

Recent Amendment of SEC'S "Qualified Client" Definition

07.18.16

The SEC recently adopted an amendment increasing the net worth threshold set forth in the definition of "qualified client" under the Advisers Act. For an investment adviser that is registered with the SEC, or one that is registered with certain states (including the State of Texas), to charge a performance-based fee (whether as a fee on a managed account or as part of a private fund structure), the advisory client, or limited partner in the case of a private investment fund, must satisfy the definition of a "qualified client" as defined by Rule 205-3 under the Advisers Act. The SEC's "qualified client" definition is also relevant for any hedge fund adviser that is relying on Texas's "Private Fund Adviser Exemption" under Rule 139.23 of the Texas Administrative Code (i.e. an exempt reporting adviser), which requires advisers relying on such exemption to manage only those hedge funds whose investors all satisfy the SEC's "qualified client" definition.

Specifically, the SEC has increased to \$2.1 million the net worth threshold of the "qualified client" definition as set forth in Rule 205-3 under the Investment Advisers Act. This new net worth threshold does not become effective until August 15, 2016, however, we are urging all advisers to update their subscription documents and any other applicable investor questionnaires prior to August 1 in order to reflect the new thresholds in order to ensure correct information is timely obtained from new and existing investors and clients.

- For existing investors in a private fund (excluding funds where prior commitments have already been made), beginning on August 15, it will be inadequate to use a subscription document that reflects only the previously-effective lower net worth threshold of \$2.0 million or relies on the investor "restating" or "reaffirming" previously made representations regarding their status as a "qualified client" (e.g. in the form of a standard "additional subscription letter"). Advisers should update their subscription documents and their additional subscription letter to include a new representation reflecting the updated definition.
- For existing clients in separately managed accounts, if money is added to the account subsequent to August 15, the adviser should obtain a new representation from the client at the time the money is added to the client.
- For new investors and new clients in separately managed accounts, the subscription documents or the managed account agreement, as the case may be, should be revised to reflect these new changes.

Fortunately, advisers should find the task of amending the subscription document, additional subscription letter or separately managed account agreement, as the case may be, to be a relatively straightforward exercise. Nevertheless, it is a task that we believe demands immediate and careful attention.

Contacts:

[Andrew Rosell](#)

817.420.8261

arosell@winstead.com

[Courtney Mitchell](#)

214.745.5717

cmitchell@winstead.com

Disclaimer: Content contained within this news alert provides information on general legal issues and is not intended to provide advice on any specific legal matter or factual situation. This information is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. Readers should not act upon this information without seeking professional counsel.