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SEC Proposes Rule to Exclude Family Offices from Regulation as Investment Advisers

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The Securities and Exchange Commission has proposed Rule 202(a)(11)(G)-1 under the Investment Advisers Act of 1940, as amended (Advisers Act), to define "family offices" that would be excluded from the definition of "investment adviser." The proposed rule was mandated in Section 409 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Act).

Family offices are established by wealthy families to manage their wealth, plan for their families' financial future and provide other services to family members. Absent an exclusion, family offices would typically fall under the definition of investment adviser under the Advisers Act.

Many family offices have previously relied on the exemption from registration under the Advisers Act in Section 203(b)(3) for an investment adviser who during the course of the preceding 12 months has had fewer than 15 clients and who neither holds itself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company or business development company. The Act eliminated the exemption contained in Section 203(b)(3), effective July 21, 2011.

The proposed rule is intended to codify the exemptive orders that the SEC has issued to family offices and generally would be limited to family offices (1) that provide advice about securities only to family clients, (2) that family members own and control, and (3) that do not hold themselves out to the public as an investment adviser. Family members would generally include the following:

- founders (i.e., a natural person and his or her spouse or spousal equivalent for whose benefit the family office was established and any subsequent spouse of such individuals), their lineal descendants (including by adoption and stepchildren), and such lineal descendants' spouses or spousal equivalents;
- parents of the founders; and

- siblings of the founders and such siblings' spouses or spousal equivalents and their lineal descendants (including by adoption and stepchildren) and such lineal descendants' spouses or spousal equivalents.

The definition of family member differs from or expands upon previous SEC exemptive orders by considering stepchildren as lineal descendants and spousal equivalents in addition to spouses and parents of the founders as family members.

Family clients would generally include any (1) family member, (2) certain key employees, (3) charities established and funded exclusively by one or more family members or former family members, (4) trust or estate existing for the sole benefit of one or more family clients, and (5) entities owned and controlled exclusively by, and operated for the sole benefit of, one or more family members. Former family members including former spouses, spousal equivalents and stepchildren and certain former key employees would be considered family clients to the extent of any investments held through the family office at the time they became a former family member or former key employee. In the event assets under the management of a family office are involuntarily transferred to a person who is not a family client, the family office could continue to advise such client for four months following the transfer of any such asset without effecting its exclusion from the definition of investment company.

The Advisers Act and the proposed rule both contain a "grandfathering clause" that precludes the SEC from excluding certain family offices from the definition that provide investment advice to certain clients and had provided investment advice to those clients before January 1, 2010.

Comments on the proposed rule are due November 18. The SEC release announcing the proposed rule may be found here.

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