



ALERTS

SEC Raises 'Qualified Client' Net Worth And Assets Under Management Thresholds

July 22, 2021

Highlights

As of Aug. 16, 2021, the SEC has raised the “qualified client” net worth threshold, from \$2.1 million to \$2.2 million, and the assets under management threshold, from \$1 million to \$1.1 million

Clients that entered into advisory contracts in reliance on the lower thresholds prior to the effective date will be grandfathered in and still be deemed to meet the “qualified client” definition

Registered investment advisers that rely on Rule 205-3 of the Advisers Act to receive performance or incentive-based compensation from their clients should consider updating their offering and subscription documents to reflect these increases

The Securities and Exchange Commission (SEC) [issued an order](#) dated June 17, 2021 that will increase the “net worth” and “assets under management” thresholds for purposes of determining whether an investment advisory client meets the definition of a “qualified client” under Rule 205-3 of the Investment Advisers Act of 1940 (the Advisers Act). The increase of the thresholds will take effect as of Aug. 16, 2021 and was made pursuant to the five-year indexing adjustment required by Section 205(e) of the Advisers Act and Section 419 of the Dodd-Frank

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The SEC's order raised the qualified client "net worth test" from \$2.1 million to \$2.2 million and raised the "assets under management" test from \$1 million to \$1.1 million.

Beginning Aug. 16, 2021, in order to meet the [definition of a qualified client](#), the client of a registered investment adviser must:

1. Have at least \$1.1 million in assets under the management of the adviser immediately after entering into an investment advisory contract with the investment adviser;
2. Have a net worth (together, in the case of a natural person, with assets held jointly with a spouse) of more than \$2.2 million (in the case of a natural person, excluding the value of such natural person's primary residence and indebtedness secured by such residence) immediately prior to entering into an investment advisory contract;
3. Be a qualified purchaser as defined under Section 2(a)(51)(A) of the Investment Company Act of 1940 (the Investment Company Act); or
4. Be a "knowledgeable employee" of the investment adviser, as defined under Rule 3c-5 promulgated under the Investment Company Act.

Clients that entered into investment advisory contracts prior to the effective date in reliance on the lower net worth or assets under management thresholds will be grandfathered in under the prior net worth threshold and not be impacted. After Aug. 16, new clients of the adviser, or existing clients entering into new subscriptions or advisory agreements relying on the net worth or assets under management tests, will need to meet the new thresholds in order to fall under the definition of a qualified client.

The "qualified client" definition is relevant to registered investment advisers that receive performance or incentive-based compensation from their clients. Registered investment advisers are prohibited, under Section 205(a)(1) of the Advisers Act, from receiving such compensation unless all of their clients meet the definition of a "qualified client." This is particularly relevant for registered investment advisers that advise managed accounts or funds that rely on Section 3(c)(1) of the Investment Company Act, as a client or investor in such funds (or, in certain circumstances, the equity owners of such investors on a "look through" basis) must be a "qualified client" in order for the registered adviser or its affiliates to receive performance fees or carried interest with respect to such client or investor.

Registered investment advisers that receive performance or incentive-based compensation, including those that advise funds relying on Section 3(c)(1), should consider updating their offering and subscription documents to reflect the new qualified client net worth and assets under management thresholds.

To obtain more information, please contact the Barnes & Thornburg attorney with whom you work or Scott Beal at SBeal@btlaw.com, Maria Monte at Maria.Monte@btlaw.com, or Travis Ortiz at Travis.Ortiz@btlaw.com.

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