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Family Office Insights

US SEC Raises "Qualified Client" Investment Thresholds Under Advisers Act Rule 205-3

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Under Section 205(a)(1) of the Investment Advisers Act of 1940, as amended (Advisers Act), SEC-registered investment advisers generally are prohibited from entering into investment advisory contracts that provide for performance-based compensation or fees (that is, compensation based on the capital gains or the appreciation in value of a client's funds under management). Many state investment adviser registration regimes include analogous prohibitions.

However, under Advisers Act Rule 205-3, a registered investment adviser is permitted to charge performance-based fees to "qualified clients." To be a "qualified client," a client must either (i) have at least a specified amount of assets under management with the adviser immediately after entering into the advisory contract, or (ii) immediately prior to entering into the contract, have a net worth exceeding a specified dollar amount. An analysis of the application of this definition often overlaps with an analysis of whether a client satisfies the definition of "qualified purchaser" in Section 2(a)(51) of the US Investment Company Act of 1940, as amended; clients who satisfy the "qualified purchaser" definition are also "qualified clients" for the purposes of Rule 205-3.

By statute, the relevant dollar thresholds are reviewed and adjusted by the SEC every five years. In Investment Advisors Act Release IA-6961, the SEC set the new definitional thresholds, which became effective for contracts entered into on or after June 29, 2026:

Test	Current threshold	New threshold
Assets under management test	$1,100,000	**$1,400,000**
Net worth test	$2,200,000	**$2,700,000**

Family offices and individuals entering into investment advisory contracts should be aware of the current definitional requirements as part of an effective and comprehensive compliance program.

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