

Corporate & Financial Weekly Digest

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SEC Proposes Adjustments to Advisers Act "Qualified Client" Standard

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The Securities and Exchange Commission has proposed amendments to Rule 205-3 under the Investment Advisers Act of 1940, as amended (the Advisers Act), to revise the definition of "qualified client." Under Rule 205-3, accounts of qualified clients are exempted from the Advisers Act's general prohibition against SEC-registered investment advisers charging performance-based fees to their advisory clients. Currently, a qualified client generally includes any client that has either (1) \$750,000 or more under management with the investment adviser or (2) a net worth of at least \$1.5 million.

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC is required to adjust the dollar amount tests set forth in certain of its rules, including the qualified client definition, for inflation. Under the SEC's proposal, the qualified client definition would be revised to increase the "assets under management" threshold described above from \$750,000 to \$1 million and the "net worth" threshold from \$1.5 million to \$2 million. In addition, the revised definition would exclude the value of a natural person's primary residence (and associated secured indebtedness) for purposes of the net worth threshold. The SEC proposal would require the SEC to make similar inflation adjustments every five years.

Finally, the SEC's proposal includes new transition rules which would have the effect of "grandfathering" many existing performance-based fee arrangements. Specifically, increases in the "qualified client" dollar amount thresholds (including future inflation adjustments) would not apply retroactively to an investment adviser's clients (including investors in private funds managed by the investment adviser) whose performance-based fee arrangements were permissible under the law in effect at the time of entering into the advisory contract, even if the client subsequently invests additional funds with the adviser. In addition, for advisers that were previously exempt from SEC registration pursuant to Section 203 of the Advisers Act and subsequently register with the SEC, the restrictions on performance-based compensation would not apply to existing clients or private fund investors whose advisory contracts were entered into while the adviser was exempt from SEC registration, but would apply to new clients and investors.

The comment period for the SEC proposal closes on July 11.

A copy of the proposal is available [here](#).

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