

Investment Management Alert

June 28, 2016

SEC Orders Increase in Qualified Client Threshold

The Securities and Exchange Commission (SEC) issued a final order on June 14 to adjust for inflation the net-worth threshold for a registered investment adviser to charge performance-based compensation¹ to its advisory clients or investors in 3(c)(1) private funds² from \$2 million to \$2.1 million (not including the client's or investor's primary residence and related debt).³ The order (available [here](#)) will be effective on August 15, 2016. Advisory contracts or investments in 3(c)(1) private funds entered into prior to the effective date will not be affected. Subscription documents and agreements for the sale of fund interests between investors should reflect these new thresholds.

The grandfathering provisions added to the qualified client rule in 2012 will continue to apply, so clients or applicable investors who satisfied a lower qualified client threshold at the time of the original investment will be permitted to make additional capital contributions to the same managed account or investments in the same fund without satisfying the new thresholds. Also, persons who received interests in a 3(c)(1) private fund through a bequest or gift or pursuant to an agreement related to a separation or divorce will be permitted to be charged performance compensation if the person from whom he or she received the interest satisfied the relevant thresholds at the time of his or her investment.

¹ A registered investment adviser is prohibited under Section 205 of the Investment Advisers Act of 1940 from receiving performance-based compensation. Rule 205-3 permits registered investment advisers to charge performance-based compensation so long as the client or, in the case of a 3(c)(1) private fund, the investor, satisfies the assets-under-management or net-worth tests to be a "qualified client." The assets-under-management test has not been adjusted for inflation and will remain at \$1 million.

² While a "private fund" may be a 3(c)(1) fund or a 3(c)(7) fund, the thresholds in Rule 205-3 under the Investment Advisers Act of 1940 apply to only 3(c)(1) funds. Also, "qualified purchasers" are automatically deemed to be "qualified clients."

³ Rule 205-3 excludes the value of the primary residence as an asset and debt secured by the primary residence as a liability, except to the extent (1) that the value of the debt would exceed the value of the residence and (2) of any increase in debt secured by the person's primary residence occurring within 60 days prior to entering into the advisory contract or investing in the 3(c)(1) private fund on the liability side of the net-worth calculation, unless the increase was a result of the acquisition of the primary residence.

Contact Information

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