



Increased Net Worth Threshold for Certain Clients and Investors to be Charged Performance Fees by U.S. Registered Investment Advisers

The U.S. Investment Advisers Act of 1940 (“Advisers Act”) prohibits an investment adviser registered with the U.S. Securities and Exchange Commission (“SEC”) from entering into, extending, renewing, or performing an investment advisory contract that provides for compensation to the adviser based on a share of capital gains on, or capital appreciation of, the funds of a client¹ (e.g., performance-based compensation such as carried interest or a performance fee). However, Rule 205-3 under the Advisers Act exempts an investment adviser from the foregoing prohibition if the client is a “qualified client.”²

Rule 205-3 under the Advisers Act currently defines a “qualified client” to include a person that has at least

\$1,000,000 under the management of the investment adviser or a net worth³ of more than \$2,000,000.⁴

On June 14, 2016, the SEC published an order approving adjustment for inflation of the dollar amount thresholds in Rule 205-3.⁵ The amount of the assets under management, or AUM, threshold (i.e., \$1,000,000) will remain the same, but the amount of the net worth threshold will increase to \$2,100,000. The effective date of the net worth threshold increase is August 15, 2016. To the extent that contractual relationships (that is, advisory agreements or subscription agreements) are entered into prior to August 15, 2016, the current net worth standard will apply.

1 Advisers Act §205(a)(1). Generally, Advisers Act Rule 205-3 provides that, in the case of a company that relies on Section 3(c)(1) for its exception from the definition of an “investment company,” an investment company registered under the Investment Company Act of 1940, as amended (the “Investment Company Act”), or a business development company, each equity owner of any such company is considered a “client” for purposes of this prohibition.

2 Also excluded from this prohibition are clients who are “non-U.S. persons.”

3 The net worth calculation excludes the value of a client’s primary residence and certain property-related debt.

4 A “qualified client” is also defined to include a “qualified purchaser” (within the meaning of Section 2(a)(51) of the Investment Company Act).

5 The Dodd-Frank Wall Street Reform and Consumer Protection Act required that the SEC adjust these dollar amount thresholds for inflation every five years, rounded to the nearest \$100,000.

Investment advisers registered with the SEC—in particular, those investment advisers that advise clients with managed accounts, or funds that rely on Section 3(c)(1)—should ensure that advisory agreements and subscription agreements entered into with new clients or investors on or after August 15, 2016, contain the new net worth standard.

Lawyer Contacts

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