

## SEC Raises the Dollar Threshold for Qualified Clients

By **Eileen Overbaugh** and **Manas Kumar**

### What You Need To Know:

- **Effective August 16, 2021, the Assets-Under-Management Test will increase to \$1.1 million, and the Net Worth Test will increase to \$2.2 million.**

On June 17, 2021, the U.S. Securities and Exchange Commission issued an **order** (SEC Order) adjusting the dollar thresholds by which investors are considered qualified clients pursuant to Section 205-3 of the Investment Advisers Act of 1940, as amended (Advisers Act). The increased dollar thresholds will become effective on August 16, 2021 (Effective Date).

Pursuant to Section 205-3 of the Advisers Act, registered investment advisers may charge performance-based compensation solely from clients that are qualified clients. This restriction also extends to investors in private funds. Under current law, a client is considered a qualified client if (i) it has at least \$1 million in assets under management with the applicable investment adviser immediately after the time of its initial investment (Assets-Under-Management Test) or (ii) the investment adviser reasonably believes, immediately prior to the time of the client's initial investment, that the investor has a net worth of more than \$2.1 million (Net Worth Test). The SEC Order has raised the Assets-Under-Management Test threshold to \$1.1 million and the Net Worth Test threshold to \$2.2 million.

Prior to the Effective Date, registered investment advisers may continue to enter into advisory contracts and admit investors to private funds based on the current dollar thresholds. In addition, registered investment advisers may continue to take performance-based compensation from existing clients and existing private fund investors

who satisfied the relevant dollar thresholds at the time of their initial investment with the adviser.

### Takeaways

Registered investment advisers should update their various offering documents and agreements—including subscription agreements for private funds and forms of advisory contracts and managed account agreements—to reflect the new thresholds for the Assets-Under-Management Test and the Net Worth Test.

These updates will be particularly important for registered investment advisers advising separately managed accounts or private funds relying on the exemption available pursuant to Section 3(c)(1) of the Investment Company Act of 1940, as amended (Company Act). On the other hand, registered investment advisers advising private funds relying on the exemption available pursuant to Section 3(c)(7) of the Company Act will be largely unaffected, as all investors in those private funds automatically are deemed qualified clients by nature of being qualified purchasers.

### Next Steps

Please contact one of the listed authors of this Client Alert or your usual Lowenstein Sandler contact if you have any questions with respect to the SEC Order.

# Contacts

Please contact the listed attorneys for further information on the matters discussed herein.

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