

June 28, 2021

SEC Increases Qualified Client Thresholds

On June 17, 2021, the Securities and Exchange Commission (the “SEC”) issued an order [[available here](#)] (the “Order”) that increased the dollar amount thresholds that permit investment advisers to charge performance-based fees to “qualified clients” under Rule 205-3 of the Investment Advisers Act of 1940, as amended (the “Advisers Act”). The adjustments increased (i) the minimum dollar amount of assets under management that a qualified client must have from \$1 million to \$1.1 million (“asset test”) and (ii) the net worth that a qualified client must have from \$2.1 million to \$2.2 million (“net worth test”).

These adjustments are important to investment advisers because Section 205(a)(1) of the Advisers Act generally prohibits an investment adviser from entering into, extending, renewing, or performing an investment advisory contract that provides for compensation to the adviser based on a share of capital gain upon, or capital appreciation of, the funds of a client - known as a “performance fee.” Section 205(e) authorizes the SEC to exempt any advisory contract from the performance fee prohibition if the contract is with a person the SEC determines does not need the protection of the prohibition. The SEC adopted Rule 205-3 to exempt an investment adviser from the prohibition of charging a client a performance fee if the client meets certain financial thresholds of a qualified client. Pursuant to the Order, a qualified client now must meet the new asset test or the new net worth test. (It should be noted that a qualified client also includes both a “qualified purchaser” as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940, as amended, and an investment adviser’s “knowledgeable employees.”)

The Dodd-Frank Wall Street Reform and Consumer Protection Act amended Section 205(e) to provide that by July 21, 2011, and every five years thereafter, the SEC adjust for inflation the dollar amount thresholds in Rule 205-3. The prior adjustment was made in 2016; the current adjustment being made will become effective as of August 16, 2021.

The Order is not retroactive. Consequently, contractual relationships that an investment adviser entered into prior to the effective date of the Order (August 16, 2021) would not be subject to the increased thresholds.

If you would like to discuss changes that might need to be made to current agreements and subscription documents to make them compliant with the amended rule, please contact Meryl Wiener (mwiener@wbny.com or 212-984-7731), any of the undersigned, or your regular Warshaw Burstein attorney.

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