

**AUGUST 4, 2021**

For more information,
contact:

Kathryn Furman
+1 404 572 3599
kfurman@kslaw.com

John Wilson
+1 212 556 2277
jdwilson@kslaw.com

Doug Elsbeck
+1 212 556 2118
delsbeck@kslaw.com

Rachel Shepardson
+1 212 556 2311
rshepardson@kslaw.com

King & Spalding

New York
1185 Avenue of the
Americas
New York, New York
10036-4003
Tel: +1 212 556 2100

Atlanta
1180 Peachtree Street,
NE
Atlanta, Georgia 30309-
3521
Tel: +1 404 572 4600

SEC Updates Qualified Client Threshold

On June 17, 2021, the SEC issued an order (the “Order”) to adjust for inflation the dollar amount thresholds that determine when an investor is a “qualified client” under Rule 205-3 of the Investment Advisers Act of 1940, as amended (the “Advisers Act”). Prior to the Order, Rule 205-3 defined a qualified client as (i) a client who either has at least \$1,000,000 under the management of an investment adviser immediately after entering into an investment advisory contract with such investment adviser (the “AUM Test”), or (ii) a client who the investment adviser reasonably believes, immediately prior to entering into an investment advisory contract with such investment adviser, has a net worth of more than \$2,100,000 (the “Net Worth Test”). The recent Order increased the amount in each clause by \$100,000, creating new dollar thresholds of \$1,100,000 for the AUM Test and \$2,200,000 for the Net Worth Test, respectively. Qualified clients also include persons who are “qualified purchasers” as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940, as amended (the “Investment Company Act”), as well as “knowledgeable employees” of the investment adviser.

Under Section 205 of the Advisers Act, registered investment advisers are generally prohibited from contracting to receive from their clients performance-based compensation, which includes performance fees, incentive distributions and carried interest. However, Rule 205-3 provides an exception where investment advisers may charge a client a performance-based fee if that client is a “qualified client.” For purposes of any fund that relies on Section 3(c)(1) of the Investment Company Act for exemption from being an investment company under the Investment Company Act (a “3(c)(1) Fund”), the investment adviser must look through to the investors of such 3(c)(1) Fund to confirm each such investor meets the qualified client requirements.

The Order is effective as of August 16, 2021. Contracts entered into prior to this effective date will be grandfathered in and will not be subject to the adjusted dollar amount, unless a client who was not a party to such contract becomes a party following such date. Investment advisers should update their offering documents and subscription or transfer materials to conform to the Order for any closings or transfers expected to occur on or after August 16, 2021.



The order can be found [here](#).

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