

Investment Management Alert

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Qualified Client Thresholds Increased – Actions Required by Private Fund Managers

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Key Points

- Subscription documents for certain private funds and investment management agreements for certain separately managed accounts will need to be updated by August 16, 2021, to reflect new “qualified client” assets-under-management and net worth thresholds.
- These changes directly affect private funds relying on the 3(c)(1) exemption, but many 3(c)(7) documents contain qualified client representations and may need to be updated.

Background

An SEC-registered investment adviser is permitted to receive incentive compensation (e.g., performance fees, allocations and other forms of “carry”) from investors in hedge funds, private equity funds and other private funds, and from separately-managed account clients, **only if** those investors and clients are “qualified clients” under Investment Advisers Act Rule 205-3. (“Qualified purchasers” and “knowledgeable employees” are deemed to be “qualified clients.”) In addition, advisers registered with a state securities regulator that incorporates the definition of “qualified client” into its rules may be affected by these changes.

New Thresholds

A qualified client is an investor or client that is not affiliated with the adviser and that satisfies an assets-under-management test or a net worth test which, as of August 16, 2021, will be increased (as a result of a re-indexing performed every five years) as follows:

- The threshold for assets under management by the adviser will increase from \$1 million to \$1.1 million.
- The investor or client net worth threshold (which includes spousal assets) will increase from \$2.1 million to \$2.2 million excluding the client’s or investor’s primary residence and related debt.

Contact Information

If you have any questions regarding this alert, please contact the Akin Gump lawyer with whom you usually work or:

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In general, **only new investors and clients are affected by this change**; most existing fund investments and SMA arrangements are grandfathered (for example, investors who previously invested in a 3(c)(1) fund and met the prior threshold can continue to make investments in that 3(c)(1) fund without meeting the new threshold). Transfers of fund interests may be grandfathered, but should be analyzed.

The order (which contains additional details and is available [here](#)) will be effective August 16, 2021.

Next Steps Checklist

Registered investment advisers should consider the following steps:

- Amend the form subscription documents being used for 3(c)(1) funds.
- Amend any forms for SMA agreements that provide for incentive compensation.
- Review form subscription documents for non-3(c)(1) funds and amend any qualified client representations.
- Establish controls to prevent future distributions of un-amended subscription documents and SMA agreements.
- Establish procedures with the adviser's operations and investor relations teams, and with each fund administrator, to flag unamended subscription documents and SMA agreements and to obtain updated qualified client representations.
- Consider including a confirmation of these steps into the annual compliance review.

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