

SEC Clarifies Application of Qualified Client Test for Related Advisers

Written by Robert G. Sawyer

November 11, 2013

Under SEC Rule 205-3 under the Investment Advisers Act of 1940 (the “Advisers Act”), an SEC registered investment adviser is permitted to enter into an engagement that includes an incentive compensation component, provided that the client is a “qualified client” within the meaning of the Rule. Many states, including Massachusetts, have extended the application of the rule to cover state registered advisers as well as unregistered advisers that have a place of business in the state. As a result, many managers of private funds that include an incentive fee or allocation must confirm that fund investors are “qualified clients” within the meaning of SEC Rule 205-3. Although there are many relevant factors in determining qualified client status, the basic test is whether the investor, at the time of making the investment, has either (i) a net worth, exclusive of the amount of any equity value in the investor’s primary residence, of at least \$2,000,000, or (ii) at least \$1,000,000 under the management of the adviser (taking into account the investment being made).

For purposes of the satisfying the second test, the SEC recently issued **IM Guidance Update No. 2013-10**, which clarifies that in certain circumstances it is possible to aggregate investments under the management of several related advisers in order to satisfy the \$1,000,000 threshold. The SEC clarified that, in circumstances where a group of private funds are managed by several related investment advisers that together operate as a single advisory firm, the investments of a single investor in all such private funds may be aggregated for purposes of determining qualified client status, notwithstanding that the investor may not have \$1,000,000 or more under the management of any individual adviser within the advisory group.

RELATED INDUSTRIES

- [Investment Advisers & Private Funds](#)
- [Professional Services](#)

RELATED PRACTICES

- [Fund Formation](#)
- [Business Counseling](#)

This communication is intended for general information purposes and as a service to clients and friends of Foley Hoag LLP. This communication should not be construed as legal advice or a legal opinion on any specific facts or circumstances, and does not create an attorney-client relationship.

United States Treasury Regulations require us to disclose the following: Any tax advice included in this document was not intended or written to be used, and it cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code.

Attorney advertising. Prior results do not guarantee a similar outcome. © 2017 Foley Hoag LLP. All rights reserved.