

June 2016

SEC Adjusts Thresholds for ‘Qualified Client’ Status – Effective Aug. 15, 2016

As it signaled its intent in May (notice available [here](#)), on June 14, 2016, the Securities and Exchange Commission (the Commission) issued an Order (available [here](#)) adjusting the net worth threshold for qualification as a “qualified client” under Rule 205-3 under the Investment Advisers Act of 1940, as amended (the Advisers Act). That Rule (available [here](#)) exempts a registered investment adviser (and its affiliates) from the prohibition against charging capital gains-based fees as long as the client being charged the fee is a “qualified client.” Such fees include, for example, carried interest and/or promote interest payments and, in the context of certain private funds (including many hedge funds, private equity funds, venture capital funds and real estate funds, among others), each investor may be considered a “client” needing to meet the threshold of being a “qualified client.” Presently, a “qualified client” includes a person that has at least \$1,000,000 in assets under management of the investment adviser (the AUM test) as well as a person with a net worth of more than \$2,000,000 (the net worth test).

The 2010 Dodd-Frank Act requires, commencing in 2011, that the Commission review these thresholds every five years and, if necessary, make adjustments for inflation (in \$100,000 increments). Following the most recent review, the Commission left the AUM test unchanged, but is raising the threshold for the net worth test to \$2,100,000. This change is effective Aug. 15, 2016. The Order states that, subject to the transition rules incorporated into Rule 205-3 itself, the adjustment will not apply retroactively to contractual relationships entered into prior to the effective date.

The change in the threshold for the net worth test should not impact already-existing client relationships or funds that have or will have had their final closings prior to Aug. 15, 2016. Registered investment advisers who charge capital gains-based fees, and particularly investment advisers sponsoring or otherwise affiliated with private fund offerings that anticipate holding one or more closings on or after Aug. 15, 2016, should consult with their counsel or their Greenberg

Traurig attorney assisting them with regulatory and/or fund formation matters now to begin the process of updating the necessary documentation and compliance procedures.

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