Proskauer

SEC Releases Final Rule Exempting Family Offices

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The SEC released on June 22, 2011 its final Rule 202(a)(11)(G)-1 exempting "family offices" from registration under the Investment Advisers Act of 1940. In order to qualify for the exemption, a family office adviser must:

- only advise "family clients" with respect to securities,
- be wholly-owned by "family clients" and exclusively controlled by "family members," and
- not hold itself out to the public as an investment adviser.

Registration Deadline

For advisers that currently rely on the Section 203(b)(3) (i.e., have fewer than 15 clients and do not hold themselves out to the public as an investment adviser), and do not qualify for the family office exemption (or another exemption from registration), such advisers will be required to register by March 30, 2012.

Definition of "Family Client"

The definition of "family client" was significantly broadened from the definition initially proposed by the SEC. Family clients now include:

- **Family members.** The SEC, as requested by many commentators, including Proskauer, eliminated the concept of a "founder" from the final rule. Families can choose a common ancestor to define the family. Although the definition of family members only includes lineal descendants no more than ten generations removed from the common ancestor, the family office is permitted to change the identity of the common ancestor over time. "Family members" include, among others, current and former spouses and spousal equivalents, adopted children, foster children, and current and former stepchildren.

- **Former family members.** Former family members can now continue to be advised by the family office and do not need to discontinue participating in new investments as the SEC had originally proposed.

- **Key employees.** The SEC generally adopted the same definition of key employee as applies to “knowledgeable employees” for purposes of Sections 3(c)(1) and (7) of the Investment Company Act. The definition generally includes senior executives and employees active in the investment process, but excludes employees providing solely clerical or administrative services. A family office can continue to provide advice to existing employees not meeting the definition, provided that the employee invested with the family office prior to January 1, 2010 and is an accredited investor. The SEC specifically rejected the request to include employees of family-run businesses in the definition.

- **Charities funded exclusively by family clients.** Advisors to charities with non-family funding may rely on the exemption until December 31, 2013, provided that such charities do not accept any additional funding from non-family members after August 31, 2011 (except in fulfillment of a pledge made prior to August 31, 2011).

- **Revocable trusts** where the sole grantors are family clients, regardless of the beneficiaries.

- **Irrevocable trusts** where family clients are the only current beneficiaries. Non family members can be contingent beneficiaries, although the family office must stop advising the trust within twelve months if the non-family members ultimately become “current” beneficiaries through an involuntary transfer.

- **Estates** of current and former family members and key employees.

- **Other Family Entities**. Any company, limited partnership, limited liability company or similar entity, including pooled investment vehicles (provided they are excepted from the definition of investment company), wholly owned, directly or indirectly, by one or more family clients and operated for the sole benefit of family clients are also treated as family clients under the rule. The final language eliminates a requirement in the proposed rule that the entity also be controlled by family clients.

Other Requirements

The SEC rejected the request for a multi-family office exemption. Family offices must be wholly-owned by family clients. Because key employees are considered family clients, key employees can own part of the adviser. However, only family members may control the adviser.

What Should Family Offices Do Now?

Family offices should analyze with their legal counsel whether they satisfy the conditions of the exemption in the new rule. The rule only restricts giving advice with respect to securities, so family offices can still give non-investment related advice to non-family clients. Family offices should also consider whether they will need to restructure in order to fit within the exemption.

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