

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 2545 / September 7, 2006**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-12409**

**In the Matter of**

**KENSINGTON INVESTMENT  
GROUP, INC.,**

**Respondent.**

**ORDER INSTITUTING PUBLIC  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS, MAKING  
FINDINGS, AND IMPOSING REMEDIAL  
SANCTIONS AND A CEASE-AND-DESIST  
ORDER PURSUANT TO SECTIONS 203(e)  
AND 203(k) OF THE INVESTMENT  
ADVISERS ACT OF 1940**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Advisers Act”) against Kensington Investment Group, Inc. (“Kensington” or “Respondent”).

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (“Order”), as set forth below.

**III.**

On the basis of this Order and Respondent’s Offer, the Commission finds that:

## **RESPONDENT**

1. Kensington, a Delaware corporation, headquartered in Orinda, California, has been registered as an investment adviser with the Commission since October 13, 1993. Kensington provides investment advisory services to the Kensington Strategic Realty Fund (“Realty Fund” or “the fund”), one of three real-estate funds managed by Kensington that have combined net assets of approximately \$1.5 billion.

## **SUMMARY**

2. In September 1999, Kensington entered into an investment advisory contract with the Coventry Group on behalf of the Realty Fund that provided for compensation to Kensington on the basis of a share of capital gains upon or capital appreciation of the assets of the Realty Fund. From October 2000 through December 2004 (the “relevant period”), Kensington collected compensation based on the Realty Fund’s net asset value on each day of the month following the performance period in violation of Section 205 of the Advisers Act, as discussed below. Over the four year period, Kensington charged the Realty Fund approximately \$617,000 more than it would have if it had calculated the fee in compliance with Section 205 of the Advisers Act.

### **Performance-Based Compensation under Section 205 of the Advisers Act**

3. Section 205 of the Advisers Act generally prohibits investment advisers, unless exempt from registration under Section 203(b) of the Advisers Act, from entering into advisory contracts that provide for compensation based on a share of capital gains upon, or capital appreciation of, the assets (or any portion of the assets) of a client (“performance-based compensation” or “total fee”), except as provided in Section 205(b) of the Advisers Act.

4. Under Section 205(b)(2) of the Advisers Act, an investment adviser may enter into an advisory contract with a registered investment company that provides for performance-based compensation that: (i) increases and decreases proportionately with the investment performance of the company or fund over a specified period in relation to the investment record of an appropriate index of securities prices; and (ii) is based on the asset value of the company or fund, “averaged over a specified period.”

5. Rule 205-2(b) under the Advisers Act defines the “specified period” over which the asset value of the company or fund under management is averaged as the “period over which the investment performance of the company or fund and the investment record of an appropriate index of securities prices . . . are computed.”<sup>1</sup> For example, if an advisory contract specifies that the fund’s performance will be measured against the performance of the S&P 500 index over a 12-month period, then the adviser’s performance-based compensation must be assessed against the asset value of the fund averaged over the same 12-month period.

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<sup>1</sup> Advisers Act Rule 205-2(b); *see* Adoption of Rule 205-2 under the Investment Advisers Act of 1940, As Amended, Definition of “Specified Period” Over Which Asset Value of the Company or Fund Under Management is Averaged, Advisers Act Release No. 347 (Nov. 10, 1972) (stating that the performance-related portion of the fee must be assessed against the assets averaged over the same period over which performance was computed).

6. Rule 205-2(c) provides a conditioned exemption from Rule 205-2(b). Under this exemption, an advisory contract providing for performance-based compensation may use a “fulcrum fee,”<sup>2</sup> for which the “specified period” over which the asset value of the company or fund under management is averaged may differ from the period over which the asset value is averaged for computing the performance-related portion of the fee, only if:

- (a) the performance-related portion of the fee is computed over a rolling period<sup>3</sup> and the total fee is payable at the end of each subperiod of the rolling period; and
- (b) the fulcrum fee is computed based on the asset value averaged over the most recent subperiod or subperiods of the rolling period.<sup>4</sup>

For the purposes of Rule 205-2(c), the rolling period must be the same as the period over which performance is measured. Thus, for example, under the exemption provided by Rule 205-2(c), an advisory contract could provide for performance-based compensation that uses a fulcrum fee (calculated by applying a total-fee rate to the asset value averaged over the most recent subperiod or subperiods of a 12-month rolling period (*e.g.*, the most recent month or three months (a quarter)), as adjusted by the performance-related portion of the fee (calculated by applying a performance-adjustment rate to the asset value of the fund averaged over the entire 12-month rolling period).

7. These provisions are designed to link an adviser’s performance-based compensation to the fund’s investment performance and thereby prevent performance-based compensation from being influenced unduly by the amount of sales or redemptions in the fund over a shorter period.<sup>5</sup>

## **FACTS**

### **Kensington’s Method for Computing Its Total Fee**

8. During the relevant period, Kensington charged the Realty Fund performance-based compensation. Specifically, the fund’s advisory contract provided that the total fee would equal the sum of a fulcrum fee and a performance-related portion of the fee. The contract further specified that the total fee would be calculated by applying the fund’s fulcrum-fee rate and performance-adjustment rate over a specified period against the fund’s average daily net assets.

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<sup>2</sup> Rule 205-2(a)(1) defines fulcrum fee to be the “fee which is paid or earned when the investment company’s performance is equivalent to that of the index or other measure of performance.”

<sup>3</sup> Rule 205-2(a)(2) defines rolling period to be “a period consisting of a specified number of subperiods of definite length in which the most recent subperiod is substituted for the earliest subperiod as time passes.” Thus, an advisory contract providing for a 12-month rolling period would be based on a rolling period consisting of 12 one-month subperiods.

<sup>4</sup> Rule 205-2(c).

<sup>5</sup> *See* Factors To Be Considered in Connection With Investment Company Advisory Contracts Containing Incentive Fee Arrangements, Investment Company Act Release No. 7113 (April 6, 1972).

The advisory contract further defined average daily net assets to mean the value of the fund's net assets at 4:00 p.m. (New York time) on each day that Kensington assessed the performance-based compensation. Under the contract, the fulcrum-fee rate was set at 1.50%. Depending on the fund's performance against the index, the performance-adjustment rate was calculated as 15% of the performance difference and could range from plus or minus 1.00%. The advisory contract provided that the fund's performance would be measured against the performance of an external index, the National Association of Real Estate Investment Trust Composite Index, over a 12-month rolling period ("performance period"). In practice, Kensington computed the fund's total fee by applying the fulcrum-fee rate and the performance-adjustment rate against the fund's net asset value at 4:00 p.m. (New York time) on each day of the month following the performance period. Consequently, Kensington did not calculate its total fee consistent with either Rule 205-2(b) or 205-2(c).

9. The Realty Fund's asset value generally increased during the relevant period, such that, on any given assessment date, the fund's net asset value on each day of the month following the performance period was usually greater than the value of the fund's assets averaged over the performance period. At times, the fund's performance exceeded the performance of its external benchmark index resulting in Kensington's assessment of its performance-based compensation to be higher than if Kensington had calculated the fee in accordance with Section 205 and Rule 205-2 of the Advisers Act. At other times, the fund's performance lagged the performance of its external benchmark index, resulting in Kensington's assessment of its performance-based compensation to be lower than if Kensington had calculated the fee in accordance with Section 205 and Rule 205-2 of the Advisers Act. The net result was Kensington overcharged the Realty Fund by \$617,098 during the relevant period.

10. Upon notification by the Commission staff that Kensington was charging the Realty Fund a total fee based on a method that did not comply with Section 205 of the Advisers Act, Kensington's management discontinued the method and subsequently reimbursed the fund plus interest of \$173,864, for a total payment of \$790,962. The Board of Directors of the fund approved the repaid amount.

### **Violations**

11. As a result of the conduct described above, Respondent willfully<sup>6</sup> violated Section 205(a) of the Advisers Act, which prohibits an investment adviser from entering into an advisory contract with a registered investment company that provides for performance-based compensation unless, pursuant to Section 205(b) of the Advisers Act, the contract provides for performance-based compensation based on the asset value of the fund averaged over a specified period and increasing and decreasing proportionately with the investment performance of the fund over a specified period in relation to the investment record of an appropriate index of securities prices.

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<sup>6</sup> "Willfully" as used in this Order means intentionally committing the act which constitutes the violation, *see Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.

**Respondent's Remedial Efforts**

12. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

**IV.**

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in the Respondent's Offer of Settlement. Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

- A. Respondent is censured.
- B. Respondent shall cease and desist from committing or causing any violations and any future violations of Section 205(a) of the Advisers Act.

By the Commission.

Nancy M. Morris  
Secretary