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The Family Office Rule: A Re-Examination

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INTRODUCTION

What if I told you a trillion-dollar industry (yes, I said trillion) was not only misunderstood, but for the most part, never even heard of?[1] Allow me to introduce you to the family office. To answer the question you are probably wondering—no, these are not family "law" offices. Family offices are nothing new, yet they are arguably the fastest-growing investment vehicles in today's world.[2] Dating back many centuries, the family office provides affluent families with a vehicle to expand wealth, achieve larger goals that families have in mind, and ultimately pass wealth down to future generations. Wealthy families create investment management entities to manage their investments and provide fiduciary services to the family.[3] Some family offices seem to evolve or mature over the years as their business ventures shift or capital requirements change.[4]

Not all family offices are alike. This is particularly true when one considers that family offices can be designated as a single-family office or a multi-family office.[5] Depending on the office's designation, different regulations apply—one being much more regulated than the other. The rules governing family offices have shifted somewhat over time.[6] The latest shift, however, seems to favor one form of family office over the other—making one form more desirable. This Note revisits a specific aspect nestled within the Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd–Frank") which effectively bestowed the Securities and Exchange Commission ("SEC" or "Commission") with the authority to determine the regulations imposed on family offices.[7] Part I of this Note will explain what family offices are,

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[1] FAMILYOFFICES.COM, THE FAMILY OFFICE REPORT 4, V. 8.0 (2017).

[2] ERNST & YOUNG, EY FAMILY OFFICE GUIDE: PATHWAY TO SUCCESSFUL FAMILY AND WEALTH MANAGEMENT 4 (2017).

[3] Ryan M. Harding & Elise J. McGee, *To Register or Not? SEC Investment Adviser Guidance for "Family Offices"*, 26 PROB. & PROP. 2, at 22 (Sept./Oct. 2012).

[4] Marv Pollack, *How Family Offices Change Over Time*, FAMILY OFFICE EXCHANGE (Jan. 26, 2015), https://www.familyoffice.com/insights/how-family-offices-change-over-time (detailing that as the family endures over time, later generations may have different goals and desires).

[5] Nathan Crow & Greg Crespi, *The Family Office Exclusion Under the Investment Advisers Act of 1940*, 69 SMU L. REV. 97, 102 (2016) (citing KIRBY ROSPLOCK, THE COMPLETE FAMILY OFFICE HANDBOOK: A GUIDE FOR AFFLUENT FAMILIES AND THE ADVISORS WHO SERVE THEM 41 (2014)).

[6] *See* 17 C.F.R. § 275.202(a)(11)(G)-1(d)(6) (2019) (In 2011 the SEC adopted a rule to define "family offices" and excluded such entities from the definition of "investment adviser" under the Investment Advisers Act of 1940 and thus are not subject to regulation under the Advisers Act. More specifically, the SEC defined a "family member" as all lineal descendants stemming from a common ancestor, effectively excluding members of a different family; implying that "non" family-members are effectively excluded.).

[7] Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 403(2), 124 Stat. 1376, 1571 (2010).

their history, some common characteristics, and how they function. Part II analyzes the Family Office Rule. The Rule effectively asserts that single-family offices are absolved of critical SEC regulations. Multi-family offices, on the other hand, do not enjoy such liberties and are required to register as investment advisers under the Investment Advisers Act of 1940. Part III argues that there is an issue of line drawing and that the SEC has implemented a rule that is far too narrow. Part III also argues that the SEC should relax the Rule to some reasonable extent and permit exceptions for qualifying multi-family offices which will be subject to minor forward-looking limitations. Lastly, Part IV concludes by noting what lies ahead for the family office industry.

I. WHAT IS A FAMILY OFFICE?

Given that family offices are relatively unknown, Part I will introduce the history and definitional aspects of their structure as well as some common objectives. In addition, this Part will explain the advantages and disadvantages of opening an office. Lastly, this Part will elucidate the determinative distinction among the types of offices which makes the Family Office Rule acute.

A. BRIEF HISTORY OF FAMILY OFFICES

The family office has been around longer than one might think. When one thinks of powerful, wealthy, and influential families, several surnames immediately come to mind: Rockefeller, Rothschild, Mellon, and Morgan. Each of these families created their own family office.[8] "The original U.S. family offices were created by wealthy merchants early in the 19th century who hired trusted comrades or advisors to oversee their wealth and provide for their families while they were traveling."[9] Traditionally, a family office was a private group of advisors hired to work exclusively for a wealthy family.[10]

However, the concept of the family office has been around much longer than the 19th century. In the past, rulers and the ruling class were the only people with the power and ability to generate vast amounts of wealth.[11] Their fortunes, not unlike the fortunes of the wealthy in the present-day, required careful management and overwatch.[12] Ancient emperors, dynasties, and monarchies required the manpower and expertise to manage their fortunes.[13] In some ancient Chinese and Japanese dynasties, groups of people—similar to the advisors noted above—were dedicated to preserving the wealth of the families across generations.[14] These ancient rulers had something in common: "they shared their wealth with a trusted inner circle comprised

[8] ERNST & YOUNG, *supra* note 2, at 4.

[9] Aspen Wealth Management, *The History of the Family Office*, https://aspen-wm.com/the-history-of-the-family-office/.

[10] *Id*.

[11] Jan van Bueren, *Family Offices A History and Definition*, THARAWAT MAGAZINE, 36, at 39 (Sept. 5, 2016).

[12] *Id*. at 39.

[13] *Id*.

[14] Dr. Steen Ehlern, *Family offices in Europe and the United States – A different evolution with common objectives*, PRIVATE, 106, at 107 (2008).

of high-ranking officials and local representatives, who took on roles that are reminiscent of family office staff members today."[15]

B. Definition

In order to understand what a family office is and how it functions, it is imperative to pare down a precise and accurate definition. A family office has many components. First, there is a requirement of capital. Without any capital, there is nothing to invest, manage, or pass down.[16] Capital that a family possesses may stem from different sources and varies from one family to the next. For some families, the wealth is generational—it has been passed down many generations and the family has decided to open an office staffed with a team that caters to the family's needs.[17] In contrast, there might be a situation where a family member experiences a significant liquidity event as a result of selling a business and decides that opening an office is the best way to either keep growing the wealth or to preserve the wealth through investment funds in a trust. Thus, a family's accumulated wealth, whether it be inherited or newfound, is the capital that is used to endow a number of investment opportunities or other goals the affluent family has in mind. The precise amount is not defined; there is no clear threshold limit that a family's wealth must hurdle to reach family office eligibility. A study in 2010, however, provides data points that give us a better idea of how much money family offices manage individually.[18] The amount of money that family offices manage ranges from $36 million to $52 billion.[19] Included in this range are figures of both single-family offices and multi-family offices. In total, an estimated 6,000 offices in the United States manage a little over $1 trillion in assets.[20]

Just as individual investors have different appetites for risk and return, a family seeking to start a family office may factor the cost of management and the expected overall return when deciding whether to open an office. This might explain the range in assets under management in the study mentioned above. Families with smaller amounts of capital may choose to forego opening a family office and instead invest their wealth using different vehicles. This is a logical decision to make since opening, operating, and staffing an office is no small task.[21] For example, a family with a net worth totaling $1 million may be better suited investing its capital with investment funds that are already established in order to avoid the costs associated with running the office. However, the converse of this scenario also holds true: a family whose wealth exceeds $100 million might be prudent in deciding to open a family office

[15] van Bueren, *supra* note 11, at 39.

[16] Barbara R. Hauser, *Family Office Primer*, WEALTH MANAGEMENT (Aug. 11, 2015), https://www.wealthmanagement.com/high-net-worth/family-office-primer (discussing that the amount of capital depends mostly on the costs of opening and running the office which usually amounts to at least $1 million).

[17] DJ Van Keuren, *For Family Offices, Preservation Of Wealth Is The Most Important Thing And Real Estate Can Help*, FORBES (Oct. 7, 2019), https://www.forbes.com/sites/forbesrealestatecouncil/2019/10/07/for-family-offices-preservation-of-wealth-is-the-most-important-thing-and-real-estate-can-help/#675e0c597499.

[18] Pamela J. Black, *The Rise of the Multi-Family Office*, FINANCIAL PLANNING (Apr. 27, 2010), https://www.financial-planning.com/news/the-rise-of-the-multi-family-office.

[19] *Id.*

[20] FAMILYOFFICES.COM, THE FAMILY OFFICE REPORT2-3, V. 8.0 (2017).

[21] *See* Hauser, *supra* note 16 (estimating that the cost of running the office is usually $1 million); *see also* Nick Rucker, *Family Offices: This Is How Much Their Top Staff Get Paid*, FAMILY CAPITAL (Jan. 31, 2018), https://www.famcap.com/2018/01/2018-1-31-family-offices-this-is-how-much-their-top-staff-get-paid/ (stating that according to a compensation survey by McNally Capital, Botoff Consulting, and Mack International, the annual average base salary of a CEO of a single-family office is $556,100).

because most, if not all, of the family's assets are streamlined and managed under one roof and not parceled out to different firms. In addition, the cost of maintaining and staffing an office might be less than the fees that are charged elsewhere.

A family office operates as a private investment firm with a particular twist.[22] That is, instead of seeking capital from outside investors, the office manages the capital solely derived from the family itself.[23] The capital is attained exclusively and directly for the benefit of the family.[24] Investment returns are sought with the intention of adding it back into the family's nest egg.[25] Lastly, a family might open a family office to preserve, grow, and transfer its wealth for an extended period of time.[26] Family offices can be thought of as a money manager or personal Chief Financial Officer ("CFO") of the family and its wealth:

> A family office is 360 degree financial and wealth management firm and personal CFO for the ultra-affluent, often providing investment, charitable giving, budgeting, insurance, taxation, and multi-generational guidance to an individual or family. The most direct way of understanding the purpose of a family office is to think of a very robust and comprehensive wealth management solution which looks at every financial aspect of an ultra-wealthy person's or family's life.[27]

With these primary tenets in mind, Crow and Crespi provide a succinct and practicable definition of a family office: "[a] private investment firm that exclusively manages a family's wealth, often with a long-term, multi-generational perspective."[28] More importantly, the SEC also provided a definition when it was tasked by Congress to promulgate the Family Office Rule. The Commission defines family offices as "entities established by wealthy families to manage their wealth and provide other services to family members, such as tax and estate planning services."[29]

C. ADVANTAGES, GOALS, AND OBJECTIVES OF FAMILY OFFICES

It is difficult to draw wide-sweeping conclusions about family offices because each family office is unique. As one author puts it, "if you've seen one family office, you've seen one family office."[30] However, several advantages may outline why families elect to open an office. Families strive to pass down wealth to future generations.[31] The family office, when managed by professionals, is one of the best ways to achieve that goal. The vast fortunes that affluent families accumulate require

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[22] Todd Ganos, *What is a Family Office?*, FORBES (Aug. 13, 2013), https://www.forbes.com/sites/toddganos/ 2013/08/13/what-is-a-family-office/#3224feb1a13f (explaining that in order for a family office to receive the connotation, the organization needs to provide more than just standard wealth management functions).

[23] *See generally* Crow & Crespi, *supra* note 5.

[24] *Id*.

[25] *Id*.

[26] *Id*.

[27] FAMILYOFFICES.COM, *supra* note 1, at 4.

[28] Crow & Crespi, *supra* note 5, at 99.

[29] *Family Office: A Small Entity Compliance Guide*, U.S. SEC. AND EXCH. COMM'N, DIV. OF INV. MGMT. (Nov. 21, 2011), http://www.sec.gov/rules/final/2011/ia-3220-secg.htm.

[30] Crow & Crespi, *supra* note 5, at 101-02.

[31] *Id*. at 102. (citing KIRBY ROSPLOCK, THE COMPLETE FAMILY OFFICE HANDBOOK: A GUIDE FOR AFFLUENT FAMILIES AND THE ADVISORS WHO SERVE THEM 10–11 (2014)).

careful and diligent oversight. These families' needs are best managed by a streamlined process, which a family office can provide. These functions include helping members file tax returns, financial and inheritance planning, supporting the family's philanthropic and community activities, organizing family meetings, and family communication.[32] When a family's wealth "exceeds a certain size and the number of family members, activities, businesses, wealth classes etc. reaches a certain complexity and opaqueness, there is the call for a *central coordinating resource* which has the global (consolidated) *overview* and control over these activities."[33] The first step for a family that desires to preserve wealth for the future is to consider the family itself and not the family office.[34] "Where does the family want to go? What does the family want to do with their financial, human, cultural and social capital? Once some sense of direction is established, a mission statement is drafted for the family office that provides the roadmap to accomplish the family's goals and objectives."[35]

Affluent families also tend to have philanthropic goals. "Philanthropy and charities have long been part of family offices and family-office services in the U.S."[36] The family office and its staff act as stewards to help facilitate and make gifts. Foundations are often created on behalf of the families. Family offices assist the family through guidance, planning, and technical advice.

Besides their aspirational goals, family offices have logistical objectives they must consider. As mentioned above, the costs of opening and running a family office should be considered when a family is deciding between opening a family office or investing their money a more traditional way. "Creating a family office can make sense if a family has sizable assets that are external to their operating business."[37] In addition to the costs associated with staffing an office, the costs of regulatory compliance will almost always be high.[38] The considerable time and effort to run the office will prove to be less than worthwhile for families that are not able to fully counterbalance the cost. The level of assets under management must be sufficient to offset all of these expenses. However, families that *do* have the financial capability to offset these costs will be better suited to open up an office. This is so for a couple of reasons. First, the family's money is managed in-house and less prone to the exorbitant fees that accumulate after long periods of time. A good analogy is the concept of renting a house or purchasing one outright: over time, it makes more sense to purchase than to continue making lease payments. A second reason is that the family will have a more direct presence in decision making and usage of capital that multi-family offices do not provide for their beneficiaries.

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[32] Lucy Warwick-Ching, *Family Offices: A History of Stewardship*, FINANCIAL TIMES (Oct. 20. 2017), https://www.ft.com/content/403a2cb4-a9cb-11e7-ab66-21cc87a2edde.

[33] Ehlern, *supra* note 14, at 106 (emphasis in original).

[34] Arthur Salzer, *Family values: When a family office makes sense to manage wealth and how to go about starting one*, FINANCIAL POST (May 2018), https://business.financialpost.com/financial-post-magazine/family-values-when-a-family-office-makes-sense-to-manage-wealth-and-how-to-go-about-starting-one.

[35] *Id*.

[36] Ehlern, *supra* note 14, at 106.

[37] *See* Salzer, *supra* note 34.

[38] Robert Elliot, *Single Family Offices Facing A Transition*, MARKET STREET TRUST COMPANY (Dec. 2015), *https://www.marketstreettrust.com/usr/PDF_Files/News/SFO_Transition_Final.pdf (stating that* regulatory and compliance burdens have increased, and though single-family offices have some regulatory exemptions, some of those may not be around forever).

A. Types of Family Offices

The main argument posed in this Note stems from the distinction between the two different categorizations of family offices. These two categorizations hinge on the number of families that the office serves. Depending on the classification given to the office, different regulations apply.

i. The Single-Family Office

A single-family office, as its name suggests, is an office whose main focus revolves around only *one* family's interests.[39] Because a single-family office is driven purely by the desires and preferences of a family, there is no standard for how one should be structured.[40] For example, some single-family offices are lean enterprises that focus exclusively on investing with a smaller staff, while others are large organizations with in-house staff, numerous vendor relationships, and a broad platform of services.[41] Single-family offices generally develop over time in response to the unique and particular needs of the founding family.[42] The family owns and fully controls the office that is providing it with the tailored services. The staff of a single-family office are usually diverse in practice and possess unique skill sets.

> A full service SFO offering everything from concierge to investment management and tax, trust and legal services gives the family an undeniably heightened level of security in that everything is being done in their best interests in an environment of complete privacy. It also enables them to concentrate on running their businesses, preserving their wealth and planning for future generations without distraction and brings cohesion and unity in an increasingly fractured world.[43]

Single-family offices are generally established by families with a net worth in excess of $150 million and with affairs that are sufficiently complex to justify the expense.[44] Under the single-family office structure, the staff are permanent employees of the legal entity and report directly to the head of the family office (who usually takes on the title of Managing Director or CEO) or the Principal (the family itself).[45] Recruitment for staff usually occurs on the basis of the family's particular requirements.[46] While the primary focus is on these professional services, some single-family offices will also include staff who are devoted to managing a broad range of

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[39] *See* 17 C.F.R. § 275.202(a)(11)(G)-1(d)(6) (2019) (defining a "family member" as all lineal descendants stemming from a common ancestor, effectively excluding members of a different family; inferring that "non" family-members are effectively excluded).

[40] Russ Alan Prince, *What Is A Family Office?*, FORBES (May 22, 2013), https://www.forbes.com/sites/russalanprince/ 2013/05/22/what-is-a-family-office/#37543c1d7708.

[41] *Id.*

[42] van Bueren, *supra* note 11, at 40.

[43] Ed Lazar & Louise Adams, *"Should I Choose A Single or Multi-Family Office?"*, CAMPDEN FB (Mar. 2008), http://www.campdenfb.com/article/"should-i-choose-single-or-multi-family-office.

[44] Paul Avon, *Key Differences Between Single Family Offices and Multi-Family Offices in 2018*, TRUE HOUSE PARTNERS (Feb. 27, 2018), https://www.truehousepartners.com/2018/02/27/key-differences-single-family-offices-multi-family-offices-2018/.

[45] *Id.*

[46] *Id.*

other areas, including concierge type activities such as general household affairs, real estate, yachts, and aircraft.[47]

ii. The Multi–Family Office

A multi-family office, on the other hand, is an amalgamation of unrelated and separate families that have entrusted the management of their wealth with one manager.[48] The focus is obviously different: instead of being fully controlled by one family, the multi-family office structure has differing classes of ownership most likely dependent on the amount of capital invested. "What distinguishes multi-family offices is they are typically third-party-owned wealth management firms that serve multiple different families and charge a management fee."[49]

> One would think that the services offered by a multi-family office would be similar to those provided by a single-family office, with the exception being that the same services are offered to a number of families as opposed to one. However, the more important difference is that multi-family offices are almost always commercially operated companies that aim to generate profit for themselves in addition to the families they work with.[50]

A multi-family office is a platform that provides professional services to a group of families who share the same team of staff.[51] Staff work across the accounts of multiple clients who are then billed for their time.[52] For clients, multi-family offices provide access to a wide range of seasoned and experienced professionals in niche areas.[53] As previously mentioned, the multi-family office structure is much more affordable than opening and maintaining a single-family office.[54] But in some smaller multi-family offices, one particularly "dominant" family can absorb the majority of the staff's time, potentially, to the exclusion of the other clients.[55]

Crow and Crespi explain why a family considering opening an office should consider a multi-family office instead of a single-family office "[m]ulti-family offices may be an attractive option for families who either do not have enough investable assets to justify opening their own single-family office, or who simply do not wish to expend the considerable time and effort required."[56] A family's preference for either type of office is largely a question of cultural fit. For example, if a family wants to be more in tune with its investments or affairs and have an advisor for every step of its wealth-preserving process, it will opt for the single-family office structure, assuming that the family has factored the relative costs into account. On the other hand, if a family wants to employ a more hands-off approach, worry less about day to day

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[47] *Id.*

[48] *See* Black, *The Rise of the Multi-Family Office*, *supra* note 18.

[49] Crow & Crespi, *supra* note 5, at 102.

[50] van Bueren, *supra* note 11, at 43.

[51] Avon, *supra* note 44.

[52] *Id.*

[53] *Id.*

[54] *See* Hauser, *supra* note 16; *see also* Rucker, *supra* note 21.

[55] Avon, *supra* note 44.

[56] Crow & Crespi, *supra* note 5, at 103.

operational idiosyncrasies, and pay less to staff an office, it may opt to open a multi-family office.[57]

iii. The Crucial Distinction

This begs the question of why it matters that a family office is defined or categorized as a single-family office or a multi-family office. First, the most significant benefit is that single-family offices do not have to register as investment advisers while multi-family offices do. The benefits of a family office not needing to register with the SEC are ostensible. Second, without having to register, the family office retains the highest level of confidentiality and privacy, where it is able to enjoy limited oversight.

> To protect the proprietary interests of investment advisers, the Dodd-Frank Act strives to maintain the confidentiality of the information contained in documents filed by advisers with regulators. Proprietary information, as described under the Act, "includes sensitive, non-public information regarding (i) the investment or trading strategies of the investment adviser; (ii) analytical or research methodologies; (iii) trading data; (iv) computer hardware or software containing intellectual property; and (v) any additional information that the Commission determines to be proprietary."[58]

Thus, even though the SEC is mandated by Dodd–Frank to maintain confidentiality of the information filed by advisers, the Act authorizes the Commission to share the reported information with the Financial Stability Oversight Council, Congress, courts, federal departments, and self-regulated organizations upon request. In addition, these institutions are required by the Act to uphold a level of confidentiality consistent with that followed by the Commission.[59] The confidentiality extends to the point that the Commission, Council, and other agencies are prevented from making any disclosures under the exemption granted in the Act even upon requests made under the Freedom of Information Act.[60]

Lastly, this confidentiality allows an office to keep investment knowledge within the family. "For most family offices, the information disclosure and compliance expense make registration an unattractive outcome."[61] Family control and governance is enhanced by the single-family office structure within the confines of which members of the family and their advisors know they possess the freedom to express their views in an insulated environment without fear of ideas being given to other clients.[62] Furthermore, the family members are assured that employees and staff of the office are working solely for the well-being of the family without the distraction of split loyalties, third party pressure, and aged debtors.[63]

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[57] Lazar & Adams, *supra* note 43.

[58] Barbara C. George & Lynn V. Dymally, *The End of an Era of Limited Oversight: The Restructured Regulatory Landscape of Private Investment Funds Through the U.S. Dodd-Frank Act and The E.U. Alternative Investment Fund Managers Directive*, 25 FLA. J. INT'L L. 207, at 236 (2013).

[59] *Id.*

[60] *Id.*

[61] Harding & McGee, *supra* note 3, at 22.

[62] Lazar & Adams, *supra* note 43.

[63] *Id.*

II. THE FAMILY OFFICE RULE

The Family Office Rule ("Rule") was a critical addition to the Investment Advisers Act of 1940 ("Advisers Act").[64] In its attempt to protect investors, the SEC provided single-family offices with an exemption to registration since they are not managing "outside" capital.[65] The Rule, however, is too narrow in scope and restricts benefits that qualifying multi-family offices should be able to enjoy. This Part will introduce the overarching aim of the Advisers Act, Dodd–Frank's notable amendment to the Advisers Act—the Family Office Rule, and a proposal to expand the Rule's coverage.

A. THE INVESTMENT ADVISERS ACT OF 1940

The Advisers Act "provides the manner in which investment advisers will register with the SEC, provides the laws that must be followed as an investment advisor, and makes it illegal for both registered and unregistered investment advisors to act fraudulently toward any investors."[66] In addition, the Advisers Act regulates enterprises that provide securities investment or valuation advice when the advice is delivered for compensation.[67] Larger investment advisers are subject to registration with the SEC, while smaller advisers are covered by the state law in which they conduct business or are incorporated.[68]

Congress enacted the Advisers Act as a result of an SEC report that documented the increasing use of abusive practices in the investment advisory industry.[69] This legislation was necessary because there seemed to be a loophole in the Securities Exchange Act of 1934 ("Exchange Act").[70] Investment advisers were not covered by the Exchange Act because they are not considered "brokers" or "dealers" as those terms were defined in that legislation. For example, a broker, under the Exchange Act, is "any person engaged in the business of effecting transactions in securities for the account of others."[71] A dealer is "any person engaged in the business of buying and selling securities . . . for such person's own account through a broker or otherwise."[72] The key to these definitions is to understand that brokers and dealers do not provide advisory services; they merely act as agents who help facilitate the exchange of securities or other similar financial instruments.

To help the general public understand who qualifies as an investment adviser, the SEC clarified under the Advisers Act that an investment adviser is:

> any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities

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[64] Investment Advisers Act of 1940, ch. 686, Title II, 54 Stat. 847 (codified as amended at 15 U.S.C. §§ 80b-1 to 80b-21 (Westlaw through Pub. L. No. 116-68)) ("Advisers Act").

[65] 17 C.F.R. § 275.202(a)(11)(G)-1(a) (2019)

[66] Bart Mallon, *Overview of Investment Advisers Act of 1940*, HEDGE FUND LAW BLOG (Oct. 9, 2008), http://hedgefundlawblog.com/overview-of-investments-advisers-act-of-1940.html.

[67] Advisers Act § 202(a)(11), 15 U.S.C. § 80b-2(a)(11).

[68] Francis J. Facciolo, *Do I Have a Bridge for You: Fiduciary Duties and Investment Advice*, 17 U. PA. J. BUS. L. 101, 153–59 (Fall 2014).

[69] Crow & Crespi, *supra* note 5, at 105.

[70] Securities Exchange Act of 1934, Pub. L. No. 111-257, 48 Stat. 881, 15 U.S.C. § 78 (2018) ("Exchange Act").

[71] Exchange Act, 15 U.S.C. § 78c.

[72] *Id*.

> or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.[73]

The SEC, in an attempt to help further define who qualifies as an investment adviser, has broken down the definition into three elements: an investment adviser is one who (1) provides advice, or issues reports or analyses, regarding investment in securities; (2) is in the business of providing such services; and (3) provides such services for compensation.[74] The first requirement, that an adviser provide advice with respect to investment in securities, involves some form of analytical judgment.[75] The second requirement, that the adviser is in the business of providing securities investment advice, depends mostly on all relevant facts. The SEC requires that the adviser actually hold himself out as an investment adviser and provides advice continuously, not on rare and non-periodic instances.[76] Lastly, the adviser must receive something in return for the services he has offered. This compensation can take the form of a fee, commission, or any arrangement of payment to the adviser for such services.[77] Payments by third parties to the adviser as a result of his services will also bring the adviser within the purview of the Act.[78]

The definition is not sweeping; there are exceptions that narrow its focus. The Act has several enumerated exclusions. Publishers of any news or financial publications that are regularly circulated are not considered investment advisers; they merely bring the news to the public without explicit advice.[79] Advisers whose investment advice does not relate to any securities other than securities of the United States government are not considered advisers.[80] Any branch of a bank, outside of divisions whose primary purpose is to provide investment advice to individuals, is not held within the meaning of an adviser in this Act.[81] Professionals, such as lawyers, accountants, engineers, or teachers, whose performance of such services is solely incidental to the practice of their profession, will not be held as advisers.[82] Additionally, nationally recognized statistical rating organizations are not considered advisers either, unless such organization engages in issuing recommendations as to purchasing, selling, or holding securities or in managing assets, consisting in whole or in part of securities on behalf of others.[83] The statute gives the SEC broad authority to exclude persons "not within the intent" of the Commission's designation.[84] The most important exclusion in this set is subsection (G), which effectively grants authority to the SEC to promulgate a definition of a family office.[85] That subsection states "any family office, as defined by rule, regulation, or order of the Commission, in accordance with the purposes of this subchapter" is to be excluded from the designation.[86]

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73 Advisers Act, 15 U.S.C. § 80b-2(a)(11).

74 Investment Advisers Act Release No. IA-1092, 52 Fed. Reg. 38,400, 38,402 (Oct. 16, 1987).

75 Crow & Crespi, *supra* note 5, at 107.

76 Release No. IA-1092, 52 Fed. Reg. 38,400, 38,402 (Oct. 16, 1987).

77 Crow & Crespi, *supra* note 5, at 108.

78 *Id*.

79 Advisers Act, 15 U.S.C. § 80b-2(a)(11)(D).

80 *Id*. § 80b-2(a)(11)(E).

81 *Id*. § 80b-2(a)(11)(A).

82 *Id*. § 80b-2(a)(11)(B).

83 *Id*. § 80b-2(a)(11)(F).

84 *Id*. § 80b-2(a)(11)(H).

85 *Id*. § 80b-2(a)(11)(G).

86 *Id*.

In sum, the Advisers Act requires that firms or sole practitioners who are compensated for advising others about investments in securities register with the SEC and conform to regulations designed to protect investors.[87] In addition, the Act was amended in 1996 and 2010 to require advisers who have at least $100 million of assets and manage or advise a registered investment company to register with the Commission as an adviser.[88] These latter amendments were most likely introduced as a way to police and monitor hedge funds. The registration requirement is at the core of the Advisers Act. All advisers must also maintain ongoing records of their financial statements and communications (sent and received) relating to investment advice.[89]

B. DODD–FRANK AND THE FAMILY OFFICE EXCLUSION

Dodd–Frank was a major amendment to the Advisers Act.[90] It sought to bring hedge funds within the coverage of the Advisers Act by requiring unregistered investment advisers to register with the SEC.[91] It took almost seventy years for the term "family office" to finally make its way into the Advisers Act. Dodd–Frank was the catalyst that allowed the SEC not only to define what a family office is, but to promulgate the Family Office Rule.[92] The Rule postulates requirements family offices need to meet in order to exclude themselves from the Advisers Act.

The private adviser exemption under the Advisers Act held that an investment adviser was exempt from registration so long as it had fewer than fifteen clients during the preceding year, did not hold itself out to the public as an investment adviser, and did not act as an investment adviser to a registered investment company or business development company.[93] Dodd–Frank essentially eliminated the "private adviser" exemption that the Advisers Act contained.[94] As a result of this requirement being eliminated, most private advisers were required to register with the SEC.[95] But what did this mean for family offices?

Section 409 of Dodd–Frank holds that family offices would not be required to register as advisers.[96] To prevent family offices from having to register with the SEC, Dodd–Frank lays out the basic criteria for the Commission to promulgate a definition of family offices that would be consistent with the previous policy of the Commission that was exemptive in nature.[97] On June 22, 2011, the SEC promulgated Advisers Act Rule 202(a)(11)(G)-1.[98] Subsection (b) defines the "family office" as follows:

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[87] Advisers Act, 15 U.S.C. § 80b-3(a).

[88] Crow & Crespi, *supra* note 5, at 106.

[89] 17 C.F.R. § 275.204-02 (2011).

[90] Pub. L. No. 111-203, § 403(2), 124 Stat. 1376, 1571 (2010).

[91] Crow & Crespi, *supra* note 5, at 106.

[92] 17 C.F.R § 275.202(a)(11)(G)-1.

[93] 15 U.S.C. § 80b-3(b)(3) (2011), *repealed by* Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 403(2), 124 Stat. 1376, 1571 (2010).

[94] Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 403(2), 124 Stat. 1376, 1573 (2010).

[95] Crow & Crespi, *supra* note 5, at 110.

[96] Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 409(b)(1)-(2), 124 Stat. 1376, 1575 (2010).

[97] *Id*.

[98] 17 C.F.R § 275.202(a)(11)(G) –1 (2019).

(b) *Family office*. A family office is a company (including its directors, partners, members, managers, trustees, and employees acting within the scope of their position or employment) that:

(1) Has no clients other than family clients; provided that if a person that is not a family client becomes a client of the family office as a result of the death of a family member or key employee or other involuntary transfer from a family member or key employee, that person shall be deemed to be a family client for purposes of this section for one year following the completion of the transfer of legal title to the assets resulting from the involuntary event;

(2) Is wholly owned by family clients and is exclusively controlled (directly or indirectly) by one or more family members and/or family entities; and

(3) Does not hold itself out to the public as an investment adviser.[99]

The "family client" requirement in subsection (b)(1) is clarified in subsection (d)(4) and explains that such client must be a "family member," "former family member," "key employee," "former key employee," the estate of one of these persons, a company owned and controlled by one or more of these persons, or a trust or non-profit organization meeting certain requirements.[100] The "ownership and control" requirement is actually parsed out into two separate requirements.[101] As for "ownership," the rule holds that the "persons" discussed above "wholly own" the office.[102] As for "control," however, it may be attributed to family members or family entities.[103] Lastly, the "private adviser" requirement prohibits the family office from advertising itself as an investment adviser for the public.[104] That is, it must not hold itself out to the general public as able and willing to invest and manage capital for persons *not* considered family members. Importantly, if any one of these three requirements is not satisfied, the so-called "family office" will not be able to enjoy the exemption.

This is where the distinction between single-family offices and multi-family offices is clear. Single-family offices are private advisers that enjoy exemption, whereas the managers in multi-family offices are treated as *regular* advisers, and are thus required to register with the SEC since they are not wholly owned by family members stemming from a common ancestor.[105]

Registration as an investment adviser, as a result of failing to fall within the exception, subjects an office to additional regulatory requirements and expenses associated with complying with those requirements.[106] "Registered investment advisers are considered fiduciaries for their clients and generally will need to treat third party clients fairly and equitably to family clients and to disclose and manage any conflicts between third party and family clients."[107] Thus, registered investment

99 *Id*. § 275.202(a)(11)(G)-1(b).

100 *Id*. § 275.202(a)(11)(G)-1(d)(4).

101 *Id*. § 275.202(a)(11)(G)-1(b)(2).

102 *Id*.

103 *Id*.

104 *Id*. § 275.202(a)(11)(G)-1(b)(3).

105 *See* 17 C.F.R. § 275.202(a)(11)(G)-1(d)(6) (2019) (defining a "family member" as all lineal descendants stemming from a common ancestor, effectively excluding members of a different family).

106 17 C.F.R. § 275 (2019).

107 Scott A. Moehrke, Nadia Murad, Alpa Patel & Josh Westerholm, *Family Offices: Structuring for*

advisers are subject to SEC oversight, consistent public filings, and regulatory compliance.

The primary downside of being forced to register is the loss of privacy for the families involved. The Advisers Act requires investment advisers to file Form ADV Part 1A and Part 2A with the Commission.[108] These forms comprise "information relating to the investment adviser, including assets under management, key personnel and names of 5 percent direct and 25 percent indirect owners, regulatory disciplinary history, types of services and clients, custody arrangements for client funds, investment methodology, compensation paid to the adviser, and material relationships and conflicts of interest."[109] The confidentiality of this information could be important for a family office that is trying to maintain low public exposure and interested in retaining a heightened level of privacy. In addition, registered investment advisers are required to maintain records and are subject to periodic inspections by the SEC for compliance with U.S. federal securities laws.[110]

Family offices have also become an attractive substitute to money managers and institutional investors such as hedge funds.[111] Regulatory considerations, investor pressures, and operational costs are often contributing factors in motivating some hedge funds to shed outside investors and adopt a family office structure.[112]

i. The Family Client Requirement

The first requirement holds that only "family clients" can be served by the family office.[113] But this definition is more than meets the eye. A family client includes: family members, key employees of the family office, estates and trusts, nonprofit organizations, and other family entities.[114] Under this rule, a family member generally includes all lineal descendants up to ten generations removed from a common ancestor.[115] This subcategory does not require actual blood relatives. For example, step children, foster children, spouses, as well as former family members who are no longer part of the family due to divorce or other similar events are still considered family members for the purpose of this rule. On that note, the statute does not state a time limit or time frame after such an event takes place that would restrict the individual to take part in the family office.[116] Unfortunately, in-laws of family members are not within the meaning of the defined "family member" term.[117] As a

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Investment Adviser Compliance, PRIVATE INVESTMENT & FAMILY OFFICE INSIGHTS (KIRKLAND & ELLIS) (Dec. 13, 2018), https://www.kirkland.com/publications/newsletter/2018/12/family-offices-structuring.

[108] 17 CFR § 279.1 (2019).

[109] Moehrke, Murad, Patel & Westerholm, *supra* note 107.

[110] *Id.*

[111] Russ Alan Prince, *When Hedge Funds Become Family Offices*, FORBES (Apr. 19, 2015), https://www.forbes.com/sites/russalanprince/2015/04/19/when-hedge-funds-become-family-offices/#2679bc0b4803.

[112] *Id.*

[113] 17 C.F.R. § 275.202(a)(11)(G)-1(b)(1) (2019).

[114] *Id.* § 275.202(a)(11)(G)-1(d)(4).

[115] Amy E. Gilbert, *Family Office Insights: The Family Office Rule Under the Investment Advisers Act*, SQUIRE PATTON BOGGS (June 2017), https://www.squirepattonboggs.com/en/insights/publications/2017/06/family-office-insights-the-family-office-rule-under-the-investment-advisers-act.

[116] *Id.*

[117] *Id.*

result, such action taken for, or on behalf, of an in-law would remove the family office from the exemption it otherwise would normally enjoy.

Key employees are considered "family clients" for the purpose of this statute.[118] There is an important reason why an employee is given this designation—it is good policy because it ensures that the employee's interests align with the family and its office.[119] In turn, this allows the family office to attract premier talent by allowing the employee to enjoy certain investment benefits and opportunities that become available without running afoul of the statute's requirements.[120] Key employees include executive officers, directors, trustees, general partners, or anyone who is serving in a similar capacity.[121] This category of family client is flexible. It recognizes that some families have other additional family offices for business structuring or tax purposes. Thus, the definition extends to cover employees of an "affiliated family office," which is defined as a separate family office that is wholly owned by family clients of the main family office, is controlled by family members or entities of the main family office, and has no clients other than family clients of the main family office.[122] Just like former family members, former key employees are permitted to keep their preexisting investments within the family office's management.[123]

To accommodate the several estates families have, trusts in the name of family members are considered to be family clients.[124] In addition, nonprofit organizations, charitable foundations, or other organizations that have some philanthropic purpose are deemed family clients, since they may be the sole reason for a family opening up an office.[125] Lastly, other family entities, such as corporations, wholly owned and operated for the sole benefit of at least one family member, are considered family clients.[126]

Irrevocable trusts "of which family clients are the sole current beneficiaries, regardless of the identity of the settlor(s) of the trust," are considered family clients.[127] Likewise, an irrevocable trust funded exclusively by one or more family clients and that solely includes family clients, nonprofit organizations, charitable foundations, charitable trusts, or other charitable organizations as the current beneficiaries is also considered a family client.[128] A trust is also considered a family client if it is a revocable trust created solely by family clients.[129] Lastly, a trust is considered a family client if each trustee and the person who funded the trust is a key employee.[130]

If any individual or entity lies outside these parameters, then the family office is not deemed to be working for or on behalf of a family client. Instead, the office would be working on behalf of someone outside of the family and therefore not covered by the statute within the spirit of the legislature's intention.

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[118] 17 C.F.R. § 275.202(a)(11)(G)-1(d)(4)(iii) (2019).
[119] Gilbert, *supra* note 115.
[120] *Id.*
[121] *Id.*
[122] *Id.*
[123] *Id.*
[124] 17 C.F.R. § 275.202(a)(11)(G)-1(d)(4)(vi) (2019).
[125] *Id.* § 275.202(a)(11)(G)-1(d)(4)(v).
[126] *Id.* § 275.202(a)(11)(G)-1(d)(4)(xi).
[127] Harding & McGee, *supra* note 3, at 25.
[128] *Id.*
[129] *Id.*
[130] *Id.*

ii. Wholly-Owned by Family Client and Exclusively Controlled by Family Member Requirement

The requirements set out for the ownership group and the group that is permitted to control the family office are distinct. Subsection (b)(2) of the Family Office Rule states that the family office must be wholly owned by "family clients," the broad group of individuals and entities discussed above.[131] However, the family office must be "exclusively controlled" by only "family members and/or family entities."[132] One can come to the realization that one group is more restrictive than the other.

The ownership group is easy to evaluate; if one is categorized into any of the aforementioned entities, then they pass muster. The control group, nonetheless, requires a more diluted group and only permits actual members of the family.[133] This excludes key employees of the office and their affiliated entities and trusts. The rule defines "control" as "the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of being an officer of such company."[134] Thus, family members filling this role are not mere figureheads, they must "establish control over the family office by controlling its governing body—its board of directors, if a corporation, or its board of managers, if a manager-managed LLC."[135] However, according to the SEC staff, "[t]he right to appoint, terminate, or replace board members, by itself, does not satisfy the 'exclusively controlled' standard."[136] Instead, the determinative factor, from the SEC's standpoint, is actual board participation by a majority of family members.[137]

Therefore, if the family office is owned in conjunction with an individual or group not considered a family client or controlled by someone who is not a family member, then the office would technically be working for someone outside of the family and would be deemed a multi-family office, at the very least.

iii. The Private Adviser Requirement

It is easy to see that there is a distinction between an office that works solely for family clients and an office that takes on other clients. If the office holds itself out to the public as anything else other than a private adviser for the family, it suggests that the family office is attempting to enter into a traditional investment adviser relationship with non-family clients.[138] As a result, if a family office engages in this type of behavior, it must register as an investment adviser under the Advisers Act.[139] The SEC has interpreted this rule broadly and has found an adviser to hold itself out to the public where it used "public advertising to obtain clients, referred to itself as an investment adviser on business cards, or sought word-of-mouth referrals from its existing clients."[140]

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[131] 17 C.F.R. § 275.202(a)(11)(G)-1(b)(2) (2019).

[132] *Id.*

[133] Crow & Crespi, *supra* note 5, at 128.

[134] 17 C.F.R. § 275.202(a)(11)(G)-1(d)(2) (2019).

[135] Crow & Crespi, *supra* note 5, at 129.

[136] *Id.* at 130.

[137] *Id.*

[138] Gilbert, *supra* note 115.

[139] *Id.*

[140] Crow & Crespi, *supra* note 5, at 134.

C. Options for Family Offices

There are several paths a family may choose to undertake when opening a family office. The office can take advantage of the exclusion and operate unregulated, if it satisfies the three requirements laid out above. The office can restructure in order to qualify for the exemption by disbanding any nonfamily clients, outside investors, or nonfamily owners in order to come within the exclusion. The office can also establish a private trust company to manage the family's affairs that provides some privacy. Lastly, the office can also choose to forego its exclusion eligibility and outsource investment activities to an external investment officer or choose to outsource *all* family office activities (including investments) through an arrangement with a multi-family office.

III. The Issue of Unyielding Narrowness and a Proposal to Relax The Family Office Rule

The Family Office Rule reflects the SEC's efforts to craft requirements "that address regulatory concerns while incorporating substantial flexibility to allow families to govern their own affairs, including through the types of trusts that families typically create for estate planning purposes. As a result, the SEC's definition of 'family office' generally is helpful and will apply to most family office structures."[141] But the problem is that the Rule is too narrow. The language of the Rule extends protection for registration only to single-family offices.

It is important to note that Dodd–Frank's requirements were an important step in remedying the problems that led to the financial crisis of 2008. The Act rightfully permitted exemptions to certain individuals and entities, but an issue of line drawing arose when it restricted the exemption to single-family offices. The SEC should relax the Rule to some reasonable extent and permit qualifying multi-family offices an exemption from registering as investment advisers.

A. The Line Drawing Issue

As a result of the passage of Dodd–Frank, the SEC was tasked with promulgating the family office exemption.[142] In their assessment, it appears that the SEC decided to choose form over substance in an effort to provide finality and a workable bright line rule. The SEC implemented a rule that was narrow and did not take into account a possible office structure comprised of a small number of families. Thus, the Rule should be widened to a reasonable extent.

For starters, even though family offices vary from one office to the next as a result of differing intentions and needs of each family, there is one common denominator: families strive to preserve and pass down wealth to future generations. This is the case for participants of single-family offices and multi-family offices. Both structures employ similar techniques in an effort to attain a common goal. The only difference is the number of participants in each office structure.

Make no mistake, there is a discernable and obvious difference between a multi-family office that manages the wealth of one hundred families and a multi-family office that manages the wealth of two to five families. This raises the question,

[141] Harding & McGee, *supra* note 3, at 26.

[142] Pub. L. No. 111-203, § 403(2), 124 Stat. 1376, 1571 (2010).

however, of what the *right* amount is. The amount of assets under management may not be a helpful characteristic since the wealth of two families may amount to $500 million, but the same amount might be reached by twenty families with $25 million each. What can be said is that the rule is far too narrow.

The main argument is best illustrated by two wholly unrelated families who want to open a family office since they have been close friends for a lengthy period of time. Their relationship does not fall within the definition of family office as defined under the Advisers Act, and more precisely, the "family" requirement of subsection (b)(1). The families have two options: open a multi-family office and be burdened by the requirements and constant regulation of the SEC, or each open a single-family office and be burdened by the high costs of staffing each office. The families may desire to open an office jointly because they want to pool their money together or because their interests are so exceedingly aligned that a key employee will not be able to be employed by both families if each operated as a single-family office.

B. Proposal

Broken down to its main attributes, a multi-family office is a third-party-owned wealth management firm that serves multiple families and charges a management fee.[143] In addition, it is an independent organization that supports multiple families to manage and preserve their entire wealth. Thus, any two families wanting to pool their money together to open an office are, by definition, operating as a multi-family office and not protected by the family office exemption enjoyed by single-family offices. Although two or more families may benefit from certain efficiencies and cost savings, the SEC's promulgation of the Family Office Rule explicitly applies only to single-family offices and does not apply to multi-family office arrangements.

The solution promulgated by the SEC is unambiguous, direct, and provides a bright line rule. It is apparent that the SEC's goal was to limit the benefits to single-family offices in order to ensure that the industry was regulated to some extent. However, a different approach may prove to be fairer. As alluded to in the previous section and throughout the course of this Note, family offices primarily operate with a specific goal in mind: preserve wealth to hand down to the next generation.[144] This statement is true for both participants in single-family offices and multi-family offices. There is an apparent drawback in this setup: assuming that two unrelated, but very close families would like to join together in a venture, invest together, or open a multi-family office, why should they be subject to the Commission's registration requirement? Why should two families who fostered a lasting and enduring relationship face the same harsh restrictions faced by a multi-family office comprised of fifty families?

In regulating the industry of family offices, the SEC took an approach that was too narrow in Dodd–Frank. Again, the amount of assets under management may not be a helpful characteristic in determining where to draw the line of registration. In lieu of divvying up the multi-family office and single-family office distinction, it would be more reasonable to additionally assign a set of requirements, or tests, that would determine whether registration with the SEC is mandatory. In other words, instead of imposing the registration requirement based solely on the number of families participating in the office, additional factors should be considered. These factors

[143] *See* Crow & Crespi, *supra* note 5.
[144] *Id*.

would include the relationship between the families (whether there is some evidence of a long, prior friendship) and a parallel source of capital origination (whether both families experienced a significant monetary realization event contemporaneously). Satisfying these two requirements would not be the only factors, however. Once the families have come within the exception, additional forward-looking requirements would be conferred onto them.

i. "Closeness" of Families: An Indication of an Enduring Relationship

There is a readily apparent difference between the typical multi-family office structure that manages the wealth of many ultra-wealthy families and a multi-family office that manages the wealth of two or three families. In the case of the latter, the families behind them may possibly know each other and desire to have their funds managed jointly.

The first requirement addresses the harsh restriction faced by separate, unrelated families who possess a close relationship. As a result of the family client requirement provided by Dodd–Frank, unrelated families seeking to open a multi-family office together are burdened by having to comply with additional regulations. Some indicia of a long, enduring relationship could be evaluated to decide whether the arrangement comes within the exception and fulfills this requirement. Two families, for example, could show that their relations date back over a period of time. This analysis would be conducted on a case-by-case basis to determine whether the families are indeed close or are just trying to circumvent the Rule.

There would be no risk of raising moral or ethical issues on behalf of legislators in attempting to conclude who is considered family and who is not since this question was partially answered in subsection (b)(1). In that subsection, we are given an indication of who is considered family and who is not. What this first requirement does is expand that "family" distinction to include friends who have an enduring relationship. It may be helpful to describe who *may not* be considered for this distinction: newfound friends who have already attained ultra-wealth or have no interrelated features in regards to the capital they have decided to pool together in an attempt to circumvent the regulation by Dodd–Frank.

ii. Consistent Lines of Business and Paralleled Capital Origination

As previously stated, a family may choose to open a family office for a myriad of reasons. The source of funds and resources that are to be managed may be generational or newfound. Families come to expect more from their wealth management advisors and desire a more all-encompassing solution to their day-to-day requests such as tax and compliance work and portfolio management.[145]

This second requirement attempts to facilitate these goals for a closed, small amount of separate families who have attained vast wealth concurrently as a result of simultaneous capital origination. For example, three unrelated individuals who have yet to reach ultra-wealthy status invent a remarkable new product. As a result of the groundbreaking technology and successful operational aspects of selling the product, the three individuals each reach a net worth of $100 million. The three business partners would be permitted to open a multi-family office that caters to their needs and

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[145] *See* FAMILYOFFICES.COM, *supra* note 1, at 3.

assists their day-to-day necessities since their interests are so exceedingly aligned. The source of their wealth has a common origination.

Again, it may be helpful to describe who *may not* be eligible. Separate, unrelated, ultra-wealthy individuals who join in a venture together to reach economies of scale and capitalize on their expertise in a given industry or practice may not be permitted under this requirement. The requirement is meant to extend to individuals who have jointly created their vast wealth and would be better suited if their capital were entrusted in a common wealth manager.

iii. Subsequent Requirements Following the Successful Multi-Family Office Arrangement

After the base requirements set by the SEC have been satisfied, the new suggested restrictions in subsections *i* and *ii* above will apply. Additional restrictions should be imposed in order to enforce and preserve the requirements that were previously met. These requirements will serve as forward-looking restrictions.

First, the newly-created multi-family office will not be able to include or add any new families into the office once it has been established. This rule will require strict adherence, as any misappropriation will indicate the new rule is useless or easily traversable. By adding new families, it may give the appearance that the multi-family office is assisting an outside family to circumvent the rule. For instance, this "outside" family may not have sufficient capital to open and operate a single-family office and thus be forced to join a typical multi-family office that must register with the SEC. If the newly-created multi-family office (which would enjoy the benefit of privatization and limited oversight) would be permitted to add that outside family, the rule would be easily penetrable.

Second, the family office must stay in business for as long as it can—ideally in perpetuity. Since the families are close, a strong policy argument is that the ultimate goal is to preserve and grow the wealth of each of the families. General capital preservation is healthy for the general economy. Nevertheless, if the families are forced to close the office, then a certain number of years must pass before either family is permitted to open another office. This requirement ensures that two families are in the office for the long haul and preserves as much capital as possible instead of "wasting" it on excessive overhead costs.

IV. CONCLUSION

The family office is the best structure for a family to preserve and pass down its wealth. The structure has been in use for centuries, yet many are misinformed about its purpose and the value it provides to participants. It is hard to nail down a single template for a family office as every family office reflects the families' needs and desires. In both single and multi-family offices, what is being offered is a full financial management solution to high net worth individuals and their families.[146]

Regulations that govern the industry are skewed to favor one form of the family office over another. The main benefit takes the form of privatization. For starters, single-family offices are not required to register with the SEC. Registering with the Commission entails disclosures of business. Without registering, the family retains a high level of confidentiality, where it enjoys scant oversight. This allows an office to

[146] *See* FAMILYOFFICES.COM, *supra* note 1, at 4.

keep investment knowledge and other valuable information within the family. Multi-family offices, on the other hand, do not enjoy such benefits. In its attempt to strengthen investor protections, Dodd–Frank introduced and amended a number of provisions relating to registration and other regulation of investment advisers under the Investment Advisers Act of 1940. These amendments included a repeal of the prior law exemption from registration for private fund advisers who had fewer than fifteen clients in the preceding twelve months and did not market themselves to the public as an investment adviser. Most family offices relied upon this exemption.

Dodd–Frank permitted the SEC to craft a new exclusion particularly for family offices. Understanding that family offices do not operate like typical investment vehicles, the Commission sought to preserve long-standing practice by generally excluding family offices as "investment advisers." However, the Commission imposed regulatory conditions and definitions that family offices had not previously been subject to. These included three major restrictions: a "family client" requirement, the office has to be wholly owned by those clients, and the family office cannot hold itself out to the public as an investment adviser that is ready and able to manage "outside" capital.

The Commission was too strong in its regulation. The regulation is harsh and does not recognize that unrelated families who have attained ultra-wealth together may be better suited to have their collective wealth managed by a common adviser. I suggest that the Commission should acknowledge that unrelated families who have similar objectives are best suited to run a multi-family office without being forced to register with the Commission—a characteristic that is only currently enjoyed by single-family offices. I propose that if two (or more) families would like to join together to create a multi-family office and enjoy those same benefits of non-registration, they must demonstrate an enduring relationship between the families and have simultaneously achieved ultra-wealth status. It is important to note that there would still be a "cut-off" for the amount of families that would be permitted to join an office and still enjoy the exception. For example, there could very well be a theoretical proposition where twenty unrelated, but close, families attempt to create a multi-family office, which would otherwise fulfill this first requirement.

I also suggest other requirements that would need to be satisfied after the initial ones have been met. First, the newly-created multi-family office will be forbidden from including or adding any new families into the office once it has been established. Next, the family office must stay in business for as long as possible. If the families are forced to close the office, then a certain number of years must pass before either family is permitted to open another office.

What developments lie in the future for the family office industry? Numerous wealth reports forecast that the number of ultra-wealthy families will increase significantly in the coming decade.[147] Because families desire to be more "in control" over their wealth, the number of family offices will continue to grow since the structure of a family office is the best way to reach that goal.[148]

[147] van Bueren, *supra* note 11, at 43.
[148] *Id.*