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# The SEC Adopts Final Rule Under the Dodd-Frank Act Defining "Family Offices"

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On June 22, 2011, the Securities and Exchange Commission (the "SEC") adopted several final rule orders effecting the implementation of portions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") that govern the registration of private investment advisors as well as provide certain exemptions from registration. One of these final rule releases allows for an exemption from registration under the Investment Advisors Act of 1940 (the "Advisors Act") for "family offices," provided that such family offices meet certain criteria. Family offices not falling under the exemption must register under the Advisors Act using Form ADV. The form asks for such information as educational background, experience, exact type of business engaged in, assets, information on clients, past history of a legal and/or criminal nature, and type of investment advice to be offered. Registered investment advisers are required to update their ADV form annually and file operating reports with the SEC or state regulatory agency. They must also provide to clients and prospective clients a written disclosure statement and allow inspection by the SEC or state regulatory agency of any books and records relating to investment advisory activities. Family offices have traditionally provided certain financial and advisory services to individual wealthy families. The furnishing of such services would require registration under the Advisors Act; however, the majority of family offices previously had been able to avoid registration by relying on an exemption in the Advisors Act precluding registration for investment advisors with fewer than fifteen clients. The Dodd-Frank Act eliminated the fifteen client exemption in an attempt to rein in small hedge and private equity funds. Noting that the removal of this exemption would have the potential unintended consequence of requiring regulation of a family's management of its own wealth, the Dodd-Frank Act provided for a "family office" exemption and tasked the SEC with defining the parameters and criteria under which a family office would be exempt from registration under the Advisors Act. The SEC's final rule states that to be exempt: a family office must (i) only provide securities advice to family clients, (ii) be wholly owned and controlled by family clients, and (iii) not hold itself out to the public as an investment adviser. In response to comments to its proposed rule, the SEC broadened

the definition of family clients. A family office may advise only the following "family clients":

- "Family members" and former family members;
- Charities funded exclusively by family members;
- Certain key employees of the family office;
- Estates of current and former family members, key employees and in some circumstances former key employees; and
- Trusts existing for the sole current benefit of family clients or, if both family clients and charitable and nonprofit organizations are the sole current beneficiaries, trusts funded solely by family clients, revocable trusts funded solely by family clients, certain key employee trusts, and companies wholly owned exclusively by, and operated for the sole benefit of, family clients.

When determining whether or not a certain person is a "family member," the final rule permits a family to choose a common ancestor, who may be deceased, regardless of whether the ancestor created the wealth being managed. Current and former spouses or spousal equivalents of the descendants of that ancestor may also be included as family members. All children of such descendants including, family members by adoption, stepchildren, foster children and children whose legal guardian is counted as a family member, are considered family members up to the tenth generation succeeding the chosen ancestor. As stated above "key employees" of the family office, as well as their spouses, are counted as family clients, but not with respect to new investments made after retirement. This definition follows closely the SEC's "knowledgeable employee" definition and covers only senior personnel participating in investment activities of the family office, such as executive officers, directors and trustees. This definition does not cover persons who provide clerical or administrative services. However, a family office will not lose its exemption because it provides advice with respect to investments made by any employee of the family office before January 1, 2010, provided that he or she is an accredited investor. Importantly, a family office owned or controlled by any person or group who are not deemed family clients must register under the Advisors Act. In order to benefit from the exemption, a family office must be wholly owned by family clients and exclusively controlled, directly or indirectly, by one or more family members and/or family entities. The final rule provides for a March 30, 2012 compliance date for family offices previously relying on the former private adviser exemption in order to give those offices affected by the final rule additional time to restructure their operations to comply with the rule or register under the Advisors Act. In order to avail itself of this compliance date, the family office must have had fewer than fifteen clients and must not have held itself out to the public as an investment advisor. Finally, in the final rule release, the SEC stated its determination not to rescind exemptive orders previously provided to family offices under the Advisors Act. The Advisors Act had allowed a family office which fell or might have fallen outside of certain parameters of the Advisors Act to appeal to the SEC for a ruling that would exempt it from registration under the Advisors Act. The final rule states that

regardless of whether the SEC's previous exemptive orders might be either broader or narrower than the final rule as adopted, family offices may continue to rely on the SEC's previous declaration.

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