

Many “Family Offices” May Have to Restructure or Register as Investment Advisers

July 28, 2011

Many "family offices" provide investment advice by managing assets for wealthy families and their friends, as well as distant relatives and affiliated not-for-profits, foundations, or pension plans. Investment advisers must register with the Securities and Exchange Commission (the "SEC") under the Investment Advisers Act of 1940 (the "Advisers Act"), unless they qualify for an exemption from registration. Until now, family offices typically have been exempt from registration as investment advisers under an exemption for advisers with fewer than 15 clients.

This so-called private adviser exemption, however, was repealed by The Wall Street Reform and Consumer Protection Act (also known as the "Dodd-Frank Act"). The Dodd-Frank Act also amended the Advisers Act to exclude "family offices" from the definition of investment adviser. As a result, "family offices" that qualify under the SEC's definition are not subject to the Advisers Act and its registration requirement for investment advisers.

On June 22, 2011, the SEC adopted a final rule which defines "family office" in order to implement this exclusion from the Advisers Act. The definition is restrictive. It is clear the SEC means for the exemption to be available primarily to families (i.e., lineal descendants of a common ancestor), key employees of the family office, and not-for-profits funded exclusively by family members. Under the SEC's definition, a "family office":

- May provide advice about securities only to a "family client";
- Must be wholly owned by one or more family clients and exclusively controlled, directly or indirectly, by "family members" or "family entities"; and
- May not hold itself out to the public as an investment adviser.

Family offices that are currently exempt from registration under the private adviser exemption (i.e., the repealed exemption for advisers with fewer than 15 clients) have an extended transition period until March 30, 2012, when they must qualify for the family office exclusion from the definition of investment adviser - or else they must register as investment advisers, unless another exemption applies.

A "family client," which is central to the SEC's definition of a "family office," means any:

- "Family member," which means any lineal descendant (including by adoption, a stepchild, a foster child, and in some cases by legal guardianship) of a common ancestor who is no more than 10 generations removed from the youngest generation of family members;
- "Former family member," which means a spouse, "spousal equivalent" (i.e., a cohabitant occupying a relationship generally equivalent to that of a spouse), or stepchild who was a family member but is no longer one due to a divorce or other similar event;
- "Key employee," which means a natural person (and his or her spouse or spousal equivalent) who is an executive officer, director, trustee, general partner or person serving in a similar capacity of the family office or its affiliated family office (or any employee of either one of them who, as part of his or her regular duties, participates in its investment activities and has performed such functions and duties for it, or substantially similar functions and duties for or on behalf of another company, for at least 12 months);
- Former key employee, who may not invest additional assets with a trust, foundation, or entity advised by the family office, and who (subject to certain exceptions) may not receive investment advice from the family office other than with respect to assets advised by the family office immediately prior to the end of his or her employment with the family office;
- Non-profit or other charitable organization that is funded exclusively by family clients;
- Estate of any family member, former family member, key employee, or (subject to certain conditions) former key employee;
- One of certain types of trust relating to family clients; or
- Company that is wholly owned (directly or indirectly) exclusively by, and operated for the sole benefit of, one or more other family clients.

The last four bullet points above describe "family entities," which is part of the definition of "family office."

A current family office needs to determine whether it can:



- **Qualify as a family office under the new SEC definition by March 30, 2012;**
- **Qualify for an exemption to the registration requirement for investment advisers; or**
- **Obtain an exemptive order from the SEC.**

If it cannot do any of these three things, then it will need to register as an investment adviser and file a Form ADV.

To discuss this client alert or any securities law matter, please contact your Lathrop Gage attorney or any of the attorneys listed on this alert.