SEC Proposal Defines "Family Offices" to be Excluded from the Investment Advisers Act

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On October 12, 2010, the Securities and Exchange Commission (the "SEC") proposed a rule specifying "family offices" that continue to be exempt from the registration as investment advisers under the Investment Advisers Act of 1940, as amended (the "Advisers Act"). While family offices have long been exempt from registration with the SEC pursuant to the "private adviser" exemption contained in Section 203(b)(3) of the Advisers Act, this exemption will be repealed by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), effective July 21, 2011. Section 409 of Dodd-Frank specifically exempts family offices from registration, but allows the SEC the latitude to define it.

The SEC now proposes to adopt a new rule 202(a)(11)(G)-1 under the Advisers Act to define family offices that would be excluded from the definition of "investment adviser" under the Advisers Act. The proposed rule mainly codifies exemptive orders and contains three general conditions for an entity to qualify as a "family office":

- *Family Clients:* Family offices are not permitted to have any investment advisory clients other than "family clients," including *family members* (i.e. the individual(s) and his or her spouse or spouse equivalent for whose benefit the family office was established and any of their subsequent spouses/spousal equivalents, parents, siblings, their lineal descendants (including by adoption and stepchildren) and such lineal descendants' spouses/spousal equivalents); certain key employees of the family office; charities established and funded exclusively by family members as well as any trusts or estates existing for the sole benefit of family clients; and entities wholly owned and controlled exclusively by, and operated for the sole benefit of, family clients;
- *Ownership and Control by Family Members:* The family office must be wholly owned and controlled by family members (as described above); the proposed rule does not allow for a minor ownership stake by a non-family member; and
- *No Holding Out as an Investment Adviser:* A family office may not hold itself out to the public as an investment adviser.

As instructed by Dodd-Frank, the SEC proposes a *grandfathering provision*. Entities that were not required to register as investment advisers on January 1, 2010 and which meet the requirements of the new rule 202(a)(11)(G)-1 outlined above *but for* providing investment advice to: (i) officers, directors or employees of a family office who are accredited investors pursuant to Regulation D under the Securities Act of 1933, as amended; or (ii) any company owned exclusively and controlled by one or more family members (this provision will likely be meaningless in practice as covered by the proposed definition of "family client" described above); or (iii) certain registered investment advisers will remain exempt. Family offices that are exempt by virtue of this grandfathering rule will be subject to the anti-fraud provision of paragraphs (1), (2) and (4) of section 206 of the Advisers Act.

It should be noted that the failure of a family office to meet the conditions of the proposed rule would not preclude the office from providing advisory services to family members. In those circumstances, a family office could try to seek an exemptive order from the SEC to avoid registration under the Advisers Act.

Comments on the proposed rule must be submitted to the SEC by November 18, 2010.

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This summary is intended to provide general information only on the matters presented. It is not a comprehensive analysis of these matters and should not be relied upon as legal advice. If you have any questions about the matters covered in this publication, please contact:

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