



## **SEC Issues Notice of Intent to Raise Net Worth Threshold for Qualified Clients**

On May 24, 2016, the Securities and Exchange Commission (“SEC”) published a notice of its intent to issue an order increasing the net worth threshold for “qualified clients,” as defined in Rule 205-3 under the Investment Advisers Act of 1940, as amended (the “Advisers Act”). The Advisers Act generally prohibits SEC-registered investment advisers from charging any client a performance-based fee – for fund managers, this includes carried interest distributions and performance allocations. Rule 205-3 offers an exemption from this prohibition for clients that meet the “qualified client” definition. Thus registered investment advisers may charge performance fees to clients, including fund investors, who are “qualified clients.” In addition, many states prohibit investment advisers operating within their borders – regardless of registration status – from charging performance fees, except as to “qualified clients” as federally defined.

Under the current definition, a “qualified client” is a person or company who either (i) has at least \$1 million under management with the investment adviser, or (ii) has a net worth (either individually or jointly with a spouse) which the investment adviser reasonably believes to be in excess of \$2 million, excluding the equity value of such person’s primary residence.

### The Proposed Order

The proposed order will increase the net worth threshold from \$2 million to \$2.1 million. It will not modify the assets under management threshold, which will remain at \$1 million. This proposal was issued pursuant to section 205(e) of the Advisers Act, as amended by the Dodd-Frank Act. Under the amended section 205(e), the SEC is required to adjust the “qualified client” standard for inflation on a quinquennial basis, beginning in May 2016.

### Effective Date and Retroactive Application

The new net worth threshold will take effect approximately 60 days following the issuance of the proposed order. At that point, investment advisers should modify their advisory contracts and fund documents to reflect the \$2.1 million net worth threshold. Advisers may continue relying on their current agreements for the time being, as the new threshold will not apply retroactively to advisory contracts entered into prior to the effective date.