



One Maritime Plaza ♦ Eighteenth Floor
San Francisco, California 94111-3598

July 9, 2021

VIA E-MAIL

To Our Investment Adviser Clients and Other Friends

Re: SEC Raises “Qualified Client” Net Worth Threshold Effective August 16, 2021

The U.S. Securities and Exchange Commission (the “SEC”) recently announced in Advisers Act [Release 5756](#) that it has adjusted for inflation the two thresholds used to determine whether a client or investor is a “qualified client” pursuant to Rule 205-3 under the Investment Advisers Act of 1940: (1) the threshold for a client’s assets under management with an investment adviser and (2) the threshold for a client’s net worth.

Currently, Rule 205-3 allows investment advisers to charge a performance-based compensation to a “qualified client,” defined as an individual or entity that:

- Has at least \$1,000,000 in assets managed by the investment adviser; or
- At the time the investment management contract is entered into, either (a) has a net worth (including, for individuals, assets held jointly with a spouse) of more than \$2,100,000 (exclusive of the person’s primary residence) or (b) is a “qualified purchaser” as defined in section 2(a)(51)(A) of the Investment Company Act of 1940 (the “ICA”).

Effective as of August 16, 2021, the dollar amount of the assets-under-management test in the first bullet above will increase to \$1,100,000. At the same time, the net-worth test described above in clause (a) of the second bullet will increase to \$2,200,000. While irrelevant for investment funds that rely on ICA section 3(c)(7), these changes will affect separate accounts and investment funds relying on ICA section 3(c)(1) that charge a performance fee (or performance-based allocation or carried interest).

These increased assets-under-management and net-worth requirements will not apply retroactively or to persons that enter into separate account agreements or invest in 3(c)(1) funds before August 16, 2021. If a client’s or investor’s assets under management with an investment adviser exceeded \$1,000,000 or net worth exceeded \$2,100,000 when such person first entered into the applicable separate account agreement or invested in a fund, the adviser may charge performance-based fees or allocations on additional capital such person contributes to that account or fund on or after August 16, 2021, even if that client’s or investor’s applicable assets under management do not exceed \$1,100,000 or net worth does not exceed \$2,200,000 at the time of such additional contribution.

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Investment advisers that charge performance-based fees or allocations to 3(c)(1) investment funds or separate account clients should contact us immediately to update their documents and forms to reflect this new threshold.

This letter is not intended as specific or complete advice and is subject to change. For further assistance, please contact one of the attorneys in the Investment Funds & Advisers group at Shartsis: John Broadhurst, Carolyn Reiser, Neil Koren, Jim Frolik, Christina Hamilton, David Suozzi, Anthony Caldwell, Jahan Raissi, Kevin Leiske, Joan Grant or Bradford Clements.

Previous letters to our investment advisory clients and friends and additional discussions of topics relevant to private fund managers, investment advisers and private investment funds can be found at our insights page: www.sflaw.com/blog/investment-funds-advisers-insights.

SHARTSIS FRIESE LLP