



SEC RELEASE EXCLUDING “FAMILY OFFICE” FROM THE DEFINITION OF “INVESTMENT ADVISER” UNDER THE INVESTMENT ADVISERS ACT OF 1940

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Summary

The Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”)¹ removed an exemption for investment advisers with fewer than 15 clients permitting the Securities and Exchange Commission (the “Commission”) to further regulate hedge funds and other private fund advisers. However, Dodd-Frank also included a provision requiring the Commission to define “family offices” in order to exempt them from regulation under the Investment Advisers Act.

In its June 22, 2011 Release,² the Commission adopted Rule 202(a)(11)(G)-1 under the Advisers Act in which it proposed a definition of “family office” which became effective on August 22, 2011. Such Rule states that a family office is any company that (i) provides investment advice only to “family clients”, (ii) is wholly owned by family clients and is exclusively controlled by family members and/or family entities, and (iii) does not hold itself out to the public as an investment adviser. The new rule adopted by the Commission enables those managing their own family’s financial portfolios to determine whether their “family offices” can continue to be excluded from the Investment Advisers Act.

The adopted rule also includes a “grandfathering” provision for the benefit of advisors that satisfy the definition of “family office” *but for* the fact that they

provide investment advice to certain non-family clients. They would also not need to register.

“Family Offices” outside of the exemption must register by March 30, 2012.

Defining A Family Office

Among those who have taken advantage of a popular exemption from registration as investment advisers under the Investment Advisers Act of 1940³ (the “Advisers Act”) are “family offices”, which provide investment management, and tax and estate planning services to wealthy families. Because they typically advise just one family, most family offices have been able to fall under the exemption which applies to advisers with fewer than 15 clients – historically enjoyed by hedge funds and other private fund advisers seeking to avoid the sometimes onerous registration and disclosure requirements of the Act.⁴

In an effort to make the “shadow banking system” less opaque, Dodd-Frank eliminated this so-called “private advisor exemption” but, acknowledging that the intent of the Act was not to regulate advisers to wealthy families,⁵ it excludes “family offices” from the definition of investment adviser. Congress tasked the Commission with defining the family office exclusion in a manner consistent with the previous exemptive policy of the Commission and which “recognizes the range of organizational, management, and employment structures and arrangements employed by family offices”.⁶ If the

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Commission's new rule ultimately does not capture the full range of family office structures, entities may still seek an exemptive order under Section 202(a) of the Advisers Act on the basis that the Commission views family offices "as not the sort of arrangement that the Advisers Act was designed to regulate."⁷

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Family Members and Key Employees

Under the exclusion, family offices may advise only "family clients", which includes "family members", "key employees", certain affiliated companies and other family clients, without falling under the definition of investment adviser. Family members include all lineal descendants, including adopted children, and stepchildren, of a common ancestor (provided that such common ancestor is no more than ten generations removed from the youngest generation of family members) and such descendants' spouses (and spousal equivalents). Key employees include executive officers, directors, general partners, trustees, or their equivalents, of the family office or of its affiliated family office, and also includes their spouses (and spousal equivalents), if such spouses have a shared ownership interest with the key employee. The family office may also advise its other employees who, in connection with his or her regular duties, has been a participant in the family offices' investment activities for at least twelve months. Other "family clients" include companies that are wholly owned exclusively by, and operated for the sole benefit of, family clients; family trusts; non-profit organizations which are funded exclusively by family clients, and the estates of family members, former family members, key employees, and certain former key employees.

Grandfathering Provision

Existing advisers that otherwise satisfy the definition of "family office" but for the fact that they provide investment advice to certain non-family clients are "grandfathered" and would not need to register. Such non-family clients include (i) persons who, at the time of their investment, were officers, directors or employees of the family office who had invested with the family office before January 1, 2010 and who are accredited investors under Regulation D of the Securities Act of 1933, as amended,⁹ (ii) any company owned exclusively and controlled by one or more family members, and (iii) any registered investment adviser who provides investment advice to, and identifies investment opportunities for, the family office, and who invests in such transactions on substantially the same terms as the family office invests, but does not invest in other funds advised by the family office, *et al.*

An adviser that does not meet the definition of "family office", unless it falls within another exemption or is subject to an exemptive order, must register with the Commission or applicable state securities authorities by March 30, 2012.

¹ Public Law 111-203.

² See Investment Advisers Act Release No. 3220, 76 FR 37983 (June 22, 2011), <http://www.sec.gov/news/press/2011/2011-134.htm>

³ 15 U.S.C. §§80b-1 through 80b-21.

⁴ Section 203(b)(3) of the Advisers Act.

⁵ See *Family Offices*, Investment Advisers Act Release No. 3098 (Oct. 12, 2010) ("Proposing Release").

⁶ Section 409(b) of the Dodd-Frank Act.

⁷ See Proposing Release 2 (§§ 1 and 11) for a discussion of the rationale for the family office exclusion.

⁸ See Investment Advisers Act Release No. 3220, 76 FR 37983 (June 22, 2011).

⁹ *N.b.*, this list is broader than the definition of "key employees", *supra*.

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