



July 27, 2016

SEC Increases Dollar Amount Threshold Test for “Qualified Clients”

Section 205 of the Investment Advisers Act of 1940, as amended (the “Advisers Act”) prohibits a registered investment adviser (“RIA”) from receiving performance-based compensation from clients. Rule 205-3 (the “Rule”) under the Advisers Act exempts from this prohibition clients that are “qualified clients,” as defined in the Rule.

On June 14, 2016, the Securities and Exchange Commission (“SEC”) issued an Order [\[available here\]](#) increasing certain dollar amount thresholds used to determine whether a client meets the qualified client definition under the Rule. After giving effect to the increase in the dollar amount threshold, a natural person or company will be deemed a qualified client when:

- the client has at least \$1 million under management with the RIA immediately after entering into an advisory contract (the “assets-under-management test”); or
- the RIA “reasonably believes,” immediately prior to entering into the advisory contract, that the client has a net worth, together with assets held jointly with a spouse, of more than \$2.1 million (the “net worth test”).

These tests apply with respect to both managed accounts and private investment funds that rely on Section 3(c)(1) of the Investment Company Act of 1940, as amended. The increase is a consequence of the Dodd-Frank Wall Street Reform and Consumer Protection Act that amended Section 205 of the Advisers Act to provide that every five years, the SEC shall issue an order “adjusting for inflation the dollar amount thresholds of the [R]ule’s assets-under-management and net worth tests....” Pursuant to the Order, the net worth threshold was increased from \$2 million to \$2.1 million; the assets-under-management threshold remains at \$1 million.

The Order is effective as of August 15, 2016. The increased dollar amount set forth in the Order will not apply retroactively to a contractual arrangement entered into prior to the

effective date of the Order, provided the client met the qualified client threshold in effect when that contract was entered into.

RIAs that charge performance fees should amend their relevant agreements to reflect the increased threshold for a client to be deemed a qualified client. Please contact Meryl Wiener or your regular Warsaw Burstein attorney if you would like help reviewing your existing documentation and agreements.

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