

Corporate & Financial Weekly Digest

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SEC Revises the "Qualified Client" Standards for Registered Investment Advisers

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The Securities and Exchange Commission has adopted 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 amendments to the rule, the qualified client definition will 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 will exclude the value of a natural person's primary residence (and associated secured indebtedness) for purposes of the net worth threshold. The SEC will make similar inflation adjustments every five years.

Finally, the amendments to the rule include new transition rules which will have the effect of "grandfathering" many existing performance-based fee arrangements. Specifically, increases in the "qualified client" dollar amount thresholds (including future inflation adjustments) will 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 will not apply to existing clients or private fund investors whose advisory contracts were entered into while the adviser was exempt from SEC registration, but will apply to new clients and investors.

The changes to Rule 205-3 will go into effect 90 days after they are published in the Federal Register. A copy of the SEC's adopting release is available [here](#).

The proposed rules will be published in the Federal Register for a 60-day public comment period. To read the proposed amendments to Rule 17a-5, click [here](#). To read SEC Chairman Mary Schapiro's opening statement at the SEC Open Meeting: Proposals to Amend Rule 17a-5, click [here](#).

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