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SEC Increases “Qualified Client” Dollar Amount Thresholds

On June 17, 2021, the SEC adjusted for inflation the dollar amount thresholds for both the assets under management and net worth tests for “qualified clients” under Rule 205-3 of the Investment Advisers Act of 1940, as amended.¹ Rule 205-3 permits investment advisers to receive performance-based compensation only when the client is a “qualified client,” which captures performance fees or distributions of carried interest. After giving effect to the increase, a qualified client² will be a client that either:

1. has at least \$1.1 million in assets under management with the investment adviser immediately after entering into the advisory contract; or
2. the investment adviser reasonably believes, immediately prior to entering into the contract, has a net worth of more than \$2.2 million.

As a reminder, each investor in a private fund relying on the exception to the definition of an investment company under §3(c)(1) of the Investment Company Act of 1940, as amended (the “40 Act”), is considered a “client” for purposes of Rule 205-3; consequently, each investor in a §3(c)(1) fund is required to satisfy the qualified client standard if the investment adviser is receiving performance-based compensation. The foregoing does not apply to a private fund relying on the exception to the definition of an investment company under §3(c)(7) of the 40 Act, which is itself a “client” for purposes of Rule 205-3.

The increases are effective August 16, 2021. Clients that enter into advisory agreements prior to the effective date in reliance on the previous dollar amount thresholds will be “grandfathered” in under the prior thresholds.³

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¹ A copy of the SEC’s Order may be found [here](#).

² Investment Advisers Act Rule 205-3(d) also provides that a “qualified purchaser” or a “knowledgeable employee” is also a “qualified client” for purposes of Rule 205-3.

³ The transition rules set forth in Rule 205-3(c)(1) provide that, if an investment adviser entered into an advisory agreement prior to the effective date with a client that satisfied the qualified client status rule in effect at the time the advisory agreement was entered into, the qualified client rule will be considered satisfied; however, if a client that was not a party to the advisory agreement becomes a party to it on or after August 16, 2021 (including an investor coming into a 3(c)(1) fund on or after August 16, 2021), the new standard would apply (*i.e.*, if the new investor is relying on the net worth test, it would need to meet the new \$2.2 million net worth threshold).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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