KILPATRICK TOWNSEND

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Attn: RIAs Charging Performance-Based Fees, Thresholds for "Qualified Client" Increased by $100K

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The Investment Advisers Act of 1940, as amended (the "Advisers Act"), generally prohibits SEC -registered investment advisers ("RIAs") from entering into an advisory contract that charges a performance fee to a client who is not a "qualified client" under Rule 205-3(d)(1) under the Advisers Act. [1] Effective Monday, August 16, 2021 (the "Effective Date"), an inflation adjustment has raised two of the thresholds for determining whether a client is a "qualified client" by $100,000, as follows:[2]

(1) The threshold for the assets-under-management test – which pegs qualified client status to a client's dollar amount of assets under management with the RIA (calculated immediately after entering into the investment advisory contract) – has increased from $1,000,000 to **$1,100,000**;

(2) The threshold for the net worth test – which pegs qualified client status to a client's net worth (based on the RIA's reasonable belief, calculated immediately prior to entering into the investment advisory contract with such client) – has increased from $2,100,000 to **$2,200,000**.[3]

The new qualified client thresholds apply to all RIA investment advisory contracts entered into on or after the Effective Date.[4] Investment advisory contracts entered into prior to the Effective Date generally remain subject to the then-existing qualified client thresholds; however, individuals or entities who become party to such an investment advisory contract (or, in the case of a fund, individuals or entities who become investors in the fund) on or after the Effective Date will typically be subject to the new thresholds.[5]

If you have any questions regarding the new qualified client thresholds, or about the regulation of investment advisers generally, please feel free to contact us.

By the ***Investment Management and Broker-Dealer Team*** at ***Kilpatrick Townsend & Stockton***

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[1] *See* 15 U.S.C. § 80b-5(a)(1); 17 C.F.R. § 275.205-3(a). This applies to both separately managed account clients (where the specific client must be a qualified client) and fund clients (where each investor in the fund who is charged the performance-based fee must be a qualified client). *See* 17 C.F.R. § 275.205-3(b).

[2] *Order Approving Adjustment for Inflation of the Dollar Amount Tests in Rule 205-3 under the Investment Advisers Act of 1940*, Advisers Act Release No. 5756 at 1-2 (June 17, 2021), https://www.sec.gov/files/ia-5756.pdf (hereinafter, "SEC Order"). The SEC is required to adjust the qualified client thresholds under Rule 205-3(d)(1)(a) and (b) for inflation, rounded to the nearest multiples of $100,000, every five years. 5 U.S.C. § 80b-5(e); 17 C.F.R. § 275.205-3(e).

[3] SEC Order, *supra* note 2, at 3.

[4] State registered investment advisers should review the applicable law in each jurisdiction in which they are registered or required to register to determine applicable requirements or restrictions regarding performance-based advisory fees.

[5] SEC Order, *supra* note 2, at note 12 (citing, among others, Rule 205-3(c)(1) ("If a registered investment adviser entered into a contract and satisfied the conditions of this [section] that were in effect when the contract was entered into, the adviser will be considered to satisfy the conditions of this [section]; provided, however, that if a natural person or company who was not a party to the contract becomes a party (including an equity owner of a private investment company advised by the adviser), the conditions of this [section] in effect at that time will apply with regard to that person or company.").