by the primary residence (regardless of whether it exceeds the fair market value of the residence) be excluded from the calculation of net worth under rule 205–3? Alternatively, should the rule exclude the entire market value of the residence from net worth, but require treatment of any associated debt as a liability? Should the rule require inclusion of debt secured by a primary residence as a liability if proceeds of the debt are used to enter into an advisory contract that involves performance compensation paid to an investment adviser? If so, how would these proceeds of the debt be traced?

• Should the rule provide that the calculation of net worth must be made on a specified date prior to the day the advisory contract is entered into, for example 30, 60, or 90 days? If not, would investors be likely to inflate their net worth by borrowing against their homes to attain qualified client status? If we were to require that the net worth calculation be made a significant period of time in advance of entering into the advisory contract, would such a requirement make the calculation unduly complex?

• Is the language of the proposed rule amendment sufficiently precise? Should we substitute the word "equity" for the word "value" when referring to the primary residence excluded from the calculation of a natural person's net worth? Should we define the term "primary residence" for purposes of rule 205–3? If so, should we address the circumstances of a person who lives in multiple residences for roughly equal amounts of time during the year? [35]

• As noted above, the Commission proposed in a separate release to adjust the net worth standards for accredited investors in our rules under the Securities Act, to exclude the value of a natural person's primary residence from the assessment of a natural person's net worth.[36] We request comment on whether the net worth standards that we consider in connection with rule 205–3 should differ from any standards we consider in connection with those proposed amendments.

3. Transition Rules

The proposed amendments would replace the current transition rules section of rule 205–3 with two new subsections to allow an investment adviser and its clients to maintain existing performance fee arrangements that were permissible when the advisory contract was entered into, even if performance fees would not be permissible under the contract if it were entered into at a later date. These transition provisions, proposed rules 205–3(c)(1) and (2), are both designed so that restrictions on the charging of performance fees apply to new contractual arrangements and do not apply retroactively to existing contractual arrangements, including investments in companies that are excluded from the definition of an "investment company" under the Investment Company Act by reason of section 3(c)(1) [37] of that Act ("private investment companies").[38] This approach would minimize the disruption of existing contracts that meet applicable standards at the time the parties entered into the contract.

First, proposed rule 205–3(c)(1) would provide that, if a registered investment adviser entered into a contract and satisfied the conditions of the rule that were in effect when the contract was entered into, the adviser will be considered to satisfy the conditions of the rule.[39] If, however, a natural person or company that was not a party to the contract becomes a party, the conditions of the rule in effect at the time they become a party would apply to that person or company. This proposed subsection would mean, for example, that if an individual meets the $1.5 million net worth test and enters into an advisory contract with a registered investment adviser, the client could continue to maintain funds (and invest additional funds) with the adviser under that contract even if the net worth test were subsequently raised and he or she no longer met the new test. If, however, another person were to become a party to that contract, the current net worth threshold would apply to the new party when he or she becomes a party to the contract.[40]

We request comment on this proposed transition provision.

• Should the rule be amended as proposed, to allow advisers to continue to provide advisory services under performance fee arrangements that were permitted under the rule in effect at the time the contract was entered into, if the client does not meet the eligibility criteria after an adjustment to the dollar amount tests or for any other reason (*e.g.,* a decrease in the client's net worth below the dollar amount test)? Should the rule in these circumstances permit the management of existing funds under previous contractual arrangements, but prohibit an adviser from charging performance fees with respect to funds committed after the effective date of the rule? If so, how should the rule treat dividends and realized capital gains reinvested by the adviser?

Second, proposed rule 205–3(c)(2) would provide that, if an investment adviser was previously exempt pursuant to section 203 from registration with the Commission and subsequently registers with the Commission, section 205(a)(1) of the Act would not apply to the contractual arrangements into which the adviser entered when it was exempt from registration with the

[35] As we stated in the Accredited Investor Proposing Release, supra note 29, at nn.35–36 and accompanying text, helpful guidance may be found in rules that apply in other contexts. For example, the IRS Publication 523, *Selling Your Home* 3–4 (Jan. 5, 2011) lists the following factors to be used, in addition to the amount of time a person lives in each of several homes, to determine a person's "principal residence" under section 121 of the Internal Revenue Code, 26 U.S.C. 121: place of employment; location of family members' main home; mailing address for bills and correspondence; address listed on Federal and state tax returns, driver's license, car registration, and voter registration card; location of banks used and recreational clubs and religious organizations.

[36] *See supra* note 29.

[37] *See* rule 205–3(d)(3) (defining "private investment company" for purposes of rule 205–3). Advisory contracts with companies excepted from the definition of an "investment company" by reason of section 3(c)(7) of the Investment Company Act are not subject to the Advisers Act performance fee prohibition. *See* section 205(b)(4) of the Advisers Act. Therefore these contractual arrangements do not need, and are not included within, the exemptive relief provided by rule 205–3.

[38] Under rule 205–3(b), the equity owner of a private investment company, or of a registered investment company or business development company, is considered a client of the adviser for purposes of rule 205–3(a). We adopted this provision in 1998, and the provision was not affected by our subsequent rule amendments and related litigation concerning the registration of investment advisers to private investment companies. *See* 1998 Adopting Release, *supra* note 9; *Goldstein* v. *Securities and Exchange Commission,* 451 F.3d 873 (D.C. Cir. 2006).

[39] Proposed rule 205–3(c)(1) would modify the existing transition rule in rule 205–3(c)(1), which permits advisers and their clients that entered into a contract before August 20, 1998, and satisfied the eligibility criteria in effect on the date the contract was entered into to maintain their existing performance fee arrangements.

[40] Proposed rule 205–3(c)(1). Similarly, a person who invests in a private investment company advised by a registered investment adviser must satisfy the rule's conditions when he or she becomes an investor in the company. *See* rule 205–3(b) (equity owner of a private investment company is considered a client of a registered investment adviser for purposes of rule 205–3(a)).

Commission.[41] This proposed subsection would mean, for example, that if an investment adviser to a private investment company with 50 individual investors was exempt from registration with the Commission in 2009, but then subsequently registered with the Commission because it was no longer exempt from registration or because it chose voluntarily to register, section 205(a)(1) would not apply to the contractual arrangements the adviser entered into before it registered, including the accounts of the 50 individual investors with the private investment company and any additional investments they make in that company. If, however, any other individuals become new investors in the private investment company after the adviser registers with the Commission, section 205(a)(1) would apply to the adviser's relationship with them.

We request comment on this proposed transition provision.

- Should the rule be amended as proposed, to allow advisers to continue to be compensated under performance fee arrangements that were permitted when the adviser was exempt from registration with the Commission? Should the rule in these circumstances permit the management of existing funds under previous contractual arrangements, but prohibit a newly registered investment adviser from charging a performance fee with respect to any additional funds to be managed under previously existing contracts?
- Should the rule differentiate between the reasons why an adviser was exempt from registration (*e.g.,* due to a particular subsection of the Advisers Act) but is no longer exempt? Should the rule include different transition provisions depending upon the reason why an adviser was exempt from registration but is no longer exempt?

C. Effective and Compliance Dates

We anticipate that, if we issue the order described above and adopt the rule amendments we are proposing, we will allow an appropriate time period before requiring compliance with the new standards. For rule amendments, the Administrative Procedure Act generally requires at least 30 days prior to the effectiveness of new rules, absent special circumstances.[42]

- We request comment on the transition period or delayed compliance date that would be appropriate for any revised thresholds that we issue by order, or for any rule amendments that we adopt. Should we allow more time than the 30 days required under the Administrative Procedure Act (*e.g.,* 60 days, 90 days, 120 days)?

III. Request for Comment

The Commission requests comment on the rule amendments we propose in this release. Commenters are requested to provide empirical data to support their views. The Commission also requests suggestions for additional changes to existing rules or forms, and comments on other matters that might have an effect on the proposals contained in this release.

IV. Cost Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. We have identified certain costs and benefits of the proposed amendments, and we request comment on all aspects of this cost benefit analysis, including identification and assessment of any costs and benefits not discussed in this analysis. We seek comment and data on the value of the benefits identified. We also welcome comments on the accuracy of the cost estimates in this analysis, and request that commenters provide data that may be relevant to these cost estimates. In addition, we seek estimates and views regarding these costs and benefits for particular investment advisers, including small advisers, as well as any other costs or benefits that may result from the adoption of these proposed amendments.

In proposing to amend rule 205–3 to provide that the Commission will issue orders every five years adjusting for inflation the dollar amount tests of the rule, we are responding to the Dodd-Frank Act's amendment of section 205(e) of the Advisers Act requiring the Commission to issue these orders.[43] The proposed amendments to rule 205–3 also would exclude the value of a natural person's primary residence and debt secured by the property from the determination of whether a person has sufficient net worth to be considered a "qualified client," and would modify the transition provisions of the rule to take into account performance fee arrangements that were permissible when they were entered into.

A. Benefits

We expect that adjusting the dollar amount thresholds in rule 205–3 for the effects of inflation would benefit advisory clients. When the Commission adopted the dollar amount thresholds in the definition of "qualified client" in rule 205–3 in 1985, it evaluated the most appropriate dollar amount for both the assets-under-management and net worth tests. The Commission stated that these standards would limit the availability of the exemption to clients who are financially experienced and able to bear the risks of performance fee arrangements.[44] The adjustment of these dollar amount tests every five years would carry forward these protections at dollar levels that are based on the current price levels in the economy. We believe that adjusting these eligibility criteria to reflect real dollar equivalents would help to preserve these protections.

The proposed exclusion of the value of an individual's primary residence also would benefit clients. As discussed above, the value of an individual's primary residence may bear little or no relationship to that person's financial experience or ability to bear the risks associated with performance fee arrangements. Therefore, a client who does not meet the net worth test of rule 205–3 without including the value of her primary residence would be protected by the performance fee restrictions in section 205 of the Advisers Act.[45]

The proposed amendments to the rule's transition provisions would benefit advisory clients and investment advisers. The proposed amendments would allow an investment adviser and its clients to maintain existing performance fee arrangements that were permissible when the advisory contract was entered into, even if performance fees would not be permissible under the contract if it were entered into at a later date. These transition provisions are

[41] Section 205(a)(1) would apply, however, to contractual arrangements into which the adviser enters after it is no longer exempt from registration with the Commission. *See* proposed rule 205–3(c)(2). The approach of the proposed subsection is similar to the transition subsections we adopted in 2004, in rules 205–3(c)(2)—(3), when we adopted rules to require the registration of investment advisers to private funds. *See* Registration Under the Advisers Act of Certain Hedge Fund Advisers, Investment Advisers Act Release No. 2333 (Dec. 2, 2004) [69 FR 72054 (Dec. 10, 2004)]. Those transition provisions were vacated by the U.S. Court of Appeals for the District of Columbia Circuit when it vacated the Commission's rulemaking in its entirety. *See Goldstein* v. *SEC, supr*a note 38.

[42] *See* 5 U.S.C. 553(d).

[43] Section 418 of the Dodd-Frank Act.

[44] *See supra* note 8 and accompanying text.

[45] As discussed above, the proposed amendments to rule 205–3 also would exclude from the net worth test the amount of debt secured by the primary residence that is no greater than the property's current market value. The exclusion of the debt might limit these benefits in some circumstances. For example, if a client meets the net worth test as a result of the exclusion of debt secured by the primary residence and the market value of the primary residence were to decline to the extent that the debt could not be satisfied by the sale of the residence, the client might be less able to bear the risks related to the performance fee contract and the investments that the adviser might make on behalf of the client.

designed so that the restrictions on the charging of performance fees apply to new contractual arrangements and do not apply retroactively to existing contractual arrangements, including investments in private investment companies. Otherwise, advisory clients and investment advisers might have to terminate contractual arrangements into which they previously entered and enter into new arrangements, which could be costly to investors and advisers.

• We request comment on these anticipated benefits, and on whether the proposed rule amendments would result in additional benefits to advisory clients and investment advisers.

B. Costs

We do not expect that adjusting the dollar amount tests in rule 205–3 would impose significant new costs on advisory clients or investment advisers. As discussed above, section 418 of the Dodd-Frank Act requires the Commission to periodically issue orders adjusting for inflation the assets-under-management and net worth tests in rule 205–3. Raising these eligibility criteria could mean that certain persons who would have qualified under the current dollar amount thresholds would no longer qualify under the dollar amount thresholds as adjusted for the effects of inflation. As a result, an investment adviser could be prohibited from charging performance fees to new clients to whom it could have charged performance fees if the advisory contract had been entered into before the adjustment of the dollar amount thresholds. This effect may result in an investment adviser declining to provide services to potential clients.[46] However, this cost is a consequence of the Dodd-Frank Act, and therefore we do not attribute this cost to this rulemaking.

Section 418 of the Dodd-Frank Act does not specify how the Commission should measure inflation. We have proposed to use the PCE Index because it is widely used as a broad indicator of inflation in the economy and because the Commission has used the PCE Index in other contexts. It is possible that the use of the PCE Index to measure inflation might result in a larger or smaller dollar amount for the two thresholds than the use of a different index, although the rounding required by the Dodd-Frank Act (to the nearest $100,000) would likely negate any difference between indexes.

The proposed amendments to the rule's transition provisions are not likely to impose any new costs on advisory clients or investment advisers. As discussed above, the proposed amendments would allow an investment adviser and its clients to maintain existing performance fee arrangements that were permissible when the advisory contract was entered into, even if performance fees would not be permissible under the contract if it were entered into at a later date.

The proposed amendments also would exclude the value of a person's primary residence and debt secured by the property (if no greater than the current market value of the residence) from the calculation of a person's net worth. Based on data from the Federal Reserve Board, approximately 5.5 million households have a net worth of more than $2 million including the equity in the primary residence (*i.e.,* value minus debt secured by the property), and approximately 4.2 million households have a net worth of more than $2 million excluding the equity in the primary residence.[47] Therefore, approximately 1.3 million households currently would not meet a $2 million net worth test under the proposed revised test, and would therefore not be considered "qualified clients," if the value of the primary residence is excluded from the test. Excluding the value of the primary residence (and debt secured by the property up to the current market value of the residence) would mean that 1.3 million households that would have met the net worth threshold if the value of the residence were included, as is currently permitted, would no longer be "qualified clients" under the proposed revised net worth test and therefore would be unable to enter into performance fee contracts unless they meet another test of rule 205–3.[48]

As noted above, the proposed amendments would allow an investment adviser and its clients to maintain existing performance fee arrangements that were permissible when the advisory contract was entered into. For purposes of this cost benefit analysis, Commission staff assumes that 25 percent of the 1.3 million households would have entered into new advisory contracts that contained performance fee arrangements after the compliance date of the amendments, and therefore approximately 325,000 clients would not meet the revised net worth test.[49] Commission staff estimates that about 40 percent of those 325,000 potential clients (i.e., 130,000) would separately meet the "qualified client" definition under the assets-under-management test, and therefore could enter into performance fee arrangements.[50] The remaining 60 percent (195,000 households) would have access only to those investment advisers (directly or through the private investment companies they manage) that charge advisory fees other than performance fees.[51] Commission staff anticipates that the non-performance fee arrangements into which these clients would enter would contain management fees that yield advisers approximately the same amount of fees that clients would have paid under performance fee arrangements. Under these arrangements, if the adviser's performance does not reach the level at which it would have accrued performance fees, a client might end up paying higher overall fees than if he were paying performance fees. For purposes of this cost benefit analysis, Commission staff assumes that approximately 80 percent of the 195,000 households (*i.e.* 156,000 households) would enter into these non-performance fee arrangements, and that the other 20 percent would decide not to invest their assets with an adviser.[52]

[46] As discussed above, the proposed amendments would allow an investment adviser and its clients to maintain existing performance fee arrangements that were permissible when the advisory contract was entered into, even if performance fees would not be permissible under the contract if it were entered into at a later date. *See supra* Section II.B.3.

[47] These figures are derived from the 2007 Federal Reserve Board Survey of Consumer Finances. These figures represent the net worth of households rather than individual persons who might be clients. More information regarding the survey may be obtained at *http://www.federalreserve.gov/pubs/oss/oss2/scfindex.html.*

[48] The net worth test includes assets that a natural person holds jointly with his or her spouse. *See* rule 205–3(d)(1)(ii)(A).

[49] The assumption that 25% of these investors would have entered into new performance fee arrangements is based on data compiled in a 2008 report sponsored by the Commission. *See* Angela A. Hung et al., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers 130 (Table C.1) (2008) (available at *http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf*) (estimating that approximately 20% of investment advisers charge performance fees). Although that report indicated that 20% of investment advisers charge performance fees and an average of only 37% of investors indicated they would seek investment advisory services in the next five years, *id.* at 105 (Table 6.13), we have used the 25% assumption in an effort to overestimate rather than underestimate the costs, especially given the inherent uncertainty surrounding hypothetical events. As noted above, the estimate concerning 1.3 million households is derived from the 2007 Federal Reserve Board Survey of Consumer Finances. *See supra* notes 47–48 and accompanying text.

[50] This estimate is based on data filed by registered investment advisers on Form ADV.

[51] Commission staff estimates that less than one percent of registered investment advisers are compensated solely by performance fees, based on data from filings by registered investment advisers on Form ADV.

[52] This assumption is based on the idea that a substantial majority of investment advisers that

Continued

Commission staff estimates that the remaining 39,000 households that would have entered into advisory contracts, if the value of the client's primary residence were not excluded from the calculation of a person's net worth, will not enter into advisory contracts. Some of these households would likely seek other investment opportunities, for example, investing in mutual funds, closed-end funds, or exchange-traded funds. Other households may forgo professional investment management altogether because of the higher value they place on the alignment of advisers' interests with their own interests associated with the use of performance fee arrangements.

We recognize that the proposed amendments that would exclude the value of a person's primary residence from the calculation of a person's net worth also might result in a reduction in the total fees collected by investment advisers. Because advisers would no longer be able to charge some clients performance fees, it is possible that the overall fees collected by advisers might be reduced. As discussed above, advisers may adjust their fees in order to obtain the same revenue from clients who do not meet the definition of "qualified clients." In addition, advisers may choose to market their services to a larger number of potential clients and thereby enter into advisory contracts with others to whom they could charge performance fees.[53] As a result, Commission staff estimates that the proposed amendments are not likely to impose a significant net cost on advisers. Because of the ability of investment advisers to attract qualified clients who satisfy the proposed standards, and the ability of non-qualified clients to invest in other investment opportunities that do not entail performance fees, we expect that the proposed rule would not have a significant impact on capital formation.[54]

We request comment on the economic costs of excluding the value of the primary residence and debt secured by the property from the net worth test for determining whether individual clients are "qualified clients."

• Would most households that no longer meet the net worth standard due to the exclusion of the value of the primary residence, still receive advisory services? Would investment advisers decline to provide advisory services to potential clients who do not qualify as "qualified clients"? Would investment advisers be able to offset the potential lost performance fees? If not, what would be the amount of lost fees that advisers would incur?

C. Request for Comment

The Commission requests comment on all aspects of the cost benefit analysis, including the accuracy of the potential benefits and costs identified and assessed in this release, as well as any other benefits or costs that may result from the proposals. We encourage commenters to identify, discuss, analyze, and supply relevant data regarding these or additional benefits and costs. For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[55] the Commission also requests information regarding the potential annual effect of the proposals on the U.S. economy. Commenters are requested to provide empirical data to support their views.

V. Paperwork Reduction Act

The proposed amendments to rule 205–3 under the Advisers Act do not contain a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[56] Accordingly, the PRA is not applicable.

VI. Regulatory Flexibility Act Certification

Section 3(a) of the Regulatory Flexibility Act of 1980[57] ("RFA") requires the Commission to undertake an initial regulatory flexibility analysis ("IRFA") of the proposed rule amendments on small entities unless the Commission certifies that the rule, if adopted, would not have a significant economic impact on a substantial number of small entities.[58] Pursuant to 5 U.S.C. section 605(b), the Commission hereby certifies that the proposed amendments to rule 205–3 under the Advisers Act, would not, if adopted, have a significant economic impact on a substantial number of small entities. Under Commission rules, for purposes of the Advisers Act and the RFA, an investment adviser generally is a small entity if it: (i) Has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.[59]

Based on information in filings submitted to the Commission, 617 of the approximately 11,888 investment advisers registered with the Commission are small entities. Only approximately 20 percent of the 617 registered investment advisers that are small entities (about 122 advisers) charge any of their clients performance fees. In addition, 24 of the 122 advisers require an initial investment from their clients that would meet the current assets-under-management threshold ($750,000), which advisory contracts would be grandfathered into the exemption provided by rule 205–3 under the proposed amendments. Therefore, if these advisers in the future raise those minimum investment levels to the revised level that we intend to issue by order ($1 million), those advisers could charge their clients performance fees because the clients would meet the assets-under-management test, even if they would not meet the proposed net worth test that would exclude the value of the client's primary residence. For these reasons, the Commission believes that the proposed amendments to rule 205–3 would not, if adopted, have a significant economic impact on a substantial number of small entities.

The Commission requests written comments regarding this certification. The Commission solicits comments as

typically charge performance fees and that in the future would calculate a potential client's net worth and determine that it does not meet the $2 million threshold, would offer alternate compensation arrangements in order to offer their services. As noted above, Commission staff estimates that less than one percent of registered advisers charge performance fees exclusively. *See supra* note 51.

[53] Commission staff notes that expanding marketing efforts could result in additional costs that offset some of the new sources of revenue. As noted above, Commission staff estimates that 39,000 households that would have entered into advisory contracts would not enter into such contracts as a result of the proposed exclusion of a client's primary residence from a determination of a client's net worth. Based on ADV filings, Commission staff estimates that 3295 registered advisers charge performance fees. Therefore, Commission staff estimates that on average each adviser would need to offset the loss of approximately 12 households (39,000/3295 = 11.8 households) to avoid a reduction in total fees collected, either by charging those households comparable fees other than performance fees, or by attracting other clients that meet the net worth test.

[54] Clients who no longer meet the net worth test as a result of the exclusion of their primary residence likely would have invested a smaller amount of assets than other clients who continue to meet the test. Therefore, the revenue loss to investment advisers from the exclusion of these clients from the performance fee exemption may be mitigated.

[55] Pub. L. 104–121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C., and as a note to 5 U.S.C. 601).

[56] 44 U.S.C. 3501–3521.

[57] 5 U.S.C. 603(a).

[58] 5 U.S.C. 605(b).

[59] Rule 0–7(a).

to whether the proposed amendments could have an effect on small entities that has not been considered. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

VII. Statutory Authority

The Commission is proposing amendments to rule 205–3 pursuant to the authority set forth in section 205(e) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–5(e)].

List of Subjects in 17 CFR Part 275

Reporting and recordkeeping requirements, Securities.

Text of Proposed Rules

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 275—RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The general authority citation for part 275 continues to read as follows:

Authority: 15 U.S.C. 80b–2(a)(17), 80b–3, 80b–4, 80b–6(4), 80b–6a, 80b–11, unless otherwise noted.

* * * * *

2. Section 275.205–3 is amended by:

a. Revising paragraph (c);

b. Revising paragraphs (d)(1)(i) and (ii); and

c. Adding paragraph (e).

The revisions and addition read as follows.

§ 275.205–3 Exemption from the compensation prohibition of section 205(a)(1) for investment advisers.

* * * * *

(c) *Transition rules.* (1) *Registered investment advisers.* If a registered investment adviser entered into a contract and satisfied the conditions of this section that were in effect when the contract was entered into, the adviser will be considered to satisfy the conditions of this section; *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 section in effect at that time will apply with regard to that person or company.

(2) *Registered investment advisers that were previously exempt from registration.* If an investment adviser was exempt from registration with the Commission pursuant to section 203 of the Act (15 U.S.C. 80b-3), section 205(a)(1) of the Act will not apply to an advisory contract entered into when the adviser was exempt, or to an account of an equity owner of a private investment company advised by the adviser if the account was established when the adviser was exempt; *Provided,* however, that section 205(a)(1) of the Act will apply with regard to a natural person or company who was not a party to the contract and becomes a party (including an equity owner of a private investment company advised by the adviser) when the adviser is no longer exempt.

(d) * * *

(1) * * *

(i) A natural person who, or a company that, immediately after entering into the contract has at least $1,000,000 under the management of the investment adviser;

(ii) A natural person who, or a company that, the investment adviser entering into the contract (and any person acting on his behalf) reasonably believes, immediately prior to entering into the contract, either:

(A) Has a net worth (together, in the case of a natural person, with assets held jointly with a spouse) of more than $2,000,000, excluding the value of the primary residence of such natural person, calculated by subtracting from the estimated fair market value of the property the amount of debt secured by the property, up to the estimated fair market value of the property; or

(B) Is a qualified purchaser as defined in section 2(a)(51)(A) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(51)(A)) at the time the contract is entered into; or

* * * * *

(e) *Inflation adjustments.* Pursuant to section 205(e) of the Act, the dollar amounts specified in paragraphs (d)(1)(i) and (d)(1)(ii)(A) of this section shall be adjusted by order of the Commission, effective on or about May 1, 2016 and issued approximately every five years thereafter. The adjusted dollar amounts established in such orders shall be computed by:

(1) Dividing the year-end value of the Personal Consumption Expenditures Chain-Type Price Index (or any successor index thereto), as published by the United States Department of Commerce, for the calendar year preceding the calendar year in which the order is being issued, by the year-end value of such index (or successor) for the calendar year 1997;

(2) For the dollar amount in paragraph (d)(1)(i) of this section, multiplying $750,000 times the quotient obtained in paragraph (e)(1) of this section and rounding the product to the nearest multiple of $100,000; and

(3) For the dollar amount in paragraph (d)(1)(ii)(A) of this section, multiplying $1,500,000 times the quotient obtained in paragraph (e)(1) of this section and rounding the product to the nearest multiple of $100,000.

By the Commission.

Dated: May 10, 2011.

Elizabeth M. Murphy,

Secretary.

[FR Doc. 2011–11801 Filed 5–12–11; 8:45 am]

BILLING CODE 8011–01–P

DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 165

[Docket No. USCG–2011–0303]

RIN 1625–AA00

Safety Zone; Shore Thing and Independence Day Fireworks, Chesapeake Bay, Norfolk, VA

AGENCY: Coast Guard, DHS.

ACTION: Notice of proposed rulemaking.

SUMMARY: The Coast Guard proposes establishing a temporary safety zone on the Chesapeake Bay in the vicinity of Ocean View Beach Park, Norfolk, VA in support of the Shore Thing and Independence Day Fireworks event. This action is necessary to provide for the safety of life on navigable waters during the Shore Thing and Independence Day Fireworks show. This action is intended to restrict vessel traffic movement on the Chesapeake Bay to protect mariners from the hazards associated with fireworks displays.

DATES: Comments and related material must be received by the Coast Guard on or before June 13, 2011.

ADDRESSES: You may submit comments identified by docket number USCG–2011–0303 using any one of the following methods:

(1) *Federal eRulemaking Portal: http://www.regulations.gov.*

(2) *Fax:* 202–493–2251.

(3) *Mail:* Docket Management Facility (M–30), U.S. Department of Transportation, West Building Ground Floor, Room W12–140, 1200 New Jersey Avenue, SE., Washington, DC 20590–0001.

(4) *Hand delivery:* Same as mail address above, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The telephone number is 202–366–9329.

To avoid duplication, please use only one of these four methods. See the